

155 FRC ¶ 61,248  
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. ER16-206-003  
ER16-206-004

ORDER ON REHEARING AND COMPLIANCE

(Issued June 8, 2016)

1. On March 11, 2016, the Commission accepted, subject to condition, an unexecuted Facilities Services Agreement (FSA) between ITC Midwest LLC (ITC Midwest) and Wisconsin Power and Light Company (Wisconsin Power).<sup>1</sup> In the March 11 Order, the Commission found that ITC Midwest had not demonstrated that its decision, through its corporate parent, ITC Holdings Corp. (ITC Holdings), to opt out of using bonus depreciation for calculation of its federal income tax expense was prudent.<sup>2</sup> The Commission directed ITC Midwest and Midcontinent Independent System Operator, Inc. (MISO), as tariff administrator, to submit a compliance filing revising the FSA to reflect the impacts of bonus depreciation in the calculation of the facilities charge under the FSA for investments made in calendar year 2015.<sup>3</sup>
2. On April 11, 2016, MISO, on behalf of ITC Midwest, submitted a revised FSA as directed by the March 11 Order to reflect the impacts of using bonus depreciation in the calculation of the facilities charge in the FSA for investments made in 2015.
3. Also on April 11, 2016, ITC Midwest sought rehearing of the March 11 Order. ITC Midwest argues that the Commission has no authority to negate the statutory right

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<sup>1</sup> *Midcontinent Indep. Sys. Operator, Inc.*, 154 FERC ¶ 61,187 (2016) (March 11 Order).

<sup>2</sup> *Id.* P 37.

<sup>3</sup> *Id.* P 46.

of a taxpayer to opt out of taking bonus depreciation by declaring such an election imprudent. ITC Midwest also argues that the Commission lacks the authority to require ITC Midwest to simulate the taking of bonus depreciation in the calculation of the facilities charge under the FSA for investments made in calendar year 2015. ITC Midwest also argues, *inter alia*, that such directive would violate the normalization rules of the Internal Revenue Service (IRS).

4. As discussed below, we deny ITC Midwest's request for rehearing and accept its compliance filing.

### **Notice and Responsive Pleadings**

5. Notice of ITC Midwest's compliance filing was published in the *Federal Register*, 81 Fed. Reg. 22,259 (2016), with protests and interventions due on or before May 2, 2016. None were filed.

6. On April 22, 2016, Wisconsin Power filed a response to ITC Midwest's request for rehearing. On May 6, 2016, ITC Midwest filed an answer to Wisconsin Power's response.

### **Procedural Matters**

7. Rule 713(d)(1) of the Commission's Rules of Practice and Procedure prohibits an answer to a request for hearing.<sup>4</sup> Therefore, we reject Wisconsin Power's answer to the request for rehearing and the answer of ITC Midwest.

### **Commission Determination**

8. We disagree with ITC Midwest that the Commission lacks authority to review the prudence of ITC Midwest's decision, through its corporate parent, to elect out of taking bonus depreciation. As the United States Court of Appeals for the Fifth Circuit has held, it is the obligation of all regulated public utilities to operate with all reasonable economies.<sup>5</sup> This obligation extends to elections made under the Internal Revenue Code.<sup>6</sup> As the Commission found in the March 11 Order, ITC Midwest's decision to opt

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<sup>4</sup> 18 C.F.R. § 385.713(d)(1) (2015).

<sup>5</sup> *E.g.*, *El Paso Natural Gas Co. v. FPC*, 281 F.2d 567, 573 (5th Cir. 1960) (*El Paso*).

<sup>6</sup> *Trunkline LNG Co.*, Opinion No. 319, 45 FERC ¶ 61,256, at 61,787 (1988), *aff'd in part and remanded in part*, *Trunkline LNG Co. v. FERC*, 921 F.2d 313 (D.C. Cir. 1990) (citing *El Paso*, 281 F.2d at 573).

out of taking bonus depreciation and forgo cost-free capital solely to inflate its rate base and revenue requirement violated this fundamental obligation necessitating Commission intervention to ensure that ITC Midwest's transmission rates are just and reasonable as required by the Federal Power Act (FPA).<sup>7</sup>

9. ITC Midwest cites the 1964 Federal Power Commission (FPC) decision *Wisconsin Michigan* for the propositions that “tax laws give management the option not to take liberalized depreciation,” and when management has chosen not to do so “as a matter of business judgement,” requiring a company to incorporate such depreciation in its rate calculation would “in effect deprive the Company of its option under the tax law.”<sup>8</sup> ITC Midwest fails to recognize, however, that the FPC, as affirmed by the United States Court of Appeals for the Seventh Circuit (Seventh Circuit), effectively reversed itself and rejected this rationale in *Midwestern I*.<sup>9</sup>

10. In that proceeding, FPC Presiding Examiner Levy explained, in his initial decision, that “regulatory rate making policy under the Natural Gas Act cannot be frustrated by invoking the Internal Revenue Code.”<sup>10</sup> Examiner Levy was “uncomfortable with the Commission’s suggestion [in *Wisconsin Michigan*] that to ‘deprive the Company of its option under the tax law’ might be a pivotal consideration.”<sup>11</sup> Examiner Levy noted that the United States, in an *amicus curiae* brief to the Supreme Court in *United Fuel Gas Company v. Public Service Commission of West Virginia*, stated:

Where the [Internal Revenue] Code provides such an option, it is in nowise inconsistent with the intent of Congress for a regulatory agency, State or federal, to require a public utility to take advantage of the tax savings and pass them on to its rate-payers. The mere fact that rapid depreciation procedures are not mandatory as a matter of federal tax law does not bespeak a congressional purpose to relieve tax payers of their obligations

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<sup>7</sup> *E.g.*, March 11 Order, 154 FERC ¶ 61,187 at PP 42-43.

<sup>8</sup> Rehearing Request at 3, 5 (quoting *Wisconsin Michigan Power Co.*, 31 FPC 1445, at 1446 (1964) (*Wisconsin Michigan*)).

<sup>9</sup> *Midwestern Gas Transmission Co.*, 36 FPC 61 (1966) (*Midwestern I*).

<sup>10</sup> *Id.* at 103. We note that cases under the Natural Gas Act and the FPA typically are read *in pari materia*. See, e.g., *Arkansas-Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 n.7 (1981); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956).

<sup>11</sup> *Midwestern I*, 36 FPC at 103.

under other federal statutes or under State law. In particular, there is no purpose to immunize public utilities from otherwise valid regulations requiring them to utilize available cost-savings opportunities.<sup>12</sup>

The FPC agreed with this rationale and required Midwestern Gas Transmission Company and East Tennessee Natural Gas Company to calculate their federal income tax allowance in their cost-of-service based on the higher depreciation deductions and lower taxes available under the liberalized depreciation tax option, irrespective of actual deductions taken in federal income tax returns:

At this juncture . . . there is no remaining validity to the contention that the tax benefits allowed public utilities by Congress, absent a clear declaration to the contrary, are for the exclusive benefit of their stockholders. Rather . . . utilities are under a positive obligation to share with their consumers the savings resulting from the exercise of the tax options.<sup>13</sup>

The Seventh Circuit agreed, finding that it was “quite reasonable and logical to recognize as inherent in the Commission the duty and requirement to exercise its expertise in

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<sup>12</sup> *Id.* (citing Memorandum for the United States and Federal Power Commission as Amici Curiae, in the case of *United Fuel Gas Co. v. Public Serv. Comm’n of West Virginia* (O.T. 63, No. 527) pp. 16-17; appeal dismissed for want of a substantial Federal question, 376 U.S. 784 (1964)).

<sup>13</sup> *Id.* at 74 (footnotes omitted); *see also id.* at 70:

The issue is whether the increased tax payments resulting from the decision to discontinue use of liberalized depreciation is a reasonable and prudent business expense which the customers may properly be required to bear. Paraphrased, the issue is whether Midwestern and East Tennessee are fulfilling their duties under the Natural Gas Act when they voluntarily take an action of the character here involved, which will necessarily have the effect of substantially raising their costs and rates. For the reasons advanced in this proceeding, we hold that they are not.

An elementary proposition of utility law and utility regulation, universally recognized, is that public utilities, in the interest of their customers as well as in their own interest, should be permitted to charge rates which are compensatory of the full cost incurred by alert, efficient, and responsible management. It is equally elementary that customers should not be required to pay more than this cost.

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>14</sup> The reasoning expressed by Examiner Levy, the FPC and the Seventh Circuit in the *Midwestern* proceeding applies equally here and supports the Commission’s assessment of ITC Midwest’s decision, through its corporate parent, to opt out of taking bonus depreciation.

11. ITC Midwest argues that the facts and circumstances of the *Midwestern* proceeding were fundamentally different from those present here.<sup>15</sup> For example, ITC Midwest notes that when the underlying FPC *Midwestern I* decision was issued, the FPC generally required the flow through of actual income taxes in rates and normalization was not permitted. ITC Midwest explains that, as a result, the FPC’s decision to require *Midwestern* to simulate the taking of liberalized depreciation in its rates, and the Seventh Circuit’s affirmance thereof, merely reduced *Midwestern*’s income taxes and correspondingly reduced the income tax component of its cost-of-service while *Midwestern*’s rate base, rate of return and earnings were unaffected. ITC Midwest argues that the Seventh Circuit’s *Midwestern II* decision “therefore, did not entail and does not provide precedent to support any claim of authority by the Commission to force a company to make a tax election that causes a significant earnings reduction for the purpose of lowering its rates.”<sup>16</sup>

12. Contrary to ITC Midwest’s argument, we believe that *Midwestern II* has continuing vitality under the Commission’s current tax normalization regulations. As discussed above, a Commission-jurisdictional entity must operate with all reasonable economies, including with respect to elections made under the Internal Revenue Code.<sup>17</sup> This duty existed in the *Midwestern* proceeding in which a jurisdictional gas pipeline discontinued the use of liberalized depreciation, resulting in an imprudent federal income tax expense. It applies equally here, in which ITC Midwest has opted out of taking bonus depreciation and has forgone zero-cost capital, ultimately resulting in imprudent capital

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<sup>14</sup> *Midwestern Gas Transmission Co. v. FPC*, 388 F.2d 444 (7th Cir. 1968) (*Midwestern II*).

<sup>15</sup> Rehearing Request at 5-6.

<sup>16</sup> *Id.* at 6.

<sup>17</sup> *E.g.*, *El Paso*, 281 F.2d at 573; *Midwestern I*, 36 FPC at 70, 74.

costs.<sup>18</sup> Further, ITC Midwest's lament that taking bonus depreciation would cause it reduced earnings and financial harm is misleading because, as the Commission explained in the March 11 Order, 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 through access to zero-cost capital.<sup>19</sup>

13. ITC Midwest also argues that the March 11 Order cannot be reconciled with the Commission's decision in *Koch Gateway*,<sup>20</sup> in which the Commission approved a rate increase resulting from a tax election made by an interstate pipeline.<sup>21</sup> ITC Midwest argues, *inter alia*, that in the same way the tax election that led to a rate increase in *Koch Gateway* was required by — as the March 11 Order noted — “a larger business transaction,” ITC Midwest's election to opt out of taking bonus depreciation “aligned with the earnings assumptions and the purchase price that underpinned its 2007 acquisition of Interstate Power and Light Company's . . . transmission assets.”<sup>22</sup> ITC Midwest explains that taking bonus depreciation was not and could not be assumed in the underlying calculations for the transaction, because bonus depreciation did not exist when that transaction was agreed to and closed. ITC Midwest argues that, “just as the Commission in [*Koch Gateway*] accepted the rate impacts of the lawful tax election made by that company that was required to make the economics of the Koch/United transaction work, so here it should accept ITC Midwest's lawful election [to opt out of taking bonus depreciation] that was required to avoid undermining the economics of its acquisition of [Interstate Power's] transmission assets.”<sup>23</sup> However, the fact that ITC Midwest actually did take bonus depreciation in 2008 and 2009 negates ITC Midwest's arguments.

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<sup>18</sup> By opting out of bonus depreciation, ITC Midwest increased its income tax liability, leading to a decrease of cash flows, which in turn increased the need for equity or debt financing costs at ratepayers' expense.

<sup>19</sup> March 11 Order, 154 FERC ¶ 61,187 at P 42.

<sup>20</sup> *Koch Gateway Pipeline Co.*, 74 FERC ¶ 61,088 (1996) (*Koch Gateway*), *reh'g denied*, 75 FERC ¶ 61,132 (1996), *remanded on other issues sub nom. Exxon Corp. v. FERC*, 114 F.3d 1252 (D.C. Cir. 1997).

<sup>21</sup> Rehearing Request at 7.

<sup>22</sup> *Id.* at 8.

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

14. In *Midwestern I*, the FPC set forth the general regulatory principle that public utilities should incur only “reasonable and prudent business expense[s] which the customers may properly be required to bear.”<sup>24</sup> This principle applies to tax elections “absent a clear declaration to the contrary” by Congress, such as that found “in the 1964 Revenue Act where Congress expressly provided that regulatory agencies were not to use the [investment tax] credits generated under Section 38 to reduce the tax component.”<sup>25</sup>

15. The Commission found similar clarity with respect to the rate treatment accorded to the investment tax credit in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) in the *Kuparuk* proceeding,<sup>26</sup> another case relied on by ITC Midwest. Under the TEFRA, Kuparuk Transportation Company (Kuparuk) could elect either a 10 percent investment tax credit with a 95 percent depreciable tax basis, or an eight percent investment tax credit with a 100 percent depreciable tax basis. Kuparuk elected the full 10 percent investment benefit with the reduced basis, and proposed to pass on this five percent loss in tax basis to ratepayers in the form of higher income tax expenses. The State of Alaska argued that Kuparuk’s income tax for ratemaking purposes should reflect a hypothetical 100 percent depreciation tax basis rather than the depreciation tax basis of 95 percent actually used by Kuparuk, so that Kuparuk’s election would not have the effect of passing on the loss in tax basis to ratepayers through increased rates.<sup>27</sup> Both Kuparuk and the State of Alaska agreed that, as required by Congress, the benefits of federal investment tax credits must be retained by the oil pipeline for its investors.<sup>28</sup>

16. The Administrative Law Judge (ALJ) denied the State of Alaska’s proposed treatment of Kuparuk’s investment tax credit election, reasoning that, “the resolution sought by the State would result in an impairment of the [investment tax credit] election created by Congress, thereby indirectly depriving Kuparuk of the full benefit of the 10 percent [investment tax credit] contrary to the intent of Congress.”<sup>29</sup> The Commission

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<sup>24</sup> *Midwestern I*, 36 FPC at 70.

<sup>25</sup> *Id.* at 74 n.26 (citing P.L. 88–272, Section 203(e), 78 Stat. 35 (1964)).

<sup>26</sup> *Kuparuk Transportation Co.*, 45 FERC ¶ 63,006 (1988) (*Kuparuk I*), order on initial decision and complaint, 55 FERC ¶ 61,122 (1991) (*Kuparuk II*).

<sup>27</sup> *Kuparuk*, 45 FERC ¶ 63,006 at 65,084.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

affirmed, holding that the ALJ “correctly concluded that TEFRA created a statutory right that may not be diminished by state or federal regulatory action.”<sup>30</sup>

17. ITC Midwest argues that, unlike the *Midwestern I* and *II* decisions, the *Kuparuk I* and *II* decisions are “directly on point” to the instant proceeding.<sup>31</sup> We disagree.<sup>32</sup> In contrast to Congress’s express prescription regarding the investment tax credit under the TEFRA, which constrained the Commission in the *Kuparuk* proceeding, nothing in the American Taxpayer Relief Act of 2012 Act (2012 Act), or any other statutory provision, provides an exception to the general regulatory principles that public utilities must operate with all reasonable economies and that they have a positive obligation to share with their customers the tax benefits Congress has afforded to them. The 2012 Act also does not limit the Commission’s authority to assess the prudence of a public utility’s decision to opt out of bonus depreciation.

18. In support of its contention that Congress granted an unconditional bonus depreciation election right,<sup>33</sup> ITC Midwest notes that the 2012 Act added the parenthetical “(respecting all elections made by the taxpayer under this section)” to the normalization accounting rules of Internal Revenue Code section 168(i)(9)(A)(ii) that are applicable only to public utility property.<sup>34</sup> ITC Midwest Witness Stibor also notes that the Joint Tax Committee explained that the 2012 Act “[clarified] that . . . public utility

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<sup>30</sup> *Kuparuk II*, 55 FERC ¶ 61,122 at 61,384.

<sup>31</sup> Rehearing Request at 6-7 (citations omitted).

<sup>32</sup> Indeed, ITC Midwest’s arguments are strikingly similar to those raised by FPC Commissioner Bagge in his dissent to the underlying FPC *Midwestern* decision:

Significantly, although the majority does not decide ‘\* \* \* at least directly, how *Midwestern* and *East Tennessee* shall pay their income taxes \* \* \*’ leaving ‘\* \* \* the companies free to choose their own method for filing their tax returns,’ the freedom is illusory because this decision effectively negates the element of management choice which has been expressly provided by the Congress.

*Midwestern I*, 36 FPC at 91 (Bagge, Comm’r dissenting).

<sup>33</sup> *E.g.*, Rehearing Request at 6, 11.

<sup>34</sup> ITC Midwest December 9 Answer at 7 (citation omitted); *see also* Rehearing Request at 6.

property elections, such as an election out of bonus depreciation, must be respected in determining when normalization accounting may be used.”<sup>35</sup>

19. We do not believe that the 2012 Act evinces a clear declaration that a public utility’s bonus depreciation election is beyond the scope of the Commission’s statutory prudence review. Although the language added by the 2012 Act confirmed the ability of all taxpayers to opt out of using bonus depreciation, it did not exempt utility taxpayers from the obligation to act prudently in accordance with well-established regulatory principles. Thus, the above-quoted language does not undermine, as ITC Midwest appears to imply,<sup>36</sup> the Commission’s plenary authority under the FPA to regulate transmission rates or its duty, as expressed by the Seventh Circuit in *Midwestern II*, to ensure that such rates are just and reasonable by intervening when a public utility’s “elected tax policies do not fairly indicate a reasonable and prudent business expense.”<sup>37</sup>

20. We also disagree with ITC Midwest’s assertion that the Commission lacks the authority to order ITC Midwest to simulate the taking of bonus depreciation. Imposing such a requirement falls squarely within the Commission’s plenary authority under the FPA to regulate the transmission rates of a public utility to ensure that they are just and reasonable. Indeed, as noted in the March 11 Order, in *Midwestern II*, the Seventh Circuit affirmed the FPC’s requirement that *Midwestern* and *East Tennessee* reflect the use of liberalized depreciation for rate purposes.<sup>38</sup> As bonus depreciation is simply a form of liberalized depreciation, such a remedy is virtually identical to that which the Commission has required in this proceeding.

21. ITC Midwest notes that under the IRS normalization rules, if a utility is required to reflect the taking of bonus depreciation in its rates for any period, it must do likewise in its tax returns for that period. ITC Midwest explains that the March 11 Order therefore effectively requires ITC Midwest and its corporate parent to take bonus depreciation in their 2015 consolidated tax return. Thus, ITC Midwest argues that because the

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<sup>35</sup> ITC Midwest December 9 Answer, *Stibor Test.* at 5 (quoting Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 112th Congress, JCS-2-13, discussing modifications made through the American Taxpayer Relief Act of 2012, Pub. L. No. 112-240 (2013), (bonus depreciation provisions in Sec. 331), Feb. 2013, at p. 202).

<sup>36</sup> Rehearing Request at 6-7.

<sup>37</sup> *Midwestern II*, 388 F.2d at 448; *see also Midwestern I*, 36 FPC at 70.

<sup>38</sup> March 11 Order, 154 FERC ¶ 61,187 at P 38 (citing *Midwestern II*, 388 F.2d at 448).

Commission cannot do indirectly what it may not directly, the Commission cannot lawfully require the simulation of any such elections in ITC Midwest's rates unless and until the Commission establishes its authority to direct the elections taken by ITC Midwest and its parent in their actual consolidated tax return.<sup>39</sup>

22. In essence, ITC Midwest is improperly attempting to use the IRS normalization rules to shield from scrutiny ITC Midwest's imprudent decision to opt out of bonus depreciation and its concomitant failure to operate with all reasonable economies. We do not believe Congress or the IRS intended the normalization rules to frustrate the goals of the FPA in such a manner, and thus we disagree with ITC Midwest that the normalization rules limit the Commission's authority in this context. Although the March 11 Order's ruling, in conjunction with the IRS normalization rules, may have the practical effect of precluding ITC Midwest and its corporate parent from opting out of bonus depreciation for 2015, this outcome is a logical consequence of ITC Midwest's being subject to two concurrent — and occasionally overlapping — regulatory regimes.

23. Further, we decline ITC Midwest's invitation to modify the March 11 Order to make the required simulation of the taking of bonus depreciation in ITC Midwest's revenue requirement no earlier than January 1, 2016. We disagree with ITC Midwest's assertion, supported by the appended testimony of ITC Midwest Witness Stibor, that even assuming ITC Midwest's corporate parent were to elect to take bonus depreciation in its 2015 tax return, the required retroactive simulation for ratemaking purposes would cause a normalization violation under applicable IRS rules.<sup>40</sup> ITC Midwest argues that retroactively simulating the taking of bonus depreciation in the calculation of the facilities charge for investments made in calendar year 2015 would violate the IRS normalization rules because, "ITC Midwest did not actually realize any of the alleged benefits of [bonus depreciation] such as increased cash flow or an interest free loan during 2015 and will not have done so even assuming that its parent takes [bonus depreciation] in its tax return for 2015."<sup>41</sup> We are not persuaded by this rationale. Bonus depreciation was retroactively authorized for 2015 by section 143 of the Protecting Americans from Tax Hikes Act of 2015, which was signed into law on December 18, 2015.<sup>42</sup> By that time, all calendar year utilities should have already made their final estimated tax payments for that year, which were due by December 15, 2015. Thus, calendar year utilities would not have been able to benefit from the increased cash flow or interest free loan during 2015 by virtue of taking bonus depreciation for that tax year.

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<sup>39</sup> Rehearing Request at 10 (citations omitted).

<sup>40</sup> *See id.* at 11-12; *id.*, Stibor Test. at 2.

<sup>41</sup> Rehearing Request at 11.

<sup>42</sup> Pub. Law. No. 114-113, Div. Q (2015).

Accordingly, under ITC Midwest's reasoning, every utility that retroactively calculates its true-up to its calendar year 2015 rates to reflect bonus depreciation would be in violation of the normalization rules. This appears illogical.

24. Finally, we accept ITC Midwest's April 11, 2016 compliance filing to reflect the impacts of using bonus depreciation in the calculation of the facilities charge in the FSA for investments made in 2015.

The Commission orders:

(A) ITC Midwest's request for rehearing is hereby denied, as discussed in the body of this order.

(B) ITC Midwest's compliance filing is hereby accepted, as discussed in the body of this order.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.