



Staff's Guidance on Formula Rate Updates

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Disclaimer: Consistent with 18 C.F.R. § 388.104(a), this document provides informal staff guidance on preparing annual formula rate updates.

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The Commission is responsible for ensuring that the rates, terms and conditions of service for wholesale sales and transmission of electric energy in interstate commerce are just, reasonable, and not unduly discriminatory or preferential. It has been the Commission's policy to permit utilities to establish rates through formulas. The Commission recognizes that the integrity and transparency of formula rates and their implementation are critically important in ensuring just and reasonable rates. Therefore, the Commission's policy is that utilities include safeguards in their transmission formula rate protocols to provide transparency in the utilities' implementation of their transmission formula rates, to ensure that the input data is the correct data and that calculations are performed consistent with the formula. Among these safeguards is a requirement for utilities to share the annual updates to their transmission rates determined pursuant to their formulas, with appropriate support, with all interested parties and to file such annual updates with the Commission on an informational basis.

In the course of reviewing transmission formula rate annual updates, Commission staff has identified certain common deficiencies that have impeded the ability to review the annual updates and verify that the resulting rates have been developed consistent with the requirements of the filed rate (i.e., the formula rate). In order to aid utilities in the development of their formula rate annual updates, Commission staff offers the following guidance for utilities in the preparation of their annual updates and annual update informational filings to avoid common deficiencies.

- 1. Format:** Formula rate annual updates posted for interested parties and filed with the Commission as informational filings must include formula templates and underlying workpapers in their native format (e.g., Microsoft Excel) fully populated and with formulas intact.¹
- 2. Level of Support:** Annual updates posted for interested parties and filed with the Commission as informational filings must contain sufficient support for all inputs so that interested parties can verify that each input is consistent with the requirements of the formula.² Accordingly, each input that is not directly taken from a referenced line and column entry in the FERC Form No. 1 must be supported with sufficient narrative description

¹ *Midwest Indep. Transmission Sys. Operator, Inc.*, 143 FERC ¶ 61,149, at P 86 (2013).

² *Id.*

of the steps taken and calculations performed to derive the input. There must also be workpapers detailing the derivation of such formula input with meaningful line item descriptors, column headings, and annotation, to reconcile the formula input to FERC Form No. 1 data from which it was derived and demonstrate that the formula input was derived consistent with the requirements of the formula rate. Typical formula rate inputs not directly taken from referenced line and column entries in the FERC Form No. 1 that require such support depend on the particular formula and include, but are not limited to:

a. Inputs that require adjustments from account balances reported in the FERC Form No. 1 consistent with Commission policies requiring that certain costs be excluded in rate determinations absent express Commission authorization, including but not limited to the following:³

- i. Unfunded Accumulated Deferred Income Tax Balances:* In its April 23, 1993 guidance,⁴ the Commission clarified that the adoption of Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes, for FERC accounting and reporting purposes should not affect the measurement of costs included in an entity's billing determinations. Accordingly, utilities using formula rates may need to adjust accumulated deferred income tax account balances in the FERC Form No. 1 line and column entries referenced by the formula rates to remove amounts resulting from the adoption of SFAS No. 109. Formula rate annual updates must provide sufficient support as described above for such SFAS No. 109 adjustments in order to demonstrate that the accumulated deferred income tax inputs are consistent with the requirements of the formula and the instructions in the referenced accounting guidance document.

³ In addition to the examples included herein, the Commission and the Chief Accountant have issued accounting guidance that restricted the inclusion of certain items from the development of rates without Commission authorization. *See, e.g.*, Commission Accounting and Reporting Guidance to Recognize the Funded Status of Defined Benefit Postretirement Plans, Docket No. AI07-1-000 (Mar. 29, 2007); Accounting and Financial Reporting for Uncertainty in Income Taxes, Docket No. AI07-2-000 (May 25, 2007).

⁴ *See* Accounting for Income Taxes, Docket No. AI93-5-000 (Apr. 23, 1993).

- ii. *Transaction-Related Costs*: Utilities may be subject to commitments made in FPA section 203 proceedings to exclude transaction-related costs from rates during a certain period, absent a filing under section 205 demonstrating that the transaction-related costs are exceeded by demonstrated transaction-related savings (otherwise known as a hold harmless commitment). Where the Commission has not authorized the recovery of transaction-related costs during the period associated with such a hold harmless commitment, the formula rate annual update must provide sufficient support as described above for the derivation of all inputs that require adjustment to remove amounts associated with the transaction-related costs. Where the utility has been granted specific authorization from the Commission to recover transaction-related costs through its formula rate during the period associated with such a hold harmless commitment, the formula rate annual update must identify the proceeding(s) in which the Commission authorized their recovery through rates, and provide sufficient support as described above for the derivation of all inputs included in such transaction-related costs to demonstrate that inputs have been derived consistent with such authorization.
- iii. *Accounting for Asset Retirement Obligations*: In Order No. 631,⁵ the Commission required public utilities to recognize asset retirement obligations for accounting purposes consistent with SFAS No. 143, Accounting for Asset Retirement Obligations. However, the Commission stated that public utilities with formula rate tariffs must not include any cost components related to asset retirement obligations in their formula rate billings without obtaining Commission approval.⁶ Accordingly, where the utility has not been granted specific approval from the Commission to recover the cost of asset retirement obligations through the formula rate, the formula rate annual updates must provide sufficient support as described above for the derivation of all inputs that require adjustment to remove amounts associated with the asset retirement obligations, in order to

⁵ *Accounting, Financial Reporting, and Rate Filing Requirements for Asset Retirement Obligations*, Order No. 631, 103 FERC ¶ 61,021 (2003).

⁶ *Id.* P 60.

demonstrate that the inputs are consistent with the requirements of Order No. 631. Where the utility has been granted specific approval from the Commission to recover the cost of asset retirement obligations through the formula rate, the formula rate annual update must identify the proceeding(s) in which the Commission authorized their recovery through rates, and provide sufficient support as described above for the derivation of all inputs that include such asset retirement obligations to demonstrate that inputs have been derived consistent with such authorization.

- iv. *Acquisition Premiums*: Absent express Commission authorization to recover acquisition premiums, including goodwill, in rates, the Commission requires removal of the effects of acquisition premiums and goodwill from utilities' cost of service.⁷ To the extent that the utility has not received Commission authorization to recover acquisition premiums in its formula rate, the annual updates must include sufficient support as described above for the derivation of all inputs that require adjustment to remove amounts associated with acquisition premiums, in order to demonstrate that the inputs are consistent with the requirements of the formula and Commission policies regarding the recovery of acquisition premiums. Where the utility has been granted specific approval from the Commission to recover acquisition premiums through the formula rate, the formula rate annual update must identify the proceeding(s) in which the Commission authorized such recovery through rates, and provide sufficient support as described above for the derivation of all inputs that include such acquisition premiums to demonstrate that the inputs have been derived consistent with such authorization.

- b. **Transmission incentives**: Annual updates for formula rates containing inputs implementing transmission rate incentives, such as including construction work in progress in rate base, recovery of deferred costs as

⁷ See *Ameren Corp.*, 140 FERC ¶ 61,034, at P 30 (2012); *ITC Holdings Corp.*, 139 FERC ¶ 61,112, at PP 47-50 (2012). See also *Arkla Energy Res. Inc.*, 61 FERC ¶ 61,004, at 61,038 (1992); *Locust Ridge Gas Company*, 29 FERC ¶ 61,052, at 61,114 (1984); *United Gas Pipe Line Co.*, 25 FPC 26, 64 (1961), *rev'd on other grounds sub nom. Willmut Gas & Oil Co. v. FPC*, 299 F.2d 111 (D.C. Cir. 1962).

regulatory assets, and recovery of the cost of abandoned plant, must indicate the portion of such formula rate inputs attributable to each project, the proceeding(s) in which the Commission granted the incentives and approved the level of deferred costs for recovery, and sufficient support as described above for the derivation of the input to demonstrate that it was derived consistent with the formula and the Commission's authorizations.

- c. Inputs that typically require adjustments from account balances reported in the FERC Form No. 1 per the requirements of the formula rates:** Such inputs include, but are not limited to: (1) administrative and general expense account balances that are often required by the formula to be adjusted for industry association membership dues, regulatory commission expenses, and advertising expenses; (2) taxes other than income taxes that are often required by the formula to be adjusted to determine those amounts that should be functionalized on the basis of labor ratios and those that should be functionalized on the basis of plant ratios; (3) accumulated deferred income tax and prepayment account balances that may, pursuant to the terms of certain formulas, require adjustments to reflect the direct assignment of amounts included in such balances, or to determine those amounts that should be functionalized on the basis of particular allocators; (4) adjustments to revenue accounts (e.g., transmission of electricity by others and rents from electric utility property) that are required by the formula rate to determine amounts appropriately credited in the annual transmission revenue requirement; (5) adjustments to load or reservation data that are required by the formula rate to determine inputs to rate divisors; and (6) adjustments to plant inputs (e.g., construction work in progress, plant-in-service, and depreciation inputs) to remove allowance for funds used during construction to prevent double recovery to the extent that construction work in progress was previously included in rate base.