

161 FERC ¶ 61,163
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Cheryl A. LaFleur, and Robert F. Powelson.

PJM Interconnection, L.L.C.

Docket Nos. ER17-528-000
ER17-528-001

ORDER REJECTING PROPOSED TARIFF REVISIONS

(Issued November 16, 2017)

1. On December 13, 2016, as amended on March 13, 2017, Baltimore Gas and Electric Company (BGE) submitted, pursuant to section 205 of the Federal Power Act (FPA),¹ proposed revisions to its formula transmission rate (Formula Rate), contained in Attachment H-2A of the PJM Interconnection, L.L.C. Open Access Transmission Tariff, to provide a mechanism to refund or recover, as appropriate, certain deferred income tax excesses and deficiencies previously recorded and on an ongoing basis. On May 9, 2017, pursuant to the authority delegated by the Commission's February 3, 2017 Order Delegating Further Authority to Staff in Absence of Quorum,² BGE's proposed Formula Rate revisions were accepted for filing, suspended for a nominal period, to become effective February 11, 2017, as requested, subject to refund and further Commission order.³

2. In this order, we find that BGE has not shown that its proposed Formula Rate provisions allowing for the recovery of previously incurred tax amounts are just and reasonable. Therefore, as discussed below, we reject BGE's filing.

I. Background

3. Under a tax normalization policy, tax savings and increases that result from different treatment for ratemaking and income tax purposes are not immediately flowed

¹ 16 U.S.C. 824d (2012).

² *Agency Operations in the Absence of a Quorum*, 158 FERC ¶ 61,135 (2017).

³ *Baltimore Gas and Electric Co.*, 159 FERC ¶ 62,145 (2017).

through to customers, but are instead recognized in rates over time. In 1981, the Commission amended its regulations to require companies to determine the income tax allowance included in jurisdictional rates on a fully normalized basis.⁴ The Commission in Order No. 144 recognized that the adoption of full normalization, as well as tax rate changes, might result in excesses or deficiencies in the deferred tax accounts and required rate applicants to make provision in the income tax component of their cost of service for any such excess or deficiency. Order No. 144 stated that rate applicants must “begin the process of making up deficiencies in or eliminating excesses in their deferred tax account reserves so that, within a reasonable period of time to be determined on a case-by-case basis, they will be operating under a full normalization policy.”⁵ Order No. 144 further specified that a rate applicant must make adjustments pertaining to reversals from prior flow-through or tax rate changes in “the applicant’s next rate case following the applicability of [Order No. 144].”⁶

4. In 1992, the Financial Accounting Standards Board issued Financial Accounting Standards Board Statement No. 109 (FAS 109), which required public utilities to make certain changes to their balance sheets. Among other things, FAS 109 required: 1) recognition of a deferred tax liability for any unfunded tax benefits previously flowed-through to ratepayers; 2) recognition of a deferred tax liability for the equity component of Allowance for Funds Used During Construction depreciation expense (AFUDC Equity); and 3) recognition in the deferred tax accounts for changes in tax laws or tax rates in the period that the change is enacted. Addressing the implementation of FAS 109, the Commission’s Chief Accountant explained that if as a result of action by a regulator, it was probable that a tax deficiency would be recovered from customers or any tax excess would be returned to customers in rates, an asset or liability must be recognized in the appropriate account. The Chief Accountant also explained that the asset or liability is a temporary difference for which a deferred tax asset or liability must be recognized in the appropriate deferred tax account.⁷ The Chief Accountant further advised that if an entity’s billing determinations would be affected by adoption of

⁴ See 18 CFR § 35.24 (2016); see also *Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes*, Order No. 144, FERC Stats. & Regs. ¶ 30,254 (1981), *order on reh’g*, Order No. 144-A, FERC Stats. & Regs. ¶ 30,340 (1982).

⁵ Order No. 144, FERC Stats & Regs. ¶ 30,254 at 31,560.

⁶ *Id.* at 31,519.

⁷ See *Accounting for Income Taxes*, Docket No. AI93-5-000 (April 23, 1993).

FAS 109, the entity shall make a filing with the proper rate regulatory authorities prior to implementing the change for tariff billing purposes.⁸

II. BGE's Filing

5. BGE proposes to implement three tax-related changes to its Formula Rate to more accurately track expenses arising from tax liabilities and to clarify the timing for recovery of various accrued tax liabilities. BGE asserts that the proposed changes do not alter the amount of taxes to be recovered, but provide clarity to ratepayers as to when various tax liabilities will be recovered, and ensure that the proper amounts will be recovered over a timeframe that is consistent with Commission policies. Although the proposed tax changes would be reflected for the first time in the rate levels charged to customers in BGE's June 1, 2018 true-up, BGE requests that the Commission accept the revised tariff sheets with an effective date of February 11, 2017.⁹

6. First, BGE proposes an adjustment for excesses or deficiencies in deferred income tax balances due to enacted changes in tax laws or rates (Excess/Deficient Deferred Taxes). BGE explains that, due to changes in state and federal tax rates that occasionally occur, BGE's deferred income tax balances do not match its actual tax liabilities. Rather than allowing such mismatches to accumulate over time, BGE proposes to correct the mismatches by including a mechanism in its Formula Rate that will automatically return any future excess deferred income taxes to customers, as well as recover any future deficiencies in deferred income taxes from customers. BGE states that this mechanism will also return to customers excess accumulated deferred income taxes (ADIT) that resulted from federal and state tax rate changes occurring in 1987, 1988, 1993, and 2008. BGE states that, consistent with the "*South Georgia* method"¹⁰ and Commission

⁸ *Id.* at 11.

⁹ BGE Transmittal Letter at 2.

¹⁰ See *South Georgia Natural Gas Co.*, Docket No. RP77-32 (May 5, 1978) (delegated letter order). Under the South Georgia method, a calculation is taken of the difference between the amount actually in the deferred account and the amount that would have been in the account had normalization continuously been followed. This difference is collected from ratepayers over the remaining depreciable life of the plant that caused the difference. When the deferred account is fully funded at the end of this transition period, the annual increment ceases. *Memphis Light, Gas and Water Div. v. FERC*, 707 F.2d 565, 569 (D.C. Cir. 1983).

precedent, BGE proposes to amortize the relevant balances over the remaining useful life of the assets impacted by the tax rate change.¹¹

7. Second, BGE proposes an adjustment for taxes on AFUDC Equity. BGE explains that federal income tax rules do not permit the deduction of AFUDC Equity on the income tax return, but that AFUDC Equity is included in depreciation expense for financial reporting purposes. Under FAS 109, this difference between the cost basis calculated for income tax and financial statement reporting purposes is recorded as a deferred regulatory asset and associated tax liability. Thus, BGE proposes to modify its Formula Rate to recover this tax difference on an ongoing basis, as well as to use a *South Georgia* catch-up provision to recover all previously unrecovered FAS 109 amounts associated with AFUDC Equity over the remaining life of the transmission assets. BGE asserts that the Commission has recognized that AFUDC Equity requires adjustment in the income tax calculation¹² and that this modification is consistent with the tax recovery mechanisms that the Commission has allowed in other transmission rate filings.¹³

8. Third, BGE proposes an adjustment for tax benefits flowed through to customers at the time that they originated (Flow-Through Items). BGE explains that, while its Formula Rate now employs the tax normalization methodology (i.e., BGE uses comprehensive tax normalization for ratemaking purposes), BGE previously employed flow-through ratemaking for property placed in service prior to 1976 (i.e., BGE immediately reflected the tax benefits of accelerated depreciation and cost of removal in retail rates).¹⁴ BGE states that both the flow-through and normalization methodologies will recover the proper amount of taxes from ratepayers over time. However, the switch from one methodology to another creates timing differences that lead to a difference

¹¹ BGE Transmittal Letter at 5-8 (citing *Virginia Elec. Power Co.*, Docket No. ER16-2116-000 (August 2, 2016) (delegated letter order) (*VEPCO*); *Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 61,374 (2015) (*ITC*); *American Transmission Co., LLC*, 93 FERC ¶ 61,335 (2000) (*ATC*); *DATC Midwest Holdings, LLC*, 144 FERC ¶ 61,015 (2013) (*DATC*); *Michigan Gas Storage Co.*, 83 FERC ¶ 63,001 (1998), *order on initial decision*, 87 FERC ¶ 61,038 (1999)).

¹² *Id.* at 8 (citing Order No. 144-A, FERC Stats. & Regs. ¶ 30,340, 30,136 (1982)).

¹³ *Id.* at 8-10 (citing *VEPCO*, Docket No. ER16-2116-000 (August 2, 2016) (delegated letter order); *ITC*, 153 FERC ¶ 61,374; *ATC*, 93 FERC ¶ 61,335; *DATC*, 144 FERC ¶ 61,015).

¹⁴ *Id.* at 10 (citing *Baltimore Gas & Elec. Co.*, Md. P.S.C. Case No. 6985, Order No. 62014 (Md. Pub. Serv. Comm'n 1976)).

between a utility's deferred tax account balance and its future tax liability. Thus, BGE proposes to modify its Formula Rate using the *South Georgia* methodology to amortize the tax balances associated with flow-through ratemaking over the remaining life of the transmission assets in place at the time it implemented its Formula Rate.¹⁵

III. Deficiency Letter and Response

9. On February 9, 2017, Commission staff issued a deficiency letter seeking additional information regarding BGE's prior ratemaking history, the specific tax liabilities BGE proposes to recover, and the proposed amortization period.

10. In its March 13, 2017 response, BGE provides work papers clarifying that it is seeking to recover approximately \$38 million, including the tax gross-up, from customers for previously incurred tax amounts. Specifically, BGE proposes to return approximately \$4 million to customers related to tax rate changes, collect approximately \$29 million from customers related to AFUDC equity, and collect approximately \$13 million from customers related to the flow-through accounting adjustment.¹⁶

11. BGE explains that, under its proposal, the transmission regulatory asset balance as of January 1, 2005 for AFUDC Equity and Flow-Through Items would be amortized over a period of 28 years, calculated by dividing the net transmission plant in service as of December 31, 2004 by BGE's 2004 transmission depreciation expense. For AFUDC Equity amounts recorded after adoption of the Formula Rate, BGE states that amortization would be calculated by multiplying the gross cumulative amount of capitalized AFUDC Equity embedded in gross plant by the book depreciation rate for the underlying plant assets. BGE further states that the previously recorded and future Excess/Deficient Deferred Taxes would be amortized using the Average Rate Assumption Method required by the Tax Reform Act of 1986.¹⁷

¹⁵ *Id.* at 10-12 (citing *Duquesne Light Co.*, Docket No. ER13-1220-000 (April 26, 2013) (delegated letter order); *PPL Elec. Util. Corp.*, Docket No. ER12-1397-000 (May 23, 2012) (delegated letter order); *San Diego Gas & Elec. Co.*, 105 FERC ¶ 61,301 (2003)).

¹⁶ See BGE Deficiency Response Attachment 1, Corrected Summary.

¹⁷ BGE Deficiency Response at 15-16.

12. BGE explains that, prior to its submittal of an open access tariff in 1996, it would have had no reason to seek recovery of these tax amounts with the Commission.¹⁸ BGE states that, in 1997, BGE filed rates as part of the initial tariff of PJM in Docket No. ER97-3189-000. According to BGE, these filings reflected a stated revenue requirement for BGE and were resolved through black box settlements that did not expressly address the tax amounts discussed above. In 2005, BGE filed its Formula Rate in Docket No. ER05-515-000, which was also resolved through settlement. BGE asserts that the Formula Rate expressly excludes FAS 109 amounts from ADIT calculations, and makes no provision for the recovery of the FAS 109 amounts at issue here.¹⁹ BGE further states that it was unaware of any formulaic mechanisms to address excess and deficient deferred taxes, and thus left recovery of any such amounts to be addressed in some other proceeding.²⁰

13. BGE asserts that, because the retail rate decisions issued by the Maryland Public Service Commission prior to 1996 and the settlements related to the 1996 and 1997 filings do not clearly address the treatment of FAS 109 amounts, BGE conservatively assumes that it was recovering these transmission-related tax amounts in rates until the established Formula Rate went into effect in 2005. Thus, BGE states that it has reduced the FAS 109 balances as of December 31, 2004, to reflect the assumed collection of these tax amounts through that date.²¹

14. BGE asserts that its filing is supported by Commission precedent.²² According to BGE, consistent with Commission Staff Guidance that FAS 109 amounts should generally be excluded from the formula rate calculation, unless and until “express Commission authorization” is obtained to recover such amounts, public utilities have

¹⁸ BGE filed an open access transmission tariff in 1996 in Docket Nos. ER96-894-000 and OA96-156-000.

¹⁹ BGE Deficiency Response at 10-11.

²⁰ *Id.* at 17.

²¹ *Id.* at 11.

²² *VEPCO Id.* at 6-8 (citing e.g., *ITC*, 153 FERC ¶ 61,374; Docket No. ER16-2116-000 (August 2, 2016) (delegated letter order); *Duquesne Light Co.*, Docket No. ER13-1220-000 (April 26, 2013) (delegated letter order); *PPL Electric Utilities Corp.*, Docket No. ER12-1397-000 (May 23, 2012) (delegated letter order)).

been recording FAS 109 amounts on their books for decades with the timing of recovery to be determined in some later Commission proceeding.²³

IV. Notice of Filings and Responsive Pleadings

15. Notice of BGE's filing in Docket No. ER17-528-000 was published in the *Federal Register*, 81 Fed. Reg. 92,809 (2016), with interventions and protests due on or before January 3, 2017. The Maryland Office of People's Counsel filed a timely motion to intervene. The Maryland Public Service Commission filed a notice of intervention.

16. Notice of BGE's deficiency response in Docket No. ER17-528-001 was published in the *Federal Register*, 82 Fed. Reg. 14,357 (2017), with interventions and protests due by April 3, 2017. None was filed.

V. Discussion

A. Procedural Matters

17. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2017), the timely, unopposed notice of intervention and motions to intervene serve to make the entities that filed them parties to this proceeding.

B. Substantive Matters

18. We reject BGE's filing upon finding that BGE has not shown that its proposed Formula Rate provisions allowing for the recovery of previously incurred tax amounts are just and reasonable. We agree that including a mechanism in BGE's Formula Rate to refund or recover on an ongoing basis Excess/Deficient Deferred Taxes and taxes on AFUDC Equity will provide for a more accurate annual revenue requirement for BGE. However, BGE has not demonstrated that its proposal to recover the accumulated amounts associated with AFUDC Equity that has already been depreciated and prior period tax balances associated with flow-through ratemaking is just and reasonable and not unduly discriminatory. Although these accumulated amounts may represent legitimate deficiencies in accumulated deferred income taxes, we find that these deficiencies should have been captured in BGE's Formula Rate since its implementation in 2005.

19. As BGE acknowledges, the Commission's regulations require companies to make provisions under a Commission-approved plan to recover FAS 109 amounts in their

²³ *Id.* at 5 (citing *FERC, Staff Guidance on Formula Rate Updates* (July 2014), <https://www.ferc.gov/industries/electric/indus-act/oatt-reform/staff-guidance.pdf>).

rates.²⁴ However, BGE contends that it should be allowed to collect any deferred amounts related to prior periods, once a specific application is made to the Commission, with the timing of recovery to be determined in that Commission proceeding. We disagree. Recording a deferred tax liability does not guarantee that the utility will be able to recover this amount; rather, the utility must receive express Commission approval for future collection.²⁵ In Order No. 144, the Commission specifically directed utilities to “begin the process of making up deficiencies or eliminating excesses in their deferred tax reserves... within a reasonable period of time to be determined on a case-by-case basis.”²⁶ The Commission also specified that a rate applicant must make adjustments pertaining to reversals from prior flow-through or tax rate changes in the applicant’s *next rate case*.²⁷ Thus, while Order No. 144 provided notice to ratepayers that companies may make adjustments for recovery of certain tax deficiencies, Order No. 144 only allowed for such adjustments made in the applicant’s next rate case, or at the least, “within a reasonable period of time.”²⁸ Contrary to BGE’s assertion, we find that utilities do not have unfettered discretion to defer these tax amounts on their books for decades without timely seeking regulatory approval to collect them.²⁹

²⁴ See *In re: Columbia Gas Transmission Corporation*, 64 FERC ¶ 61,352, at 63,461 (1993) (noting that the Commission’s regulations require “companies compute the tax component of their cost of service by making provisions under a Commission-approved plan for any excess or deficiency in deferred taxes resulting from prior flow-through rate practices or change in tax rates.”) (citing 18 CFR § 154.63a(c) (1992) and 18 CFR § 35.24(c) (1992)).

²⁵ See, e.g., *Stingray Pipeline Co.*, 50 FERC ¶ 61,159, at 61,469 (1990) (reaffirming the Commission’s decision to disallow rate recovery of a portion of Stingray’s deficiency in its deferred tax account, finding it “reasonable to assume — in view of the regulations’ clear requirement that normalization be employed and the failure of Stingray to request waiver of the regulation — that Stingray began making up any deficiency in its deferred tax account as of the [effective date of its] settlement rates”).

²⁶ Order No. 144, FERC Stats & Regs. ¶ 30,254 at 31,560.

²⁷ *Id.* at 31,519.

²⁸ *Id.* at 31,519, 31,560.

²⁹ We further note that the published Staff Guidance that BGE references merely states the Commission’s policy that FAS 109 amounts be excluded in rate determinations absent express Commission authorization; the guidance does not comment on when utilities may seek such authorization.

20. Moreover, the Commission has long recognized the importance of matching (i.e., the recognition in rates of the tax effects of expenses and revenues with the expenses and revenues themselves).³⁰ Had BGE properly addressed the tax deficiencies when its Formula Rate was initially filed in 2005, BGE may have been allowed to collect some portion of these deficiencies over the remaining life of the underlying plant assets that created the deficiencies. BGE's violation of the matching principle is particularly noticeable through its treatment of the Flow-through Items. Because these Flow-through Items are related to pre-1976 plant, most of which have been either fully depreciated or retired by 2016, it is unclear if there are any relevant assets left on BGE's books in 2017 to match the amortization period over the next 28 years. Similarly, the additional taxes associated with AFUDC Equity are only applicable to the relevant year's depreciation expense.

21. Although BGE argues that it had a settled rate before implementing its Formula Rate and therefore needed authorization from the Commission for recovery of FAS 109 amounts since 2005, BGE does not explain why it failed to make provisions for such recovery for nearly 12 years after implementing its Formula Rate.³¹ Nor does BGE present any changed circumstances since 2005 that would affect the amortization treatment of FAS 109 amounts. Because BGE did not address the tax deficiency in a reasonable time, its proposal no longer has the requisite matching of the amortization period with the relevant transmission assets. Thus, we find that it is not appropriate for BGE to propose, at this late date, a mechanism to recover years of accumulated deferred tax liability amounts.

22. We further find that the precedent BGE cites in support of its proposal is inapposite. As an initial matter, the delegated letter orders cited by BGE do not establish precedent binding on the Commission and the exercise of delegated authority cannot serve to supplant Commission policies established in its decisions and regulations.³² As previously mentioned, Order No. 144 provided that the Commission may make

³⁰ See Order No. 144, FERC Stats. & Regs. ¶ 30,254 at 31,522 (finding that the primary rationale for tax normalization is matching the costs of plant (i.e., tax benefits from depreciation expense) to the periods that they are allocated to in rates).

³¹ BGE merely states that it was unaware of any formulaic mechanisms to address Excess/Deficient Deferred Taxes.

³² See *Millennium Pipeline Co., LLC*, 145 FERC ¶ 61,088, at P 10, n.11 (2013); *Westar Energy, Inc.*, 124 FERC ¶ 61,057, at P 26 (2008); *Norwalk Power, LLC*, 122 FERC ¶ 61,273, at P 25 (2008); see also *Mid-Continent Area Power Pool*, 97 FERC ¶ 61,038, at 61,184 n.10 (2001) (citing *Phoenix Hydro Corp.*, 26 FERC ¶ 61,389, at 61,870 (1984), 775 F.2d 1187, 1191 (D.C. Cir. 1985)).

determinations regarding such tax adjustments on a case-by-case basis. Moreover, the records in the *ITC* and *VEPCO* proceedings do not reflect that either VEPCO or ITC requested a *South Georgia* catch-up provision to recover prior accumulated amounts related to AFUDC Equity, as alleged by BGE. In fact, the Commission in *ITC* did not address the recovery of any previously incurred tax amounts.³³ Accordingly, because BGE has not demonstrated that its proposal is just and reasonable, we reject BGE's proposed Formula Rate revisions.

The Commission orders:

BGE's revisions to its Formula Rate are hereby rejected, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

³³ See, *ITC*, 153 FERC ¶ 61,374 (finding that “[t]he proposed Attachment O revisions and related depreciation rates provide for a more accurate annual revenue requirement for the ITC Companies.”).