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FERC ISSUES PROPOSED RULE ON RETURN OF EXCESS ADITS BY ELECTRIC UTILITIES

To Our Clients and Friends:

On November 15, 2018, the Federal Energy Regulatory Commission ("FERC") issued a Notice of Proposed Rulemaking ("NOPR") addressing how electric utilities are to modify their cost-based rates to account for the impact of the Tax Cuts and Jobs Act of 2017 on accumulated deferred income taxes ("ADITs"). FERC's prior orders related to tax reform had deferred action on how to treat ADITs.

FERC-jurisdictional transmission providers have billions of dollars of ADITs recorded on their books and the return of excess ADITs resulting from the Tax Act could return billions of dollars to ratepayers in coming years. FERC's rulemaking proceeding should provide guidance on how utilities are to address these ADITs, but the details will likely only be decided in company-specific proceedings initiated in the next year or so.

ADITs are values recorded on the books of utilities that arise from the differences between the accelerated rates of depreciation used to calculate federal corporate income taxes and straight-line depreciation used to calculate FERC jurisdictional cost-based rates. ADITs are generally liabilities that reflect money that will need to be paid to the IRS in the future and are based on an assumption that current income tax rates will remain the same.

If federal corporate income tax rates fall, however, the amount the utility will actually need to pay to the IRS in the future is less than what was assumed. And, as a result, the utility will be viewed as having over-collected from customers in the past. In accounting parlance, the utility will be considered to have recovered "excess ADITs" through rates that, in the view of many, will need to be returned to customers, lest the utility enjoy a windfall from the tax cut that is not shared with customers.

Indeed, this is the view taken by FERC in its NOPR. It proposes to require utilities with formula transmission rates to adjust their rates to reflect the impact of the Tax Act on ADITs, whether that means returning excess ADITs to ratepayers or collecting deficient ADITs from ratepayers (though the former is likely to eclipse the latter for most utilities).

Specifically, FERC proposes requiring such utilities to include a mechanism in their formula transmission rates that deducts any excess ADITs from rate base (or adds any deficient ADITs to rate base). Notably, FERC states in the NOPR that it does not intend to adopt a "one size fits all" approach. Instead, it intends to "allow public utilities to propose any necessary changes to their formula rates on an individual basis."

FERC also proposes that these utilities include a mechanism to decrease (or increase) any income tax allowances—i.e., a mechanism that provides for the return to or collection of excess or deficient ADITs from ratepayers over time. In keeping with its approach of allowing flexibility, FERC does not propose any specific period of time but, instead, states that a "case-by-case approach to amortizing excess or deficient unprotected ADIT remains appropriate." Following this case-by-case approach, shortly before the NOPR issued, FERC approved a proposal by Emera Maine to return unprotected excess ADITs to customers over a period of 10 years.

For utilities with stated transmission rates, however, FERC does not propose to require rate base adjustments prior to their next rate case. But it does propose to require that such utilities determine their excess and deficient ADITs and propose in compliance filings a manner to return or recover these amounts from ratepayers.

FERC-regulated transmission providers appear to have billions of dollars of ADITs recorded on their books. Assuming FERC's final rule generally follows its proposal, these utilities will likely need to return billions of dollars in excess ADITs. But the precise manner in which this is done—and importantly the period of time over which excess ADITs will be returned—will likely be resolved only in company specific proceedings in the future.

These proceedings are likely to be contentious at times, as customers will generally push for a faster return, but at the same time will need to balance that speed against future rate shock once the amortization is complete. FERC recently approved Emera Maine's request to return unprotected excess ADITs over 10 years, finding that doing so "balances passing through the benefits of the Tax Cuts and Jobs Act to ratepayers in a timely manner with avoiding rate shock." Whether other utilities will propose similar or different periods, and how FERC will respond, remains to be seen.

The deadline for comments on the NOPR (issued in Docket No. RM19-5-000) is December 24, 2018. FERC proposes that compliance filings be due within 90 days of the date of any Final Rule.

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Gibson Dunn was counsel to Emera Maine in the matter noted above.

Gibson Dunn's Energy, Regulation and Litigation lawyers are available to assist in addressing any questions you may have regarding the developments discussed above. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work, or the authors:

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