

## **Alert** | Energy & Natural Resources



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### **FERC Clarifies and Reaffirms ADIT Rules**

On April 16, 2020, the Federal Energy Regulatory Commission (FERC) issued [Order 864-A](#) on Public Utility Transmission Rate Changes to Address Accumulated Deferred Income Taxes (ADIT). Order No. 864-A addresses requests for clarification and rehearing concerning the obligation of public utilities with either transmission formula rates or transmission stated rates to return excess ADIT arising from the reduction in the federal corporate income tax rate under the Tax Cuts and Jobs Act of 2017 (TCJA).

FERC reaffirmed its determination in Order No. 864 that public utilities with transmission formula rates must, *inter alia*, return the full amount of excess ADIT resulting from the TCJA to customers. The Commission also affirmed that utilities with transmission stated rates must return excess ADIT to customers, but clarified how such utilities should treat excess and deficient ADIT between rate cases. To the extent a public utility with a transmission stated rate has a FERC-approved ratemaking method for addressing excess and deficient ADIT, the utility should return excess ADIT (or recover deficient ADIT) according to that FERC-approved method. Public utilities with transmission stated rates that lack a FERC-approved ratemaking method must use some ratemaking method to make provision for excess and deficient ADIT. Importantly, the Commission clarified that such utilities could begin amortizing excess and deficient ADIT balances immediately upon the tax rate change, subject to Commission review in its next rate case.

The reduction in the corporate income tax rate under the TCJA results in a reduction in the amount of income taxes public utilities must pay. Consequently, a portion of an ADIT liability that was collected from customers will no longer be due from public utilities to the IRS, and is now considered excess ADIT, which the Commission requires to be returned to customers in a cost of service ratemaking context.

Consistent with FERC's regulations, public utilities are required to adjust their ADIT assets and liabilities to reflect the effect of the change in tax rates in the period the change is enacted.

Order No. 864 requires public utilities with transmission formula rates to propose tariff revisions to implement certain excess and deficient ADIT-related mechanisms. Specifically, public utilities must include the following in their transmission formula rates: (1) a mechanism to deduct any excess ADIT from, or add any deficient ADIT to, their rate bases; (2) a mechanism to decrease or increase their income tax allowances by any amortized excess or deficient ADIT, respectively; and (3) a new permanent worksheet that will annually track information related to excess or deficient ADIT. FERC required that public utilities with transmission formula rates return the full amount of excess ADIT resulting from the Act to customers and recover the full amount of deficient ADIT resulting from the TCJA. For utilities with transmission stated rates, excess and deficient ADIT would be addressed in that utility's next rate case.

The American Public Power Association (APPA) asserted that Order No. 864 creates ambiguity regarding whether customers of public utilities with transmission stated rates will receive the full amount of excess ADIT resulting from the TCJA. APPA argued that public utilities with stated rates should not be allowed to deprive customers of the full excess ADIT regulatory liability by amortizing the excess ADIT between rate cases. By amortizing ADIT on the utility's books before the filing of a rate case, the ADIT balance that would be returned through rates in the utility's next rate case would be lower. In the alternative, APPA requested rehearing of Order No. 864 arguing that to the extent FERC's guidance would result in any portion of excess ADIT not being returned to customers, FERC departed from prior policy without adequate explanation by permitting public utilities with transmission stated rates to amortize excess ADIT immediately as of the effective date of the Act.

In response to APPA, the Commission disagreed that allowing utilities to amortize excess ADIT between rate cases will deprive customers of the appropriate amount of excess ADIT. The Commission reasoned that utilities with a FERC-approved ratemaking method for addressing excess ADIT are presumed to recover their costs when their rates are in effect, and will return the appropriate amount of excess ADIT to customers through their transmission stated rates. For utilities that lack a FERC-approved method for addressing excess ADIT, the Commission relied on the same rationale to allow the utility to begin amortizing excess and deficient ADIT balances immediately upon a tax rate change, but stated that the appropriateness of such amortization would be subject to review in its next rate case.

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