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Energy ADVISORY ■

NOVEMBER 27, 2018

FERC Addresses ADIT in Light of Decrease to Federal Corporate Income Tax Rate

The Federal Energy Regulatory Commission (FERC) on November 15, 2018, took steps to respond to the effects of the Tax Cuts and Jobs Act on accumulated deferred income taxes (ADIT), including the issuance of a Notice of Proposed Rulemaking (NOPR), a policy statement, and an order on the accounting effects resulting from the Tax Cuts and Jobs Act. The NOPR also proposes certain new requirements that will address the impact of future tax changes on transmission provider public utilities.

Signed into law by the President on December 22, 2017, the Tax Cuts and Jobs Act reduces the federal corporate income tax rate from a maximum 35 percent to a flat 21 percent, effective January 1, 2018. This tax rate reduction will result in a reduction in ADIT liabilities and ADIT assets on the books of rate-regulated companies.

- The NOPR initiated in Docket No. RM19-5-000 addresses the effects of the Tax Cuts and Jobs Act on the ADIT reflected in all transmission formula or stated rates of a public utility transmission provider under an open access transmission tariff (OATT), a transmission owner tariff, or a rate schedule of public utility transmission providers. Comments responding to the NOPR are due December 24, 2018.
- The Policy Statement, issued in Docket No. PL19-2-000, is intended to provide FERC's policy regarding the treatment of ADIT for accounting and ratemaking purposes for certain FERC-jurisdictional entities in light of the reduction of the federal corporate income tax rate. The Policy Statement took effect November 23, 2018.
- The Order Granting Accounting Request in *Edison Electric Institute*, 165 FERC ¶ 61,114 (2018) permits a reclassification of stranded tax effects for certain public utilities and centralized service companies resulting from the Tax Cuts and Jobs Act.

Notice of Proposed Rulemaking

In response to the potential impact on ADIT, FERC issued a notice of inquiry (NOI) on March 15, 2018, seeking comments on, among other things, how it should address the effects of the Tax Cuts and Jobs Act on ADIT. After receiving and reviewing comments on the NOI, FERC has proposed certain requirements. The NOPR does not prescribe a "one-size-fits-all" approach to its proposed requirements, instead allowing public utilities to propose individual compliance changes.

FERC proposes to require that all public utilities with transmission formula rates include a mechanism in their rates that deducts excess ADIT from or adds deficient ADIT to their rate bases. This mechanism is intended to preserve rate base neutrality. The NOPR does not propose adjustments to the rate bases of public utilities with transmission stated rates.

Under the NOPR, public utilities with transmission formula rates will also be required to include a mechanism in their formula rates that decreases or increases their income tax allowances by any amortized excess or deficient ADIT. Consistent with the Tax Cuts and Jobs Act, public utilities are required to return excess protected ADIT (or recover deficient ADIT), no more rapidly than over the life of the underlying asset using the average rate assumption method or through an alternate method approved by FERC if a public utility's books and underlying records do not contain the vintage account data necessary. The NOPR allows public utilities with transmission formula rates to propose a case-by-case approach to amortizing excess or deficient unprotected ADIT.

FERC proposes that public utilities with transmission stated rates be required to determine the amount of excess and deficient income tax caused by the reduced federal corporate income tax. This amount would then be returned to, or recovered from, customers. To calculate this amount, public utilities would use the ADIT approved in their last FERC rate case. The compliance filings for public utilities with transmission stated rates must address:

- How any ADIT accounts were re-measured.
- The accounting of any excess or deficient ADIT amounts.
- Whether the excess or deficient ADIT is protected or unprotected.
- The accounts to which the excess or deficient ADIT will be amortized.
- The amortization period of the excess or deficient ADIT to be returned or recovered through the rates.

The NOPR also proposes to require public utilities with transmission formula rates to incorporate a new, permanent worksheet into their transmission formula rates that will annually track ADIT information. This requirement is intended to provide transparency for the impact on ADIT of future tax decreases or increases. While the worksheet would need to include information in five set categories, FERC would not require utilities to adopt an across-the-board, pro forma worksheet. FERC does not propose additional information requirements for public utilities with transmission stated rates.

Though FERC does not generally permit single-issue ratemaking, given the limited scope of reforms proposed in the NOPR, FERC proposes that compliance filings made in response to the NOPR's final requirements be reviewed on a single-issue basis.

Comments on these proposals are due on December 24, 2018.

Policy Statement

The Policy Statement offers accounting and ratemaking guidance relating to two aspects of the treatment of ADIT for public utilities, natural gas pipelines, and oil pipelines in light of the Tax Cut and Jobs Act: (1) the accounts in which public utilities, gas pipelines, and oil companies should record amortization of excess and/or deficient ADIT; and (2) for both accounting and ratemaking purposes, whether, and if so how, such entities should address excess and/or deficient ADIT that is recorded on their books after December 31, 2017, as a result of assets being sold or retired. It arose out of comments on the March 15, 2018, NOI relating to the amortization of excess and deficient ADIT and the treatment of ADIT for assets sold or retired after December 31, 2017.

The Policy Statement indicates the accounts that public utilities and natural gas companies should use to record the amortization of excess and deficient ADIT for accounting and ratemaking purposes. The Policy Statement clarifies that oil pipelines will not record excess or deficient ADIT for accounting purposes but that they should provide additional disclosures accompanying their FERC Form No. 6.

On the issue of asset sales and retirement, the Policy Statement reiterates that public utilities and natural gas pipelines must continue to follow the accounting guidance issued in 1993 in Docket No. AI93-5-000, and clarified that such entities should provide additional disclosures in their 2018 FERC annual financial filings. For ratemaking purposes, the Policy Statement concludes that for public utilities or natural gas pipelines that continue to have an income tax allowance, any excess or deficient ADIT associated with an asset must continue to be amortized in rates even after the sale or retirement of an asset. Oil pipelines should continue maintaining excess or deficient ADIT within the appropriate ADIT accounts and continue to amortize such amounts when assets are retired or sold.

FERC expects regulated entities to follow its policies outlined in the Policy Statement; however, if a public utility, natural gas pipeline, or oil pipeline determines that its unique circumstances merit a different treatment of ADIT, the company is free to request it.

The Policy Statement became effective November 23, 2018.

Order Granting Accounting Request

FERC has also granted a request for blanket approval of the recording of an accounting reclassification resulting from the decrease in the federal corporate income tax rate under the Tax Cuts and Jobs Act. Under an accounting standards update issued in 2018 by the Financial Accounting Standards Board (FASB), stranded tax effects resulting from the federal income tax change may be reclassified from accumulated other comprehensive income to retained earnings. On behalf of certain of its members, the Edison Electric Institute requested approval for a related reclassification under FERC's Uniform System of Accounts. The FERC order permits the requested reclassification of stranded tax effects, which would relate only to specific income and expenses for certain public utilities and centralized service companies. A public utility or centralized holding company that chooses to make these reclassifications must disclose this accounting election in FERC Form No. 1, FERC Form No. 1-F, and FERC Form No. 60 in the year the election is made.

FERC further clarifies that its approval of this request is only for accounting purposes, and it is not intended to influence any future rate considerations.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any member of our Energy Group.

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