

**ORDER NO. 88236**

IN THE MATTER OF THE APPLICATION OF POTOMAC ELECTRIC POWER COMPANY FOR ADJUSTMENTS TO ITS RETAIL RATES FOR THE DISTRIBUTION OF ELECTRIC ENERGY <hr/>	* * * * * * * * *	BEFORE THE PUBLIC SERVICE COMMISSION OF MARYLAND  <hr/> CASE NO. 9418 <hr/>
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**Issued: June 2, 2017**

**ORDER ON REQUEST FOR CLARIFICATION OF ORDER NO. 88177  
 REGARDING POTOMAC ELECTRIC POWER COMPANY’S TREATMENT  
 OF IRS TAX SETTLEMENT**

On May 16, 2017, pursuant to Code of Maryland Regulations (“COMAR”) 20.07.02.08 and 20.07.04.12, Potomac Electric Power Company (“Pepco” or “Company”) filed a *Request for Clarification of Potomac Electric Power Company of Order No. 88177 Regarding Treatment of IRS Tax Settlement and Request for Expedited Treatment* (“Request for Clarification”). The Request for Clarification asks the Maryland Public Service Commission (“Commission”) to clarify its recent Order on Petitions for Rehearing (“Rehearing Order”) issued May 4, 2017, in the above-captioned proceeding. This Order grants the clarification and reaffirms Commission Order No. 88177.

**I. Background**

A. Pepco Request

In its *Request for Clarification*, Pepco raises an issue with the Commission’s adoption of Staff’s recommendation in Order No. 88177 to have the Company “seek a private letter ruling [“PLR”] from the IRS to determine whether treatment of the IRS

global settlement revenues in the Commission’s Order would in fact violate the Normalization Rules, as was done in Case No. 9311.”<sup>1</sup> Specifically, Pepco points out that unlike the present case, in Case No. 9311 the Commission avoided the treatment that gave rise to the normalization violation while the PLR was being pursued by “err[ing] on the side of caution and accept[ing] Pepco’s NOLC [Net Operating Loss Carryforward] ratemaking adjustments at this time …”<sup>2</sup> Here, in Case No. 9418, Pepco points out that the Commission “did not address in the Rehearing Order whether, while waiting for the outcome of the PLR, Pepco should “(a) employ the 13-month average calculation of the effect of the IRS settlement on the accumulated deferred federal income tax (ADFIT) balance, which Pepco contends would not give rise to a normalization violation; or (b) employ an end-of-test-period ADFIT balance, which treats the IRS tax settlement as though it was available throughout the entire test period, resulting in a relatively higher ADFIT balance (and therefore producing a relatively lower rate base upon which to calculate the authorized rate of return). The latter result is the very treatment that Pepco believes would constitute a normalization violation and which will be the subject of the PLR.”<sup>3</sup>

Therefore, Pepco states that “out of an abundance of caution”<sup>4</sup> it proposes two alternatives for the Commission’s consideration to provide the clarity and direction it needs during the pendency of pursuing the PLR. The first alternative is to have the Company “employ the 13-month average treatment to calculate the effect of the IRS tax

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<sup>1</sup> Pepco’s Request for Clarification at 1-2 quoting Order No. 88177 at 17.

<sup>2</sup> Pepco’s Request for Clarification at 2.

<sup>3</sup> *Id* at 3 citing Motion for Leave to Supplement the Petition for Rehearing of Potomac Electric Power at 5 (February 2, 2017).

<sup>4</sup> *Id* at 3.

settlement on AFDIT pending receipt of an IRS PLR ruling”, revise its rates in effect no later June 15, 2017 or another Commission determined date (the “Revised ADFIT Date”) to reflect the 13-month average, and then include the amount Pepco believes was under-collected between November 15, 2016 to the Revised ADFIT Date in a Bill Stabilization Adjustment filing for June 2017.<sup>5</sup> Additionally, under this alternative Pepco would also “track the effect on rates that would have occurred had it used the end-of-test-year-period ADFIT balance and if the IRS PLR finds that this method would not constitute a normalization violation, then the Commission will make the appropriate adjustment no later than the Company’s subsequent rate case to reflect the Commission’s previous decision in Order No. 87884,” and Pepco will refund the amount over-collected plus carrying costs at the Company’s then effective authorized rate of return.<sup>6</sup> Pepco asserts that this first alternative would place the treatment of the IRS tax settlement in Case No. 9418 on par with the NOLC treatment in Case No. 9311. The Company additionally notes that the revenue requirement impact of this action would be an increase of \$1.875 million on an annual basis to reflect the 13-month average methodology.<sup>7</sup>

Alternatively, Pepco proposes to leave the current rates in effect but requests that the Commission: “clarify that its decision on the IRS tax settlement is not a final order pending the outcome of the PLR”<sup>8</sup>; initiate a Phase II to Case 9418 for the sole purpose of addressing the PLR when received; direct the Company to calculate the effect on rates of the IRS tax settlement based on the end-of-the-test-period ADFIT balance until the Commission issues a decision in Phase II or authorizes rates to be put into effect in Case

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<sup>5</sup> *Id* at 3.

<sup>6</sup> *Id* at 4.

<sup>7</sup> *Id* at 4.

<sup>8</sup> *Id* at 5.

No. 9443 currently before the Commission; and lastly directs Pepco to track the effects on rates that would have occurred had it used the 13-month average ADFIT calculation to reflect the IRS tax settlement from the rate effective date for Case No. 9418 and to create a regulatory asset to record the difference between end-of-the-test-period ADFIT balance compared to 13-month average ADFIT method.<sup>9</sup> If the PLR finds that the end-of-the-test-period ADFIT balance constitutes a normalization violation, the Commission will make the appropriate adjustment in Phase II of Case No. 9418 and Pepco will recover the regulatory asset plus carrying costs at Pepco's then effective authorized rate of return.<sup>10</sup>

B. Staff's Comments

On May 26, 2017, Office of Staff Counsel ("Staff") filed a letter responding to Pepco's Request for Clarification and found that either of Pepco's proposed options would prevent the normalization violation and would leave Pepco ratepayers in the appropriate financial position.<sup>11</sup> Nonetheless Staff prefers that the Commission select the second option which would require no immediate financial impact on Pepco ratepayers until an IRS PLR ruling is made. Specifically, Staff notes that "Pepco's preferred first alternative would require ratepayers to begin paying higher rates now but would ultimately make them whole if the IRS finds that the Order No. 87884 regulatory treatment of the tax settlement does not violate the normalization rules."<sup>12</sup> Staff also points out that Pepco's basis for even filing its *Request for Clarification* was a misunderstanding and "overly broad" reading of Staff's February 21, 2017 letter responding to Pepco's Request for Rehearing on this issue in Case No. 9418.

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<sup>9</sup> *Id* at 5.

<sup>10</sup> *Id* at 5-6.

<sup>11</sup> Letter filed on May 26, 2017 by Office of Staff ("Staff Response") at 2.

<sup>12</sup> Staff Response at 2.

Specifically, Staff indicated that when it advised the Commission to seek an IRS PLR on this issue as was done in Case No. 9311 it had “no expectation that this would require reversing the Order No. 87884 regulatory treatment of the tax settlement prior to seeking or receiving the PLR.”<sup>13</sup> Staff states that it sees “no compelling reason to reverse this aspect of Order No. 87884 unless and until the IRS rules”<sup>14</sup> that the Commission must do so.

### C. OPC’s Comments

On May 26, 2017, Office of People’s Counsel (“OPC”) also filed a letter responding to Pepco’s Request for Clarification and opposed any changes to Pepco’s tariffs as well as the creation of a Phase II. First, OPC argues that although the Commission allowed Pepco to supplement its Request for Rehearing, the Company’s filing “does not constitute evidence upon which the Commission can set rates”<sup>15</sup> and the testimony offered was from a separate proceeding in a different jurisdiction not subject cross examination in Case No. 9418. Therefore, OPC asserts, there is no evidence on the record in this proceeding on the issue of normalization; thus it is inappropriate for the Commission to change its rates especially to increase them as proposed under Pepco’s first option. OPC also rejects Pepco’s main argument for its Request for Clarification, i.e., consistent treatment of a disputed normalization violation in Case No. 9311 with Case No. 9418. OPC argues that in “CN 9311, the issue of a normalization violation arose before the close of the evidentiary record and was fully briefed by the parties. This case is procedurally different and therefore

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<sup>13</sup> Staff Response at 2.

<sup>14</sup> Staff Response at 3.

<sup>15</sup> Letter filed on May 26, 2017 from the Office of People’s Counsel (“OPC Response”) at 1.

requires a different outcome; [sic] the Commission cannot set or increase rates without evidence in the record.”<sup>16</sup>

## **II. Commission Ruling**

The Commission has carefully reviewed Pepco’s Request for Clarification and the related responses. While OPC may be technically correct in suggesting that Pepco’s Request for Clarification should be disregarded because the Company had the burden of proof and should have raised any potential normalization issues during the evidentiary phase of Case No. 9418<sup>17</sup>, we conclude that in as much as the Commission granted the Company’s Motion for Leave to Supplement the Petition for Rehearing in Case No. 9418, which raised the potential normalization violation, it is appropriate at this time to clarify our Order on this specific issue. We also agree with Staff’s assessment of both of Pepco’s proposed options. However, we find that it inappropriate to allow Pepco to increase its revenue requirement by *any* amount at this time and thus reject Pepco’s first option. In applying an abundance of caution for ensuring consistent treatment of the IRS normalization rules between Case No. 9311 and 9418, we will initiate a Phase II to Case No. 9418 as described in Pepco’s Request for Clarification.

**IT IS THEREFORE**, this 2<sup>nd</sup> day of June, in the year of Two Thousand Seventeen, by the Public Service Commission of Maryland,

**ORDERED:** (1) That the Commission hereby initiates Phase II to Case 9418 for the sole purpose of addressing the IRS Private Letter Ruling upon receipt;

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<sup>16</sup> OPC Response at 2.

<sup>17</sup> Order No. 88177 at 16.

(2) That Potomac Electric Power Company is hereby directed to calculate the effect on rates of the IRS tax settlement based on the end-of-the-test-period ADFIT balance until the Commission issues a decision in Phase II or authorizes rates to be put into effect in Case No. 9443 currently before the Commission; and,

(3) That Potomac Electric Power Company is directed to track the effects on rates that would have occurred had it used the 13-month average ADFIT calculation to reflect the IRS tax settlement from the rate effective date for Case No. 9418 and to create a regulatory asset to record the difference between end-of-the-test-period ADFIT balance compared to 13-month average ADFIT method. If the PLR finds that the end-of-the-test-period ADFIT balance constitutes a normalization violation, the Commission will make the appropriate adjustment in Phase II of Case No. 9418 and Pepco will recover the regulatory asset plus carrying costs at Pepco's then effective authorized rate of return.

*/s/ W. Kevin Hughes* \_\_\_\_\_

*/s/ Harold D. Williams* \_\_\_\_\_

*/s/ Michael T. Richard* \_\_\_\_\_

*/s/ Anthony J. O'Donnell* \_\_\_\_\_

Commissioners