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APPLICATION OF SOUTHWESTERN ELECTRIC POWER COMPANY FOR AUTHORITY TO CHANGE RATES	§ § §	BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

COMMISSION STAFF'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Staff (Staff) of the Public Utility Commission (Commission) proposes the following findings of fact and conclusions of law, which are organized in a manner consistent with the briefing outline in this proceeding. To the extent an issue in this proceeding is not specifically addressed below, Staff respectfully requests the entry of findings of fact and conclusions of law that are consistent with Staff's positions in this proceeding.

PROPOSED FINDINGS OF FACT

II. Invested Capital - Rate Base [PO Issues 4, 5, 10, 11, 12, 13, 14, 15, 16, 18, 19, 20, 21, 22]

A. Generation, Transmission, and Distribution Capital Investment [PO Issues 4, 5, 10, 11, 13, 14, 15, 16]

1. Dolet Hills Power Station [PO Issues 67, 68, 69, 70, 71]

- Dolet Hills is a lignite-fired power plant located in De Soto Parish, Louisiana.
- Dolet Hills is co-owned by Cleco Power LLC, SWEPCO, North Texas Electric Cooperative, and Oklahoma Municipal Power Authority. Cleco is the majority owner and operator. Southwestern Electric Power Company's (SWEPCO) ownership share is 262 MW, approximately 40%.
- SWEPCO and Cleco Power, LLC determined that all economically recoverable lignite had been recovered from the associated Dolet Hills mines and the decision was made that the Dolet Hills plant would be retired no later than December 31, 2021.
- SWEPCO proposed in its application to offset the undepreciated balance of Dolet Hills with the balance of excess Accumulated Deferred Federal Income Tax (ADFIT) liabilities owed to ratepayers associated with the Tax Cuts and Jobs Act of 2017.

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- Then SWEPCO proposed to amortize the remaining balance after the offset over a four-year period, which is the time period SWEPCO anticipates between rate cases.
- This is because the offset for the excess ADFIT liabilities owed ratepayers as calculated by SWEPCO is less than the undepreciated book balance of Dolet Hills.
- SWEPCO quantified its total requested revenue requirement associated with Dolet Hills as $29,434,851. However, an additional $1,847,918 of base rate fuel expenses, and $442,574 of property insurance expense are included in its requested revenue requirement.
- Also included are costs related to the Dolet Hills mining operations that will cease production. These include $1,412,622 of return and associated federal income taxes on SWEPCO's Oxbow mine investment and the equity return of $1,418,666 on its Dolet Hills Lignite Company investment.
- The sum of these additional expenses plus SWEPCO's initial quantification equals $34,556,631 of expenses in SWEPCO's requested annual revenue requirement for the Dolet Hills plant and related mining operations.
- SWEPCO is to recover the return, depreciation, Operating and Maintenance (O&M), and taxes associated with the operation of Dolet Hills from March 18, 2021 (the relate-back date of rates in this proceeding) through December 31, 2021.
- SWEPCO's requested net book value associated with Dolet Hills and the Oxbow mine investment is removed from rate base as well as the associated Dolet Hills depreciation expense from cost of service after that date.
- SWEPCO will book a regulatory asset of $118,936,606 to allow recovery of but not on the remaining net book balance of SWEPCO's Dolet Hills investment on December 31, 2021 over the projected remaining life for the plant as provided in Docket No. 46449.
- This will allow an amortization period for recovery on Dolet Hills regulatory asset of 24.5 years.
- SWEPCO will be allowed $11,573,440 relating to Dolet Hills to be put into its revenue requirement for rates.
- This will include $1,865,403 related to return and FIT; $1,625,489 related to deprecation; $3,944,326 related to amortization; $3,174,560 related to O&M expenses; $254,737 related to a return on the Oxbow mine, and $708m925 associated with property taxes.

2. Retired Gas-Fired Generating Units [PO Issue 13]

- SWEPCO has retired five generating units since its last base rate case in Docket no. 46449.
- Those units include:
  - Knox Lee Unit 4 retired in January 2019;
  - Knox Lee Unit 2 retired in May 2020;
  - Knox Lee Unit 3 retired in May 2020;
  - Lieberman Unit 2 retired in May 2020; and
  - Lone Star Unit 1 retired in May 2020.
- The net book value of these plants of $13,240,470 shall not be included in rate base as these plants have been retired and will not serve customers during the rate years.
- Instead the net book value of the retired plants shall be placed in a regulatory asset and amortized over the four-year period that rates from this case are expected to be in effect.
- A $3,310,118 adjustment to amortization expense is made to add the regulatory asset related to the retired plants.
- An adjustment of (464,939) is made to depreciation expense to remove the depreciation on the retired units from rate base.

C. Accumulated Deferred Federal Income Tax [PO Issues 20]

1. Net Operating Loss ADFIT

- SWEPCO records its stand-alone federal income tax net operating loss carryforward (NOLC) ADFIT on its books and records consistent with generally accepted accounting principles (GAAP) and the Federal Energy Regulatory Commission (FERC) uniform system of accounts.
- For the period 2009 through the March 20, 2020 test-year end, SWEPCO recorded a total net amount of stand-alone tax net operating loss carryforward ADFIT of $455,122,490.
- SWEPCO does not actually file a separate federal income tax return as it is a subsidiary of AEP, Inc., included in the AEP, Inc. consolidated federal income tax return.
- SWEPCO participates in the AEP, Inc. Tax Allocation Agreement for allocating the consolidated income taxes for AEP, Inc. and its consolidated affiliates.
- Under the AEP, Inc. Tax Allocation Agreement, for the period 2009 through the March 20, 2020 test-year end, SWEPCO received net cash payments of $455,122,490 for the use of its

tax net operating losses to offset the taxable income of its affiliates on the AEP, Inc. consolidated income tax return.

- The receipt of these payments under the Tax Allocation Agreement reduced the balance of SWEPCO's NOLC ADFIT to $0 on its actual books and records in accordance with GAAP and FERC accounting.
- SWEPCO claims that using its actual books and records, which reflects a NOLC ADFIT balance of $0 to set rates creates operational economic risk for SWEPCO.
- SWEPCO claims that it is in a net operating loss position on a stand-alone basis for federal income tax purposes and that the Company seeks to add the $455,122,490 NOLC ADFIT associated with its stand-alone net operating losses back to its rate base because doing so is consistent with Public Utility Regulatory Act (PURA) § 36.060 and the Internal Revenue Service (IRS) normalization rules.
- In SWEPCO's last base rate case, Docket No. 46449, SWEPCO's records at the end of the test year reflected a NOLC ADFIT of $0 as a result of SWEPCO's participation in the AEP, Inc. consolidated Tax Allocation Agreement, the same as in this proceeding, and no adjustments were made by SWEPCO in Docket No. 46449 to reflect the level of NOLC ADFIT on a separate return basis.
- $388,968,550 of the $455,122,490 that SWEPCO seeks to add to its rate base in this case would have existed as of the end of the test year in Docket No. 46449 leaving just $66,153,940 related to tax years after the Docket No. 46449 test year end.
- SWEPCO seeks to redefine the stand-alone basis of determining income tax expense in this case by reaching back and changing how tax losses that were incurred prior to the end of the test year in its previous cases should be treated for ratemaking purposes.
- This departure from the stand-alone calculation of federal income tax expense and the associated treatment of NOLC ADFIT that has previously been used in SWEPCO's prior rate cases would have a substantial impact on regulatory ratemaking in this case.
- SWEPCO claims that Staff's recommendation to exclude the NOLC ADFIT asset from rate base is akin to a consolidated tax savings adjustment (CTSA) that was prohibited by the Texas legislature and is inconsistent with PURA § 36.060(a).

- Including the actual test-year-end balance of SWEPCO's NOLC ADFIT of $0 is not a CTSA akin to the adjustments to rates recognized by the Commission prior to the changes to PURA § 36.060 in 2013.
- While the title of the section is "consolidated income tax returns," the plain text of PURA § 36.060 does not mention consolidated returns and merely addresses the inclusion or exclusion of expenses in rates and investment in rate base, and the treatment of the related tax benefits in the computation of federal income tax expense to reduce rates.
- The prior interpretation of PURA required CTSAs to reflect the tax losses of utility affiliates in rates through the use of the tax shield or interest credit methodology based on mathematical calculations and not actual transactions between utilities and their affiliates. It is this type of CTSA that the change to PURA § 36.060 was designed to prohibit.
- There is nothing in the amended version of PURA § 36.060 that prevents the Commission from recognizing actual financial transactions with true economic substance even if those transactions are the result of a consolidated tax return, nor does it require the Commission to ignore the actual operating results of SWEPCO as recognized by GAAP and FERC accounting, which reflect the true economic costs of the utility.
- Real substantive financial transactions that have real economic impacts, or true economic costs, must be reflected in SWEPCO's rates whether they are the result of a consolidated tax return or not since PURA § 36.060 does not require the Commission to ignore real substantive financial transactions.
- Because of the payments received under the Tax Allocation Agreement, SWEPCO no longer has the NOLC ADFIT on its books and, just like the sale or disposition of any other asset, SWEPCO should not be allowed to earn a return on an asset for which it already received cash compensation. The fact that this transaction is the result of a consolidated tax sharing agreement does not require it to be treated differently than other transactions related to any other assets that are sold or traded for cash compensation.
- SWEPCO acknowledged in its rebuttal testimony that cash received through the Tax Allocation Agreement reduced the otherwise needed capital to fund prudent plant investment and, as a result, SWEPCO needed less capital through debt and equity than it would have required absent the cash received through the agreement. SWEPCO is therefore seeking a debt

and equity return on assets that were financed not by its own debt and equity capital, but by the tax attributes of its affiliates.

- SWEPCO's current rates, set in Docket No. 46449, include assets that were financed by the tax allocation payments received for the tax attributes of SWEPCO's affiliates and not by its own debt and equity capital.
- SWEPCO had NOLC ADFIT that it exchanged for cash payment, which it then used to finance plant assets that are included in rate base. As a result of financing plant assets with the cash received for the tax attributes of its affiliates, SWEPCO essentially exchanged the NOLC ADFIT that was previously recorded in its rate base for plant assets that are now included in its rate base.
- This interpretation of PURA§ 36.060 is consistent with the stand-alone tax calculation used by the Commission to set SWEPCO's current rates, recognizes SWEPCO's true economic costs, and does not result in either an increase or decrease in rates because of the consolidated tax return.
- Allowing SWEPCO to include the assets financed by the NOLC ADFIT and also adding the NOLC ADFIT back to rate base results in SWEPCO earning a return twice on the same $455,122,490 because SWEPCO is just picking one item of a theoretical stand-alone calculation and failing to recognize the offsetting impact of adding the NOLC ADFIT back to rate base.
- SWEPCO's interpretation of PURA § 36.060 and its newly-proposed version of a stand-alone tax calculation would result in an increase in SWEPCO's rates merely because of the filing of the consolidated tax return and participation in the tax sharing agreement.
- If the NOLC ADFIT is added back to rate base, then the assets financed by the tax attributes of SWEPCO's affiliates through the payments received for the NOLC ADFIT must be removed from rate base to prevent SWEPCO from earning a double return on the same $455,122,490 and avoid including assets in rate base that were financed by SWEPCO's affiliates and not its own capital, consistent with SWEPCO's new interpretation of a theoretical stand-alone tax calculation.
- Although SWEPCO asserts that it must include the $455,122,490 NOLC ADFIT in its rate base to avoid a normalization violation, it did not seek a private letter ruling (PLR) from the

IRS with respect to the issue of whether it is required to compute its NOLC ADFIT on a separate stand-alone basis.

- The PLRs provided by SWEPCO in testimony and discovery support the Staff position that there is no normalization violation if the actual book NOLC ADFIT balance of $0 is reflected in rate base.
- Neither the IRC nor the SWEPCO-cited PLRs require consideration of the NOLC on a stand-alone basis.
- The Commission includes the full amount of the difference between tax and regulatory depreciation expense in cost of service without any reduction for the NOLC, so SWEPCO's rates have already taken its NOLC into account.
- SWEPCO used the funds it received from the tax allocation agreement to finance plant assets so its rate base is neutral with respect to the consolidated tax return and its level is not below what would be required for normalization purposes.
- The IRS has previously allowed recognition of a reduction to NOLC ADFIT due to a tax allocation agreement payment, only requiring that it be treated in a manner consistent with other elements of rate base. Staff's proposal treats all elements of SWEPCO's rate base, including the reduction to its NOLC ADFIT due to the tax allocation agreement payment, in a consistent manner.
- Staff's recommendation to reflect SWEPCO's actual book NOLC ADFIT balance of $0 is consistent with PURA § 36.060, and the Commission's accepted stand-alone method of calculating tax expense and rate base, reflects SWEPCO's true economic costs in rate base, prevents SWEPCO from earning a return on the same $455 million twice, and is consistent with the IRC normalization rules.
- GAAP and FERC accounting also support the reduction of ADFIT by the cash payments received by SWEPCO for its tax losses under the AEP, Inc. tax sharing agreement, and this treatment is not inconsistent with the IRS PLRs identified above.
- Staff's recommendation protects the public interest inherent in rates and assures that SWEPCO's rates are just and reasonable to its consumers and itself consistent with PURA § 11.002(a).

2. Excess ADFIT

- The Tax Cuts and Jobs Act of 2017 (TCJA) reduced the corporate federal income tax rate from 35 % to 21 % effective January 1, 2018. This reduction, and the associated revaluation of the ADFIT balances previously recorded at 35 percent decreased down to the new 21 percent tax rate, results in excess ADFIT balances that should be returned to SWEPCO's ratepayers.
- The Commission determined in Docket No. 46449 that the regulatory treatment of excess deferred taxes resulting from the reduction in the federal tax rate would be addressed in SWEPCO's next base rate case. This proceeding is SWEPCO's next base rate base after Docket No. 46449.
- The normalization provisions of the IRC provide that excess ADFIT related to differences in method and life for calculating depreciation expense for book and tax purposes is considered to be protected excess ADFIT that cannot be amortized or otherwise returned to ratepayers, more rapidly than over the remaining lives of the assets that gave rise to the deferred taxes. All other excess ADFIT is considered to be unprotected, meaning there are no limitations on the timing or manner of returning it to ratepayers.
- SWEPCO began amortizing the protected excess ADFIT on January 1, 2018 by recording a provision for refund on its books as a regulatory liability related to the Texas jurisdictional portion of the excess ADFIT amortization.
- SWEPCO acknowledges that protected excess ADFIT represents cash that customers have paid to the utility through rates that the utility will no longer pay to the IRS in the future, that it is an amount in excess of the utility's future tax liability, and that where the utility has collected such taxes from customers in rates and is no longer required to pay the IRS because of the lower tax rate, it is reasonable for such excess to be refunded and returned to customers.
- SWEPCO disagrees with Staff's proposal to exclude excess ADFIT related to its requested stand-alone return NOLC by implying that ratepayers have only paid the amount of excess ADFIT net of the NOLC ADFIT.
- Staff witness Ms. Stark testified that the total of the current and deferred taxes are included in cost of service and the ADFIT balance.
- SWEPCO's Schedule G-7.6 confirms that there is no reduction to the current and deferred taxes included in cost of service for a federal tax net operating loss. Therefore, the

Commission's tax expense calculation provides for the inclusion of the full difference between accelerated and regulatory depreciation in rates without regard for any net operating loss consistent with PURA § 36.059 and 16 TAC § 25.231(b)(1)(D).

- The fact that SWEPCO has a net operating loss and has not been able to use the full difference between ratemaking and tax depreciation to offset taxable income is a function of the federal tax code and does not change the fact that ratepayers have paid the full amount of the excess ADFIT through rates.
- Ratepayers should be refunded the full amount of protected excess ADFIT without regard to any stand-alone net operating loss, and SWEPCO's proposed adjustments to reduce the protected excess ADFIT amortization owed to ratepayers by its requested adjustments related to a stand-alone NOLC should be rejected.
- The normalization provisions of the Internal Revenue Code prevent the return of the protected excess ADFIT to ratepayers more rapidly than over the remaining lives of the assets that gave rise to the excess ADFIT so the remaining balance of excess ADFIT will be amortized through the income tax expense calculation in cost of service over the course of those remaining lives.
- Ratepayers paid the full amount of the excess deferred taxes without regard to any net operating loss so SWEPCO's request to reduce the annual amortization of excess deferred taxes by its stand-alone NOLC in the tax expense calculation should be rejected as recommended by Staff.
- SWEPCO's proposal to offset its remaining balance of the Dolet Hills plant with the excess ADFIT owed to ratepayers resulting from the TCJA should be rejected. Instead, SWEPCO should refund the total amount of the excess ADFIT to ratepayers by first crediting the refund against any amount owed by ratepayers because of the March 18, 2021 relate-back date in this proceeding, and any remaining excess ADFIT should be refunded over a six month period with carrying charges at the Commission allowed weighted average cost of capital.

III. Rate of Return [PO Issues 4, 5, 8, 9]

A. Overall Rate of Return, Return on Equity, Cost of Debt [PO Issue 8]

1. Return on Equity

- SWEPCO's requested overall rate of return of 7.22% is not supported by SWEPO's requested cost of capital rate.
- The appropriate overall rate of return for SWEPCO is 6.62%.

- SWEPCO's requested return on common equity (ROE) of 10.35% is not supported by a reasonable application of the discounted cash flow, conventional risk premium, and capital asset pricing methodologies used to support SWEPCO's requested ROE.
- A 12.5 basis point reduction to SWEPCO's ROE is appropriate due to SWEPCO's improper vegetation management practices and service and reliability problems.
- The appropriate ROE for SWEPCO is 9.225%.
- An ROE of 9.225% will allow SWEPCO a reasonable opportunity to earn a reasonable return on its invested capital.
- An ROE of 9.225% is reasonable and consistent with comparable utilities taking into consideration recent authorized ROEs for utilities comparable to SWEPCO.
- SWEPCO's energy conservation efforts, the quality of its services, the efficiency of its operations, and the quality of its management support a 9.225% ROE.
- The results of reasonable discounted cash flow models and a conventional risk premium approach support an ROE of 9.225%.
- A 9.225% ROE is consistent with SWEPCO's business and regulatory risk.
- A 9.225% ROE will support an investment grade bond rating for SWEPCO and provide sufficient cash flow to maintain SWEPCO's financial integrity.

2. Cost of Debt

- SWEPCO's requested cost of debt of 4.18% is not supported because of SWEPCO's inclusion of a full annual amount of amortization of a Series I Hedge Loss incurred in February 2012 that will be fully amortized in January 20222.
- The appropriate cost of debt for SWEPCO is 4.08%.

B. Capital Structure [PO Issue 7]

- SWEPCO's requested capital structure of 50.63% debt and 49.37% equity is reasonable.

C. Financial Integrity, Including "Ring Fencing" [PO Issue 9]

- AEP, Inc. is a large corporation that includes not only SWEPCO as a subsidiary, but also a number of other regulated and non-regulated entities.

- The transactions, business, operations, finances, and leveraging activities of SWEPCO's parent company and its subsidiaries can have wide-ranging effects, not only on the credit profile and financial exposure of the parent, but on SWEPCO as well.
- The transactions, business, operations, finances, and leveraging activities of SWEPCO's parent company and its subsidiaries can affect certain of the SWEPCO's rate-related elements such as capital structure and cost of capital (both equity costs and debt costs).
- It is necessary to require SWEPCO to implement and abide by certain financial protections in order to protect SWEPCO's financial integrity and ensure reliable service at just and reasonable rates for Texas ratepayers.
- The following financial protections are necessary to protect the financial integrity of SWEPCO and ensure SWEPCO's ability to provide reliable service at just and reasonable rates:
    a. <u>SWEPCO Credit Ratings.</u> SWEPCO must work to ensure that its credit ratings at S&P and Moody's remain at or above SWEPCO's current credit ratings.
    b. <u>Notification of Less-than-Investment-Grade Rating.</u> SWEPCO must notify the Commission if its credit issuer rating or corporate rating as rated by either S&P or Moody's falls below investment-grade level.
    c. <u>Regulatory Return on Equity (ROE) Commitment.</u> If SWEPCO's issuer credit rating is not maintained as investment grade by S&P or Moody's, SWEPCO must not use its below-investment-grade ratings to justify an argument in favor of a higher regulatory ROE.
    d. <u>Stand-Alone Credit Rating.</u> SWEPCO must take the actions necessary to ensure the existence of a SWEPCO stand-alone credit rating.
    e. <u>No Cross-Default Provisions.</u> SWEPCO's credit agreements and indentures will not contain cross-default provisions by which a default by AEP or its other affiliates would cause a default by SWEPCO.
    f. <u>No Financial Covenants or Rating-Agency Triggers Related to Another Entity.</u> The financial covenant in SWEPCO's credit agreement will not be related to any entity other than SWEPCO. SWEPCO will not include in its debt or credit agreements any financial covenants or rating-agency triggers related to any entity other than SWEPCO.

g. No Sharing of a Credit Facility. SWEPCO must not share a credit facility with any unregulated affiliates;

h. No SWEPCO Debt Secured by Non-SWEPCO Assets. SWEPCO's debt must not be secured by non- SWEPCO assets.

i. No SWEPCO Assets Pledged for Other Entities' Debt. SWEPCO assets must not secure the debt of AEP or its non-SWEPCO affiliates. SWEPCO assets must not be pledged for any other entity.

j. No Credit for Affiliate Debt. SWEPCO must not hold out its credit as being available to pay the debt of any AEP affiliates.

k. No Commingling of Assets. Except for access to the utility money pool and the use of shared assets governed by the Commission's affiliate rules, SWEPCO must not commingle its assets with those of other AEP affiliates.

l. Affiliate Asset Transfer Commitment. SWEPCO must not transfer any material assets or facilities to any affiliates, other than a transfer that is on an arm's-length basis in accordance with the Commission's affiliate standards applicable to SWEPCO, regardless of whether such affiliate standards would apply to the particular transaction.

m. No Inter-Company Lending and Borrowing Commitment. Except for any participation in an affiliate money pool, SWEPCO must not lend money to or borrow money from AEP affiliates.

n. No Debt Disproportionally Dependent on SWEPCO. Without prior approval of the Commission, neither AEP nor any affiliate of AEP (excluding SWEPCO) may incur, guaranty, or pledge assets in respect of any incremental new debt that is dependent on: (1) the revenues of SWEPCO in more than a proportionate degree than the other revenues of AEP; or (2) the stock of SWEPCO.

o. No Bankruptcy Cost Commitment. SWEPCO must not seek to recover from customers any costs incurred as a result of a bankruptcy of AEP or any of its affiliates.

IV. Expenses [PO Issues 1, 14, 24, 29, 30, 32, 33, 40, 41, 42, 44, 45, 46, 49, 72, 73, 74]

A. Transmission and Distribution O&M Expenses [PO Issue 14, 24]

1. Transmission O&M Expense [PO Issue 24]

- SWEPCO's proposal to recover transmission O&M expenses of $46.7 million is reasonable.

3. Proposed Deferral of SPP Wholesale Transmission Costs [PO Issues 72, 73, 74]

- SWEPCO's proposal to track changes in SPP transmission charges from Commission approved test year SPP transmission charges is not appropriate because it does not account for the fact that SWEPCO receives wholesale transmission revenues from other SPP customers that offset the Approved Transmission Charges that SWEPCO pays.
- The appropriate mechanism for SWEPCO to account for changes in Approved Transmission Charges outside of SWEPCO's base rate case is the TCRF mechanism found in 16 Texas Administrative Code (TAC) § 25.239.

5. Distribution Veg Mgmt Expense & Program Expansion [PO Issue 27]

- SWEPCO's proposal to recover distribution vegetation management O&M expenses of $14.57 million total, consisting of a test-year amount $9.57 million and an additional amount of $5 million is reasonable.
- Though additional monies for vegetation management are necessary for increased reliability further steps are needed to address consistent vegetation management issues that have led to decreased reliability in SWEPCO's service area.
- SWEPCO shall move towards a 4-year trim cycle within 12 months of the date of this order.
- Doing so will ensure reliability on the system and improve System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI) for customers in SWEPCO's Texas jurisdictional service area.

C. Labor Related Expenses

1. Payroll Expenses

- SWEPCO's requested revenue requirement includes an increase of $2,143,713 to its test year payroll expense based on the annualization of the last pay period of the test year (March 2020) and reflecting a 3.5% salary increase to the base payroll cost.
- SWEPCO reported that in June and July of 2020, retirement incentive packages were offered to certain employees and, while only one SWEPCO employee accepted the retirement incentive package, a total of 189 AEPSC employees accepted the package.
- Staff proposes an adjustment of $544,331 in addition to SWEPCO's requested payroll adjustment based on a more recent time period, October 31, 2020, that was after the retirement incentives were offered.
- SWEPCO requests an increase of $3,804,876 to the test-year payroll expense allocated from its affiliate, American Electric Power Service Corporation (AEPSC), based on an annualization of the end of test-year headcount and inclusion of a merit increase.
- Staff proposes an adjustment of ($4,480,512) to the allocated AEPSC payroll, also based on annualization of the October 2020 AEPSC payroll that was after the retirement incentives were offered.
- Recognizing the changes to SWEPCO's and the allocated AEPSC payroll caused by the retirement incentive offer is not inconsistent with the Commission's Cost of Service rule as alleged by SWEPCO.
- There is no requirement in 16 TAC § 25.231 that known and measurable changes be known and measurable as of the test year end, or that a known and measurable change to test year data be known as of the date a rate case is filed.
- It is known that one SWEPCO employee and 189 AEPSC employees accepted the retirement incentive offer and the most recent measurement of the impact of that provided by SWEPCO is reflected in Staff's adjustment of $544,331 to SWEPCO's payroll and an adjustment of ($4,480,512) to SWEPCO's requested AEPSC payroll.

D. Depreciation and Amortization Expense [PO Issue 29]

- Consistent with the removal Staff's proposed treatment of the Dolet Hills plant retirement, $10,120,877 of Dolet Hills depreciation expense should be removed from SWEPCO's requested revenue requirement.

- Consistent with the removal of capitalized financial-based incentive compensation from invested capital, an adjustment of ($1,306) to depreciation expense is appropriate.
- An adjustment of ($464,939) related to the removal of the retired gas generating units from plant in service is appropriate.
- The loss from the test-year disposition of utility property should be recovered over four years as opposed to one year as requested by SWEPCO. This results in an adjustment of ($489,906) to depreciation expense.
- SWEPCO's requested revenue requirement includes an amount of amortization related to an intangible asset that was fully amortized as of the end of the test year. An adjustment of ($1,855,750) to amortization expense is required to correct this error.

H. Taxes Other Than Income Tax [PO Issue 30]

1. Ad Valorem (Property) Taxes

- SWEPCO's requested effective ad valorem tax rate excludes Texas jurisdictional differences that would decrease the effective rate but includes Texas jurisdictional differences that increase the effective rate.
- The effective ad valorem tax rate should be synchronized with the plant to which the rate is to be applied.
- Including SWEPCO's proposed Texas jurisdictional plant differences related to depreciation and AFUDC rates in the plant balance used to calculate ad valorem taxes requires that such jurisdictional differences be included in the determination of the effective ad valorem tax rate.
- Including SWEPCO's proposed Texas jurisdictional plant differences related to depreciation and AFUDC rates in the determination of the effective ad valorem tax rate does not result in other states subsidizing Texas customers.
- The appropriate effective ad valorem tax rate that includes the Texas jurisdictional differences in the determination of the rate is 0.961262%.

2. Payroll Taxes

- It is reasonable to synchronize payroll taxes with adjustments to SWEPCO's payroll expenses.
- Incentive compensation is part of SWEPCO's payroll expenses.

- the Commission has previously ruled that removing the corresponding flow through reductions associated with the elimination of incentive plan costs results in an allowable expense for the incentive plan that is reasonable and necessary for the provision of service.
- Any potential offset of incentive compensation with additional base pay by SWEPCO in the future is pure speculation.
- An adjustment of ($258,162) to SWEPCO's payroll tax expense is necessary to synchronize payroll taxes with the adjustments to payroll and incentive compensation expenses as recommended by Staff.

3. Gross Margin Tax

V. Billing Determinants [PO Issue 4, 5, 6, 54]

- Adjusting billing determinants to account for estimated customer migration violates 16 TAC § 25.234(b).

VI. Functionalization and Cost Allocation [PO Issues 4, 5, 52, 53, 55, 56, 57, 58]

- Staff's functional and class cost of service model is reasonable and appropriate and should be used to set rates.

VII. Revenue Distribution and Rate Design [PO Issues 4, 5, 47, 48, 52, 59, 60, 61, 62, 75, 76, 77, 78, 79]

- All present base-rate related revenues, inclusive of Transmission Cost Recovery Factor (TCRF) and Distribution Cost Recovery Factor (DCRF) revenues, are the appropriate starting point for evaluating any rate increase.
- Under 16 TAC § 25.234, the rates for each rate classes are required to be set at cost. Gradualism and rate moderation are appropriate exceptions to this requirement when a class's proposed rate increase leads to "rate shock."
- Gradualism and rate moderation exceptions are not intended to allow customers in certain rate classes to be subject to rates that are perpetually above or below cost.
- Rates set at cost advance economic efficiency and rate stability and allow the revenues recovered by a utility to match the cost incurred by customer usage even as the customer usage changes over time.

- A proposed rate increase of 43.26% or less for a rate class does not lead to "rate shock."
- SWEPCO's proposal to revise its General Services tariff encourages rate migration and is unreasonable.
- Rate migration provides special treatment to some customers and undermines the ability to establish rates based on cost.
- ETSWD's proposed adjustments to SWEPCO's CCOSS to reflect load changes due to the COVID-19 pandemic are not reasonably quantifiable and do not describe a situation that is apt to prevail in the future.
- ETSWD's proposed adjustments to SWEPCO's CCOSS to reflect load changes due to the COVID-19 pandemic do not meet the "known and measurable" standard under 16 TAC § 25.234(b).
- Staff's proposed phased-in revenue distribution is a multi-year mechanism that for each phase revenue increases, net of TCRF and DCRF revenues are capped at 43%, then the residual revenues for the rate classes subject to the 43% cap are reallocated proportionally among the classes within the rate bundle not subject to the 43% cap. The revenue increases, net of TCRF and DCRF revenues are capped at 86% and 129% for the next two years with the residual revenues for the rate classes subject to the respective cap reallocated until by the fourth year all rate classes are at cost.
- The revenue methodology applied within each phase of Staff's phased-in revenue distribution is consistent with the approved revenue methodology adopted in Docket No. 46449.
- Staff's proposed phased-in revenue distribution is reasonable and gradually moves all rate classes to cost based rates while employing gradualism and rate moderation to mitigate rate shock.

VIII. Baselines for Cost-Recovery Factors [PO Issue 4, 5, 52, 63]

- Staff's baselines are appropriate to use in TCRF and DCRF proceedings.
- The baselines proposed by Staff are reasonable.

IX. Reasonableness & Recovery of Rate Case Expenses [PO Issues 26, 27,28]

- SWEPCO can recover up to $550 per hour in rate case expenses for legal counsel.
- Any amount over $550 per hour for legal counsel cannot be recovered in rate case expenses as it is unreasonable to make rate payers pay such costs.

X. Other Issues [including but not limited to PO Issues]

A. Additional issues

Affiliate Expenses

- Staff's proposed adjustments of ($1,164,427) to remove carrying charges paid by SWEPCO associated with affiliate or shared assets and ($530,384) to remove carrying charges the Company received from its affiliates are consistent with prior Commission precedent.

Factoring Expense

- The effective factoring rate should be determined based on the ROE adopted by the Commission in this proceeding to properly synchronize factoring expense with the approved revenue requirement.

Interest on Customer Deposits

- Interest on customer deposits should be based on the most recent Commission-adopted rate. In this case that is 0.61% which results in an adjustment of ($1,041,156) to SWEPCO's request.

Supplemental Executive Retirement Plan (SERP)

- Removal of SWEPCO's SERP expenses of $93,181 from SWEPCO's requested revenue requirement complies with the Commission's finding in Docket No. 40443 that these expenses are not reasonable or necessary.

Executive Perquisites

- SWEPCO identifies $12,111 of its own executive perquisites and $8,484 allocated by AEPSC that are included in its requested cost of service.
- These executive perquisites totaling $20,595 should be removed from SWEPCO's revenue requirement consistent with the Commission's order in Docket No. 40443 which found that these expenses should not be included in rates because they provide no benefit to ratepayers and are not reasonable or necessary for the provision of electric service.

Regulatory Commission Expense

- SWEPCO inadvertently included $46,306 in its requested regulatory commission expenses that should have been removed. An adjustment of ($46,306) is necessary to exclude this amount from SWEPCO's requested revenue requirement.

C. Cash Working Capital [PO Issue 18]

- SWEPCO's working cash allowance is based on the use of its lead/lag study approved in Docket No. 46449 and is synchronized with the Commission's adjustments to operations and maintenance expenses and taxes.

L. Should PUC approve requests for waivers? [PO Issue 65]

- In Docket No. 50917, the ALJ granted SWEPCO a waiver of the schedule S filing requirement in this base-rate case.

CONCLUSIONS OF LAW

- SWEPCO has the burden of proving that the rate change it is requesting is just and reasonable pursuant to PURA § 36.006.
- In compliance with PURA § 36.051, SWEPCO's overall revenues approved in this proceeding permit SWEPCO a reasonable opportunity to earn a reasonable return on its invested capital used and useful in providing service to the public in excess of its reasonable and necessary operating expenses.
- The ROE and overall rate of return authorized in this proceeding are consistent with the requirements of PURA §§ 36.051 and 36.052.
- SWEPCO must implement and adhere to the financial protections ordered under PURA §§ 11.002, 14.001, and 36.051.
- SWEPCO's rates, as approved in this proceeding, are just and reasonable in accordance with PURA § 36.003.
- The Commission must determine a reasonable return, original cost, appropriate depreciation for utility invested capital under PURA §§ 36.051 through 36.053.
- Prudence is the exercise of that judgment and the choosing of one of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives available at the point in time such judgment

is exercised or option is chosen. *Gulf States Utilities Company v. Public Utility Commission of Texas*, 841 S.W.2d 459, 475 (Tex. App—Austin 1992, writ denied).

- There may be more than one prudent option within the range available to a utility in a given context. Any choice within the select range of reasonable options is prudent, and the Commission should not substitute its judgment for that of the utility. The reasonableness of an action or decision must be judged in light of the circumstances, information, and available options existing at the time, without benefit of hindsight. *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing at 5 (citing *Nucor Steel v. Public Utility Commission of Texas*, 26 S.W.3d 742, 752 (Tex. App.—Austin 2000, pet. denied)).
- A utility may demonstrate the prudence of its decision-making through contemporaneous evidence. Alternatively, the utility may obtain an independent, retrospective analysis that demonstrates that a reasonable utility manager, having investigated all relevant factors and alternatives, as they existed at the time the decision was made, would have found the utility's actual decision to be a reasonably prudent course. *Gulf States*, 841 S.W.2d at 476.
- The Supreme Court of Texas has held that "the Commission possesses the authority to authorize deferred accounting treatment," but "this authority is not unfettered." The Commission's discretion to use deferred accounting to alleviate regulatory lag is limited to when it is "necessary to carry out the provisions of PURA." *Office of Pub. Util. Counsel v. Public Util. Comm'n of Texas*, 888 S.W.2d 804, 808 (Tex. 1994) (citing *State v. Pub. Util. Comm'n of Texas*, 883 S.W.2d 190, 196 (Tex. 1994)).
- The Commission's rules provide for truing-up and refunding over-collected Interim TCOS and DCRF revenues.
- 16 TAC § 25.231(b)(1)(B) states that depreciation expense based on original cost and computed on a straight-line basis as approved by the Commission shall be used; it also provides that other methods may be used when the Commission determines such depreciation methodology is a more reasonable means of recovering the costs of plant.
- Affiliate expenses to be included in SWEPCO's rates must meet the standards articulated in PURA §§ 36.051 and 36.058 and in *Railroad Commission of Texas v. Rio Grande Valley Gas Co.*, 683 S.W. 2d 783 (Tex. App.—Austin 1984, no writ).

ORDERING PARAGRAPHS

- SWEPCO must file a separate proceeding to address any disallowances to transmission related or distribution related invested capital ordered above in order to reflect the true-up of the Commission's disallowance for the time period between the date rates are set in this proceeding and the effective date of rates in the Interim TCOS or DCRF in which the capital investment was initially placed into rates.
- SWEPCO must eliminate the potential for customer migration by SWEPCO's next major rate proceeding.
- SWEPCO must implement a four-year trim cycle for its distribution system within 12 months of the filing of the final order in this proceeding.
- SWEPCO must hire an independent consultant to promptly conduct a comprehensive review of SWEPCO's transmission system and make recommendations regarding SWEPCO's vegetation management practices, facilities replacement, and transmission system protection.
- Within 30 days of the Final Order, SWEPCO must open a compliance docket and file regular reports regarding its hiring and use of an independent consultant.
- SWEPCO must file in a compliance docket to detail the spending of its annual distribution vegetation management funds.
- SWEPCO must implement and adhere to the financial protections listed in finding of fact ##.
- Within 30 days of the Final Order, SWEPCO must file in a compliance docket its non-consolidation opinion in accordance with finding of fact ##.
- The Commission grants SWEPCO a waiver of the requirement to file schedule S and perform the related audit in this rate case.

SOAH DOCKET NO. 473-21-0538
PUC DOCKET NO. 51415

CERTIFICATE OF SERVICE

I certify that, unless otherwise ordered by the presiding officer, notice of the filing of this document was provided to all parties of record via electronic mail on July 1, 2021, in accordance with the Order Suspending Rules, issued in Project No. 50664.

/s/ Robert Dakota Parish
Robert Dakota Parish