Filing Receipt

Received - 2021-08-27 02:13:52 PM
Control Number - 51415
ItemNumber - 660

State Office of Administrative Hearings

Kristofer S. Monson
Chief Administrative Law Judge

August 27, 2021

TO: Stephen Journeay, Commission Counsel **VIA EFILE TEXAS**
Commission Advising and Docket Management
William B. Travis State Office Building
1701 N. Congress, 7th Floor
Austin, Texas 78701

RE: SOAH Docket No.473-21-0538
PUC Docket No.51415

Application of Southwestern Electric Power Company for Authority to Change Rates

Enclosed is the Proposal for Decision (PFD) in the above-referenced case. By copy of this letter, the parties to this proceeding are being served with the PFD.

Please place this case on an open meeting agenda for the Commissioners' consideration. The final order deadline is October 27, 2021. Please notify me and the parties of the open meeting date, as well as the deadlines for filing exceptions to the PFD, replies to the exceptions, and requests for oral argument.

Sincerely,

Steven H. Neinast
Administrative Law Judge/Mediator

Enclosure
xc: All Parties of Record

SOAH DOCKET NO. 473-21-0538

PUC DOCKET NO. 51415

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

TABLE OF CONTENTS

LIST OF ACRONYMS AND DEFINED TERMS

TERM	DEFINITION
1CP	1 Coincident Peak
4CP	4 Coincident Peak
12CP	12 Coincident Peak
A&E/4CP	Average and Excess/4 Coincident Peak
ADFIT	Accumulated Deferred Federal Income Taxes
AEP	American Electric Power Company
AEPSC	American Electric Power Service Company
AFUDC	Allowance for Funds Used During Construction
ALJ	Administrative Law Judge
ASC	Accounting Standards Codification
ATC	Approved Transmission Charges
BTMG	Behind-the-Meter Generation
CAISO	California Independent System Operator
CAPM	Capital Asset Pricing Model
CARD	Cities Advocating Reasonable Deregulation
CCOSS	Class Cost of Service Study
CLECO	Cleco Power LLC
CoL	Conclusion of Law
Commission	Public Utility Commission of Texas
Company	Southwestern Electric Power Company
CONE	Cost of New Entry
DCF	Discounted Cash Flow
DCRF	Distribution Cost Recovery Factor
DHLC	Dolet Hills Lignite Company
Dolet Hills	Dolet Hills Power Station
ECAPM	Empirical Capital Asset Pricing Model
ECOM	Investment that Exceeded Market
ERCOT	Electric Reliability Council of Texas
ETEC/NTEC	East Texas Electric Cooperative, Inc. and Northeast Texas Electric Cooperative, Inc.
ETSWD	East Texas Salt Water Disposal Company
FERC	Federal Energy Regulatory Commission
FoF	Finding of Fact
GAAP	Generally Accepted Accounting Principles
GCRR	Generation Cost Recovery Rider
GDP	Gross Domestic Product
GS	General Service
IRS	Internal Revenue Service
ISO	Independent System Operator
kV	Kilovolt
kVAR	Kilovolt-Ampere Reactive
kW	Kilowatt

TERM	DEFINITION
kWh	Kilowatt-hour
LLP	Large Lighting and Power
LLP-T	Large Lighting and Power–Transmission
LP	Lighting and Power
LTI	Long Term Incentive
MDD	Maximum Diversified Demand
MISO	Midcontinent Independent System Operator, Inc.
MW	Megawatt
NITS	Network Integration Transmission Service
NOLC	Net Operating Loss Carry-forward
Nucor	Nucor Steel-Longview
O&M	Operations and Maintenance
OAG	Office of the Attorney General of Texas
OATT	Open Access Transmission Tariff
OLT	Observed Life Table
Oncor	Oncor Electric Delivery Company
OPEB	Other Post-Employment Benefits
OPUC	Office of Public Utility Counsel
PEV	Plug-in Electric Vehicle
PFD	Proposal for Decision
PJM	PJM Interconnection
PO	Preliminary Order
PRPM	Predictive Risk Premium Method
PUC	Public Utility Commission of Texas
PURA	Public Utility Regulatory Act
PURPA	Public Utility Regulatory Policies Act of 1978
QF	Qualifying Facility
RCE	Rate Case Expense
RCS	Rate Case Surcharge
REC	Renewable Energy Credit
RFI	Request for Information
RFP	Rate Filing Package
ROE	Return on Equity
RR	Revision Request
RSU	Restricted Stock Units
RTO	Regional Transmission Organization
S&L	Sargent & Lundy
S&P	Standard & Poor's
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
SBMAA Tariff	Supplementary, Backup, Maintenance and As-Available Power Service Tariff

TERM	DEFINITION
SERP	Supplemental Executive Retirement Plan
Sierra Club	Sierra Club and Dr. Lawrence Brough
SOAH	State Office of Administrative Hearings
SPP	Southwest Power Pool
SPS	Southwestern Public Service Company
SSD	Sum of Squared Differences
SSGL	Synchronous Self-Generation Load
Staff	Staff of the Public Utility Commission of Texas
STI	Short Term Incentive
SWEPCO	Southwestern Electric Power Company
TAC	Texas Administrative Code
TCGA	Texas Cotton Ginners Association
TCJA	Tax Cuts and Jobs Act of 2017
TCRF	Transmission Cost Recovery Factor
TIEC	Texas Industrial Energy Consumers
USofA	FERC Uniform System of Accounts
Value Line	Value Line Investment Survey
WACC	Weighted Average Cost of Capital
Walmart	Walmart Inc.
Zacks	Zacks Investment Research

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

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

PROPOSAL FOR DECISION

I. INTRODUCTION

Southwestern Electric Power Company (SWEPCO or the Company) is a wholly-owned subsidiary of American Electric Power Company (AEP). SWEPCO, as an electric utility providing service in Texas, is subject to the Texas Public Utility Regulatory Act (PURA) and the jurisdiction of the Public Utility Commission of Texas (PUC or Commission) thereunder.[1] On October 14, 2020, SWEPCO filed an application in this docket to change its base rates (Application).

SWEPCO is a fully integrated electric utility providing service to 543,400 retail customers and six wholesale customers in Texas, Arkansas, and Louisiana. Of those retail customers, 187,400 reside in Texas. Two of the Company's six Federal Energy Regulatory Commission (FERC)-approved wholesale customer contracts are with electric cooperatives in Texas. Through wholesale arrangements with these Texas cooperatives, SWEPCO supplies generation to cooperatives serving approximately 240,000 retail customers in Texas. SWEPCO's Texas service area generally includes the area between Waskom (on the eastern Texas border) and Sulphur Springs on the west, and Texarkana and Center on the north and south, with an additional five counties along the Texas border with Oklahoma in the Texas panhandle, running north of Childress to Wheeler.[2] The largest cities in SWEPCO's Texas service area include Longview, Texarkana, Marshall, Mount Pleasant, Kilgore, and Henderson.

[1] Tex. Util. Code §§ 11.001-66.016 (PURA).

[2] Most of SWEPCO's service territory is in the northeast corner of Texas, well east of Dallas. But SWEPCO also serves customers in the Texas panhandle along Texas's eastern border with Oklahoma.

This service area is entirely in the Southwest Power Pool (SPP). The SPP maintains functional control of the SWEPCO transmission system and executes an organized wholesale market in which SWEPCO participates.[3]

In its Application, SWEPCO states that it will retire its Dolet Hills Power Station (Dolet Hills) on December 31, 2021, rather than extend operation of the plant through its original estimated life into 2046. SWEPCO proposes a number of rate treatments to address this early retirement, including using its excess deferred federal income taxes as an offsetting accounting entry. Other significant proposals in SWEPCO's Application include proposals to: (1) increase its vegetation management costs by $5 million over its recorded test year vegetation management expense; (2) establish a self-insurance reserve; (3) defer recovery of Hurricane Laura costs; (4) establish a mechanism to track certain costs it is billed by SPP; (5) establish baseline calculations to be used in the Company's future Transmission Cost Recovery Factor (TCRF), Distribution Cost Recovery Factor (DCRF), and Generation Cost Recovery Rider (GCRR) filings; and (5) new or revised rate schedule provisions.

The test year in this case is the 12 months ending March 31, 2020. In its Application, SWEPCO asks the Commission to approve a total Texas retail base rate revenue requirement of $534,165,103 and a base rate increase of $105,026,238, which is an increase of 30.31% over adjusted Texas retail test year base rate revenues exclusive of fuel and rider revenues. The proposed increase in annual Texas retail revenues will be offset by setting SWEPCO's current TCRF and DCRF to zero, which reduces its revenue deficiency by $14,826,502, resulting in a net proposed increase of $90,199,736. This is a 26.03% increase over adjusted Texas retail test-year base rate revenues exclusive of fuel and other rider revenues. The overall impact of the proposed revenue requirement increase, considering both fuel and non-fuel revenues, is a 15.57% increase. The impact of the rate change on various customer classes will vary from the overall impact.[4]

---

[3] SWEPCO Ex. 3 (Smoak Dir.) at 3-4.

[4] SWEPCO Ex. 1 (Application) at 4.

SWEPCO calculated its proposed revenue requirement based on an overall weighted average cost of capital (WACC) of 7.22%. This WACC includes the Company's proposed return on equity (ROE) of 10.35%.[5]

In its rebuttal testimony filed on April 23, 2021, SWEPCO proposed a Texas retail base rate revenue requirement of $529,371,963, which is approximately $5 million less than its as-filed request.[6] After accounting for $82,905,762 in revenue credits, which offset the $529 million unadjusted requested Texas retail base rate revenue requirement, SWEPCO requests that the Commission approve a Texas retail base rate revenue requirement (also referred to as Texas retail cost of service) of $446,466,201.[7] SWEPCO's rebuttal Texas retail cost of service for its Residential rate class is $625,801 higher than the cost of service for the Residential rate class in the Company's as-filed case, while the other rate classes experienced a lower Texas retail cost of service as a result of the rebuttal revisions.[8]

II. JURISDICTION AND NOTICE

SWEPCO is a "public utility" as that term is defined in PURA § 11.004(1) and an "electric utility" as that term is defined in PURA § 31.002(6). The Commission exercises regulatory authority over SWEPCO, and jurisdiction over the subject matter of this application, pursuant to PURA §§ 14.001, 32.001, and 36.101. The State Office of Administrative Hearings (SOAH) has jurisdiction over the contested case hearing, including the preparation of the proposal for decision (PFD), pursuant to PURA § 14.053 and Texas Government Code § 2003.049(b).

---

5 SWEPCO updated its ROE analyses in its rebuttal testimony, but did not revise its requested 10.35% ROE. *See* SWEPCO Ex. 38 (D'Ascendis Reb.) at 6.

6 SWEPCO Ex. 34 (Aaron Reb.), *e.g.*, JOA Workpapers, SWEPCO TX COS_Class TY 3_ 2020 Rebuttal, "TX Class" Schedule at line 827. SWEPCO's changes between its as-filed case and its rebuttal case are listed in this same workpaper at the schedule labeled "COS Changes-Rebuttal."

7 SWEPCO Ex. 34 (Aaron Reb.) at 6, Table 1, and, *e.g.*, JOA Workpapers, SWEPCO TX COS_Class TY 3_ 2020 Rebuttal, "TX Class" Schedule at line 802.

8 SWEPCO Ex. 34 (Aaron Reb.) at 6, Table 1. SWEPCO's rebuttal testimony does not indicate the percentage base rate increases that result from its rebuttal case, as compared to the 26% increase (exclusive of fuel and rider revenues) stated in its as-filed case.

Those municipalities in SWEPCO's service area that have not ceded jurisdiction to the Commission continue to have exclusive original jurisdiction over SWEPCO's rates, operations, and services in their respective municipalities, pursuant to PURA § 33.001. When SWEPCO filed the Application with the Commission, it also filed the Application with its original jurisdiction cities. Pursuant to PURA §§ 32.001(b), 33.051, and 33.053, SWEPCO appealed the actions of the original jurisdiction cities to the Commission and requested that those appeals be consolidated with this docket. All of the appeals were consolidated into this docket in a series of SOAH orders issued in 2021 prior to the hearing on the merits.

SWEPCO's notice of its application and notice of the hearing were not contested and, therefore, do not require further discussion but will be addressed in the proposed Findings of Fact (FoFs) and Conclusions of Law (CoLs) listed at the end of this PFD.

III. PROCEDURAL HISTORY

On October 30, 2020, the Commission referred this case to SOAH. On December 17, 2020, the Commission issued its Preliminary Order setting forth 85 issues to be addressed in this proceeding. The Preliminary Order also ruled that SWEPCO's request for a declaratory order related to battery storage would not be addressed in this proceeding.

Ten parties intervened, and Commission Staff (Staff) also participated:

Parties	Counsel
SWEPCO	William Coe, Kerry McGrath, Patrick Pearsall[9]
Cities Advocating Reasonable Deregulation (CARD)	Alfred Herrera, Brennan Foley, Sergio Herrera

[9] Several other attorneys appeared on behalf of SWEPCO.

Parties	Counsel
East Texas Electric Cooperative, Inc. and Northeast Texas Electric Cooperative, Inc. (ETEC/NTEC)	Adrianne Waddell, Jacob Lawler
East Texas Salt Water Disposal Company (ETSWD)	Todd Kimbrough, Dane McKaughan
Eastman Chemical Company (Eastman)	Andrew Kever, Katherine Mudge
Nucor Steel-Longview (Nucor)	Damon E. Xenopoulos, Laura Baker, Joseph Briscar
Office of Public Utility Counsel (OPUC)	Zachary Stephenson, Tucker Furlow, Chris Ekoh
Sierra Club and Dr. Lawrence Brough (Sierra Club)	Joshua Smith, Matthew Miller, Tony Mendoza
Texas Cotton Ginners' Association (TCGA)	Zachary Brady
Texas Industrial Energy Consumers (TIEC)	Rex VanMiddlesworth, Benjamin Hallmark, James Zhu
Walmart Inc. (Walmart)	Julie Clark
Staff	Rashmin Asher, Robert Parish, Justin Adkins

Between May 19 and 26, 2021, four SOAH Administrative Law Judges (ALJs)[10] held a hearing on the merits in this docket using the Zoom videoconferencing application.[11] Prior to the hearing on the merits, SWEPCO extended the final order deadline to October 27, 2021.[12]

The parties submitted initial post-hearing briefs on June 17, 2021, and reply briefs and proposed FoFs, CoLs, and Ordering Paragraphs on July 1, 2021. The record closed on July 1, 2021, except that SWEPCO, CARD, and Staff were authorized to continue to file updates to SWEPCO's

[10] Administrative Law Judges (ALJs) Andrew Lutostanski, Steven Neinast, Robert Pemberton, and Cassandra Quinn.

[11] As authorized by SOAH Order No. 13, SWEPCO filed a motion for optional completeness of exhibits, offering additional pages that were not included within Staff Ex. 67. Staff Ex. 67 was admitted during the hearing on the merits. SWEPCO's optional completeness pages were offered as SWEPCO Ex. 88. No party objected to SWEPCO Ex. 88. Therefore, SWEPCO Ex. 88 is admitted into the record.

[12] *See* Agreed Motion to Adopt Procedural Schedule filed by SWEPCO on November 19, 2020.

and CARD's rate case expenses and supporting testimony through the end of July 2021.[13] Calculation of the numerical impacts of the ALJs' recommendations in this PFD (number-running) commenced on August 4, 2021, and concluded on August 12, 2021.

IV. EXECUTIVE SUMMARY

As shown in the schedules attached to this PFD, the ALJs recommend that SWEPCO's Texas retail base rate annual revenue requirement be set at $402,643,175, which is $43.8 million less than its Texas retail base rate revenue requested through its rebuttal testimony. The ALJs' primary recommendations on discrete issues are summarized below.

A. Rate Base

1. Retired Gas-Fired Generation Units

Consistent with the Commission's treatment of Welsh Unit 2 in Docket No. 46449, the ALJs recommend that the Commission remove from rate base (and, therefore, deny SWEPCO any return upon) the net book value of the now-retired Lieberman Unit 2, Lone Star Unit 1, and Knox Lee Units 2, 3, and 4, and place those values into a regulatory asset, to be amortized over the four-year period in which the rates adopted in this proceeding are anticipated to remain in effect.

2. Dolet Hills Power Station (Dolet Hills)

Also informed by Docket No. 46449, the ALJs recommend that the Commission address the upcoming retirement of Dolet Hills by removing from base rates all cost recovery for Dolet Hills, the plant's lignite inventory, SWEPCO's investment in the Oxbow mine reserves, and

---

[13] The rate case expense reports or supplemental testimony filed by SWEPCO, CARD, and Staff on July 6, 20, and 27, 2021, in accordance with SOAH Order No. 13, were not subject ot objections and are hereby admitted into the record.

SWEPCO's return on equity and associated taxes concerning the Dolet Hills Lignite Company (DHLC), and address cost recovery for these items in a Dolet Hills Rate Recovery Rider, as follows:

- For the period between March 18, 2021 (the relate-back date for the rates to be approved in this proceeding) through December 31, 2021 (when Dolet Hills will be retired) (the Operational-Plant Phase):
    - Dolet Hills, its lignite inventory, and the Oxbow investment are treated as if in rate base, earning a return.
        - The ALJs also recommend that the Commission approve SWEPCO's requested test-year capital investment and operations and maintenance (O&M) expense at Dolet Hills.
        - The ALJs further recommend that the Commission approve the 45-day target lignite inventory level requested by SWEPCO for Dolet Hills.
    - Similarly, SWEPCO continues to recover the return on equity and associated taxes for DHLC.
    - SWEPCO continues to depreciate Dolet Hills in accord with the plant's previously established 2046 useful life.
    - Similarly, SWEPCO can continue to recover O&M and the other categories of expenses associated with the operation of a generating plant.
- For the period beginning January 1, 2022 (the Post-Retirement Phase):
    - The then-remaining net book value of Dolet Hills and the Oxbow investment will be placed in a regulatory asset, to be depreciated in accord with the plant's 2046 useful life.
    - All other cost recovery relating to Dolet Hills, including return and expenses, its lignite inventory, the Oxbow investment, or DHLC ends.

3. Coal and Lignite Inventories

In addition to the above recommendations concerning Dolet Hills, the ALJs recommend that the Commission approve SWEPCO's requested 30-day burn levels of inventory at the Flint Creek, Welsh, Turk, and Pirkey plants.

4. Test-Year Capital Spending and O&M

The ALJs recommend that the Commission approve SWEPCO's proposed test-year capital investment and O&M at the Flint Creek and Welsh plants, which Sierra Club has challenged.

5. Net Operating Loss Carry-Forward (NOLC) Adjustment

The ALJs recommend that the Commission disallow SWEPCO's requested $455,122,490 reduction of its accumulated deferred federal income taxes (ADFIT) balance to recognize a NOLC ADFIT asset.

6. Excess ADFIT/Surcharge Offset

The ALJs recommend that the Commission order SWEPCO to return its refundable excess ADFIT balance (unprotected ADFIT and accrued protected ADFIT) by: (1) crediting the balance against any surcharge owing from customers by virtue of the relate-back date; and (2) refunding any remaining balance over a six-month period, with carrying charges at the same WACC that the Commission approves in this proceeding.

7. Self-Insurance Reserve

Due to a failure in the proof of public interest required by Commission rule, the ALJs recommend that the Commission deny SWEPCO's request to establish a self-insurance reserve at this time.

B. Rate of Return

The ALJs recommend an ROE of 9.45%, a cost of debt of 4.18%, a capital structure comprised of 50.63% debt and 49.37% equity, and an overall rate of return of 6.79%. The ALJs' recommendation is a downward adjustment to SWEPCO's request for a 10.35% ROE, but adopts SWEPCO's proposed cost of debt, which only Staff opposed, and SWEPCO's proposed capital structure, which was unopposed.

C. Financial Integrity (Ring-Fencing Protections)

The ALJs recommend that the Commission require SWEPCO to implement most of the ring-fencing protections that Staff proposed, with the exception of four provisions that SWEPCO opposed.

D. Cost of Service

1. Transmission O&M Expense

The ALJs recommend approval of SWEPCO's transmission O&M expenses.

2. Transmission Expenses and Revenues under FERC-approved tariff

Other than Eastman and TIEC's challenge regarding SPP Open Access Transmission Tariff (OATT) charges incurred for Eastman's retail behind-the-meter load, the inclusion of the test year SPP OATT expenses and revenues in SWEPCO's requested cost of service is uncontested. The ALJs recommend that SWEPCO's SPP OATT expenses and revenues be approved except as otherwise stated.

3. Proposed Deferral of SPP Wholesale Transmission Costs

SWEPCO proposes that the portion of its ongoing SPP OATT bill that is above or below the net test year level approved by the Commission in this proceeding be deferred into a regulatory asset or liability until it can be addressed in a future TCRF or base rate proceeding. The ALJs recommend that SWEPCO's proposal be rejected.

4. Distribution O&M Expense

The ALJs recommend approval of SWEPCO's proposed distribution O&M expense.

5. Distribution Vegetation Management Expenses and Program Expansion

SWEPCO seeks an increase of $5 million over the $9.57 million in vegetation management expenses incurred in the test year. The ALJs recommend that an additional $5 million for vegetation management be approved. The ALJs also recommend that a compliance docket be opened to examine SWEPCO's vegetation management practices and spending. The ALJs decline to require SWEPCO to implement a four-year trim cycle.

6. Generation O&M Expense

SWEPCO proposes to include the O&M expense for Dolet Hills in its rates. The ALJs recommend that SWEPCO recover the test-year average monthly O&M expense for Dolet Hills until its retirement in December 2021 but not after.

SWEPCO proposes to include the O&M expense for five natural gas plants in its rates. The ALJs recommend that SWEPCO recover its requested O&M expenses for these units.

7. Payroll Expense

SWEPCO requested a payroll increase for employees. The ALJs recommend that Staff and OPUC's adjustment be adopted: a $544,331 increase for SWEPCO's direct payroll increase and a ($4,480,512) decrease for AEP Service Company's (AEPSC's) allocated payroll expense.

8. Incentive Compensation

The ALJs recommend that SWEPCO's incentive compensation expense be approved, with two small changes recommended by Staff and agreed to by SWEPCO.

9. Severance Costs

For SWEPCO's direct severance costs, the ALJs recommend a ($504,067) adjustment. For AEPSC's severance costs charged to SWEPCO, the ALJs recommend a ($636,576) adjustment.

10. Other Post-Retirement Benefits

The ALJs recommend that SWEPCO recover its other post-employment benefits expense.

11. Depreciation and Amortization Expense

The ALJs recommend the values proposed in SWEPCO's Application except for the following:

- <u>Remaining Net Book Value of Retired Gas-Fired Generating Units and Dolet Hills</u>: As summarized above, the remaining net book value of SWEPCO's five retired gas-fired generating units (Lieberman Unit 2, Lone Star Unit 1, and Knox Lee Units 2, 3, and 4) should be removed from base rates, placed in a regulatory asset, and amortized over four years. Further, the remaining net book value of Dolet Hills (and the associated Oxbow investment) should be removed from base rates and recovered through the Dolet Hills Rate Rider based on a 2046 useful life.

- Account 354 – Transmission Towers and Fixtures: adopt CARD's S1.5-74 curve life combination.
- Account 355 – Transmission Poles and Fixtures: adopt CARD's recommended L1.5- 9 curve life combination.
- Account 364 – Distribution Poles, Towers and Fixtures: adopt SWEPCO's rebuttal correction to use the S-.5-55 curve life combination.
- Account 366 – Distribution Underground Conduit: adopt CARD's recommended R4.0-80 curve life combination.
- Amortization: Adopt Staff's (unopposed) adjustment to intangible plant amortization.

12. Purchased Capacity Expense

SWEPCO purchases power under a contract with the Louisiana Generating Company (formerly Cajun Electric Power Cooperative). The ALJs recommend that SWEPCO continue to recover these costs through base rates.

SWEPCO purchased power from four wind projects. The ALJs recommend that the cost of the wind energy should continue to be collected through SWEPCO's fuel factor.

13. Affiliate Expenses

The ALJs recommend approval of Staff's adjustment of ($634,043) to affiliate expenses.

14. Federal Income Tax Expense

The ALJs recommend approval of SWEPCO's federal income tax expense as adjusted for flow-through matters (*e.g.*, invested capital and rate of return).

15. Ad Valorem (Property) Taxes

The ALJs recommend approval of Staff's adjustment to synchronize the effective ad valorem tax rate with the associated property subject to tax and the assets to which it is applied.

16. Payroll Taxes

The ALJs recommend approval of Staff's adjustment of ($258,162) to payroll tax expense.

17. Gross Margin Tax

SWEPCO's calculation of the cost-of-service margins was not contested. The ALJs recommend that revenue-related taxes should be updated and synchronized with the final revenue requirement set in this case.

E. Allocated Transmission Expenses Related to Retail Behind-the-Meter Generation

The ALJs conclude that SWEPCO's test-year charges from SPP for Network Integration Transmission Service are reasonable as a matter of law under the filed rate doctrine. The ALJs do not address whether SWEPCO's decision to report Eastman's retail behind-the-meter generation (BTMG) load to SPP for purposes of allocating such costs was required by SPP's OATT,because FERC has exclusive jurisdiction to resolve disputes involving the interpretation of a FERC-approved tariff, such as the OATT.

However, the ALJs recommend that SWEPCO's proposals to allocate transmission costs at both the jurisdictional and class levels by adding Eastman's BTMG load to the Texas jurisdiction and Large Lighting and Power–Transmission (LLP-T) class, respectively, should be rejected. Eastman's BTMG load should be removed when performing both allocations.

F. Billing Determinants

The ALJs recommend the Commission approve the adjusted test-year billing determinants proposed by SWEPCO, and that the billing determinants not be adjusted to attempt to account for the effects of the COVID-19 pandemic. The continuing effects of COVID-19 are transitory and unknown.

SWEPCO's use of estimated billing determinants to account for anticipated customer migration among existing rate schedules in between rate cases is acceptable.

G. Jurisdictional Cost Allocation

The underlying methodology and calculations of Staff's jurisdictional cost of service study are appropriate when the inputs addressed in this PFD are used to run the jurisdictional cost of service study.

SWEPCO properly removed its inadvertent assignment in Rate Filing Package Schedule P-3 of costs to the wholesale jurisdiction.

H. Class Cost Allocation

SWEPCO appropriately does not allocate major account representative-related costs to the Residential class. SWEPCO appropriately used a single coincident peak (1CP) system load factor to weight average demand in the class average and excess four coincident peak (A&E/4CP) allocation methodology.

In its next base rate case, SWEPCO should address why three classes—the Cotton Gin, Oilfield Secondary, and Public Street and Lighting classes—historically have been well under a unity (1.0) relative rate of return as a result of the class cost of service study, and what can and should be done to address these under-recoveries through methods other than gradualism.

I. Revenue Distribution and Rate Design

1. Revenue Distribution/Gradualism

The ALJs recommend that the Company's use of four rate groupings—the Residential, Commercial and Industrial, Municipal, and Lighting class Groups—to address revenue distribution/gradualism and rate design is appropriate. The Company's revenue distribution approach is a reasonable interpretation of the Commission's Orders in SWEPCO's two prior base rate cases. The ALJs therefore recommend that the Commission approve SWEPCO's revenue distribution/gradualism mechanism as proposed in SWEPCO's rebuttal case, as adjusted to reflect the class cost of service ultimately approved in this case.

2. Other Rate Design Issues

- TCRF and DCRF Revenues: SWEPCO must evaluate a class's present revenues inclusive of TCRF and DCRF revenues as required by Docket No. 46449.

- Cotton Gin, Oilfield Secondary, and Public Street and Highway Lighting Classes: The relative rates of return issue addressed in the class cost of service summary above may also be addressed in the context of rate design. That is, why are these three classes in particular well below a unity relative rate of return?

- General Service (GS) Rate Design: The ALJs recommend that the Commission reject SWEPCO's request to remove the 50 kilowatt (kW) maximum demand that applies to the GS rate schedule.

- Migration Among Classes Between Rate Cases: The ALJs recommend against Staff's proposal to require SWEPCO to revise many of its rate schedules to preclude customers from migrating among classes between rate cases. This issue, however, should be addressed in more detail in SWEPCO's next base rate case.

- Lighting and Power (LP) Secondary Class: SWEPCO should not collect fixed demand-related costs through energy charges in the LP Secondary rate class.

- Reactive Power Charge in the Large Lighting and Power (LLP) Rate Schedule: SWEPCO has not justified its proposal to increase the reactive demand charge in the LLP rate schedule. If SWEPCO proposes to increase this charge in its next base rate case, it should provide a more detailed explanation, or a study, that support the requested increase.

J. Riders

- Proposed Residential Service Plug-in Electric Vehicle (PEV) Rider: The Commission should approve SWEPCO's proposed PEV Rider.

- Renewable Energy Credit (REC) Rider: SWEPCO should revise the REC Rider to allow a customer to link its RECs to specific renewable resources. SWEPCO's REC opt-out credit applicable to transmission level customers that "opt out" of paying RECs should be allocated based on energy, not demand.

K. Retail Choice Pilot Project

ETSWD's request that the Commission implement a retail choice pilot project in SWEPCO's service territory is moot based on the Commission's rejection of that request in its declaratory order issued in Docket No. 51257.

L. Baselines

SWEPCO's proposals to reset the baselines for the components that are used for a subsequent implementation of the TCRF and DCRF, and to establish a baseline for the GCRR should be approved. The TCRF, DCRF, and GCRR baselines should be set in the compliance phase of this case.

M. Rate Case Expenses

SWEPCO should be authorized to recover its own and CARD's rate case expenses totallling $3,700,021 through its proposed Rate Case Surcharge (RCS) Rider. The Commission should deny SWEPCO's request to recover $65,167 attributable to the hourly fees charged by two attorneys in excess of $550 per hour. The total amount stated above includes $2,500 in CARD's rate case expenses finally incurred in Docket No. 47141.

V. RATE BASE/INVESTED CAPITAL
[PO Issues 4, 5, 10, 11, 12, 13, 14, 15, 16, 18, 19, 20, 21, 22, 23, 36, 37, 38, 39, 40, 41, 50, 67, 68, 69, 70, 71]

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

SWEPCO presented for review approximately $636.7 million in capital additions to its transmission system, approximately $143.5 million in distribution capital additions, and approximately $320.9 million in capital additions to its generating plants, made between the June 30, 2016 conclusion of the historical test year used in SWEPCO's last base rate case—Docket No. 46449[14]—and the March 31, 2020 conclusion of the test year in the present case. The capital additions were discussed in the testimony and exhibits of SWEPCO witnesses Wayman Smith (transmission), Drew Seidel (distribution), and Monte McMahon (generation). No party challenged the capital additions or the costs thereof aside from a challenge by Sierra Club (addressed below) to spending at three solid-fuel-fired generating units. The ALJs recommend including the capital additions in setting rates in this case.

The more controversial issues in regard to capital investment, rather, concern the proper rate treatment of SWEPCO's investments in generating plants that have been retired or soon will be.

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

Since the Commission's decision in Docket No. 46449, SWEPCO has retired five of its gas-fired generating units:

Unit	Year Entered Service	Date Retired
Knox Lee Unit 4	1956	January 1, 2019

[14] *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order on Rehearing, FoF No. 7 (Mar. 19, 2018) (Docket No. 46449).

Knox Lee Unit 2	1950	May 1, 2020
Knox Lee Unit 3	1952	May 1, 2020
Lieberman Unit 2	1949	May 1, 2020
Lone Star Unit 1	1954	May 1, 2020[15]

SWEPCO's vice-president over generating assets, Mr. McMahon, testified that the Company determined the retirements to be in its customers' best interests, considering the age and condition of the units' equipment, the significant capital investment required to keep them operating, and the units' relatively high cost to generate electricity compared to the forecasted market price of electricity.[16]

No party questions the plant retirements themselves, which occurred at or near the ends of the units' respective useful lives.[17] However, the retired units still had remaining undepreciated value, which gives rise to a dispute between SWEPCO and Staff concerning the appropriate rate treatment for that investment. Their respective positions distill to a disagreement over the extent to which SWEPCO's rate recovery relating to the retired units is, or should be, governed by the Commission's rate treatment of the retired Welsh Unit 2 in Docket No. 46449.

In 2016, 24 years before the end of the plant's previously projected useful life, SWEPCO had retired Welsh Unit 2, a coal-fired generating plant, pursuant to a broader strategy of SWEPCO and other AEP affiliates to respond to increasingly stringent federal air-quality regulations by retiring or retrofitting coal and lignite-fired plants across the AEP system.[18] In Docket No. 46449,

---

15 SWEPCO Ex. 7 (McMahon Dir.) at 9-10.

16 SWEPCO Ex. 7 (McMahon Dir.) at 9.

17 SWEPCO Ex. 7 (McMahon Dir.) at 9-10; *see* Staff Ex. 3 (Stark Dir.) at 19 (noting that the units "were retired at the end of their estimated useful lives as established in Docket No. 46449").

18 Docket No. 46449, Order on Rehearing, FoF Nos. 21-23, 65 (Mar. 19, 2018); *see also* Docket No. 46449, PFD at 87 (Sep. 22, 2017); *Application of Southwestern Electric Power Company for Authority to Change Rates and Reconcile Fuel Costs*, Docket No. 40443, Order on Rehearing, FoF No. 199 (Mar. 6, 2014) (estimated useful life through 2040).

the Commission found that the Welch Unit 2 retirement was prudent.[19] The Commission also found, and there was no dispute, that SWEPCO was entitled to recover the undepreciated value of Welch Unit 2 remaining upon its retirement, roughly $75 million.[20] However, parties differed as to whether SWEPCO was also entitled to earn a return on that undepreciated value, which SWEPCO had sought to do, considering that PURA and Commission rules contemplate a return only on invested capital that is "used and useful" in providing service to the public.[21]

SWEPCO argued that it was entitled to earn this return by virtue of the accounting treatment prescribed by the FERC Uniform System of Accounts (USofA) and thus mandated by the Commission.[22] That accounting treatment, as the parties agreed and the Commission ultimately found, was to credit the relevant Plant in Service account (reflecting the original cost of electric utility plant) in the amount of Welsh Unit 2's original cost (thereby removing that value from the account) and debiting the corresponding Accumulated Depreciation account by the same amount, leaving a debit balance in Accumulated Depreciation equaling the plant's undepreciated balance.[23] But this adjustment, standing alone, would enable SWEPCO to earn a return on the undepreciated value of Welsh Unit 2 because that value (now reflected as a debit balance in Accumulated Depreciation) would also continue to be reflected in Net Plant in Service (the difference of subtracting Accumulated Depreciation from Plant in Service, *i.e.*, the plant's net book value, the figure that ultimately goes into rate base).[24] In SWEPCO's view, this accounting treatment served to remove Welsh Unit 2 from "invested capital" while also still enabling it to earn a return on the plant's undepreciated value.[25] SWEPCO further argued that this rate treatment was consistent with

---

[19] Docket No. 46449, Order on Rehearing, FoF Nos. 53-64 (Mar. 19, 2018).

[20] Docket No. 46449, Order on Rehearing, FoF No. 69 (Mar. 19, 2018); *see also* Docket No. 46449, PFD at 89 (Sep. 22, 2017).

[21] Docket No. 46449, PFD at 89-90 (Sep. 22, 2017); *see* PURA §§ 36.051, .053; 16 Tex. Admin. Code (TAC) § 25.231(c)(2)(A)).

[22] *See* 16 TAC § 25.72(c).

[23] Docket No. 46449, Order on Rehearing, FoF No. 67 (Mar. 19, 2018); *see also* Docket No. 46449, PFD at 87-89 (Sep. 22, 2017).

[24] *See* Docket No. 46449, PFD at 87-91 (Sep. 22, 2017); 16 TAC § 25.231(c)(2)(A).

[25] Docket No. 46449, PFD at 89-90 (Sep. 22, 2017).

Commission precedent and the principle that a utility be allowed to recover a return on its prudent investments.[26] Urging that a retired plant is not "used and useful" in providing service, Staff and various intervenors contended that the remaining undepreciated value should be cleared from Accumulated Depreciation and moved to a regulatory asset account, from which the value would be repaid to SWEPCO, but without a return.[27]

The Commission agreed with Staff and intervenors and rejected SWEPCO's approach, finding that: (1) "Welsh [U]nit 2 no longer generates electricity and is not used by and useful to SWEPCO in providing electric service to the public"; (2) "[b]ecause Welsh [U]nit 2 is no longer used and useful, SWEPCO may not include its investments associated with the plant in its rate base, and may not earn a return on that remaining investment"; (3) "[a]lowing SWEPCO a return of, but not on, its remaining investment in Welsh [U]nit 2 balances the interests of ratepayers and shareholders with respect to a plant that no longer provides service"; and (4) "[t]he appropriate accounting treatment that results in the appropriate ratemaking treatment was, as Staff and intervenors had urged, "to record the undepreciated balance of Welsh [U]nit 2 in a regulatory-asset account" rather than leaving it in Accumulated Depreciation.[28] The PFD, which the Commission adopted in material part, elaborated:

> This issue is actually quite simple. The FERC [USofA] requires a journal entry to account for retirement. But for an asset such as a power plant, the journal entry does not end as SWEPCO contends if the utility is not entitled to earn a return on the undepreciated balance of the asset remaining at retirement. So, the princip[al] question here is whether SWEPCO is entitled to earn a return on the undepreciated balance of Welsh Unit 2. If it is, then the journal entry proposed by SWEPCO should be approved; if not, then an additional clearing entry, moving the undepreciated balance to a regulatory asset where SWEPCO will receive only the return of the asset is allowed . . . .
>
> The issue is fundamental to ratemaking. Accounting does not determine the appropriate ratemaking treatment. The statutory framework determines ratemaking treatment. To earn a return, an asset must be both used and useful. SWEPCO argues

[26] Docket No. 46449, PFD at 90-94 (Sep. 22, 2017).

[27] Docket No. 46449, PFD at 90 (Sep. 22, 2017).

[28] Docket No. 46449, Order on Rehearing, FoF Nos. 66, 68-69, 71 (Mar. 19, 2018).

> that the remaining value of Welsh Unit 2 continues to be used and useful, even after its retirement, but SWEPCO has failed to provide any evidence as to how a retired plant will still be useful in serving the public. There is no dispute that Welsh Unit 2 did serve the public in the past, but, to be included in rate base, an investment must be both used and useful. The plain meaning of "useful" is: being of use or service; serving some purpose; advantageous; of practical use, as for doing work; producing material results; supplying common needs. A retired plant does none of these things . . . .[29]

The Commission also found it reasonable for SWEPCO to recover Welsh Unit 2's remaining undepreciated balance over the 24-year remaining lives of Welsh Units 1 and 3,[30] an amortization schedule that also corresponded roughly to Welsh Unit 2's estimated remaining useful life as determined before retirement.[31]

As with Welsh Unit 2, professing adherence to the USofA, SWEPCO has credited the relevant Plant in Service accounts with the book values of the five retired plants, debited the relevant Accumulated Depreciation accounts by the same amounts, and made no additional adjustment to remove the remaining undepreciated values of the retired plants from rate base.[32] Citing Docket No. 46449 as governing "Commission precedent for the treatment of retired generating units," Staff proposes to adjust SWEPCO's requested rate base to remove the net book values of the retired plants and place those values in a regulatory asset.[33] Because the units were retired at or near the end of their estimated useful lives (unlike the "early" retirement of Welch Unit 2), Staff proposes to amortize payment of the units' remaining undepreciated value to SWEPCO over the four-year period in which rates in this case are expected to be in effect.[34] As explained by Staff witness Ruth Stark, "these adjustments provide for a return of, but not on,

---

[29] Docket No. 46449, PFD at 93-94 (Sep. 22, 2017) (internal citations omitted).

[30] Docket No. 46449, Order on Rehearing, FoF No. 70 (Mar. 19, 2018).

[31] Docket No. 40443, Order on Rehearing, FoF No. 199 (Mar. 6, 2014).

[32] Staff Ex. 3 (Stark Dir.) at 18, Attachment RS-25, SWEPCO's response to CARD RFI 9-2 at 1; SWEPCO Ex. 36 (Baird Reb.) at 26.

[33] Staff Ex. 3 (Stark Dir.) at 18-19.

[34] Staff Ex. 3 (Stark Dir.) at 19; *see* 16 TAC § 25.246(c) (utility generally must initiate next base rate case "on or before the fourth anniversary of the date of the final order in the utility's most recent comprehensive base rate proceeding").

SWEPCO's remaining investment in these units[,] consistent with Commission precedent."[35] TIEC joins with Staff in advocating these adjustments.[36]

SWEPCO counters that "the Docket No. 46449 Welch Unit 2 rate treatment" was an unprecedented departure from the USofA and prior Commission practice that should not be applied categorically to all cases in which a power plant is retired with some undepreciated value.[37] According to SWEPCO witness Michael Baird, Managing Director of Accounting Policy and Research for SWEPCO's affiliate service company, AEPSC, it is not unusual that some undepreciated value remains upon the retirement of a gas plant at the end of its useful life. He added that the normal practice has been simply to include any under- or over-appreciated value in determining future depreciation rates for the remaining units. He further asserted that "the Commission has never singled out and addressed gas plants" in the manner of the retired Welsh Unit 2 coal-fired plant.[38] The "unique" circumstances of the Welch Unit 2 adjustment, SWEPCO maintains, were illustrated even within Docket No. 46449 itself, pointing out that it had retired another unit in 2015, Lieberman Unit 1, without the Commission requiring any adjustment to rate base and "[i]nstead . . . allow[ing] the ratemaking for Lieberman Unit 1 to follow the requirements of the FERC USofA."[39] SWEPCO insists that "Staff presents no compelling reason to depart from that practice with respect to these retired gas-fired generating units."[40]

"To apply the Docket No. 46449 Welsh Unit 2 rate treatment to the retirement of any generation unit independent of the circumstances," SWEPCO adds, would effectively penalize utilities who have prudently invested capital in generation plant by depriving them, upon a plant's retirement, of a return on any undepreciated portion of that investment, requiring that portion to be written off as expense, as well as creating the "perverse incentive" to imprudently continue

[35] Staff Ex. 3 (Stark Dir.) at 20.

[36] Staff Initial Brief at 12-13; TIEC Initial Brief at 11-12.

[37] SWEPCO Initial Brief at 13-14; SWEPCO Reply Brief at 10-12.

[38] SWEPCO Ex. 36 (Baird Reb.) at 26.

[39] SWEPCO Initial Brief at 14; SWEPCO Reply Brief at 10-11.

[40] SWEPCO Initial Brief at 14.

running plants that should be retired.[41] Likewise, SWEPCO urges, its opportunity to earn a reasonable return on prudently invested capital will be made contingent on the depreciation rates the Commission is persuaded to adopt rather than its prudent management of its business, and will relatedly incent parties in rate cases to advocate extensions of plants' depreciable lives in order to leave undepreciated value upon retirement.[42]

In reply, Staff and TIEC observe that the Commission in Docket No. 46449 rejected similar arguments by SWEPCO that emphasized the USofA and SWEPCO's interest in recovering a return on its prudent capital investments.[43] They also dispute SWEPCO's premise that Docket No. 46449's rate treatment of Welsh Unit 2 represented a departure from Commission precedent.[44] Each notes that neither the Commission's Order nor the PFD in Docket No. 46449 addressed the retirement or ratemaking treatment of Lieberman Unit 1, whereas those issues were squarely presented and addressed with regard to Welsh Unit 2.[45] TIEC adds that, similarly, SWEPCO has not identified any case where the Commission has affirmatively held that a utility should earn a return on a retired plant, further suggesting that SWEPCO's invocation of professed policy concerns reflects tacit acknowledgment that it is seeking a departure from precedent.[46] Staff, on the other hand, points to a 1997 order in Docket No. 14965 that reflects the Commission's recognition of its authority to reduce or deny rate recovery of capital investment, including prudent capital investment, when such investment is not being used to provide service.[47]

---

[41] SWEPCO Reply Brief at 11-12; SWEPCO Ex. 36 (Baird Reb.) at 26.

[42] SWEPCO Reply Brief at 11.

[43] Staff Reply Brief at 9-10 (citing Docket No. 46449, Order on Rehearing, FoF Nos. 69, 72 (Mar. 19, 2018); PFD at 94 (Sep. 22, 2017)); TIEC Reply Brief at 6 (citing Docket No. 46449, PFD at 87-88, 93-94 (Sep. 22, 2017)).

[44] Staff Reply Brief at 10-11; TIEC Reply Brief at 7-8.

[45] Staff Reply Brief at 10 (citing Docket No. 46449, Order on Rehearing (Mar. 19, 2018), PFD (Sep. 22, 2017)); TIEC Reply Brief at 6-7 (citing same).

[46] TIEC Reply Brief at 6-8.

[47] Staff Reply Brief at 10-11 (citing *Application of Central Power and Light Company for Authority to Change Rates*, Docket No. 14965, Second Order on Rehearing at 2 (Oct. 16, 1997)).

In Docket No. 14965, in the context of addressing a utility's rate recovery of investment that exceeded market value (ECOM) (*i.e.*, that which was economically "unuseful" or "less useful" in rendering service), the Commission observed that it had the duty to set overall revenues at a level to provide a reasonable opportunity to earn a reasonable return on invested capital used and useful in rendering service. It further stated that "[u]nder the 'used' standard applied in past cases, the Commission [had] exercised its authority to balance equities by allowing recovery of capital costs while eliminating or reducing the return on those assets that have been found prudent, but that are not used to provide service."[48] "The same rationale," the Commission reasoned, "may be consistently applied when assets are unuseful," and it went on to balance the interests of the utility and its owners (in regard to potential under-recovery) versus current and future utility customers (in regard to paying for assets that are less "useful") in adjusting a proposed recovery of ECOM with return by reducing the recovery period but lowering the rate of return.[49]

The order in Docket No. 14965 could be read to imply a governing principle that is more nuanced than simply a categorical bar prohibiting a utility from ever recovering a return on the undepreciated value of a retired plant, one that perhaps leaves room for balancing the sorts of economic and policy interests SWEPCO invokes in determining the extent to which the utility should receive a return on that investment. Yet the ALJs must also be guided by the Commission's more recent order in Docket No. 46449. And the clear import of the Commission's holdings and reasoning there regarding Welsh Unit 2 is that "the interests of ratepayers and shareholders with respect to a plant that no longer provides service" are properly balanced by "[a]llowing [the utility] a return on, but not of, its remaining investment" in that plant. Moreover, and perhaps more critically, the Commission reasons that a retired plant is not considered a "used and useful" investment that would be included in rate base under PURA and Commission rules.[50] In the very least, Docket No. 46449 would stand for the proposition that utility customers should not be required to continue paying a return on a retired plant absent some unique and compelling

[48] Docket No. 14965, Second Order on Rehearing at 2 (Oct. 16, 1997).

[49] Docket No. 14965, Second Order on Rehearing at 2-3 (Oct. 16, 1997).

[50] Docket No. 46449, Order on Rehearing, FoF Nos. 66, 68, 69, 71 (Mar. 19, 2018); Docket No. 46449, PFD at 94 (Sep. 22, 2017).

circumstance justifying that they do so, one that somehow amounts to the ongoing "use and usefulness" of the plant. Whether fairly characterized as consistent with prior precedent or a departure from it, the ALJs will follow this most recent authoritative pronouncement from the Commission, unless and until the Commission or the Legislature instructs otherwise.[51]

Although suggesting that the Commission's order in Docket No. 46449 should be distinguished from this case, SWEPCO offers no persuasive reason why it would not apply. The Commission's reasoning turned on the fact that Welch Unit 2 had been retired, not any specific circumstance relating to that plant *vis a vis* any other retired plant, the plant's fuel source, or the amount of net book value or remaining useful life. Nor does SWEPCO point to any circumstance unique to the five retired plants that might justify treating them differently. SWEPCO's appeals to economic or policy considerations implicate interests that would be present in regard to any plant retirement where some amount of prudently incurred but undepreciated value remains.

Accordingly, the ALJs recommend that the Commission, as Staff has proposed, adjust SWEPCO's requested rate base to remove the net book values of the five retired gas plants and place those values in a regulatory asset. The ALJs further conclude that Staff's proposal to amortize SWEPCO's recovery of those values over four years is reasonable and should be adopted.

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

a. Background

Dolet Hills is a 650-net-megawatt (MW), single-unit, lignite-fueled generating plant, located southeast of Mansfield, Louisiana, that is owned jointly by Cleco Power LLC (CLECO), SWEPCO, NTEC (intervenor in this case), and Oklahoma Municipal Power Authority, with SWEPCO's ownership interest being 262 MW, approximately 40% of the unit's total capacity.[52]

---

[51] *Cf.* PURA § 39.352 (providing an affirmative right to recover "stranded costs" resulting from transition to retail competition).

[52] SWEPCO Ex. 4 (Brice Dir.) at 5-6.

CLECO operates and manages Dolet Hills pursuant to the Dolet Hills Power Station Ownership, Construction and Operating Agreement between CLECO and SWEPCO, effective November 13, 1981.[53]

Dolet Hills has been in service since 1986,[54] although SWEPCO did not seek to include its share of the plant in its Texas rate base until Docket No. 37364, in which the Commission did so by order issued in 2010.[55] In the ensuing Docket No. 40443—SWEPCO's base rate case immediately preceding its most recent Docket No. 46449—the Commission established a 60-year estimated useful life for Dolet Hills (ending in 2046),[56] which was also maintained in Docket No. 46449.[57]

Dolet Hills is a "mine-mouth" plant, fueled by lignite mined in the area and transported by conveyor belt.[58] In 2009, SWEPCO acquired, with CLECO, additional area lignite reserves known as the Oxbow reserves and sought in Docket No. 40443 to include its share of the acquisition costs (its Oxbow investment) in rate base.[59] SWEPCO presented evidence that the Dolet Hills mine reserves on which it had heretofore relied were becoming depleted, that the investors had evaluated alternative means of fueling Dolet Hills, and that acquiring the Oxbow reserves and merging resources represented the least costly option for securing a reliable fuel supply sufficient to meet Dolet Hills' needs for the remainder of its economic life.[60] The Commission found that the Oxbow investment "was necessary to extend the life of the Dolet Hills power plant from 2016 through 2019 to at least 2026" and that it was reasonable to include the Oxbow investment (along with the

53 SWEPCO Ex. 4 (Brice Dir.) at 6.

54 SWEPCO Ex. 7 (McMahon Dir.) at 5.

55 SWEPCO Ex. 33 (Brice Reb.) at 5-6; Docket No. 37364, Order, FoF No. 39 (Apr. 16, 2010).

56 Docket No. 40443, Order on Rehearing, FoF No. 198 (Mar. 6, 2014).

57 Tr. at 106.

58 SWEPCO Ex. 33 (Brice Reb.) at 6; Tr. at 108.

59 Docket No. 40443, PFD at 71-73 (May 20, 2013).

60 Docket No. 40443, PFD at 71-73 (May 20, 2013).

plant itself) in SWEPCO's rate base.[61] The Oxbow investment was also included in SWEPCO's rate base in Docket No. 46449, where the Commission further found that "[s]ince the Docket No. 40443 test year, the Dolet Hills lignite reserves have been depleted and all of the draglines and mining operations are moving to the Oxbow reserve."[62] Also included in SWEPCO's rate base in both Docket No. 40443 and Docket No. 46449 has been a return on equity SWEPCO contributed to DHLC—a subsidiary that performs the mining operations—as well as income taxes associated with that return.[63]

In Docket No. 49466, the Commission additionally found that SWEPCO had acted prudently in making—and thereby permitted rate recovery of—an investment of approximately $56.2 million in environmental-compliance retrofits to Dolet Hills.[64] Among other considerations noted by the Commission was SWEPCO's Oxbow investment a few years earlier.[65] The economic analysis presented by SWEPCO to justify the retrofits presumed the 2046 useful life for Dolet Hills.[66]

However, SWEPCO and CLECO have since determined to retire Dolet Hills in light of intervening developments. According to Thomas Brice, SWEPCO's Vice President for Regulatory and Finance, increases in lignite-production costs prompted SWEPCO and CLECO in 2019 to reduce mining operations and move Dolet Hills to seasonal operations, running the plant only in peak summer months but keeping it available in case called upon for reliability reasons by SWEPCO's or CLECO's respective Regional Transmission Organizations (RTOs) (for SWEPCO,

---

61 Docket No. 40443, FoF Nos. 140-41 (Mar. 6, 2014).

62 Docket No. 46449, Order on Rehearing, FoF No. 139 (Mar. 19, 2018); Docket No. 46449, PFD, Attachment A, Schedule III (Sep. 22, 2017).

63 Staff Ex. 3 (Stark Dir.), Attachment RS-28 (SWEPCO Response to Staff RFI 5-61).

64 Docket No. 46449, Order on Rehearing at 2-5, FoF Nos. 24-36, CoL No. 18 (Mar. 19, 2018); *see* Docket No. 46449, PFD at 18 (Sept. 22, 2017) (noting that SWEPCO's share of the investment, for which it sought recovery through rates, was "approximately $56.2 million").

65 Docket No. 46449, Order on Rehearing at 4, FoF Nos. 30P-30Q (Mar. 19, 2018).

66 Tr. at 82.

SPP).[67] Despite attempts to reduce mining costs, including reducing mining operations from what were formerly three drag lines to only one, it was determined in early 2020 that the economically recoverable lignite reserves were depleted, that mining activity should cease, and that Dolet Hills should be retired by the end of 2021.[68]

Lignite production at the mine ceased in May 2020, although Dolet Hills has continued to run on previously-mined lignite that DHLC has delivered or will deliver to the plant, which will fuel the plant until its retirement.[69] At the hearing, SWEPCO's Mr. McMahon confirmed that the Dolet Hills retirement will occur on December 31, 2021.[70] In the meantime, SWEPCO plans to continue operating Dolet Hills seasonally while maintaining its availability in case called upon by SPP.[71]

While Mr. Brice testified that the decision to retire Dolet Hills was driven primarily by the economics of recovering the remaining lignite reserves,[72] SWEPCO's President and Chief Operating Officer, Malcolm Smoak, acknowledged that the plant's retirement is also a component of a broader strategy among AEP and its affiliates to transition away from lignite- and coal-fueled generation in favor of "cleaner" power sources.[73] Within the last decade, as Mr. Smoak explained, AEP has retired or sold nearly 13,500 MW of coal-fueled generation and expects to reduce coal capacity by another 5,600 MW by 2030.[74] And recently, citing concerns with climate change, AEP has announced a new goal of achieving net zero carbon emissions by 2050, with an 80% reduction in carbon emissions compared to 2000 levels by 2030, and to these ends plans to add 10,000 MW

---

67 SWEPCO Ex. 33 (Brice Reb.) at 6-7.

68 SWEPCO Ex. 33 (Brice Reb.) at 6-7; Tr. at 101-03. A study was performed in aid of this decision, which is found at SWEPCO Ex. 4A (Brice workpapers).

69 SWEPCO Ex. 4 (Brice Dir.) at 6.

70 Tr. at 176.

71 SWEPCO Ex. 37 (McMahon Reb.) at 2.

72 Tr. at 100.

73 Tr. at 52-57.

74 Tr. at 52-53; TIEC Ex. 5 (AEP News Release Mar. 22, 2021) at 1.

of renewables by 2030.[75] Consistent with this strategy, SWEPCO is planning to retire another lignite-fueled plant, Pirkey, in 2023, and intends either to convert to gas or retire outright the currently coal-fired Welsh Units 1 and 2 in 2028.[76]

Although the retirement of Dolet Hills has not yet occurred, the Commission directed that the ALJs consider the prudence of SWEPCO's retirement decision in this proceeding.[77] No party has contested the prudence of that decision, and the evidence supports a finding that it was prudent. Of much greater controversy, however, is the appropriate rate treatment regarding Dolet Hills in light of that impending retirement.

b. SWEPCO's Proposal

SWEPCO's analytical starting point is the assertion that Generally Accepted Accounting Principles (GAAP) and "standard regulatory practice" would require it to depreciate Dolet Hills' remaining net book value over the asset's "expected useful life"—which, SWEPCO insists, has now become the plant's December 31, 2021 retirement date rather than the previously projected 2046 retirement date.[78] That is to say, SWEPCO would recover the entirety of the plant's Texas share of net book value from its Texas customers—approximately $45.4 million ($122.8 million on a total company basis)—during the roughly nine months between the new rates' March 18, 2021 effective date and the year's end.[79] But as Mr. Baird explained, SWEPCO "determined that recovery over the remaining life [of Dolet Hills] was not feasible, as it would have required a significant increase in revenue requirements due to the very large depreciation

---

75 Tr. at 52; TIEC Ex. 5 (AEP News Release Mar. 22, 2021) at 1.

76 Tr. at 56, 73-74, 76-79, 109.

77 Preliminary Order at ¶ 67 (Dec. 17, 2020); *cf.* Docket No. 40443, Order on Rehearing, FoF Nos. 125-125A (Mar. 6, 2014) (deferring decision of whether then-anticipated Welsh Unit 2 retirement was prudent until "a future proceeding that addresses the actual retirement of the plant when it occurs").

78 SWEPCO Ex. 4 (Brice Dir.) at 7; SWEPCO Ex. 36 (Baird Reb.) at 8-9.

79 SWEPCO Ex. 36 (Baird Reb.) at 8.

expense."[80] Accordingly, SWEPCO proposes to "mitigate" this asserted rate impact through two means.[81]

First, SWEPCO would seize the "unique opportunity" afforded by the excess accumulated deferred federal income tax SWEPCO owes to its customers by virtue of the Tax Cut and Jobs Act of 2017 (TCJA).[82] Other aspects of SWEPCO's proposed treatment of ADFIT and "excess" ADFIT attributable to the TCJA (excess ADFIT) are addressed below, and the ALJs will reserve a more detailed explanation of both ADFIT and excess ADFIT until it becomes relevant to analysis of those other issues. For present purposes, the excess ADFIT can be understood as the portion of SWEPCO's projected future federal income tax payments it has collected from customers through its current rates that, due to the TCJA's intervening tax-rate cut that took effect beginning in 2018, now exceed the actual amount of taxes SWEPCO would ultimately pay the Internal Revenue Service (IRS) under the lower tax rate.[83] SWEPCO has recorded this excess ADFIT as a regulatory liability[84] and the Commission in Docket No. 46449 deferred its treatment until this proceeding.[85]

SWEPCO proposes to utilize its excess ADFIT accruing between January 1, 2018 (when the TCJA became effective) through April 1, 2021, to offset the remaining net book value of the Dolet Hills plant, which would leave approximately $6.4 million for Texas ($11.5 million total company) on the books.[86] This remaining balance is the focus of SWEPCO's second "mitigation"

---

[80] SWEPCO Ex. 36 (Baird Reb.) at 12-13.

[81] SWEPCO Ex. 4 (Brice Dir.) at 7-8.

[82] SWEPCO Ex. 4 (Brice Dir.) at 7-8; SWEPCO Ex. 36 (Baird Reb.) at 12-13.

[83] SWEPCO Ex. 17 (Hodgson Dir.) at 21-22.

[84] SWEPCO Ex. 17 (Hodgson Dir.) at 21.

[85] Docket No. 46449, Order on Rehearing, Ordering Par. No. 10 (Mar. 19, 2018) ("The regulatory treatment of any excess deferred taxes resulting from the reduction in the federal-income-tax rate will be addressed in SWEPCO's next base-rate case.").

[86] SWEPCO Ex. 6 (Baird Dir.) at 48-49; SWEPCO Ex. 17 (Hodgson Dir.) at 21; SWEPCO Ex. 36 (Baird Reb.) at 5-6, Exh. MAB-2R. SWEPCO quantifies its excess ADFIT as approximately $39 million for Texas ($111.3 million total company), although the amount is one of the disputed ADFIT-related issues addressed below. There are also some nuances regarding a distinction between "protected" and "unprotected" ADFIT that are best explained in the context of that discussion.

proposal—SWEPCO would amortize its recovery over the four years during which the rates are expected to remain in effect, as opposed to the months remaining before Dolet Hills' retirement.[87]

While acknowledging that SWEPCO benefits by "receiv[ing] immediate recovery of a portion of the Dolet Hills Power Plant"—indeed, 91% of its net book value—as well as a significantly shortened amortization period compared to the previous 2046 time frame, Mr. Baird termed the proposal a "win-win" for not only the utility but also its customers, given the rate impact that customers would otherwise absorb in SWEPCO's view.[88] He further asserted that the offset was "equitable" because it utilizes taxes overpaid by the same customers who also "have not paid enough of Dolet [Hills] depreciation in hindsight" to reduce the remaining balance.[89] He similarly reasoned that the four-year amortization of the remaining balance was "reasonable," as "a longer period . . . simply pushes depreciation costs to future customers."[90] In SWEPCO's view, spreading the costs of Dolet Hills to future customers "for decades," as with a 2046 useful life, is inequitable because those costs should properly be borne by the customers who were actually served by the plant, particularly including the customers to whom the excess ADFIT is owed.[91]

SWEPCO further contends that the offset is consistent with PURA and the Commission's Cost of Service Rule, which lists ADFIT as a required deduction from invested capital in determining rate base.[92] The Company also points to the Commission's order in Docket No. 48577, which approved a settlement whereby the parties agreed to offset AEP Texas's catastrophe-reserve regulatory asset with unprotected excess ADFIT.[93] While acknowledging that the order "does not constitute binding precedent" and that "the asset might be different," SWEPCO urges that the Commission's approval and incident finding that "[t]he Settlement Agreement's treatment of

---

[87] SWEPCO Ex. 6 (Baird Dir.) at 49.

[88] SWEPCO Ex. 36 (Baird Reb.) at 6, 13.

[89] Tr. at 475.

[90] SWEPCO Ex. 36 (Baird Reb.) at 13.

[91] SWEPCO Reply Brief at 7.

[92] SWEPCO Initial Brief at 10-11; *see* 16 TAC § 25.231(c)(2)(C)(i).

[93] SWEPCO Initial Brief at 11 (citing *Application of AEP Texas, Inc. for Determination of System Restoration Costs*, Docket No. 48577 (Feb. 28, 2019)).

ADFIT is appropriate" reflect that "the Commission is open to using Excess ADFIT as a means to reduce the cost of an asset includable in customer rates and that such an offset is consistent with PURA."[94]

But because some undepreciated balance for Dolet Hills would remain on SWEPCO's books under any scenario suggested, a question arises—particularly given the Commission's treatment of Welsh Unit 2 in Docket No. 46449—regarding the extent to which that value should be included in SWEPCO's rate base, and thereby earn a return, for purposes of the rates set in this proceeding. SWEPCO urges that Docket No. 46449's treatment of Welsh Unit 2 has no application here because Dolet Hills provided service throughout the test year ending on March 31, 2020, whereas Welch Unit 2 had been retired before the end of the Docket No. 46449 test year.[95] The more applicable Commission precedent, according to Mr. Baird, is thus the preceding Docket No. 40443, in which Welsh Unit 2, still operating through the test year, was included in rate base despite SWEPCO's then-already-formulated plans to retire the plant while the rates would be in effect (although the Commission, unlike in this case, deferred deciding the prudence of that retirement).[96]

The Commission's Cost of Service Rule, 16 Texas Administrative Code (TAC) § 25.231, permits post-test-year adjustments for known and measurable rate-base decreases relative to test-year data (such as with the four May 2020 gas-unit retirements discussed above). However, as SWEPCO emphasizes, Section 25.231(c)(2)(F)(iii) of the rule prescribes that such adjustments can be made "*only when* . . . [t]he decrease represents . . . [p]lant that has been removed from service, mothballed, sold, or removed from the electric utility's books *prior to the rate year*."[97] The "rate year" in this case, as SWEPCO observes, begins on March 18, 2021, the relate-back date from

---

[94] SWEPCO Initial Brief at 11 (citing Docket No. 48577, Order, FoF No. 54 (Feb. 28, 2019)).

[95] SWEPCO Ex. 36 (Baird Reb.) at 18; *see* Docket No. 46449, Order on Rehearing, FoF Nos. 7, 65 (findings that Welsh Unit 2 was retired in April 2016 and that the historical test year ended on June 30, 2016).

[96] SWEPCO Ex. 36 (Baird Reb.) at 18; *see* Docket No. 40443, Order on Rehearing, FoF Nos. 119, 124, 125, 125A (Mar. 6, 2014).

[97] SWEPCO Ex. 36 (Baird Reb.) at 7; 16 TAC § 25.231(c)(2)(F)(iii) (emphases added).

which the rates ultimately approved in this case will be effective.[98] As of that date, Dolet Hills was undisputedly still operating (unlike the gas units). Consequently, SWEPCO reasons, Dolet Hills must remain in rate base for purposes of the rates set in this proceeding, including paying a return on that investment to SWEPCO, for so long as those rates remain in effect, without regard to the plant's retirement in the meantime. As Mr. Baird put it, "[t]he Commission's rules are clear that a plant in service at the beginning of the rate year will be included in rate base and thus receive a full return."[99] (A corollary, according to SWEPCO, is that its excess-ADFIT-offset proposal would confer the further benefit to customers of significantly reducing the rate base on which they would otherwise have to pay a return).[100]

It follows, in SWEPCO's view, that its Oxbow mine investment should also be included in rate base for purposes of the rates set in this proceeding, and that it should likewise continue recovering return on equity and associated taxes for DHLC.[101] Although acknowledging that mining of additional lignite ceased in May 2020, SWEPCO argues that its Oxbow investment has not been removed from service but will continue providing benefit to customers through Dolet Hills' retirement, as previously mined lignite is burned to produce electricity.[102] Similarly, SWEPCO reasons that DHLC has continued to exist and to deliver previously-mined lignite to Dolet Hills, such that SWEPCO has continued to incur the associated non-eligible fuel expense.[103]

Staff, CARD, ETEC/NTEC, Nucor, OPUC, Sierra Club, and TIEC all oppose aspects of SWEPCO's proposal. Generally, these parties advocate one or more adjustments in reliance on, and similar in effect to, Docket No. 46449's rate treatment of the retired Welsh Unit 2, at least

---

98 SWEPCO Ex. 36 (Baird Reb.) at 6, 18; *see* 16 TAC § 25.5(101) (defining "rate year" under the Commission's rules, in relevant part, as "[t]he 12-month period beginning with the first date that rates become effective").

99 SWEPCO Ex. 36 (Baird Reb.) at 7.

100 SWEPCO Ex. 36 (Baird Reb.) at 14.

101 SWEPCO Ex. 6 (Baird Dir.) at 37, 47.

102 SWEPCO Reply Brief at 5-6; SWEPCO Ex. 36 (Baird Reb.) at 21.

103 SWEPCO Reply Brief at 5-6; SWEPCO Ex. 36 (Baird Reb.) at 21.

with respect to the period after Dolet Hills' retirement.[104] However, they differ somewhat in their precise reasoning and the specific adjustments they propose.

c. Staff's Position

Staff argues that SWEPCO should be allowed to recover return and depreciation associated with the Dolet Hills plant only for the period between the rates' March 18, 2021 effective date through the plant's December 31, 2021 retirement.[105] This recovery would occur over the four-year period in which the rates are presumed to remain in effect.[106] But SWEPCO's recovery for periods following Dolet Hills' retirement would be limited—similar to Welsh Unit 2 in Docket No. 46449—to recovery *of* the remaining plant investment, but no return *on* it, amortized over the asset's 2046 useful life.[107] More specifically, upon Dolet Hills' retirement, Staff would remove from rate base the net book value of the plant then remaining, as well as that of the Oxbow investment, and place the plant balance in a regulatory asset whose value would be returned to SWEPCO in accord with the plant's previously established 2046 useful life.[108]

According to Ms. Stark, the Commission should in these ways follow the "early retirement" precedent of Welsh Unit 2 in Docket No. 46449.[109] Although she acknowledged "Welsh Unit 2 was retired prior to the end of the test year in Docket No. 46449 [whereas] the Dolet Hills plant is still in service," Ms. Stark pointed out that the Dolet Hills retirement also differs from the posture of the then-anticipated Welsh Unit 2 retirement as presented in the earlier Docket No. 40443, in that the Dolet Hills retirement will occur during the rate year associated with this proceeding.[110]

---

104 Staff, OPUC, CARD, ETEC/NTEC, and TIEC also propose adjustments to reduce O&M or other expenses related to Dolet Hills. Although these proposals overlap with or rely on much the same logic as with their arguments concerning capital investment, they are addressed below in connection with other expense-related issues.

105 Staff Initial Brief at 5, 7; Staff Ex. 3 (Stark Dir.) at 25.

106 Staff Ex. 3 (Stark Dir.) at 25.

107 Staff Initial Brief at 7; Staff Ex. 3 (Stark Dir.) at 25.

108 Staff Initial Brief at 7; Staff Ex. 3 (Stark Dir.) at 25.

109 Staff Ex. 3 (Stark Dir.) at 24 ("While Welsh Unit 2 was retired prior to the end of the test year in Docket No. 46449, the Dolet Hills plant is still in service.").

110 Staff Ex. 3 (Stark Dir.) at 24.

Moreover, she emphasized, the retirement will occur only about two months after the Commission is anticipated to issue its final order in this proceeding, meaning that the costs SWEPCO requests in its revenue requirement with respect to Dolet Hills will be "outdated" for most of the period in which the rates are expected to remain in effect.[111] "These circumstances," urged Ms. Stark, "suggest that the Commission should address the retirement of Dolet Hills in this case, not four years from now when SWEPCO would have recovered in excess of $138,000 million [by her calculation] from its ratepayers for a plant that did not provide service to them for the majority of that time period."[112] She further suggested that the additional anticipated retirement of the Pirkey plant in March 2023, also during the period in which the rates are expected to remain in effect, was an additional consideration warranting that the Commission address Dolet Hills in this proceeding.[113]

While tacitly acknowledging that Staff's proposed rate-base adjustments for Dolet Hills are inconsistent with the Cost of Service Rule's limitations on post-test-year rate-base reductions, Ms. Stark maintained that SWEPCO's proposal had itself deviated from Section 25.231(c)(2)(F)(iii)(II) by reducing the Dolet Hills end-of-test-year plant balance in rate base.[114] Consequently, she explained, she had "assum[ed] SWEPCO was requesting an exception [to the rule] by its own proposal," further observing that "[t]he Commission makes exceptions to its rules all the time."[115] In that context, Ms. Stark was "just responding to SWEPCO's proposal."[116]

Nor would a GAAP-prescribed accounting treatment be a bar to Staff's proposed amortization schedule, according to Ms. Stark, because the Commission's Cost of Service Rule explicitly authorizes "[o]ther means of depreciation . . . when it is determined that such

---

111 Staff Ex. 3 (Stark Dir.) at 24, 27.

112 Staff Ex. 3 (Stark Dir.) at 24.

113 Staff Ex. 3 (Stark Dir.) at 27.

114 Staff Ex. 3 (Stark Dir.) at 24-25; Tr. at 409-10.

115 Tr. at 417-18; *see* 16 TAC § 25.3(b) ("The commission may make exceptions to this chapter for good cause.").

116 Tr. at 418.

depreciation methodology is a more equitable means of recovering the cost of the plant."[117] And considerations supporting the continued use of the 2046 projected useful life, in Ms. Stark's view, include the Commission's approval in Docket No. 46449 of SWEPCO's substantial investments in environmental retrofits to Dolet Hills—approximately 39% of the plant's test-year-end total book value—with the expectation that those costs would be recovered through 2046 and not the compressed time frame SWEPCO now seeks.[118]

Ms. Stark also criticized SWEPCO's offset proposal as "greatly benefit[ting] [SWEPCO] to the detriment of ratepayers."[119] She recommended instead that SWEPCO be made to refund the excess ADFIT to its customers, first by crediting the balance against any amount owed by the Company's customers because of the March 18, 2021 relate-back date in this proceeding, and then return the remainder over a six-month period with carrying charges at the same WACC that is determined in this proceeding.[120]

Although citing the anticipated 2023 Pirkey retirement as a justification for addressing the Dolet Hills retirement in this proceeding, Ms. Stark did not recommend making further cost-of-service adjustments based on that subsequent retirement, reasoning that the posture of the Pirkey retirement (unlike Dolet Hills') is materially similar to Welsh Unit 2 in Docket No. 40443 and that its projected retirement date is also much less certain.[121] Instead, she recommended that the Commission address the Pirkey retirement by ordering SWEPCO to file monthly earnings reports every six months following that unit's retirement until SWEPCO files its next base rate case, "to ensure that any potential overearnings related to the plant's early retirement are dealt with in a timely manner."[122] However, Ms. Stark also presented several potential alternatives to her

[117] Tr. at 415; *see* 16 TAC § 25.231(b)(1)(B).

[118] Staff Ex. 3 (Stark Dir.) at 26.

[119] Staff Ex. 3 (Stark Dir.) at 24-25, 29.

[120] Staff Ex. 3 (Stark Dir.) at 46-47. Ms. Stark also takes issue with SWEPCO's calculation of its excess ADFIT balances. Staff Ex. 3 (Stark Dir.) at 44. Those issues, again, are addressed below.

[121] Staff Ex. 3 (Stark Dir.) at 27-28.

[122] Staff Ex. 3 (Stark Dir.) at 28.

proposed treatments of Dolet Hills and Pirkey. The Commission could: (1) in its final order, require SWEPCO to file another rate case in June 2022 using a December 31, 2021 test-year-end, and then another in September 2023 using a March 31, 2023, to coincide with the Dolet Hills and Pirkey retirement dates[123]; (2) leave open the appropriate time for SWEPCO's next post-retirement rate case(s) and later act as warranted based on SWEPCO's monthly earnings monitoring reports; (3) require SWEPCO to begin recording regulatory liabilities for costs incurred in the revenue requirement associated with Dolet Hills and Pirkey beginning on the plants' respective retirement dates (a mechanism proposed by CARD and ETEC/NTEC, as discussed below); or (4) require a step-down of SWEPCO's rates in January 2022 and April 2023 to recognize the plants' early retirements.[124]

d. OPUC's Position

Similar to Staff, and likewise relying on Docket No. 46449's treatment of Welsh Unit 2, OPUC proposes that SWEPCO be allowed to recover a return on Dolet Hills only through the plant's retirement date and thereafter recover only the plant's remaining net book value, without a return or offset, with depreciation or amortization based on the asset's 2046 useful life.[125] OPUC would accomplish this, however, by removing the return on the plant from base rates altogether (although leaving in base rates the annual amortization of the plant's remaining net book value) and charging it through a rate rider that would be discontinued upon the plant's retirement.[126] According to OPUC witness Constance Cannady, the rate rider would have the advantage of allowing SWEPCO to recover costs related to the operation of the Dolet Hills plant during the period in which that asset continued to provide service, but not beyond, without need to revise

---

[123] While acknowledging that "these proceedings would necessitate the incurrence of rate-case expenses," Ms. Stark maintained that "those expenses should still be much less than the costs of Dolet Hills and Pirkey included in SWEPCO's requested revenue requirement in this case." Staff Ex. 3 (Stark Dir.) at 28.

[124] Staff Ex. 3 (Stark Dir.) at 28.

[125] OPUC Initial Brief at 3-6; OPUC Ex. 1 (Cannady Dir.) at 11-20.

[126] OPUC Ex. 1 (Cannady Dir.) at 11-12, 20. Ms. Cannady similarly proposed that SWEPCO's lignite inventory for Dolet Hills be included in the rider. OPUC Ex. 1 (Cannady Dir.) at 13, 29-30. The ALJs address issues relating to the lignite inventory in the next subsection.

base rates upon the plant's retirement.[127] Ms. Cannady also urged that SWEPCO's return of the excess ADFIT "should be accomplished through a more transparent refund" than SWEPCO's proposed offset, one "that assures Texas retail customers receive the refund amounts resulting from the passage of the TCJA."[128]

OPUC also proposes similarly to remove SWEPCO's Oxbow mine investment from rate base and amortize recovery of its remaining net book value over the same period as with the Dolet Hills plant.[129] OPUC would also remove from base rates the expenses and associated taxes for DHLC.[130] These proposed adjustments, Ms. Cannady explained, reflected that: (1) the Commission had previously found SWEPCO's Oxbow mine investment to be prudent, such that SWEPCO should recover its value; but (2) mining operations had ceased, such that the Oxbow mine and DHLC, in her view, were no longer used and useful in providing service to SWEPCO's customers.[131]

Regarding Section 25.231(c)(2)(F)(iii)(II)'s time limitation on post-test-year adjustments, OPUC urges that this condition should not bar its proposed rate rider under the circumstances—in substance a request for a good-cause exception[132]—because SWEPCO manipulated the timing of the rate year (also the Section 25.231(c)(2)(F)(iii)(II) deadline) "to maximize its returns on Dolet Hills at the expense of its customers."[133] OPUC points out that: (1) SWEPCO had decided in early 2020 to retire the Dolet Hills plant at the end of 2021[134]; (2) SWEPCO was not required to file a

[127] OPUC Ex. 1 (Cannady Dir.) at 20.

[128] OPUC Ex. 1 (Cannady Dir.) at 11.

[129] OPUC Initial Brief at 7-8; OPUC Ex. 1 (Cannady Dir.) at 21-27.

[130] OPUC Initial Brief at 8-9; OPUC Ex. 1 (Cannady Dir.) at 27-28.

[131] OPUC Ex. 1 (Cannady Dir.) at 22-28.

[132] *See* 16 TAC § 25.3(b) ("The commission may make exceptions to this chapter for good cause.").

[133] OPUC Initial Brief at 4-5; OPUC Reply Brief at 3.

[134] OPUC Initial Brief at 4 (citing SWEPCO Ex. 4 (Brice Dir.) at 6).

base-rate case until March 19, 2022[135]; and (3) SWEPCO (with awareness of its prior decision to retire Dolet Hills at the end of 2021) initiated the present base rate case roughly one-and-a-half years before the deadline,[136] which had the effect of commensurately accelerating the new rates' relate-back date (155 days after filing), and thus the beginning of the rate year, to a date that would precede the plant's retirement.[137] Had SWEPCO not accelerated the deadline in this way, OPUC observes, the Dolet Hills retirement would have preceded the test year and thereby been subject to post-test-year adjustment under Section 25.231(c)(2)(F)(iii)(II).[138] Under these circumstances, OPUC argues, SWEPCO "should not burden [its] ratepayers for three years with payments on Dolet Hills, especially when it is no longer used and useful in providing service to the public."[139]

Moreover, OPUC argues that its proposed adjustments regarding SWEPCO's Oxbow mine investment and DHLC independently comport with Section 25.231(c)(2)(F)(iii)(II), without need for the exception it advocates in regard to the Dolet Hills plant, because mining had ceased by May 2020, long before the rate year began in March 2021.[140]

e. CARD's Position

Similar to Staff and OPUC, CARD cites Docket No. 46449's rate treatment of the retired Welsh Unit 2 in arguing that SWEPCO should not earn a return on Dolet Hills after the plant's retirement.[141] However, in the view that Dolet Hills differs from Welsh Unit 2 in being retired between rate cases, CARD would address the Dolet Hills retirement by requiring SWEPCO to

---

135 Docket No. 49449, Order on Rehearing (Mar. 19, 2018); *see* 16 TAC § 25.246(c)(1)(A) (general deadline of "on or before the fourth anniversary of the date of the final order in the utility's most recent comprehensive base rate proceeding").

136 SWEPCO Ex. 1 (rate filing package, filed October 14, 2020).

137 OPUC Initial Brief at 4-5; OPUC Reply Brief at 3.

138 OPUC Initial Brief at 5.

139 OPUC Initial Brief at 5.

140 OPUC Initial Brief at 7-9.

141 CARD Initial Brief at 5-6; CARD Ex. 2 (M. Garrett Dir.) at 15-16. CARD similarly argues that SWEPCO's requested level of lignite inventory for Dolet Hills should be eliminated to account for the plant's retirement. This issue is addressed below, in conjunction with a broader challenge CARD brings regarding SWEPCO's method of determining target lignite and coal inventories.

establish a regulatory liability that accrues the post-retirement return it receives on the plant and refund that balance to customers through the rates implemented in SWEPCO's next rate case.[142] CARD asserts that this proposed regulatory liability "is a commonplace mechanism used in utility rate-making," observing that SWEPCO's excess AFDIT balances are themselves a regulatory liability that the Commission ordered created to account for the effects of the TCJA's corporate tax rate reduction.[143] To the extent this regulatory liability or rate-base adjustments to account for the Dolet Hills retirement could arguably violate Section 25.231(c)(2)(F)(iii)(II), CARD suggests the adjustments would still be within the Commission's discretion in setting "just and reasonable" rates.[144]

Regarding the remaining plant balance, CARD again cites Docket No. 46449 in urging that SWEPCO should continue to depreciate or amortize it in accord with the plant's 2046 useful life.[145] According to CARD witness Mark Garrett, utilities nationwide are experiencing "abnormally high investment levels" to comply with environmental regulations, including "stranded costs that result from early plant retirements," and Docket No. 46449 is representative of many regulatory decisions, including cases involving AEP affiliates, that have rejected proposals to accelerate recovery of those stranded costs.[146] A key rationale underlying those decisions, Mr. Garrett testified, has been "generational equity—the recognition that the entire cost should not be borne by current ratepayers, but instead, that future ratepayers should share in the costs of achieving a cleaner, safer environment because those future ratepayers are the primary beneficiaries of the

---

142 CARD Initial Brief at 5-6; CARD Ex. 2 (M. Garrett Dir.) at 15-16.

143 CARD Reply Brief at 4.

144 CARD Reply Brief at 8-9. CARD further contends that Section 25.231(c)(2)(F)(iii)(II) might be avoided entirely if the Commission's order in this case ultimately issues after the Dolet Hills retirement. This is so, CARD reasons, because the "rate year" actually begins on the date the Commission issues its final order, not on the March 18, 2021 relate-back date, leaving open the possibility that Dolet Hills might be retired before the order issues. CARD Reply Brief at 4, 8. However, the ALJs share the consensus view of SWEPCO, Staff, and other intervenors that the "rate year" in this case begins on the March 18, 2021 relate-back date, the date from which the rates to be implemented in this case become effective. *See* 16 TAC § 25.5(101) (defining "rate year" under Commission's rules, in relevant part, as "[t]he 12-month period beginning with the first date that rates become effective").

145 CARD Initial Brief at 3-6; CARD Ex. 2 (M. Garrett Dir.) at 5-14.

146 CARD Ex. 2 (M. Garrett Dir.) at 7 & n.3, 8-9, 13-14.

improvements."[147] Another rationale, he stated, has been a recognition "that by spreading the recovery of these costs into the future[,] opportunities arise to offset some of the costs with other savings" from "improved technologies, increased operating efficiencies, lower capital costs, or load growth," in addition to affording time for depreciation to reduce "rate bases that are currently inflated with environmental compliance costs . . . to more reasonable levels."[148] Mr. Garrett further asserted that SWEPCO's proposed offset and other acceleration of its recovery of "the Dolet Hills stranded costs" "would unduly increase costs for ratepayers at a time when it is least affordable," noting COVID-related financial distress and also the increased fuel costs resulting from the catastrophic winter weather events of February 2021.[149]

In Mr. Garrett's view, arguments that the useful life of an early-retiring plant should be the retirement date and depreciation recovered over the new shortened life, such as SWEPCO advances here, have "no merit."[150] Rather, he contended, both GAAP and "standard regulatory practice" would be to: (1) "move the unrecovered Dolet Hills balance to a regulatory asset account, to which "the depreciation rules no longer apply" because those rules "apply only to plant in service"; and (2) "recover that balance over whatever period the commission deems appropriate"—just as the Commission did with Welch Unit 2 in Docket No. 46449.[151]

f. ETEC/NTEC's Position

ETEC/NTEC argues that SWEPCO's recovery of Dolet Hills' remaining net book value should not be addressed until the plant is actually retired, in SWEPCO's next rate case, and ETEC/NTEC further specifically opposes accelerated or other special recovery of the plant's value while SWEPCO would also still be recovering ordinary depreciation and return on the plant.[152]

[147] CARD Ex. 2 (M. Garrett Dir.) at 7.

[148] CARD Ex. 2 (M. Garrett Dir.) at 7-9.

[149] CARD Ex. 2 (M. Garrett Dir.) at 7-8.

[150] CARD Ex. 2 (M. Garrett Dir.) at 12-13.

[151] CARD Ex. 2 (M. Garrett Dir.) at 13-14 & n.13.

[152] ETEC/NTEC Initial Brief at 6-7.

However, to the extent the Commission "is inclined to grant special ratemaking treatment given the imminent retirement of Dolet Hills," ETEC/NTEC offers an "alternative proposal"—amortize Dolet Hills' remaining book value over 33 years, the average remaining life of the composite group of SWEPCO's coal and lignite-burning generating assets.[153] ETEC/NTEC further joins with other parties in urging that SWEPCO not be permitted to earn a return on that remaining investment.[154]

According to ETEC/NTEC witness Steven Hunt, a former FERC Chief Accountant and Director of the agency's Division of Audits and Accounting,[155] this rate treatment is consistent with both the USofA and Docket No. 46449's treatment of Welsh Unit 2.[156] He elaborated that a debit balance in Accumulated Depreciation resulting from the accounting entry following a plant retirement would be "incorporated in future determinations of depreciation on the composite group of assets over [the group's] average remaining life," which in Dolet Hills' case was 33 years.[157] Mr. Hunt further opined that while the USofA permitted "significant unrecovered costs of a prematurely retired asset . . . to be recorded as a regulatory asset when approved by the Commission," as SWEPCO was seeking to do, this "should not result in an acceleration of the amortization period compared to the rate effect of recording the unrecovered amount in accumulated depreciation."[158] To the extent FERC or Commission rules would require accelerated depreciation of a retiring plant, Mr. Hunt maintained that such requirements should yield to the overarching requirements that rates be just and reasonable and in the public interest.[159]

ETEC/NTEC likewise opposes SWEPCO's proposed offset of excess ADFIT, instead favoring refunding the amounts to customers over the four-year period in which the rates are

---

[153] ETEC/NTEC Initial Brief at 6-9; ETEC/NTEC Ex. 1 (Hunt Dir.) at 9-11.

[154] ETEC/NTEC Reply Brief at 7.

[155] ETEC/NTEC Ex. 1 (Hunt Dir.) at 1-3.

[156] ETEC/NTEC Ex. 1 (Hunt Dir.) at 9-11.

[157] ETEC/NTEC Ex. 1 (Hunt Dir.) at 10-11.

[158] ETEC/NTEC Ex. 1 (Hunt Dir.) at 10.

[159] Tr. at 322-23.

expected to remain in effect.[160] In Mr. Hunt's view, the excess ADFIT owing to SWEPCO's customers and cost recovery for Dolet Hills present two separate and unrelated rate issues.[161]

ETEC/NTEC would also require SWEPCO to defer its actual Dolet Hills demolition and removal costs as a regulatory asset, to be addressed in SWEPCO's next rate proceeding, rather than factoring estimated costs into its calculation of net book value.[162]

g. TIEC's Position

Relying on the analysis of its witness Billie LaConte, TIEC argues that SWEPCO's proposal is "internally inconsistent" in seeking accelerated cost recovery and special ratemaking treatment for Dolet Hills based on the plant's impending retirement, yet also treating the plant as if fully operational by including a return on the plant.[163] Instead, urged Ms. LaConte, the rates "should either be based on the assumption that (1) Dolet Hills is an operational plant or (2) Dolet Hills has been retired."[164] Under either assumption, Ms. LaConte maintained, SWEPCO's proposal would be inconsistent with the Commission precedent addressing Welsh Unit 2.[165]

Regarding the operational-plant assumption, Ms. LaConte observed that in Docket No. 40443 the Commission refused SWEPCO's request to accelerate depreciation of the remaining undepreciated plant costs so as to recover them by the anticipated 2016 retirement date rather than the plant's original useful life through 2040. Instead, the Commission left the anticipated

---

160 ETEC/NTEC Initial Brief at 10-11; ETEC/NTEC Ex. 1 (Hunt Dir.) at 7-8.

161 ETEC/NTEC Ex. 1 (Hunt Dir.) at 7-8.

162 ETEC/NTEC Initial Brief at 13; ETEC/ETEC Ex. 1 (Hunt Dir.) at 11-12. ETEC/NTEC also complains that SWEPCO has increased its depreciation rate and expense for Dolet Hills by 23% and urges that SWEPCO should continue using the rate approved in Docket No. 46449. ETEC/NTEC Initial Brief at 12-13; ETEC/NTEC Ex. 1 (Hunt Dir.) at 13-14. Informed by the rebuttal testimony of SWEPCO's Jason Cash, SWEPCO Ex. 43 (Cash Reb.) at 4-5, the ALJs understand ETEC/NTEC's argument to refer to an implication of the four-year amortization SWEPCO proposes, and thus do not address it separately.

163 TIEC Initial Brief at 3-5; TIEC Ex. 4 (LaConte Dir.) at 8.

164 TIEC Ex. 4 (LaConte Dir.) at 9.

165 TIEC Ex. 4 (LaConte Dir.) at 9-10.

retirement date unchanged until the Commission could evaluate the prudence of the retirement in a future rate proceeding.[166] Accordingly, she reasoned, a "reasonable alternative [under the operational-plant assumption] would be to include the plant in base rates in this case, using its current expected retirement date of 2046, and to address any subsequent cost recovery after the plant has been retired."[167] Alternatively, were Dolet Hills to be treated as if retired, she urged that the Docket No. 46449 precedent would require SWEPCO to remove the plant from rate base; place the plant's remaining undepreciated balance in a regulatory asset; and amortize SWEPCO's recovery of that balance, without a return, through 2046.[168] While either option is reasonable in its view, TIEC argues that the Commission should treat Dolet Hills as a retired plant under the circumstances presented.[169]

Ms. LaConte further opined that there would be good cause to remove Dolet Hills from rate base (*i.e.*, for an exception to Section 25.231(c)(2)(F)(iii)(II)) considering: (1) the "significant and unusual" dimensions of the plant's unamortized balance due to the 25-year acceleration of retirement date and the inclusion of the recent retrofits that were to be recovered over the asset's useful life ending in 2046; (2) that the plant will be in service for at most nine months after rates are effective in this case; (3) significant additional unrecovered fixed costs associated with the Oxbow and Dolet Hills mines; and (4) the approaching 2023 Pirkey retirement, or others that may follow, which will present similar early-retirement cost-recovery problems and issues.[170] Additionally, similar to OPUC, TIEC points to SWEPCO's choice to file its rate case with "timing [that] facilitates SWEPCO's central contention . . . that it is entitled to a return on the remaining balance of [Dolet Hills] because the plant will be operational during the rate year."[171]

---

166 TIEC Ex. 4 (LaConte Dir.) at 9-10 (citing Docket No. 40443, Order on Rehearing, FoF Nos. 198-199 (Mar. 6, 2014); Docket No. 40443, PFD at 176-77 (May 20, 2013)).

167 TIEC Ex. 4 (LaConte Dir.) at 10, 13.

168 TIEC Ex. 4 (LaConte Dir.) at 10-11, 13.

169 TIEC Initial Brief at 3.

170 TIEC Ex. 4 (LaConte Dir.) at 11-12.

171 TIEC Initial Brief at 10-11.

Finally, Ms. LaConte recommended that the Commission reject SWEPCO's offset proposal, urging that the matter of TCJA excess ADFIT "is not related to the impending retirement of Dolet Hills," but is money over-collected from and owed to customers—since 2018—and would be so regardless how the Commission decides to treat the plant retirement.[172] She proposed that SWEPCO "promptly" refund the excess ADFIT to customers over one year, with carrying costs calculated using SWEPCO's regulated rate of return, on the balance from the relate-back date.[173]

h. Sierra Club's Position

Although Sierra Club did not file testimony in opposition to SWEPCO's proposed rate treatment of Dolet Hills,[174] in briefing it joins with other parties in opposing SWEPCO's recovery of a return on the remaining undepreciated value of that asset, citing the Commission's treatment of Welsh Unit 2 in Docket No. 46449.[175] Further, alluding to its opposition to the environmental retrofit costs that the Commission ultimately approved in that docket, Sierra Club urges that the Commission "should not allow [SWEPCO] to collect a 'return on' those ill-conceived (and soon-to-be-unused) retrofit investments," as "[d]oing so would serve only to further encourage risky and potentially unnecessary investments in marginally economical assets."[176]

---

172 TIEC Ex. 4 (LaConte Dir.) at 8, 14-15.

173 TIEC Ex. 4 (LaConte Dir.) at 14-17; Tr. at 356-57.

174 Sierra Club Ex. 2A (Glick Dir., redacted) at 11 (explaining that her testimony "focuse[d] solely on the economic performance and the operational and planning practices at the Flint Creek and Welsh units" and did not evaluate Dolet Hills).

175 Sierra Club Initial Brief at 22.

176 Sierra Club Initial Brief at 22-24. Sierra Club also seeks adjustments to eliminate or reduce SWEPCO's test-year new capital spending at Dolet Hills. Sierra Club Initial Brief at 16-19. This challenge is addressed separately below.

The remaining intervenor to oppose SWEPCO's proposal, Nucor, filed briefing supporting "the consensus of the testifying parties other than SWEPCO [that] the Commission should reject [SWEPCO's] proposed accelerated depreciation plan and instead require that SWEPCO recover the remaining costs over a longer period of time, such as the [previously established] useful life, through 2046," including rejecting SWEPCO's offset proposal. Nucor Initial Brief at 2-3. Accordingly, Nucor's position is not discussed separately.

i. SWEPCO's Responses

In addition to arguments noted previously, SWEPCO urges that all rival proposals that would directly or indirectly remove Dolet Hills or its Oxbow investment from rate base would violate Section 25.231(c)(2)(F)(iii)(II) because those assets, unlike Welsh Unit 2 in Docket No. 46449, were still providing service through the first day of the rate year.[177] Nor, SWEPCO insists, is there any justification for the Commission to depart from "the clear requirements of the Cost of Service rule."[178] SWEPCO disputes Ms. Stark's assertion that its offset proposal violates Section 25.231(c)(2)(F)(iii)(II), observing that other Cost of Service Rule provisions prescribe that ADFIT is to be deducted from invested capital when determining rate base.[179] SWEPCO acknowledges, however, that its proposal to offset the value of a single asset differs from the historically accepted deduction from rate base as a whole,[180] a distinction that CARD emphasizes in arguing that the Cost of Service Rule does not permit linkage to a specific rate-base item.[181] TIEC would also distinguish *excess* ADFIT, such as SWEPCO proposes to offset here, which represents taxes that customers have paid through rates yet which the utility will never have to pay, as contrasted with ADFIT resulting from mere timing differences between the utility's collection of taxes through rates and its tax payments.[182]

As for any strategic tailoring of its timing in filing this case, Mr. Brice acknowledged that SWEPCO's early filing had resulted in Dolet Hills operating during a portion of the rate year and that this fact is integral to the arguments it now makes regarding Section 25.231(c)(2)(F)(iii)(II).[183] However, he denied that this had been a consideration for SWEPCO when choosing when to file

[177] SWEPCO Initial Brief at 7-10; SWEPCO Reply Brief at 1-4, 22.

[178] SWEPCO Reply Brief at 3.

[179] SWEPCO Reply Brief at 2-3; *see* 16 TAC § 25.231(c)(2)(C)(i).

[180] SWEPCO Reply Brief at 3.

[181] CARD Reply Brief at 5-6.

[182] TIEC Reply Brief at 3-4.

[183] Tr. at 70-71.

the case, insisting that the timing was a function of SWEPCO's inability to earn a reasonable return in excess of its operating costs.[184]

SWEPCO also emphasizes the concept that utility customers do not pay for any specific asset used to provide service, only for the service itself.[185] It follows, SWEPCO reasons, that its customers will not in any relevant sense be made to "pay for" Dolet Hills after its retirement any more that they could be said to receive service "free of charge" from generating assets that are not yet included in rate base.[186] In this regard, SWEPCO observes that the temporal cut-off in Section 25.231(c)(2)(F)(iii)(II) serves a sound regulatory purpose, as Mr. Brice testified:

> [A] utility's rate base continually changes—existing investment is depreciated over time, investment is retired, and investment is added. If the Commission is going to use actual historical investment to set rates, a line must be drawn after which the Commission will no longer allow changes to test year investment. The Commission has drawn that line with the date that the new rates become effective—the beginning of the rate year.[187]

And if SWEPCO's rate base should be reduced based on Dolet Hills' retirement, Mr. Brice added, it follows logically that SWEPCO's rate base should likewise be increased for any new investment placed in service between the March 31, 2020 test-year end and that retirement.[188] Absent the corresponding increase, he argued, the effect of the "asymmetry" would be to deprive SWEPCO of its opportunity to earn a reasonable return on its invested capital, because "in [his] experience rate base tends to increase over time, not decrease."[189] In fact, SWEPCO points out, since the

---

184 Tr. at 71.

185 SWEPCO Reply Brief at 1 (quoting *Board of Pub. Util. Comm'n v. New York Tel. Co.*, 271 U.S. 23, 32 (1926) ("Customers pay for service, not for the property used to render it.")).

186 SWEPCO Reply Brief at 7-8; SWEPCO Ex. 33 (Brice Reb.) at 11. To emphasize the point, SWEPCO observes that the Dolet Hills plant was in service for approximately twenty-five years before SWEPCO sought and obtained a corresponding adjustment to its Texas base rates. SWEPCO Ex. 33 (Brice Reb.) at 5-6, 11. To the extent this would be an appeal for a corresponding inverse treatment of Dolet Hills, Staff urges that "[i]f SWEPCO felt that it was not earning a sufficient return without Dolet Hills included in rates, SWEPCO could have come in for a rate case at any time during those 25 years." Staff Reply Brief at 6-7.

187 SWEPCO Ex. 33 (Brice Reb.) at 9.

188 SWEPCO Ex. 33 (Brice Reb.) at 10.

189 SWEPCO Ex. 33 (Brice Reb.) at 10.

March 31, 2021 test-year end, its gross plant has increased by $244 million while its net plant has increased by $88 million, increases that will continue through the time of the Dolet Hills retirement.[190]

Consequently, SWEPCO contends, there is "simply no evidence" or reason to assume that its overall cost of service to customers will necessarily decrease following the Dolet Hills retirement.[191] And regardless, it suggests, that risk would be one inherent to Texas cost-of-service ratemaking and shared by both a utility and its customers.[192] As Mr. Baird testified:

> The reality is, in Texas regulation, there is lag between rate cases. If the lag goes in [SWEPCO's] favor[,] that will show up in the annual Earnings Monitoring Report (EMR) via an actual return on equity that is higher than the approved return on equity, [and] then the Commission can call SWEPCO in for a rate case. If the lag goes in the customer's favor, that too will show up in the annual EMR via an actual return on equity that is lower that the approved return on equity. At that time, [SWEPCO] has the ability to file a base rate case.[193]

In fact, SWEPCO emphasizes, Ms. Stark suggested this very option—waiting and watching SWEPCO's earnings-monitoring reports, intervening only when and if warranted by SWEPCO's actual performance—as an alternative means by which the Commission could address any issues arising from the retirement of Dolet Hills, or the subsequent Pirkey retirement.[194]

Additionally, SWEPCO argues that denying it a return on its Dolet Hills and Oxbow investment, or its proposed means of accelerating recovery, would unfairly "penalize" it for its prudent decision to retire the plant, by leaving it with a large undepreciated balance—from investments that the Commission had also found prudent—on which it would lose its costs of

---

190 SWEPCO Reply Brief at 8 (citing SWEPCO Ex. 33 (Baird Reb.) at 17).

191 SWEPCO Initial Brief at 10.

192 SWEPCO Ex. 36 (Baird Reb.) at 17-18.

193 SWEPCO Ex. 36 (Baird Reb.) at 17-18.

194 SWEPCO Reply Brief at 3-4 (citing Staff Ex. 3 (Stark Dir.) at 28).

capital.[195] Nor would recovery over the 2046 useful life serve "intergenerational equity" in SWEPCO's view, reasoning that Dolet Hills' costs should properly be borne by the current customers who have been served by the plant (and from whom the excess ADFIT was collected) rather than future customers who will not be.[196] And Docket No. 40443 does not require that treatment here, SWEPCO argues, reasoning that the Commission made no change to Welsh Unit 2's depreciable service life in that case because the Commission deferred the prudence of the unit's retirement until SWEPCO's next base rate case.[197] By contrast, as SWEPCO emphasizes, the Commission's Preliminary Order in this case includes the prudence of Dolet Hills' retirement among the issues to be addressed.[198] Consequently, SWEPCO reasons, the Commission can (and should) allow SWEPCO a more expeditious recovery of its investment in Dolet Hills, given the plant's now-shortened useful life. It adds that the same treatment would also be appropriate in regard to Pirkey or the remaining Welsh Units, to the extent future changes involving those units are considered in this proceeding.[199]

j. ALJs' Analysis

i. Rate-Base Reduction

The most pivotal question presented here distills to whether or how the Commission's rate treatment of Welsh Unit 2 in Docket No. 46449 should also guide its treatment of Dolet Hills in light of that plant's imminent retirement. On one hand, the Dolet Hills retirement, once it occurs, will squarely implicate the substantive principles that guided the Commission in Docket No. 46449—namely, that a retired plant is not considered a "used and useful" investment properly included in rate base under PURA and Commission rules, and that "the interests of ratepayers and shareholders with respect to a plant that no longer provides service" are properly balanced by

---

195 SWEPCO Reply Brief at 4-6, 9-10.

196 SWEPCO Reply Brief at 6-7.

197 SWEPCO Reply. Brief at 8-9 (citing Docket No. 40443, Order on Rehearing, FoF No. 125A (Mar. 4, 2014)).

198 SWEPCO Reply Brief at 9; *see* Preliminary Order ¶ 67.

199 SWEPCO Reply Brief at 9.

"[a]llowing [the utility] a return on, but not of, its remaining investment."[200] Yet the circumstances of the Dolet Hills retirement plainly differ from those of Welsh Unit 2 in Docket No. 46449, which had been retired before the test-year end (although they do not quite match the circumstances of Welsh Unit 2 in Docket No. 40443, either). It is likewise true that, as SWEPCO emphasizes, Section 25.231(c)(2)(F)(iii)(II) would preclude a rate-base reduction based on the Dolet Hills retirement because the plant has remained in service into the rate year. But the Commission has left itself discretion to make exceptions to Section 25.231(c)(2)(F)(iii)(II) or other Chapter 25 requirements where it finds "good cause."[201] So, is there "good cause" here for the Commission to make an exception and a post-test-year reduction to SWEPCO's rate base to reflect the Dolet Hills retirement? Or stated another way, which set of governing principles now in conflict—the substantive principles of Docket No. 46449 relating to retired generating plants, versus Section 25.231(c)(2)(F)(iii)(II)'s timing restriction—should prevail?

As SWEPCO points out, the Section 25.231(c)(2)(F)(iii)(II) timing restriction is no mere empty formalism, but serves important and beneficial regulatory purposes in the context of ratemaking founded principally on actual data from an historical test year. In such a regime, as Mr. Brice observed, the Commission must necessarily draw *some* temporal cut-off line for post-test-year rate-base adjustments, and it has done so in Section 25.231(c)(2)(F)(iii)(II)—the start of the rate year.[202] It is also true, as Mr. Brice pointed out, that rate base is somewhat a moving target and that one-sided (or "asymmetrical," as he termed it) rate-base reductions without corresponding increases for new capital can potentially distort a utility's earnings relative to cost of service.[203] Likewise, as Mr. Baird testified, a certain amount of regulatory lag is inherent in the system and, in theory, both utility and customers bear the risk that post-test-year events may not go their way.[204]

---

200 Docket No. 46449, Order on Rehearing, FoF Nos. 66, 68, 69, 71 (Mar. 19, 2018); PFD at 94 (Sep. 22, 2017).

201 16 TAC § 25.3(b).

202 SWEPCO Ex. 33 (Brice Reb.) at 9.

203 SWEPCO Ex. 33 (Brice Reb.) at 10.

204 SWEPCO Ex. 36 (Baird Reb.) at 17-18.

Yet bright-line rules like Section 25.231(c)(2)(F)(iii)(II) bring the potential for arbitrary effect in a particular case, both with regard to the rule's own underlying purposes and broader fundamental policies of the surrounding regulatory scheme—like the principles that utility rates should include only assets and expenses that are used and useful in providing service and must ultimately be just and reasonable. In this case, Section 25.231(c)(2)(F)(iii)(II), applied as written, would bar the Commission from making a rate-base reduction to reflect a plant retirement occurring just over nine months past the rule's start-of-rate-year deadline, not to mention mere weeks (at most) after the Commission's final order issues. The consequence would be to leave a power plant in rate base for what is expected to be more than four years until SWEPCO's next base-rate case, with customers paying a return, as with a fully operational plant, even though the plant will be retired and thus not providing service for over three years of that period.

These outcomes are especially arbitrary considering that the Section 25.231(c)(2)(F)(iii)(II) deadline precedes the Dolet Hills retirement not because of mere random chance, the Commission's normal timetables for filing base-rate cases, or even the timing of the retirement in itself, but because SWEPCO chose to file this base rate case over one-and-a-half years before it was required to do so. Had SWEPCO waited until its March 19, 2022 deadline to file, or even until sometime after July 2021, the beginning of the rate year (the relate-back date, 155 days after filing) would have fallen after the December 31, 2021 Dolet Hills retirement date, such that a post-test-year rate-base reduction would undisputedly have been allowed under Section 25.231(c)(2)(F)(iii)(II). The ALJs will take Mr. Brice at his word in professing that SWEPCO did not time its filing to achieve any such tactical benefit, but was driven merely out of concern with the utility's perceived inability to earn a reasonable return in excess of its operating costs.[205] Even so, ascribing outsized significance to the Section 25.231(c)(2)(F)(iii)(II) deadline under these circumstances would invite such manipulation in the future by utilities anticipating retirements of generation units (and the implications of Docket No. 46449 upon retirement), particularly units being retired early or otherwise with substantial remaining net book value.

[205] Tr. at 71.

Which brings the ALJs to the next factor weighing in favor of finding good cause—the sheer size of the asset in question. While it may be true in theory that SWEPCO's customers pay for service and not the Dolet Hills plant itself or any other specific asset used to provide that service, they would still be paying a return on tens of millions in capital investment—approximately $122.8 million on a total company basis, or approximately $45.4 million Texas retail—that will not be providing them any of that service for the vast majority of the period in which the rates are expected to remain in effect. Although SWEPCO insists there is a possibility of offsetting new capital investment, it cites a figure ($88 million) that would be dwarfed by the effect of the Dolet Hills retirement.[206] Moreover, to the extent SWEPCO would have legitimate concerns about under-recovery following an "asymmetrical" rate-base reduction to account for the Dolet Hills retirement, Staff and CARD point out that SWEPCO now has resort to interim mechanisms through which it can update its rates to account for new capital investment—the GCRR, the TCRF, and the DCRF.[207]

As for SWEPCO being unfairly "penalized" by being denied recovery of its cost of prudently invested capital, this is less a justification for enforcing Section 25.231(c)(2)(F)(iii)(II) than a complaint about Docket No. 46449's holdings. As observed in regard to the retired gas units, the ALJs conclude they should follow Docket No. 46449 unless and until the Commission or the Legislature instructs otherwise. And as weighed against the policies reflected in Docket No. 46449 and PURA's broader directive of just and reasonable rates, the ALJs conclude that the timing requirement of Section 25.231(c)(2)(F)(iii)(II) should yield under the circumstances of this case. That is to say, the ALJs recommend that the Commission find good cause to make an exception to Section 25.231(c)(2)(F)(iii)(II), and in turn to make post-test-year adjustments to remove Dolet Hills from rate base in light of its retirement.

---

206 SWEPCO Reply Brief at 8 (citing SWEPCO Ex. 33 (Baird Reb.) at 17).

207 Staff Reply Brief at 6 (citing 16 TAC §§ 25.239, .243, .248); CARD Reply Brief at 5 (citing same). As Staff notes, "it is unlikely that the GCRR would provide for an update to remove a retired Dolet Hills facility." Staff Reply Brief at 6.

But the logic of Docket No. 46449 also implies that, likewise, SWEPCO should be permitted to continue earning a return on Dolet Hills so long as it is used and useful in providing service to customers. Indeed, this was the prevailing view among Staff and most intervenors who briefed the issue, and the ALJs share it. Accordingly, the ALJs recommend that, essentially, Dolet Hills be treated for ratemaking purposes as an operational, used and useful, power plant, including earning a return on the plant's net book value, with respect to the period between March 18, 2021 (the rates' effective date) and December 31, 2021 (the plant's retirement), but not thereafter.

ii. Depreciation/Amortization Schedule

The next question to be addressed, also pivotal in resolving this case, concerns SWEPCO's recovery *of* (as opposed to the return *on*) Dolet Hills' remaining net book value. Consistent with the foregoing analysis and Docket No. 46449, SWEPCO should (1) continue ordinary depreciation of Dolet Hills with respect to the period between March 18, 2021, and the December 31, 2021 plant retirement, and (2) with respect to the period thereafter, place any remaining net book value into a regulatory asset, to be amortized over some period of time. The issue then becomes the period of time over which SWEPCO should recover Dolet Hills' net book value, whether as pre-retirement depreciation or post-retirement amortized recovery.

Even accepting SWEPCO's disputed premise of GAAP-required depreciation of Dolet Hills' entire net book value by the December 31, 2021 retirement date, any such requirement would not necessarily dictate the Commission's ratemaking treatment, as several parties point out. The Commission recognized in Docket No. 46449 that "[a]ccounting does not determine the appropriate ratemaking treatment," as ratemaking is instead a function of the Commission's regulatory authority.[208] And with regard to depreciation passed on in rates, the Commission's Cost of Service Rule directs that allowable depreciation expense is generally to be "based on original cost and computed on a straight line basis as approved by the commission," but provides that "[o]ther methods of depreciation may be used when it is determined that such depreciation

---

208 Docket No. 46449, PFD at 94 (Sep. 22, 2017).

methodology is a more equitable means of recovering the cost of the plant."[209] As such, the Cost of Service Rule recognizes the Commission's discretion to depart from straight-line depreciation over a plant's expected useful life (however "expected useful life" might be defined) in favor of a different methodology that it deems "a more equitable means of recovering the cost of the plant."[210] SWEPCO essentially conceded this point during the hearing, as Mr. Baird acknowledged that the Commission could order a ratemaking treatment that differed from GAAP, that the Commission had done so in the past, and that SWEPCO's own proposed four-year amortization would depart from its view of GAAP's requirements.[211]

Consequently, the amortization question turns ultimately on what the Commission deems equitable, an inquiry that must necessarily weigh the respective interests of SWEPCO and its current or future customers. At first blush, Docket No. 46449 would seem to indicate the appropriate balancing of interests once again, as the Commission directed that Welsh Unit 2's remaining net book value would be amortized over the 24-year remaining lives of Welsh Units 1 and 3,[212] which also corresponded roughly to Welsh Unit 2's estimated remaining useful life as determined before retirement.[213] Yet the Commission did not analyze the specific amortization questions SWEPCO now presents because SWEPCO's arguments centered on whether Welsh Unit 2's net book value should remain in rate base post-retirement, in the form of a debit balance in Accumulated Depreciation, an accounting treatment that also effectively tied its amortization to that of the two remaining units.[214]

SWEPCO reasons that the equities favor placing the cost of its Dolet Hills investment upon the customers who have obtained or will obtain service during the plant's period of operation, first

---

[209] 16 TAC § 25.231(b)(1)(B); *see also* 16 TAC § 25.231(c)(2)(A)(ii) (Accumulated depreciation (as deducted in determining rate base) "shall be computed on a straight line basis or by such other method approved under [the provision governing depreciation expense] over the expected useful life of the item or facility.").

[210] 16 TAC § 25.231(b)(1)(B).

[211] Tr. at 472-73.

[212] Docket No. 46449, Order on Rehearing, FoF No. 70 (Mar. 19, 2018).

[213] Docket No. 40443, Order on Rehearing, FoF No. 199 (Mar. 6, 2014).

[214] Docket No. 46449, PFD at 87-95 (Sep. 22, 2017).

by offsetting the refundable excess ADFIT, then amortizing the remaining balance over four years (if not by the December 31, 2021 retirement date). SWEPCO resists the notion that the cost should be carried into future decades and shifted (increasingly as time passes) onto future customers who will never have been served by Dolet Hills. But SWEPCO takes too narrow a view of the competing interests to be balanced.

As CARD's witness Mr. Garrett testified, the relevant interests concern not merely one soon-to-be-retired power plant viewed in isolation, but the broader context of a long-term shift by SWEPCO (like its AEP affiliates and other utilities) from reliance on solid-fuel-fired generation toward alternative, "cleaner" energy sources.[215] These changes have responded to seismic and often-rapid shifts in the legal and regulatory environment, as well as the marketplace, as solid-fuel-fired generation once permitted and thought prudent and acceptable has increasingly become popularly disfavored. A byproduct, as Mr. Garrett observed, has been early retirements of solid-fuel-fired plants that are replaced with other forms of generation, with attendant stranded costs.[216] But these stranded costs are not merely a problem for the customers formerly served by the retiring plants. As Mr. Garrett suggests, they amount to a type of investment being made—by the utility, its customers, and the governmental regulators that in theory serve all the citizenry—to ensure cleaner air going forward. And that resultantly cleaner air, as Mr. Garrett argues, benefits future customers, perhaps to a greater extent than current customers.[217] Consequently, as Mr. Garrett reasons, it is fair that those future customers bear a share of the costs.[218]

The ALJs also find persuasive other rationales Mr. Garrett offers for extending amortization of Dolet Hills over its 2046 useful life. In addition to the potential that the costs will decrease over time, Mr. Garrett observes that the amortization period chosen in Docket No. 46449 is consistent with regulatory decisions from other states that have addressed similar early

[215] CARD Ex. 2 (M. Garrett Dir.) at 7.

[216] CARD Ex. 2 (M. Garrett Dir.) at 7.

[217] CARD Ex. 2 (M. Garrett Dir.) at 7.

[218] CARD Ex. 2 (M. Garrett Dir.) at 7.

retirement issues.[219] Accordingly, the ALJs recommend that the Commission retain the same depreciation rates it previously approved for Dolet Hills, predicated on a useful life ending in 2046, and use this same schedule for both pre-retirement depreciation and post-retirement amortization of the regulatory asset.

It follows from this analysis that the ALJs also would reject SWEPCO's proposed offset utilizing refundable excess ADFIT, as this mechanism would achieve the contrary result of an immediate recovery of most of Dolet Hills' net book value. The ALJs address the ultimate disposition of the excess ADFIT below.

iii. Implementation

The ALJs next address the appropriate mechanism through which the foregoing recommendations should be implemented. The ALJs would follow the basic rate-rider model proposed by OPUC's Ms. Cannady,[220] but with some modifications. That is, cost recovery for Dolet Hills would be removed from rate base entirely and addressed instead through the rider, as follows:

- For the period between March 18, 2021 (when the rates are effective) and December 31, 2021 (the Dolet Hills retirement date), *i.e.*, while the plant is still used and useful in providing service (the Operational-Plant Phase):
  - SWEPCO will earn a return on Dolet Hills, as if in rate base.
  - SWEPCO will continue to depreciate Dolet Hills in accord with its useful life ending in 2046.
- For the period beginning January 1, 2022 (*i.e.*, after Dolet Hills is retired) (the Post-Retirement Phase):

---

[219] CARD Ex. 2 (M. Garrett Dir.) at 7-14.

[220] OPUC Ex. 1 (Cannady Dir.) at 11-28.

- The then-remaining net book value of Dolet Hills will be placed in a regulatory asset, to be amortized in accordance with the estimated useful life ending in 2046.[221]

- All other cost recovery relating to Dolet Hills, including return, will cease.

The ALJs recommend the rider mechanism because it has the dual benefits of (1) segregating and separately addressing the unique cost-recovery issues associated with Dolet Hills, (2) while also aligning the costs of the plant while still operating with the rates paid by SWEPCO customers who are receiving service at that time.

iv. Oxbow Investment and DHLC

The same logic underlying the above recommendations regarding Dolet Hills guides the ALJs' proposed rate treatment of SWEPCO's Oxbow investment and the equity return and associated taxes for DHLC. More specifically, the ALJs conclude that: (1) both the Oxbow investment and the DHLC equity return and taxes should be removed from base rates and addressed in the same rate rider with Dolet Hills; (2) during the Operative-Plant Phase, SWEPCO should continue to earn a return on the Oxbow investment and the DHLC equity return and taxes; but (3) during the Post-Retirement Phase, the Oxbow investment should be placed in a regulatory asset and amortized over the same useful life as with Dolet Hills.

These recommendations reflect the ALJs' conclusion that both the Oxbow investment and DHLC will cease to be used and useful in providing service to SWEPCO customers when Dolet Hills retires. However, the ALJs have rejected OPUC's argument that both assets already ceased to be used and useful in providing service when further lignite extraction ended in May 2020. As Mr. Baird testified, both the Oxbow mine and DHLC have continued to provide benefit and will do so through the plant's final operations, as DHLC delivers and Dolet Hills burns already-mined lignite in generating electricity.[222]

[221] This aspect of the ALJs' recommendation differs from Ms. Cannady's proposal, as she would have the rate rider expire upon Dolet Hills' retirement and address amortization of the regulatory asset as part of base rates. OPUC Ex. 1 (Cannady Dir.) at 12.

[222] SWEPCO Ex. 36 (Baird Reb.) at 21-22.

Mr. Baird also pointed out that amortizing the Oxbow investment while Dolet Hills is still operating, as OPUC's Ms. Cannady proposed, would result in a double-recovery for SWEPCO.[223] He explained that as lignite has been mined, it is amortized and billed to SWEPCO, which records the billings as fuel inventory and recovers the cost through eligible fuel expense only when the lignite is burned.[224] The ALJs have addressed this overlap by recommending that amortized recovery of SWEPCO's remaining Oxbow investment begin only after the Dolet Hills retirement.

v. Demolition Costs

Through the testimony of its witness Jason Cash, Accounting Senior Manager with AEPSC,[225] SWEPCO presented evidence that its currently approved depreciation rates have included a component for each production plant's estimated final demolition costs in its calculation of net salvage, that it is normal to do so, and how these estimates were determined.[226] The ALJs find that SWEPCO's reliance on the estimated Dolet Hills demolition costs is reasonable and, accordingly, do not recommend adoption of ETEC/NTEC proposal to require SWEPCO to defer its actual demolition and removal costs for Dolet Hills into a regulatory asset.[227]

3. Coal and Lignite Inventories

SWEPCO's witness Mark Leskowitz submitted evidence concerning the fuel inventory levels maintained at the three coal plants at which the Company owns an interest—Flint Creek, Welsh, and Turk—and the two lignite-burning plants, Dolet Hills and Pirkey.[228] He testified that the purpose of maintaining solid fuel inventories is to assure a continuous supply of coal or lignite of the appropriate quality to all of AEP's solid-fuel generating stations, delivered at a reasonable

---

[223] SWEPCO Ex. 36 (Baird Reb.) at 22.

[224] SWEPCO Ex. 36 (Baird Reb.) at 21-22.

[225] SWEPCO Ex. 16 (Cash Dir.) at 1.

[226] SWEPCO Ex. 16 (Cash Dir.) at 6-9; SWEPCO Ex. 43 (Cash Reb.) at 4.

[227] ETEC/NTEC Initial Brief at 13; ETEC/ETEC Ex. 1 (Hunt Dir.) at 11-12.

[228] Mr. Leskowitz adopted the direct testimony of SWEPCO witness Amy Jeffries and presented rebuttal testimony.

cost over a period of years.[229] Mr. Leskowitz indicated that solid fuel target inventory levels are determined based on the number of days that the respective plant can be expected to operate using only fuel inventory available at the plant site, expressed or quantified in terms of a "days-burn," defined as the number of tons that the plant would burn in one day at full load.[230] This determination, he further explained, is made by initially allocating each plant a base level of days-burn inventory, then making additions based on criteria that include the probability of interruptions in the fuel supply (*e.g.*, extreme weather events, mining issues), how long such interruptions may last, how much fuel is necessary to provide for these contingencies, and plant-specific criteria (*e.g.*, fuel transportation and unloading options).[231] Mr. Leskowitz added that these targets are set annually for the three coal plants and the Pirkey lignite plant by AEPSC Fuel Procurement, Engineering, and SWEPCO power plant management, while CLECO, which manages Dolet Hills, sets the target for that plant.[232]

Based on these determinations of inventory target levels, SWEPCO proposes to include in rate base a 45-day level of fuel inventory at Dolet Hills and a 30-burn-day level at each of the other plants.[233] These levels, Mr. Leskowitz attested, were the same as approved in Docket No. 46449.[234] CARD witness Scott Norwood asserts that these levels are excessive in two ways.

First, Mr. Norwood observes that SWEPCO makes no adjustment for the Dolet Hills retirement, instead treating the plant as if it would continue to operate throughout the period in which the rates will remain in effect.[235] For this reason, Mr. Norwood recommends that the Commission disallow the entirety of SWEPCO's requested inventory for Dolet Hills "because the

---

229 SWEPCO Ex. 25 (Jeffries Dir., adopted by Leskowitz) at 13-14.

230 SWEPCO Ex. 25 (Jeffries Dir., adopted by Leskowitz) at 15.

231 SWEPCO Ex. 25 (Jeffries Dir., adopted by Leskowitz) at 14-15.

232 SWEPCO Ex. 25 (Jeffries Dir., adopted by Leskowitz) at 14.

233 SWEPCO Ex. 25 (Jeffries Dir., adopted by Leskowitz) at 16.

234 SWEPCO Ex. 25 (Jeffries Dir., adopted by Leskowitz) at 16; *see also* Docket No. 46449, Order on Rehearing, FoF Nos. 136-140 (affirming continued use of 45-day inventory target that "has been in use for many years" at Dolet Hills).

235 CARD Ex. 3 (Norwood Dir.) at 9.

plant is scheduled to be retired no later than two months after [SWEPCO's] new rates are put into effect and . . . will not require fuel inventory in the future.[236] In this regard, CARD also emphasizes that Dolet Hills has been operating only seasonally and points to the plant's equivalent available factors as provided by SWEPCO, which reflect that SWEPCO did not operate the plant between September and December 2017, in November and December 2018, nor in November and December 2019.[237] "Thus," CARD concludes, "it would neither be just nor reasonable to allow SWEPCO to include in rate base the fuel inventory for Dolet Hills when SWEPCO will almost certainly not operate Dolet Hills after September of 2021.[238] In the alternative, CARD requests the Commission to require SWEPCO to create a regulatory liability to track this component of its cost of service, similar to its proposal concerning return on the Dolet Hills plant.[239]

Mr. Norwood also criticizes SWEPCO's use of days-burn as the relevant unit of measure at not only Dolet Hills but the other four plants.[240] He maintains that the assumption underlying the target—the need for continuous operations at full load for 30 or more days—is unrealistic and unjustified compared to the actual average energy production at SWEPCO's coal and lignite plants, which decreased by 36.5% between 2014 and 2019.[241] And this trend will continue downward, Mr. Norwood insisted, emphasizing the retirements of Dolet Hills and the Pirkey plant.[242] CARD also points out the broader strategy of SWEPCO and AEP to transition away from carbon-based fuels.[243] In light of these considerations, Mr. Norwood recommended replacing the days-burn measure in SWEPCO's inventory calculation with the test-year average daily burn level

236 CARD Ex. 3 (Norwood Dir.) at 9.

237 CARD Ex. 9 at 2, 9, 15.

238 CARD Reply Brief at 9.

239 CARD Reply Brief at 9.

240 CARD Ex. 3 (Norwood Dir.) at 8.

241 CARD Ex. 3 (Norwood Dir.) at 7-9.

242 CARD Ex. 3 (Norwood Dir.) at 8.

243 CARD Initial Brief at 9 (citing Tr. at 52).

at each plant, *i.e.*, a target inventory at Flint Creek, Welsh, Turk, and Pirkey of enough fuel to supply each plant for 30 days of operation at its respective test-year-average daily burn level.[244]

Mr. Leskowitz urged that the Commission reject Mr. Norwood's recommendation, reasoning that the proposed shift to an historical average burn level would negatively impact SWEPCO's ability to reliably serve its customers.[245] He asserted that reliance on historical average burn rates is problematic because future conditions can "easily" differ from the past conditions that underlie the averages (*e.g.*, weather events or unit outages), that the averages can likewise be skewed by such events, and that the averages fail to account for the peak coal inventories needed during heavier parts of the year.[246] In contrast, Mr. Leskowitz maintained, SWEPCO's reliance on full-load burn days avoids such issues, ensuring that adequate inventory will be on hand to provide necessary reliability. He emphasized that the Commission had approved this approach in Docket Nos. 46449 and 40443.[247]

Mr. Leskowitz further denied that any decline in energy production from SWEPCO's coal and lignite units over years impacted its present inventory needs, maintaining that SWEPCO still had to be prepared for periods in which coal generation is in high demand, a plant would be required to run at or near full capacity for an extended period, and unforeseen supply disruptions could require the plant to rely only on the fuel supply it has on hand.[248] The same is true of Dolet Hills through its retirement date, he argued, and added that the plant had to be available for seasonal burn and reliability year-round for SPP for SWEPCO and in the Midcontinent Independent System Operator, Inc. (MISO) market for CLECO.[249]

---

[244] CARD Ex. 3 (Norwood Dir.) at 9, Attachment SN-7.

[245] SWEPCO Ex. 49 (Leskowitz Reb.) at 3.

[246] SWEPCO Ex. 49 (Leskowitz Reb.) at 4.

[247] SWEPCO Ex. 49 (Leskowitz Reb.) at 4.

[248] SWEPCO Ex. 49 (Leskowitz Reb.) at 5-6.

[249] SWEPCO Ex. 49 (Leskowitz Reb.) at 5-6.

CARD points out that SWEPCO has been required to offer each of its coal and lignite plants into the SPP market since 2014, and the aforementioned declines in average energy production have occurred notwithstanding.[250] Thus, CARD reasons, "the more credible evidence in the record is that it is no longer necessary for SWEPCO to maintain inventory sufficient to operate the units for 30 or 45 days of continuous operations at their full-rated output."[251] CARD further insists that reliance on averages squares with "normal ratemaking principles" that rates are set to reflect normal historical operating conditions.[252]

The ALJs conclude that SWEPCO presented sufficient evidence to demonstrate the prudence of setting inventory levels at its coal and lignite plants based on burn-days rather than the historical averages that CARD champions. As Mr. Leskowitz persuasively testified, if SWEPCO is to assure reliability for its customers, it must be prepared for instances in which each plant may need to be operated at peak capacity and with only the fuel then on hand. While perhaps reflective of longer-term or broader trends, historical averages (being averages) tend to obscure peak or extreme periods for which SWEPCO must be prepared. Likewise, reliance on historical averages presumes that materially the same underlying conditions will persist into the future—a risky assumption given the vicissitudes of weather and other factors that may impact both power demand and the supply chain. Finally, the ALJs note that SWEPCO's burn-day methodology, and indeed the same resulting inventory targets, were approved by the Commission in Docket No. 46449 and Docket No. 40443. Accordingly, the ALJs recommend that the Commission reject CARD's proposal to employ the averages instead.

With regard to Dolet Hills specifically, SWEPCO argues in part that Section 25.231(c)(2)(F)(iii)(II) bars a post-test-year adjustment to reduce its lignite inventories in light of the Dolet Hills retirement.[253] For the same reasons explained in regard to Dolet Hills, the ALJs recommend that the Commission find good cause to make a post-test-year adjustment removing

[250] CARD Initial Brief at 9.

[251] CARD Initial Brief at 9.

[252] CARD Reply Brief at 10.

[253] SWEPCO Reply Brief at 22.

the Dolet Hills lignite inventory from base rates, placing it in the Dolet Hills Rate Rider, allowing SWEPCO to earn a return on the inventory during the Operative-Plant Phase, and ceasing all cost recovery in the Post-Retirement Phase. However, the ALJs would likewise reject CARD's proposal to disallow the lignite inventory for Dolet Hills entirely. As Mr. Leskowitz testified, the inventories will continue to be needed at Dolet Hills through its retirement date, including during periods beyond seasonal usage, when the plant must remain available for reliability.[254]

4. New Generation Capital Investment

Sierra Club seeks adjustments to disallow or reduce SWEPCO's test-year new capital investment (and also test-year O&M) at Dolet Hills, and to disallow all test-year capital investment and O&M at three other units: Flint Creek and Welsh Units 1 and 3. Sierra Club also requests additional relief addressed to ongoing or future capital spending at Flint Creek and Welsh that SWEPCO did not present for review in this case.

a. Dolet Hills Test-Year Investment

Although it did not present direct evidence to contest the issue,[255] Sierra Club argues in its briefing that "SWEPCO failed to present *any* evidence" to support the prudence or reasonableness of its test-year capital investment or O&M at Dolet Hills.[256] As an initial observation, the ALJs would note that their preceding recommendations regarding Dolet Hills would bar SWEPCO from recovering either a return on any new capital spending or O&M with respect to the period beyond the December 31, 2021 plant retirement date. Consequently, Sierra Club's challenge to SWEPCO's Dolet Hills test-year spending (and O&M) implicates only cost of service with respect to the period between March 18, 2021, and December 31, 2021, and whether SWEPCO ultimately recovers the new capital investment as part of the plant's amortized remaining net book value.

---

254 SWEPCO Ex. 49 (Leskowitz Reb.) at 5-6.

255 Sierra Club Ex. 2A (Glick Dir., redacted) at 11 (explaining that her testimony "focuses solely on the economic performance and the operational and planning practices at the Flint Creek and Welsh units" and does not evaluate Dolet Hills).

256 Sierra Club Initial Brief at 17 (emphasis in original).

The legal standard for determining prudence is well established:

> 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.[257]

"The 'prudence' standard explicitly incorporates a utility's reasonableness and, by speaking in terms of available alternatives, implicitly recognizes that an expense must be necessary."[258] But "[w]hat is prudent, reasonable, and necessary depends on circumstances. The prudence standard does not require perfection."[259]

> 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.[260]

A utility seeking to raise its rates, as SWEPCO seeks to do here, bears the burden of proving that each dollar of cost was reasonably and prudently invested.[261] It enjoys no presumption that the expenditures reflected in its books have been prudently incurred merely by opening the books to inspection.[262] But while the ultimate burden of *persuasion* on the issue of prudence remains with the utility, its initial burden of *production* (*i.e.*, to come forward with evidence) is shifted to

---

[257] Docket No. 46449, Order on Rehearing, CoL No. 15 (citing *Gulf States Utilities Co. v. Public Util. Comm'n*, 841 S.W.2d 459, 476 (Tex. App—Austin 1992, writ denied)).

[258] *Nucor Steel v. Public Util. Comm'n*, 26 S.W.3d 742, 748 (Tex. App.—Austin 2000, pet. denied).

[259] *Nucor*, 26 S.W.3d at 749.

[260] Docket No. 46449, Order on Rehearing, CoL No. 16 (citing Docket No. 40443 Order on Rehearing at 5 (Mar. 6, 2014) (citing *Nucor*, 26 S.W.3d at 752)).

[261] *See, e.g., Entergy Gulf States, Inc. v. Public Util. Comm'n*, 112 S.W.3d 208, 214 (Tex. App.—Austin 2003, pet. denied) (citing *Public Util. Comm'n v. Houston Lighting & Power Co.*, 778 S.W.2d 195, 198 (Tex. App.—Austin 1989, no writ).

[262] *Entergy Gulf States, Inc.*, 112 S.W.3d at 214 (citing *Houston Lighting & Power Co.*, 778 S.W.2d at 198).

opponents if the utility establishes a *prima facie* case of prudence.[263] This is a "Commission-made" rule, intended "to aid in the trial of utility prudence reviews" and facilitate "efficient hearings," allowing the utility to establish prudence "by introducing evidence that is comprehensive, but short of proof of the prudence of every bolt, washer, pipe hanger, cable tray, I-beam, or concrete pour."[264]

While decrying "Sierra Club's tactics" in raising its "new claim" in a manner that has "denied SWEPCO the opportunity to provide testimony rebutting its specific allegations,"[265] SWEPCO points to evidence it presented to make a *prima facie* showing of the prudence of its requested test-year capital and O&M at all of its generating plants.[266] This included Schedule H-5.2b of SWEPCO's Rate Filing Package (RFP), which lists every capital project with a value of greater than $100,000 that SWEPCO placed in service at its generating plants (including Dolet Hills, Flint, and Welsh) since the test-year end in Docket No. 46449.[267] The schedule further indicates whether a cost-benefit analysis was performed for each project and classifies each project according to one or more of ten categories of purposes (*e.g.*, "Immediate Personnel Safety Requirement," "Regulatory Safety of Operations Requirement," "Reliability").[268] SWEPCO also presented testimony from Mr. McMahon describing SWEPCO's decisional process in determining whether to make a capital addition to a plant.[269] According to Mr. McMahon, the first step is to research alternatives that may exist and to perform a cost-benefit analysis when warranted to estimate a project's value.[270] Once the need for a capital project is determined, Mr. McMahon explained, the most efficient way to manage the project is selected, typically through competitive

---

263 *Entergy Gulf States, Inc.,* 112 S.W.3d at 214.

264 *Entergy Gulf States, Inc.,* 112 S.W.3d at 214-15 & n.5.

265 SWEPCO Reply Brief at 17-18.

266 SWEPCO Reply Brief at 12-14.

267 SWEPCO Ex. 1 (Application), Schedule H-5.2b.

268 SWEPCO Ex. 1 (Application), Schedule H-5.2b.

269 SWEPCO Ex. 7 (McMahon Dir.) at 17-18.

270 SWEPCO Ex. 7 (McMahon Dir.) at 17.

bidding to ensure that a fair market price is paid, although projects may also be expedited or sole-sourced if there is a lack of competition for a given piece of equipment or service.[271]

Regarding O&M incurred at SWEPCO's generating plants during the test year, SWEPCO presented: (1) Schedule H-1.2, which provides a description of the O&M incurred by FERC account by plant for each month of the test year[272]; (2) Schedule H-3, which provides historical SWEPCO generation O&M, by FERC account, by year since 2015[273]; and (3) Schedule H-4, which lists the major O&M projects undertaken during the test year by plant.[274] Additionally, Mr. McMahon testified that SWEPCO uses multiple processes to ensure that its generation plant O&M expenses are reasonable, including scrutinizing budgets on an annual basis to ensure they are reasonable, tracking and projecting expenses on a monthly basis, using competitive bids when it is reasonable to do so, and comparing generation plant O&M to past years to ensure it is not unreasonably high or low.[275] Mr. McMahon further observed that SWEPCO's generation fleet O&M had decreased from approximately $136 million in 2017 to approximately $130 million during the test year.[276]

The gravamen of Sierra Club's arguments is that this evidence should be disregarded as incompetent with respect to Dolet Hills because "SWEPCO apparently deferred to the analyses and investments of the operator of the plant, Cleco Power."[277] It similarly argues that SWEPCO's proof of prudence falls short because it "unreasonably failed to evaluate opportunities for reducing its capital and O&M spending at the [Dolet Hills] plant to reflect its shortened useful life," reasoning that CLECO rather that SWEPCO would be making such decisions.[278] To support its

---

271 SWEPCO Ex. 7 (McMahon Dir.) at 17.

272 SWEPCO Ex. 1 (Application), Schedule H-1.2.

273 SWEPCO Ex. 1 (Application), Schedule H-3.

274 SWEPCO Ex. 1 (Application), Schedule H-4.

275 SWEPCO Ex. 7 (McMahon Dir.) at 21-22.

276 SWEPCO Ex. 7 (McMahon Dir.) at 23-24.

277 Sierra Club Initial Brief at 17-18; Sierra Club Reply Brief at 8-9.

278 Sierra Club Initial Brief 18-19.

premise, Sierra Club emphasizes testimony from Mr. McMahon acknowledging that CLECO, as the plant's operator, handled day-to-day operation and maintenance of the plant and that SWEPCO, therefore, had no "direct role" in determining capital and O&M expenditures and could not override CLECO's decisions regarding them.[279] However, SWEPCO disputes the insinuation that SWEPCO has merely deferred blindly to potentially imprudent investment decisions by CLECO,[280] and indeed the evidence belies that notion. When read in proper context, Mr. McMahon also made clear that SWEPCO management provides "input and feedback" to CLECO regarding its investment decisions and that based on "communications with plant management and others at CLECO," he believed that CLECO had acted prudently in making capital and O&M investment decisions that would get the plant safely and reliably to the end of its life.[281]

Nor is there anything inherently wrong with SWEPCO's reliance on CLECO in its decision-making processes at Dolet Hills, as SWEPCO points out. It notes that the Commission addressed this relationship in Docket No. 46449, in the context of determining that retrofitting Dolet Hills was prudent at the time of that decision, as was SWEPCO's reliance on CLECO in the decision-making process:

> In particular, the Commission finds it important that Mr. Franklin relied upon the study performed for the majority owner of the power plant, Cleco Power LLC (Cleco). SWEPCO and Cleco had a long and ongoing professional relationship related to Dolet Hills. Cleco owns 50% of the Dolet Hills power plant and is responsible for the operations and maintenance of the plant. As such, Cleco has the obligation to make all repairs, replacements, and capital additions to the plant. However, Cleco is required to consult with SWEPCO's operating committee representative in making major decisions, and the operating committee is required to unanimously approve such decisions. Further, the business relationship between Cleco and SWEPCO related to Dolet Hills had been ongoing since at least 1981, or for more than 30 years, at the time of the decision to retrofit the power plant. Over those years, SWEPCO had collaborated with Cleco in its management role on the operations and maintenance of the power plant and all capital improvements. The

[279] SWEPCO Ex. 7 (McMahon Dir.) at 5; Tr. at 159-60.

[280] SWEPCO Reply Brief at 18.

[281] Tr. at 159-60.

> Commission finds it is reasonable for SWEPCO to have had confidence in this longstanding relationship as part of its decision-making process as to the retrofits.[282]

Sierra Club further suggests that the approaching Dolet Hills retirement or the plant's seasonal operation in themselves raise an inference that SWEPCO's test-year capital spending and O&M was wholly unsupported or at least inflated.[283] A "commensurate reduction," in Sierra Club's view, would be to allow SWEPCO only one-third of its requested test-year capital and O&M expenditures, or "[a]t a minimum" a one-third reduction to reflect that the plant will likely not be operating during the last three months of 2021.[284] The ALJs conclude, however, that it would be unreasonable to infer that the Dolet Hills retirement or seasonal operation automatically equals imprudence or unreasonableness in the test-year capital investment and O&M amounts presented by Mr. McMahon, let alone by any specific ratio or percentage of excessiveness.

As both Mr. Brice and Mr. McMahon testified during the hearing while being cross-examined by Sierra Club, SWEPCO necessarily had to spend both capital and O&M at Dolet Hills to ensure that the plant could operate reliably and safely through its retirement date.[285] Mr. McMahon further explained that an approaching retirement did not automatically translate to a reduced need for capital spending, but would depend upon the circumstances.[286] As he put it, SWEPCO was "not going to go out and build training facilities, office buildings, things that we know are absolutely not necessary, but we will deploy the appropriate level of capital to get those plants safely to the end of life."[287] Similarly, with regard to seasonal operations, Mr. McMahon

---

[282] Docket No. 46449, Order on Rehearing at 2 (Mar. 19, 2018).

[283] Sierra Club Initial Brief 18-21.

[284] Sierra Club Reply Brief at 12-13. Sierra Club further reasons that these post-test-year adjustments would be permissible under Cost of Service Rule Section 25.231(c)(2)(F)(iii)(II) because, "as a practical and regulatory matter" SWEPCO had "seasonally mothballed" Dolet Hills prior to the rate year that began March 18, 2021, thereby satisfying that rule's temporal limitation. Sierra Club Reply Brief at 11-12.

[285] Tr. at 90, 159-61.

[286] Tr. at 165.

[287] Tr. at 165-66.

noted that the plant had to remain available for the entire year, and had recently been called into operation during the February 2021 winter storm event.[288] Additionally, Mr. McMahon, as noted previously, attested to his belief that CLECO had aligned the capital and O&M spending at Dolet Hills with the plant's needs through retirement.[289]

In sum, contrary to Sierra Club's assertions, SWEPCO has presented evidence to make a *prima facie* showing of the prudence of its test-year capital investment at Dolet Hills, and otherwise met its burden as to that issue and the reasonableness of its test-year O&M spent at that plant.

b. Flint Creek and Welsh Test-Year Investment

Similar to its challenge to test-year capital investment and O&M at Dolet Hills, Sierra Club contends that SWEPCO has failed to prove that any of its test-year capital spending or O&M at Flint Creek or Welsh Units 1 and 3 is prudent or reasonable. This is so, Sierra Club reasons, because SWEPCO failed to demonstrate that it is economically rational to continue operating the units rather than retiring them. In support of that proposition, Sierra Club advances two arguments.

First, Sierra Club posits that SWEPCO's initial burden includes not only presenting the evidence regarding capital spending and O&M described in the preceding section, but also providing economic modeling, a unit-disposition study, or other "quantified analysis" to justify continuing to operate the Flint Creek and Welsh units instead of retiring them.[290] The ALJs disagree that SWEPCO was required to make any such showing in the first instance. Aside from referencing the general concept that SWEPCO must prove that "every dollar of its revenue requirement is reasonable and necessary,"[291] Sierra Club points to no authority for its premise, which would imply that a utility must, as a component of its *prima facie* showing in every rate case, continually re-justify the prudence of the entire generation fleet that the Commission has

---

288 Tr. at 163.

289 Tr. at 159.

290 Sierra Club Initial Brief at 2-3, 6, 8-9.

291 Sierra Club Initial Brief at 8 (citing PURA § 36.006(1)).

previously deemed prudent and placed in rates. The ALJs add that Flint Creek has been in service since 1978, the two Welsh units since 1977 and 1982,[292] and in SWEPCO's most recent rate case, Docket No. 46449, the Commission found prudent SWEPCO's decisions to retrofit those three units (and others) to comply with emerging environmental regulations, thereby enabling their continued operation in lieu of retiring them.[293] The Commission cited a "robust" series of monthly economic analyses of unit-disposition alternatives that had informed the decision, which had taken account of "the projected operating and capital costs of the alternatives studied, as well as varying assumptions on the timing and amount of retrofit capital that reasonably reflected uncertainties regarding the timing and evolution of the various environmental programs in play," and "[m]ultiple commodity-price forecasts . . . include[ing] sensitivities for future gas prices, market energy prices, carbon dioxide prices, and other commodity inputs."[294] Given this historical context—which, contrary to Sierra Club's assertions, is not "irrelevant"[295]—SWEPCO has made a sufficient initial showing of the prudence and reasonableness of its test-year capital investment and O&M at Flint Creek and Welsh.

Sierra Club's second argument relies on the opinions of its expert, Devi Glick.[296] According to calculations prepared by Ms. Glick, SWEPCO incurred losses of $153 million and $144 million at Flint Creek and Welch respectively during the past six years (2015-2020).[297] She further concluded that Flint Creek and Welch will continue to incur losses of $161 million and $266 million respectively during the next decade.[298] SWEPCO contends that Ms. Glick's analyses are flawed in three chief ways.

---

[292] SWEPCO Ex. 7 (McMahon Dir.) at 4-5.

[293] Docket No. 46449, Order on Rehearing, FoF Nos. 40-52, CoL No. 18 (Mar. 19, 2018).

[294] Docket No. 46449, Order on Rehearing, FoF Nos. 42-44, 48 (Mar. 19, 2018).

[295] Sierra Club Reply Brief at 5.

[296] Sierra Club Initial Brief at 10-16.

[297] Sierra Club Ex. 2A (Glick Dir., redacted) at 12-19.

[298] Sierra Club Ex. 2A (Glick Dir., redacted) at 19-28.

First, SWEPCO witnesses Jason Stegall (AEPSC's Manager of Regulatory Pricing and Analysis)[299] and Mark Becker (AEPSC Manager of Resource Planning)[300] opined that Ms. Glick conflated two concepts—the prospective evaluation of a capital investment (such as was done with the retrofits in Docket No. 46449) and the historical evaluation of a generating unit's performance.[301] A generating unit's performance, they maintained, properly compares the unit's market revenues to the incremental variable costs of generating the power being sold.[302] This is so, Mr. Stegall explained, because the measure corresponds to the way that SWEPCO's generating units are offered into the SPP Integrated Marketplace (IM), using "offer curves" derived from the unit's incremental variable costs.[303] He further observed that the Commission in Docket No. 46449 found that SWEPCO had correctly bid its solid-fueled generating units into the SPP Integrated Marketplace based on the offer curves that represented the incremental cost of dispatch.[304] And looking to this measure, according to Mr. Stegall, that SWEPCO's revenues from sales from the Flint Creek and Welsh units between 2016 through 2020 had exceeded their variable costs by $196 million.[305]

In contrast, Mr. Stegall observed, Ms. Glick's calculations were not based on the incremental cost of dispatching the units, but incorporated fixed costs, creating what he termed "an apples to oranges comparison that is misleading and inaccurate."[306] Mr. Becker further noted that much of the capital investment that Ms. Glick had included in her historical loss calculations had been reviewed by the Commission, found to be prudent, and placed in SWEPCO's rate base in Docket No. 46449.[307] A related criticism, and one that extended also to Ms. Glick's projections

---

299 SWEPCO Ex. 47 (Stegall Reb.) at 1.

300 SWEPCO Ex. 48 (Becker Reb.) at 1.

301 SWEPCO Ex. 47 (Stegall Reb.) at 5; SWEPCO Ex. 48 (Becker Reb.) at 3.

302 SWEPCO Ex. 47 (Stegall Reb.) at 3-5; SWEPCO Ex. 48 (Becker Reb.) at 3.

303 SWEPCO Ex. 47 (Stegall Reb.) at 3-4.

304 SWEPCO Ex. 47 (Stegall Reb.) at 4-5; *see* Docket No. 46449, Order on Rehearing, FoF Nos. 343-346 (Mar. 19, 2018).

305 SWEPCO Ex. 47 (Stegall Reb.) at 4.

306 SWEPCO Ex. 47 (Stegall Reb.) at 5; *see* Sierra Club Ex. 2A (Glick Dir., redacted) at 12-19.

307 SWEPCO Ex. 48 (Becker Reb.) at 5-6.

of future losses, was that she had "manufacture[d]" the losses by recognizing multi-million-dollar SWEPCO capital investments as expenditures made entirely during the year of the investment rather than expensing them (as SWEPCO would normally do) over the life of each asset.[308]

A third critique, one that Mr. Becker termed "most important[]," was that Ms. Glick's analysis "considers only one side of the analysis—where the plant continues to operate—and fails to consider the cost to customers . . . where the plant is retired and replacement energy and capacity costs are incurred."[309] These costs would include, according to Mr. Becker, $150 million in transmission-system upgrades that would become necessary to maintain system reliability in northwest Arkansas were Flint Creek retired.[310] Ms. Glick's analysis, in other words, was not in Mr. Becker's view a proper "unit disposition analysis that studies the costs to serve consumers with a unit's retirement versus the costs to serve customers with a unit's . . . continued operation."[311]

Sierra Club counters that Ms. Glick's analysis is (or is intended to be) a unit-disposition analysis (also termed a "going-forward analysis" by Sierra Club), which must necessarily take account of fixed and capital costs and not merely variable or incremental costs.[312] It emphasizes Mr. Becker's agreement during the hearing that a unit-disposition analysis would include fixed and capital costs (albeit without conceding that Ms. Glick's analysis was a proper unit-disposition analysis).[313] Consequently, Sierra Club urges, SWEPCO's emphasis on the units' net revenues over the units' incremental variable costs is "irrelevant" and "not resource planning evidence."[314]

---

[308] SWEPCO Ex. 48 (Becker Reb.) at 3-7.

[309] SWEPCO Ex. 48 (Becker Reb.) at 7.

[310] SWEPCO Ex. 48 (Becker Reb.) at 8.

[311] SWEPCO Ex. 48 (Becker Reb.) at 7.

[312] Sierra Club Reply Brief at 7-8.

[313] Sierra Club Reply Brief at 7-8; *see* Tr. at 689-90, 694-97.

[314] Sierra Club Reply Brief at 5-6.

As for SWEPCO's criticism that Ms. Glick presented only "one side" of a unit-disposition analysis, Sierra Club argues that SWEPCO is "simply wrong" that Ms. Glick failed to account for the costs of replacing the Flint Creek or Welch units.[315] Sierra Club points out that Ms. Glick included in her analysis, alongside the energy and ancillary market revenues that SWEPCO had obtained from sales into the SPP market, a capacity value.[316] Because SPP does not have a capacity market (and thus no actual capacity market revenues for SWEPCO), Ms. Glick calculated a capacity value based on SWEPCO's forward capacity price forecast between the years 2016-19.[317] Ms. Glick also ran a "conservative sensitivity" using SPP's Cost of New Entry (CONE) as a proxy for the value of capacity in the region.[318] CONE, according to Ms. Glick, is "calculated based on the revenue needed to cover the capital and fixed costs of a hypothetical gas-burning peaking facilities," and is thus "conservative" because "unless a region is capacity constrained (which it is not, as evident by SWEPCO's incredibly low capacity price forecast), then capacity can generally be procured for less than the cost of building an entirely new plant."[319]

Thus, Sierra Club concludes, "Ms. Glick did, in fact, include an energy generation alternative—replacing both Flint Creek and Welsh with energy market purchases" and/or constructing a new gas-fired resource at the CONE value.[320] And with regard to any additional transmission infrastructure required if Flint Creek is retired, Sierra Club asserts that these costs would be much less than losses Ms. Glick has projected for that unit, and would not be incurred at all if SWEPCO converted the unit to gas.[321]

Finally, concerning the timing of Ms. Glick's recognition of fixed and capital costs at the three units, Sierra Club acknowledges the witness's reliance on the "assumption that all fixed and

---

315 Sierra Club Reply Brief at 7.

316 Sierra Club Ex. 2A (Glick Dir., redacted) at 18.

317 Sierra Club Ex. 2A (Glick Dir., redacted) at 13, 16 & n.21, 18.

318 Sierra Club Ex. 2A (Glick Dir., redacted) at 13.

319 Sierra Club Ex. 2A (Glick Dir., redacted) at 13 & n.15.

320 Sierra Club Reply Brief at 7.

321 Sierra Club Initial Brief at 15-16.

capital costs are expensed in the year those costs are incurred, rather than depreciating the costs over the life of the unit."[322] But "Ms. Glick's analysis presents a reasonable forecast of the [units'] forward-looking economics," Sierra Club insists, because as Mr. Becker acknowledged, that analysis "is dependent on the assumed useful life of the plant" and "a plant generally cannot recover costs through market revenues after it has ceased operations."[323] And the assumption of a reduced useful life is "not unreasonable" in the case of Welsh and Flint Creek, Sierra Club urges, given that the Welsh units will be retired or converted to gas in 2028, "the declining economics at Flint Creek and coal generation generally," and the broader SWEPCO and AEP strategy entailing early coal-plant retirements.[324]

Yet Sierra Club does not bridge a more fundamental disconnect between Ms. Glick's assumption of same-year expensing of fixed and capital costs and the manner in which SWEPCO actually has been expensing those investments. So long as that gap remains, Ms. Glick's assertions of historical or projected losses amount to mere unsupported conclusions rather than competent evidence of losses.[325] Nor should the witness's analysis be considered a probative unit-disposition analysis merely by virtue of incorporating some capacity value. As Mr. Becker explained, a proper unit-disposition analysis, such as that approved by the Commission in Docket No. 46449, would ordinarily entail consideration of multiple alternative resources and not merely a single resource or CONE input.[326]

In short, Sierra Club has not presented any evidence for disallowing the test-year capital and O&M spending at the Flint Creek and Welsh units.

---

[322] Sierra Club Initial Brief at 14.

[323] Sierra Club Initial Brief at 14; *see* Tr. at 703-05.

[324] Sierra Club Initial Brief at 14-15.

[325] *See, e.g., Houston Unlimited, Inc. v. Mel Acres Ranch*, 443 S.W.3d 820, 832-33 (Tex. 2014) ("If an expert's opinion is unreliable because it is based on assumed facts that vary from the actual facts, the opinion is not probative evidence. . . . [and] if the record contains no evidence supporting an expert's material factual assumptions . . . opinion testimony founded on those assumptions is not competent evidence" (internal citations and quotations omitted)).

[326] Tr. at 742-43.

c. Additional Investment

In addition to the above challenges to test-year spending at Dolet Hills, Flint Creek, and Welsh, Sierra Club requests that the Commission address ongoing spending on environmental retrofits at Flint Creek that—as confirmed by multiple SWEPCO witnesses during the hearing[327]—SWEPCO is *not* seeking to include in the rates to be approved in this proceeding.[328] Nonetheless, Sierra Club has sought to challenge the prudence of the retrofits in this case, in the view that the spending "is likely to harm customers and saddle them with paying back the costs of stranded assets in the future."[329] The propriety of Sierra Club attempt to challenge spending that SWEPCO has not yet sought to include in rates was litigated prior to the hearing, principally through a SWEPCO motion to strike the corresponding portion of Ms. Glick's testimony, which the ALJs granted,[330] and a Sierra Club motion for reconsideration of that ruling, which the ALJs denied.[331] In the alternative to reconsideration, Sierra Club appealed the ALJs' ruling to the Commission, but no Commissioner voted to add it to an open-meeting agenda.[332]

Sierra Club has again urged the Commission to reverse the ALJs' ruling, reach the prudence of the Flint Creek retrofits, and disallow them.[333] The ALJs remain of the view that the earlier rulings were correct.[334] As the ALJs have explained, the appropriate forum and time for Sierra Club's challenge will occur "[i]f and when SWEPCO seeks to recover the costs of retrofitting Flint Creek in a future rate case," at which time "the prudence of those expenditures will be subject to Commission scrutiny."[335] Those investments will be passed on to consumers

327 Tr. at 84-85, 123-24, 156-58.

328 SWEPCO Initial Brief at 27-29.

329 Sierra Club Initial Brief at 27.

330 SOAH Order No. 7 at 1-6 (Apr. 27, 2021).

331 SOAH Order No. 12 at 1-3 (May 17, 2021).

332 Commission Advisory (May 13, 2021).

333 Sierra Club Initial Brief at 27.

334 Both of the earlier orders were signed by ALJs Neinast and Pemberton, prior to the assignments of ALJs Lutostanski and Quinn.

335 SOAH Order No. 12 at 3.

only to the extent SWEPCO can then show them to be prudent.[336] Accordingly, the ALJs recommend that the Commission again decline Sierra Club's request to address ongoing spending that is beyond the scope of this case.[337]

The same logic extends to a request by Sierra Club for the Commission to "supervise" SWEPCO's resource-planning decisions, including requiring an advance prudence determination of any future decision to convert Welsh to gas, to protect consumers in light of the utility's "recent history of undertaking costly environmental retrofits and then retiring units soon thereafter."[338] As Sierra Club's witness Ms. Glick observed, Texas, unlike some other states, "does not have an official resource planning process," making it "especially important for the Commission to address resource planning concerns through rate cases in test year spending."[339] Only if and when SWEPCO requests to include those costs in rates through a future rate case, can those costs ever be passed on to consumers—and only if and to the extent the Commission, in that proceeding, finds the investments to be prudent.[340]

B. Prepaid Pension and OPEB Assets [PO Issue 41]

SWEPCO's Mr. Baird testified that SWEPCO has recorded an additional cash investment in its pension trust fund as a prepaid pension asset in accordance with GAAP under Accounting

---

336 SOAH Order No. 12 at 3. The supplemental Kentucky authority submitted by Sierra Club, which was submitted well after the close of the record in this case, does not compel any contrary result. Among other considerations, the regulatory body addressed the environmental-compliance costs in the context of a utility's request to recover them through a surcharge. *See In the Matter of: Electronic Application of Kentucky Power Co. for Approval of a Certificate of Public Convenience and Necessity for Environmental Project Construction at the Mitchell Generating Station, an Amended Environmental Compliance Plan, and Revised Environmental Surcharge Tariff Sheets*, Docket No. 2021-00004, Order at 4 (July 15, 2021).

337 In the alternative, Sierra Club urges the Commission to "make clear" that SWEPCO cannot recover the retrofit costs in its Texas rates. Sierra Club Initial Brief at 27-29. That proposition is already inherent in the preceding analysis and recommendations.

338 Sierra Club Initial Brief at 25-26.

339 Sierra Club Ex. 2A (Glick Dir., redacted) at 12.

340 SOAH Order No. 12 at 3.

Standards Codification (ASC) 715-30.[341] He maintained that the prepaid pension asset represents the cumulative additional pension cash contributions beyond the amount of pension cost and that, accordingly, an additional cash investment recorded as a prepaid pension asset should be included in rate base under PURA § 36.065.[342] No party has contested SWEPCO's inclusion of the prepaid pension asset in rate base, and the ALJs recommend its inclusion.

C. Accumulated Deferred Federal Income Taxes [PO Issue 20]

As noted previously, SWEPCO's proposed offset of the Dolet Hills' remaining net book value is not the only subject of dispute concerning ADFIT or "excess" ADFIT presented in this case. Staff raises additional challenges to SWEPCO's proposed treatment of both items, and there also remains the question of how, in lieu of SWEPCO's proposed offset, the excess ADFIT should be refunded to SWEPCO customers. Before turning to these issues, some additional background regarding the nature of ADFIT is helpful.

As applicable here, ADFIT derives from temporary timing differences in a public utility's recognition of income or expenses for tax purposes versus the "book" purposes of financial or regulatory reporting.[343] A primary example of such temporary differences arises when a utility avails itself of accelerated depreciation of assets for tax purposes while using straight-line depreciation for book purposes.[344] While both methods will recognize the same total amount of depreciation over the asset's useful life, accelerated depreciation will initially yield larger deductions (and lower taxes) than will straight-line depreciation, but the difference will eventually reverse itself as straight-line depreciation yields larger deductions in later years.[345]

341 SWEPCO Ex. 6 (Baird Dir.) at 15.

342 SWEPCO Ex. 6 (Baird Dir.) at 15-16.

343 SWEPCO Ex. 17 (Hodgson Dir.) at 7-8; SWEPCO Ex. 45 (Hodgson Reb.) at 7.

344 SWEPCO Ex. 17 (Hodgson Dir.) at 9.

345 SWEPCO Ex. 17 (Hodgson Dir.) at 9-10.

Federal law requires that regulated public utilities use "normalized" accounting in determining tax expense in order to take advantage of accelerated depreciation of their property.[346] Commission rules likewise require that federal-income-tax expense be calculated "on a normalized basis."[347] Normalization requires a utility, when computing its tax expense for establishing cost of service for ratemaking purposes and reflecting operating results for book purposes, to use a method of depreciation for property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for establishing its cost of service for ratemaking purposes.[348] With respect to any temporary timing differences in deductions for accelerated versus book depreciation, the utility must also distinguish between (1) the portion of tax expense that is actually payable to the IRS during the current year, which is recorded as a current liability, and (2) the portion for which payment has been effectively "deferred" through use of accelerated depreciation, which is reflected through adjustments to a reserve account—ADFIT—that is calculated with reference to the applicable corporate tax rate.[349] To the extent a utility's future or deferred taxes exceed its currently payable taxes, the ADFIT balance is adjusted upward.[350] Conversely, as the utility pays its taxes year after year over a depreciating asset's usable life, the difference between the taxes it has collected from customers and what it has paid to the IRS will shrink, causing the ADFIT balance to decrease.[351] A further aspect of normalization, known as the consistency rule, requires a utility, when determining for rate making purposes its tax expense, depreciation expense, and ADFIT, to use consistent estimates or projections with respect to all of the items and to rate base.[352]

---

346 SWEPCO Ex. 17 (Hodgson Dir.) at 11-12; Rev. Proc. 2020-39 at 1.

347 16 TAC § 25.231(b)(1)(D).

348 SWEPCO Ex. 17 (Hodgson Dir.) at 11-12 (quoting 26 U.S.C. § 168(i)(9)(A)(i)); Rev. Proc. 2020-39 at 2.

349 SWEPCO Ex. 17 (Hodgson Dir.) at 7-8, 11-12 (quoting 26 U.S.C. § 168(i)(9)(A)(ii)); SWEPCO Ex. 45 (Hodgson Reb.) at 7; Rev. Proc. 2020-39 at 2. *Accord* Staff Ex. 3 (Stark Dir.) at 30 (summarizing these aspects of normalization rules as requiring SWEPCO "to compute the federal income tax expense recovered in rates using a period no shorter than the period used to compute depreciation expense and the same method used to compute depreciation expense in setting rates," with ADFIT representing "the temporary difference between the amount of federal income tax collected through rates and the actual federal income tax paid because of the use of accelerated depreciation").

350 SWEPCO Ex. 17 (Hodgson Dir.) at 7; SWEPCO Ex. 45 (Hodgson Reb) at 7; Rev. Proc. 2020-39 at 2-3.

351 SWEPCO Ex. 45 (Hodgson Reb.) at 6.

352 Rev. Proc. 2017-47 at 3-4 (discussing 26 U.S.C. § 168(i)(9)(B)); Tr. at 402-03.

Under both normalization requirements and Commission rules, the ADFIT balance offsets, and thereby reduces, rate base.[353] This relationship reflects the concept that the utility has, by virtue of having its tax payments deferred temporarily through use of accelerated depreciation, effectively received an interest-free "loan" of that capital until those tax payments come due, such that the amount of the "loan" should in fairness be excluded from rate base and not earn a return.[354] Likewise, because the lower rate base will result in lower utility rates, the utility is made to share the benefits it receives from accelerated depreciation with its customers ratably over the regulatory useful life of the assets being depreciated.[355] Thus, as Staff observes, normalization of the "tax savings derived from liberalized depreciation" ensures that those benefits are "balanced equitably between present and future ratepayers and between ratepayers and the utility," which is also a PURA requirement.[356]

The consequences of a utility's depreciation-related normalization violation include losing the right to accelerate depreciation on property used to provide regulated service in the jurisdiction where the violation occurred, as well as quicker required payment of the taxes that had been deferred by virtue of the accelerated depreciation.[357] This would mean both that the utility would lose "loaned" cost-free capital (as ADFIT would be reduced) and that customers would lose the corresponding benefit of lower rates (as the loss of ADFIT would mean higher rate base).[358]

With this background in mind, the ALJs now turn to the remaining ADFIT-related issues.

---

[353] SWEPCO Ex. 45 (Hodgson Reb) at 7; 16 TAC § 25.231(c)(2)(C)(i).

[354] SWEPCO Ex. 45 (Hodgson Reb) at 7-8.

[355] SWEPCO Ex. 17 (Hodgson Dir.) at 8; Rev. Proc. 2020-39 at 1-2.

[356] Staff Initial Brief at 26; PURA § 36.059(a).

[357] SWEPCO Ex. 17 (Hodgson Dir.) at 15 (citing 26 U.S.C. § 168(f)(2)).

[358] SWEPCO Ex. 17 (Hodgson Dir.) at 16.

1. NOLC ADFIT

The first issue concerns a proposed adjustment by SWEPCO to reduce its ADFIT balance by $455,122,490 to reflect the effects of a net operating loss, attributable to accelerated depreciation that exceeded taxable revenues, as calculated on a stand-alone basis as of the end of the test year.[359] Neither SWEPCO's stand-alone loss calculation nor the type of adjustment it proposes, in itself, is controversial. SWEPCO and Staff agree, at least in concept, that SWEPCO is required to calculate its income-tax expense (including ADFIT) on a stand-alone basis—*i.e.*, reflecting only SWEPCO's own benefits and burdens in providing service to its customers, without commingling any tax benefits obtained by its affiliates—and that this is the basic import of PURA § 36.060, which states in pertinent part:

> If an expense is allowed to be included in utility rates or an investment is included in utility rate base, the related income tax benefit must be included in the computation of income tax expense to reduce the rates. If an expense is not allowed to be included in utility rates or an investment is not included in the utility rate base, the related income tax benefit may not be included in the computation of income tax expense to reduce the rates.[360]

In this respect, Section 36.060 in its current form differs from a prior version of that statute, in effect until September 1, 2013, which had provided instead that "[u]nless it is shown . . . that it was reasonable to choose not to consolidate returns, an electric utility's income taxes shall be computed as though a consolidated return had been filed and the utility had realized its fair share of the savings resulting from that return."[361]

It is likewise undisputed that federal tax law allows SWEPCO to carry its net operating losses forward to future years (known as a net operating loss carry-forward, or NOLC) to use in offsetting otherwise taxable income produced in those future years.[362] More specifically, where

---

359 SWEPCO Ex. 17 (Hodgson Dir.) at 27.

360 PURA § 36.060(a); *see* SWEPCO Ex. 45 (Hodgson Reb.) at 2-3; Tr. at 389, 395, 423-24.

361 *See* Act of May 25, 2013, 83rd Leg., R.S., ch. 787 (S.B. 1364).

362 SWEPCO Ex. 17 (Hodgson Dir.) at 11; Staff Ex. 3 (Stark Dir.) at 30.

the use of accelerated depreciation creates tax-purpose losses that cannot be used to offset taxable income in a given year, the amount of taxes not being offset (*i.e.*, the amount of the NOLC times the tax rate) is recorded as a "NOLC ADFIT" asset, offsetting the ADFIT liability. This treatment reflects that this amount of depreciation-related ADFIT has not provided the "loan" of interest-free deferred tax payments to the utility and that, correspondingly, the NOLC (rather than the deferral of tax payment) will benefit customers in future years, by offsetting the taxes as they come due.[363] In fact, as both SWEPCO and Staff recognize, a series of IRS private letter rulings (not precedential as a formal matter, but often relied upon) have determined that to the extent an NOLC ADFIT asset is attributable to accelerated depreciation, it must be included in rate base in order to comply with normalization requirements.[364] The basic reasoning, as Staff's Ms. Stark acknowledged, is that the customer benefit associated with ADFIT (lower utility rates) should occur no faster than when the deferred taxes actually come due (as opposed to being offset by a NOLC) over the life of the associated assets.[365]

It is in this legal context that SWEPCO proposes its adjustment, which more specifically entails the deduction of a $455,122,490 NOLC ADFIT asset from its ADFIT balance, thereby increasing rate base by the same amount.[366] While having no quarrel with the proposed adjustment otherwise, Staff contends it is improper, and should be disallowed, in light of some additional circumstances relating to the NOLC ADFIT asset.[367] Namely, it is undisputed that SWEPCO was paid for the NOLC ADFIT asset—apparently the same total amount of $455,122,490[368]—and that its financial books at test-year end accordingly reflected a zero balance for NOLC ADFIT assets.[369]

[363] SWEPCO Ex. 17 (Hodgson Dir.) at 12-14; Staff Ex. 3 (Stark Dir.) at 30-31; Tr. at 391-92.

[364] SWEPCO Ex. 17 (Hodgson Dir.) at 12-14; SWEPCO Ex. 45 (Hodgson Reb) at 12; Staff Ex. 3 (Stark Dir.) at 30-31.

[365] Tr. at 401-02.

[366] SWEPCO Ex. 17 (Hodgson Dir.) at 27.

[367] SWEPCO Initial Brief at 19-22; Tr. at 392-95; Staff Ex. 3 (Stark Dir.) at 31.

[368] Tr. at 268-73; Staff Ex. 42 (SWEPCO Response to Staff RFI 9-20); Staff Ex. 3 (Stark Dir.) at 37-38, Attachment RS-38.

[369] Tr. at 272-73; Staff Ex. 40 (SWEPCO Response to Staff RFI 9-15).

The payments were made to SWEPCO pursuant to a tax-allocation agreement among SWEPCO and other members of a consolidated group for which AEP files federal income tax returns.[370] The agreement states that "[a] member with net positive tax allocation shall pay the holding company the net amount allocated, while a tax loss member with a net negative tax allocation shall receive current payment from the holding company in the amount of its negative allocation."[371] It further provides that "[t]he payment made to a member with a tax loss should equal the amount by which the consolidated tax is reduced by including the member's net corporate tax loss in the consolidated tax return."[372] Thus, pursuant to this agreement, SWEPCO was paid for the use of its NOLC ADFIT asset in offsetting otherwise-taxable income earned by other AEP affiliates, thereby reducing the taxable income of the consolidated group as a whole.

Staff argues that SWEPCO cannot use the NOLC ADFIT asset to offset ADFIT (and increase rate base) because SWEPCO has already sold the asset and taken it off its books, which Ms. Stark thought akin to the effects of selling accounts receivable to obtain cash more quickly than if it waited for customers to pay.[373] Ms. Stark also pointed out that SWEPCO's proposed accounting treatment of its NOLC ADFIT differed from the Company's approach, later approved by the Commission, in Docket No. 46449.[374] In that earlier rate case, she observed, SWEPCO's financial books at test-year end reflected, as in this case, an NOLC ADFIT balance of zero as a result of SWEPCO's participation in the AEP consolidated tax-allocation agreement. Yet in that case, SWEPCO did not propose or make any adjustments to recognize NOLC ADFIT again and thereby include it in rate base, as it seeks to do now.[375] Staff further touts this aspect of Docket No. 46449 as reflecting the Commission's "established" and "accepted" method of interpreting PURA § 36.060 and making a stand-alone tax calculation.[376] However, Staff does not identify any

[370] SWEPCO Ex. 45 (Hodgson Reb.) at 2; Staff Ex. 41 (SWEPCO Response to Staff RFI 9-17), Attachment 1 at 2. To be precise, SWEPCO apparently received the total amount through a series of payments. Tr. at 272.

[371] Staff Ex. 41 (SWEPCO Response to Staff RFI 9-17), Attachment 1 at 2.

[372] Staff Ex. 41 (SWEPCO Response to Staff RFI 9-17), Attachment 1 at 2.

[373] Staff Ex. 3 (Stark Dir.) at 31, 39-40.

[374] Staff Ex. 3 (Stark Dir.) at 33-34.

[375] Staff Ex. 3 (Stark Dir.) at 34-35; Staff Ex. 43 (SWEPCO response to Staff RFI 9-21).

[376] Staff Initial Brief at 29; Staff Reply Brief at 16.

other case in which the Commission applied the statute's current version, let alone had occasion to address the specific contentions SWEPCO makes now.

SWEPCO counters that the Commission cannot validly recognize the payments SWEPCO received for the NOLC ADFIT asset or the corresponding zero book balance in determining SWEPCO's tax expense. This is so, SWEPCO reasons, because PURA § 36.060 requires a "stand-alone" calculation reflecting SWEPCO's own benefits and burdens in serving its customers, whereas the payment was a product of the activities and attendant tax consequences of other affiliates within the AEP consolidated group.[377] In fact, in the view of SWEPCO witness David Hodgson—AEPSC's Tax Accounting and Regulatory Support Manager, who presented SWEPCO's tax schedules and federal income tax-expense calculations[378]—the Commission would, by recognizing the payments and disallowing SWEPCO's adjustment, make the "exact type of consolidated tax adjustment" made under the former version of PURA § 36.060 and that the Texas Legislature prohibited through its 2013 amendments to that statute.[379]

Staff disputes that current PURA § 36.060 would bar the Commission from following the same approach as in Docket No. 46449 and recognizing the tax-allocation payments, the resultant zero balance for NOLC ADFIT, and thus no offset.[380] Staff observes that Section 36.060 (aside from a heading, "Consolidated Income Tax Returns," which cannot singularly expand or limit the statute's meaning[381]) does not mention consolidated income tax returns or any special status conferred on payments made incident thereto. Instead, Section 36.060 merely prohibits the lowering of a utility's income-tax expense based on an income-tax benefit related to "an expense not allowed to be included in utility rates or an investment . . . not included in the utility rate base."[382] This language, in Staff's view, reflects an underlying concern with a mathematically

[377] SWEPCO Initial Brief at 23-24; SWEPCO Reply Brief at 23-28.

[378] SWEPCO Ex. 17 (Hodgson Dir.) at 2-7.

[379] SWEPCO Ex. 45 (Hodgson Reb.) at 3.

[380] Staff Initial Brief at 14-15.

[381] *See* Tex. Gov't Code § 311.024.

[382] Staff Initial Brief at 16.

imputed form of "consolidated tax savings adjustment" that the Commission would impose under the prior version.[383] The situation here is different, Staff urges, involving "actual financial transactions with true economic substance," "actual operating results of SWEPCO as recognized by GAAP and FERC accounting," and "true economic costs of the utility."[384] Staff disputes that Section 36.060 requires the Commission to "ignore" these attributes merely because "those transactions are the result of a consolidated tax return."[385]

Nor does SWEPCO's "stand-alone" calculation take account of all of the effects of the tax-allocation payments, Staff insists. As Ms. Stark articulated this concern, she urged that SWEPCO is "cherry-picking" one item of a stand-alone tax calculation—seeking to add the NOLC ADFIT asset of $455,122,490 (rather than zero) into rate base—yet not correspondingly removing from rate base assets that were funded by the $455,122,490 tax-allocation payments.[386] The result, she maintained, would be that SWEPCO includes in rate base both (1) the $455,122,490 NOLC ADFIT asset and (2) $455,122,490 in other assets that are now in its rate base, financed by the tax-allocation payments, thereby enabling SWEPCO to earn a return on the same $455,122,490 twice.[387] And this net addition of $455,122,490 to rate base, Ms. Stark added, would occur "just because of the filing of the consolidated tax return and for no other reason," by virtue of the tax attributes of SWEPCO's affiliates. She further contends that he correspondingly higher rates charged to SWEPCO customers would effectively be subsidizing the operations of those affiliates by lowering their taxes.[388]

To support Staff's premise that SWEPCO would effectively be earning a return on the amount of the tax-allocation payments, in addition to the NOLC ADFIT, Ms. Stark referenced

[383] Staff Initial Brief at 16.

[384] Staff Initial Brief at 17.

[385] Staff Initial Brief at 17.

[386] Tr. at 392-94, 396, 419-20.

[387] Tr. at 393-94, 419-20.

[388] Tr. at 394, 420; Staff Ex. 3 (Stark Dir.) at 40-41.

rebuttal testimony from Mr. Hodgson acknowledging that SWEPCO would have used the payment to invest in plant assets.[389] Mr. Hodgson's specific testimony on this point is the following:

> Staff has pointed out in its testimony, and [SWEPCO] has acknowledged, that [SWEPCO] has received cash as a result of its tax allocation agreement. Being a rate regulated utility, [SWEPCO] must prudently invest its capital into plant that is to the benefit of providing service to its customers. The Commission reviews the prudency of those investments when approving [SWEPCO's] rates. To the extent that [SWEPCO] received cash through its tax allocation agreement, [SWEPCO] would not use that additional capital to build plant beyond what would be prudent in serving its customers. Instead, the cash received by [SWEPCO] through the tax allocation agreement would reduce the otherwise needed capital to fund those prudent investments. As a result, [SWEPCO] would need less capital through debt and equity than it would absent the cash received through the tax allocation agreement.[390]

Or as the argument is restated in SWEPCO's briefing:

> The consolidated tax sharing agreement payments did not result in any incremental spend[ing] on capital investments that would not have otherwise occurred. The only thing that changes was that SWEPCO did not have to increase its debt and equity to fund the projects. As a result, customers received the benefit of the reduced cost of capital (i.e., an equity investment with no assigned cost). . . . The consolidated tax sharing agreement payments are not added to the debt/equity included in rates.[391]

In short, SWEPCO maintains that the tax-allocation payments should not be considered to increase rate base, as Staff assumes. This view, in turn, was a key premise in a larger analysis in which Mr. Hodgson sought to establish that Staff, in its expressed concerns about the rate impact of the NOLC ADFIT, has overlooked a "rate impact" from the tax-allocation payments (or, more

---

389 Tr. at 394, 419-20.

390 SWEPCO Ex. 45 (Hodgson Reb.) at 14-15.

391 SWEPCO Reply Brief at 27-28.