

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

American Electric Power Service Corporation)	Docket Nos. ER17-405-000
)	ER17-406-000
)	
American Municipal Power, Inc., <i>et al.</i>)	
)	
Complainants,)	
)	
v.)	Docket No. EL23-51-000
)	
AEP Appalachian Transmission Company Inc., <i>et al.</i>)	(not consolidated)
)	
Respondents.)	

**MOTION FOR LEAVE TO ANSWER AND ANSWER OF
THE JOINT CUSTOMER GROUP**

Pursuant to Rules 212 and 213 of the Federal Energy Regulatory Commission’s (“FERC” or “Commission”) Rules of Practice and Procedure,¹ American Municipal Power, Inc. (“AMP”), Blue Ridge Power Agency, Indiana Municipal Power Agency, Mishawaka Utilities, Old Dominion Electric Cooperative, Inc., and Wabash Valley Power Association, Inc. (“Joint Customer Group”) hereby submit this motion for leave to answer and answer to the AEP East Operating Companies² and the AEP East Transmission Companies³ (collectively “AEP East”) April 24, 2023 answer (“AEP East Answer”) to the Joint Customer Group’s Formal Challenge and Complaint for Rate Years 2021 and 2022.⁴

¹ 18 C.F.R. §§ 385.212, 385.213.

² The AEP East Operating Companies are Appalachian Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company, and Wheeling Power Company.

³ The AEP East Transmission Companies are AEP Appalachian Transmission Company Inc., AEP Indiana Michigan Transmission Company Inc., AEP Kentucky Transmission Company Inc., AEP Ohio Transmission Company Inc., and AEP West Virginia Transmission Company Inc.

⁴ The Formal Challenge and Complaint was filed in Docket Nos. ER17-405-000 and ER17-406-000 on March 8, 2023, and in Docket No. EL23-51-000 on March 15, 2023.

I. MOTION FOR LEAVE TO ANSWER

The Joint Customer Group respectfully requests leave to answer the AEP East Answer. Rule 213(a)(2) generally prohibits answers to answers, unless such answers have been authorized by the decisional authority.⁵ However, the Commission exercises its discretion to grant motions for leave to submit answers when doing so will clarify the issues, assist in the Commission's decision-making processes, or otherwise ensure an accurate and complete record.⁶

As explained in further detail below, the AEP East Answer includes misleading arguments, confuses the issues, and fails to demonstrate that AEP East has properly implemented its filed formula transmission service rates in accordance with Attachments H-14 and H-20 to the PJM Interconnection, L.L.C. ("PJM") Open Access Transmission Tariff ("Tariff"). Accordingly, the Commission should grant leave and accept this answer to clarify the issues, assist in the Commission's decision-making process, and ensure a complete decision-making record.

II. ANSWER

A. Overview of Joint Customer Group's answer to AEP East's Answer.

This dispute involves application of the Commission's long-standing income tax normalization rules governing the ratemaking treatment of income tax benefits resulting from public utility net operating losses ("NOL") included in and utilized on federal income tax returns filed with the Internal Revenue Service ("IRS"). This issue is not new. The Commission has previously issued decisions finding that the income tax benefits resulting from utilization of a public utility's net operating losses as income tax deductions on consolidated tax returns should

⁵ 18 C.F.R. § 385.213(a)(2).

⁶ See, e.g., *PJM Interconnection, L.L.C.*, 145 FERC ¶ 61,035, at P 32 (2013); *Wisconsin Pub. Serv. Corp.*, 144 FERC ¶ 61,093, at P 27 (2013); *Iberdrola Renewables, Inc.*, 137 FERC ¶ 61,185, at P 17 (2011); *Virginia Elec. And Power Co.*, 125 FERC ¶ 61,391, at P 26 (2008).

be given to ratepayers when ratepayers have paid in rates the costs that lead to the losses and therefore to the tax deductions.

AEP East's ratemaking adjustments included as inputs to the 2021 ATRRs and True-Ups, however, erroneously reduce (*i.e.*, make a positive adjustment to) the total ADIT balances that are included as reductions to rate base. This results in AEP East excluding from formula rate calculations consolidated federal income tax benefits that are the fruit of costs paid for by transmission customers in rates. This is contrary to the Commission's income tax normalization requirements and Opinion No. 173.⁷

AEP East's NOL ratemaking adjustments improperly affect Worksheet WS B-1 – Actual Stmt. AF and Worksheet WS B-2 – Actual Stmt. AG, which reduce the ADIT balances used as reductions to rate base, thereby causing an increase in rate base, the return component of the transmission revenue requirement, and the income tax allowance (“ITA”) computed on the return component. As demonstrated in the Joint Customer Group's Formal Challenge and Complaint, AEP East's inclusion of the ratemaking NOL carryforward ADIT adjustments as inputs in the AEP East 2021 ATRRs and True-Up calculations results in unjust and unreasonable rates. The impact of AEP East's noncompliance is significant: it is estimated to be \$55.9 million for the 2021 Rate Year and is expected to similarly impact future years' ATRR and True-Up calculations.⁸

AEP East's NOL ADIT ratemaking adjustments result primarily from accelerated depreciation of public utility assets. The tax benefits resulting from the use of the associated NOL carryforwards in a consolidated income tax return should therefore flow back to the customers who pay the underlying depreciation expense in transmission rates. Since the AEP East Companies

⁷ *Columbia Gulf Transmission Co.*, Opinion No. 173, 23 FERC ¶ 61,396, at 61,848 (1983). See Affidavit of Janice Nicholas Exh. FCC-0001 at 23 (“Nicholas Affidavit”).

⁸ See *id.* at 7.

had fully utilized all of their consolidated federal NOL carryforwards on the AEP consolidated federal tax return as of December 31, 2020, it is clear that the AEP East Companies had realized the full tax savings benefits of accelerated depreciation and all other deductions as of that date.⁹ However, AEP East argues that the source of the consolidated taxable income offset by the AEP East NOL carryforwards is its non-utility affiliates' taxable income, and it is therefore appropriate to make NOL carryforward ADIT ratemaking adjustments to formula transmission service rate inputs because the non-utility affiliates' income is not included in the transmission revenue requirement. Further, AEP East argues that the failure to include the NOL carryforwards ADIT ratemaking adjustments in the ATRRs and True-Ups calculations would cause an IRS normalization violation.

AEP East fundamentally misinterprets and misapplies Commission tax normalization requirements and Commission precedent regarding the ratemaking treatment of income tax benefits resulting from income tax deductions and NOL carryforwards associated with expenses that are paid for by customers in rates. In its Answer, AEP East attempts to confuse the issue with irrelevant information and employs various tactics to shift the focus from the relevant facts and Commission regulations, principles, and policies. For example, AEP East attempts to distort the procedural background leading to AEP East's improper implementation of a Separate Return Methodology instead of the Commission's Stand-Alone Method by incorrectly alleging that the Joint Customer Group requested AEP East's improper application of the Stand-Alone Method.¹⁰

⁹ See Nicholas Affidavit at 28-30. As of December 31, 2021, Appalachian Power Company and AEP Appalachian Power Transmission Company Inc. did accumulate a small NOL carryforward ADIT balance associated with their transmission functions totaling approximately \$1 million.

¹⁰ AEP East Answer at 2. The Joint Customer Group's references to "Stand-Alone Method" and "Separate Return Method" have the same meaning as those terms were used in the Joint Customer Group's Formal Challenge and Complaint filed in Docket Nos. ER17-405-000 and ER17-406-000 on March 8, 2023, and in Docket No. EL23-51-000 on March 15, 2023.

AEP East erroneously asserts that the Joint Customer Group changed its position once they realized the Stand-Alone Method would increase rates.¹¹ In fact, the Joint Customer Group has always asserted that AEP East should be utilizing the Commission's Stand-Alone Method, as described in the Nicholas Affidavit.¹² AEP East's assertions are untrue and are not relevant to the pertinent facts of this case. The Joint Customer Group simply asks the Commission to require AEP East to properly implement the Commission's long-standing income tax normalization requirements and the Commission's Stand-Alone Method to provide transmission customers with the income tax benefits that they are entitled to receive in transmission rates.

What is relevant in this proceeding is that AEP East implemented NOL carryforwards ADIT ratemaking adjustments as inputs to the formula transmission rate ADIT worksheets (Worksheet WS B-1 – Actual Stmt. AF and Worksheet WS B-2 – Actual Stmt. AG) to increase rate base for NOL carryforwards that have already been utilized on AEP consolidated federal income tax returns filed with the Internal Revenue Service (“IRS”). The NOL carryforwards ADIT issue in this proceeding is squarely a matter of whether a utility is permitted to include an NOL carryforward ADIT asset as an addition to rate base when the related income tax deductions have been fully utilized on filed consolidated group income tax returns, the consolidated group has received the resulting income tax savings benefits, and no consolidated NOL carryforwards actually exist. Contrary to AEP East's assertions, the primary issue is not a matter of whether there has been an inter-company payment, but instead whether income tax savings and benefits have been realized from tax deductions funded by transmission customers through the inclusion and recovery of the related expenses in transmission rates. AEP East's ratemaking adjustments for

¹¹ AEP East Answer at 2.

¹² See Nicholas Affidavit at 19-32.

separate return NOL carryforwards fail to recognize in the 2021 ATRR and True-Up calculations, the AEP East NOL tax deductions that result from AEP East expenses that were recovered in transmission rates when these deductions were utilized on the AEP consolidated federal income tax returns and reduced consolidated taxable income.¹³ Inter-company cash payments for the use of NOL carryforwards in the AEP consolidated federal income tax return are relevant (but are not the primary issue as AEP East asserts) because the cash payments demonstrate that the related NOL and NOL carryforwards have been utilized by the AEP consolidated tax group.

In the discussion below, the Joint Customer Group responds to specific arguments made in AEP East's Answer regarding AEP East's separate return NOL carryforwards ratemaking adjustments to aid the Commission in understanding the underlying issues and facts. The Joint Customer Group explains that:

- AEP East incorrectly concludes that it can make separate return NOL carryforwards ratemaking adjustments as inputs to its filed transmission formula rate.
- AEP East fails to recognize the appropriate source of the NOL carryforwards ADIT, leading to the incorrect conclusion that its ratemaking adjustments for separate return NOL carryforwards ADIT are consistent with the Commission's Stand-Alone Method.
- AEP East's NOL carryforwards ADIT ratemaking adjustments are based on a Separate Return Methodology and do not comply with the Commission's income tax normalization requirements and Stand-Alone income tax policy.
- The Commission precedent cited by the Joint Customer Group demonstrates that the Commission has previously addressed the principles at issue and AEP East's separate

¹³ See *id.* at 55.

return NOL carryforwards ratemaking methodology conflicts with long-standing Commission precedent on income tax normalization requirements.

- AEP East’s concern regarding an IRS income tax normalization violation is not supported by the facts in this proceeding.
- AEP East’s NOL carryforwards ADIT ratemaking adjustments to compute deficient ADIT do not comply with Order No. 864.¹⁴
- AEP East initiated and implemented the separate return NOL carryforwards ratemaking adjustments on its own initiative and that ratemaking change was not requested by the Joint Customer Group during the 2019 Rate Year review.

B. AEP East incorrectly concludes that it can make the separate return NOL carryforwards ADIT ratemaking adjustments within the framework of its filed transmission formula rates.

AEP East asserts that Worksheet WS B ADIT & ITC in the existing formula rate templates permit AEP East to adjust the FERC Form No. 1 ADIT balances based on “Company records.”¹⁵ AEP East also claims that its use of contra-entries to adjust reported ADIT balances and implement its separate return NOL carryforwards ADIT method is authorized because they are sourced from “Company Records” and that doing so is consistent with Commission precedent.¹⁶ AEP East claims it has the flexibility to add the separate return NOL carryforwards ratemaking adjustments and contra-entries in the formula rate Worksheets WS B-1 and WS B-2 because the Worksheets allow for the addition and removal of individual ADIT timing differences, as applicable each year,

¹⁴ *Public Utility Transmission Rate Changes to Address Accumulated Deferred Income Taxes*, Order No. 864, 169 FERC ¶ 61,139 (2019), *order on reh’g and clarification*, Order No. 864-A, 171 FERC ¶ 61,033 (2020).

¹⁵ AEP East Answer at 34.

¹⁶ *Id.* at 14 and 34. *See also* AEP East Affidavit of Christopher Duffy Exh. AEP-0002 at 3 (“Duffy Affidavit”).

and the Worksheets include a column for “Non-Applicable/Non-Utility” deferrals used to remove certain ADIT timing differences.¹⁷

AEP East’s assertions and claims are incorrect because Worksheet WS B ADIT & ITC, Note 1, specifically defines the term “Company records” by stating: “[o]n this worksheet, ‘Company Records’ refers to AEP’s tax forecast and accounting ledger.” Accordingly, the definition of “Company records” for Worksheet WS B ADIT & ITC is limited to AEP’s tax forecast and accounting ledger, which do not include AEP East’s separate return NOL carryforwards ratemaking adjustments or contra-entries ratemaking adjustments. Additionally, Worksheets WS B-1 and WS B-2 specifically require use of “Per Books” amounts, which also excludes AEP East’s NOL carryforwards ratemaking adjustments and contra-entries ratemaking adjustments. The ratemaking adjustments for AEP East’s Separate Return Method are not reflected on AEP East’s accounting books and are not allowed as inputs to AEP East’s transmission formula rates. There is simply no provision in Worksheets WS B, WS B-1, or WS B-2 that would allow AEP East to include inputs for its NOL carryforwards ratemaking adjustments and contra-entries ratemaking adjustments in populating AEP East’s filed transmission formula rate templates.¹⁸

AEP East attempts to refute the Joint Customer Group’s position that AEP East is not following its filed rate by stating that no legal support was provided to support this claim and that the inputs to the formula are not the filed rate. However, the Joint Customer Group cited and relies on the clear language of AEP East’s transmission formula rates on file with FERC; the Tariff requirements of Worksheets WS B, WS B-1 and WS B-2, and the AEP East transmission formula rate implementation protocols provide specific guidance on what is permitted as inputs to the

¹⁷ Duffy Affidavit at 4 and 5.

¹⁸ See also Nicholas Affidavit at 48-50, 65-67.

transmission formula rates. Worksheet WS B states inputs should be “Per Books,” but the amounts AEP East has included as inputs are not sourced from the AEP East Companies’ accounting books. Similarly, AEP East has included amounts that are not based on “Company records.” AEP East’s failure to comply with the clear instructions of Worksheets WS B, WS-B-1, and WS B-2 by including unauthorized ratemaking adjustments to the formula transmission rate inputs is a violation of the filed transmission rates.

AEP East asserts that its practice of including the unauthorized ratemaking-only NOL and contra-entries adjustments in its formula rates does not violate the Commission’s filed rate doctrine.¹⁹ AEP East cites the Commission’s Opinion No. 505 as support for its assertion.²⁰ AEP East claims that Opinion No. 505 allows it to make adjustments to various ADIT account balances for ratemaking purposes, but the formula rate at issue in the Opinion No. 505 proceeding simply stated the companies were to “remove amounts not generally and properly includable for cost of service purposes.”²¹ AEP East’s reliance on Opinion No. 505 is misplaced.

Opinion No. 505 does not support AEP East’s decision to include unauthorized ratemaking adjustments as inputs to the ADIT Worksheets WS B, WS B-1, and WS B-2. The ADIT adjustments allowed by the Commission in Opinion No. 505 were ratemaking adjustments to ADIT balances properly recorded on the books of the Entergy Operating Companies and reported in the Entergy Operating Companies’ FERC Form 1 submissions that the Commission found were not “generally and properly includable for FERC cost of service purposes” pursuant to an explicit tariff provision memorializing the Entergy Operating Companies’ filed formula rate. While AEP East asserts there is no meaningful difference between the AEP East Companies’ ratemaking

¹⁹ AEP East Answer at 15.

²⁰ *Entergy Servs., Inc.*, Opinion No. 505, 130 FERC ¶ 61,023, at PP 233-36 (2010) (“Opinion No. 505”).

²¹ *Id.* P 233.

adjustments at issue in this proceeding and the NOL carryforwards ADIT issue addressed in Opinion No. 505, AEP East is wrong. The NOL carryforwards ADIT adjustments made in the formula rate calculations addressed by Opinion No. 505 were made pursuant to a provision in the filed formula rate tariff and the Commission simply ruled on the appropriate interpretation and application of that tariff provision in the context of the proceeding that led to the issuance of Opinion No. 505. In the case of AEP East, there is no tariff provision allowing the ratemaking adjustments and contra-entries that AEP East made to implement its separate return NOL carryforwards ADIT methodology.

Opinion No. 505 provides no support for AEP East's implementation of its separate return ratemaking adjustments and contra-entries to add NOL carryforwards ADIT to rate base representing income tax deductions previously utilized on the consolidated tax returns that reduced consolidated taxable income and resulted in tax savings benefits to the AEP consolidated tax return group. As the income tax deductions related to the separate return NOL carryforwards were realized on the consolidated tax returns, the NOL carryforwards ADIT was removed from AEP East's accounting books and income tax records. Opinion No. 505 precedent requiring removal of ADIT that exists on the accounting books and income tax records while not associated with revenues and expenses properly includable for FERC cost-of-service purposes is simply not relevant to the NOL carryforwards ADIT issue in this proceeding.

AEP East's ratemaking adjustments for NOL ADIT are documented in the testimony of AEP East witness Duffy, Fig. 2, which provides the content of Worksheet WS B.²² The inputs allowable in Worksheet WS B are those items that are reflected on the AEP East Companies' books and reported in their FERC Form 1 submissions. However, AEP East's separate return NOL

²² Duffy Affidavit at 10.

carryforwards ADIT ratemaking adjustments and contra-entries are not included in the AEP East Companies' accounting ledgers; nor are they reported in the AEP East Companies' FERC Form 1s. Rather, the NOL carryforwards ratemaking adjustments and contra-entries are amounts that do not exist on AEP East's accounting books and income tax records because the NOL carryforwards were claimed and utilized in the filed AEP consolidated federal income tax returns. That is, since the inputs in Columns B and C of Worksheet WS B-1 and Worksheet WS B-2 are "Per Books" amounts, AEP East's NOL ratemaking adjustments and NOL contra-entries on Lines 5.48 and 5.49 of Fig. 2 of Exh. AEP-0002 should be \$0 to reflect the fact that those amounts have no value on the AEP East Companies' books and accounting ledgers and income tax reports.

AEP East's approach, if allowed by the Commission, would afford AEP East unfettered discretion to include inputs to the transmission formula rate ADIT schedules that improperly adjust ADIT book balances by amounts that are not included in the AEP East Companies' FERC Form 1 filings, tax forecasts, or accounting ledgers. AEP East's method results in improper and unauthorized inputs to the transmission formula rate ADIT Worksheets WS B, WS B-1, and WS B-2 by including separate return NOL carryforwards ADIT adjustments that are not included in the AEP East Companies' accounting books or income tax records, and then creating separate contra-entry "offsetting" ratemaking adjustments in the "Per Books" columns that do not actually offset the improper ADIT adjustments in the columns used to compute the transmission revenue requirement (Column F). AEP East's separate return ratemaking methodology for NOL carryforwards ADITs clearly violates the filed rate doctrine.

C. AEP East fails to recognize the appropriate source of NOL carryforward ADIT.

The AEP East Companies claim that they go several steps beyond the utility's separate tax expenses and revenues in purportedly implementing what it claims is its Stand-Alone Method,

which AEP East argues is consistent with Opinion No. 173.²³ For example, AEP East explains that it derives taxable income from all FERC-jurisdictional revenue and cost-of-service of the utility irrespective of which company's return the cost (or corresponding deduction) would appear on a separate return basis.²⁴ AEP East also explains that it excludes non-jurisdictional items that would be included in a separate return. The Joint Customer Group has not challenged those procedures as part of the Formal Challenge in this proceeding.

The Joint Customer Group, however, specifically has challenged the treatment of NOL carryforwards ADIT when the AEP East NOL has been used on the AEP consolidated federal income tax returns to offset the taxable income of affiliates and the resulting tax savings has been realized by the AEP consolidated tax group. The Joint Customer Group recognizes that the tax deductions relevant to the NOL carryforwards issue were largely due to accelerated tax depreciation of utility plant assets that are protected under IRS normalization rules. When the NOL deductions are utilized on the AEP consolidated tax return to reduce taxable income, thereby resulting in tax savings for the consolidated group, the deductions for protected accelerated depreciation expenses associated with utility plant assets are utilized. Similarly, for ratemaking purposes, the realization of the tax savings benefits from the accelerated tax depreciation deductions through the inclusion of the NOL deductions in the consolidated federal income tax returns represents an income tax event associated with the depreciation expenses related to depreciation costs included in the AEP East Companies' cost-of-service rate and recovered from ratepayers. Therefore, the separate return NOL carryforwards ADIT ratemaking adjustments must be removed from the ADIT Worksheets (*i.e.*, WS B, WS B-1, and WS-B-2), and excluded from

²³ AEP East Answer at 17, 18.

²⁴ *Id.* at 18; AEP East Affidavit of David Hodgson Exh. AEP-0001 at 12 (“Hodgson Affidavit”).

the ADIT rate base adjustments, consistent with the accounting and income tax treatments. In sum, the ratemaking treatment for the use of NOL carryforwards in the AEP consolidated federal income tax returns must be based on the source of the deductions that gave rise to the NOL carryforwards, which in this case are expenses resulting from deductions for accelerated tax depreciation of utility assets and other miscellaneous expenses recovered in transmission rates.

AEP East argues that the source of the NOL ADIT is the affiliated companies' taxable income that it uses to offset the NOL carryforwards in the group consolidated income tax return and that the affiliates' income that the NOL is applied against is not associated with the AEP East Companies' revenue requirements.²⁵ AEP East states that this approach is consistent with the Commission's benefits and burdens test. AEP East states "that the appropriate methodology 'flow[s] the tax benefits *created by its deductions through to the ratepayers who pay the associated expenses* when those expenses are recognized in rates."²⁶ AEP East improperly interprets and applies the Opinion No. 173 benefits and burdens test.

The tax benefit at issue in this proceeding is a reduction in the AEP consolidated federal tax group's income taxes payable due to the use of accelerated depreciation for tax purposes of the public utility affiliates' assets. The tax benefit here is not a result of the non-utility affiliates' taxable income—that benefit offsets the tax liability associated with the affiliates' taxable income. The non-utility affiliates' taxable income generates a tax liability, not a tax benefit. AEP East has cause and effect backwards. In the AEP consolidated federal income tax return filing, public utility NOL deductions resulting from accelerated tax depreciation expenses are used as a deduction to offset the taxable income of non-utility affiliates. Therefore, AEP East must flow realized tax

²⁵ AEP East Answer at 20-22.

²⁶ *Id.* at 21 n.87 (quoting Opinion No. 173, 23 FERC at 61,859) (emphasis added).

benefits back to the transmission customers who pay the depreciation expense in transmission rates.

The non-utility affiliates' taxable income is not the source of the tax benefit referenced in Opinion No. 173 because that taxable income did not create the NOL. When it comes to the ratemaking treatment of tax benefits resulting from the utilization of NOL carryforwards, AEP East must determine the underlying source of the tax loss or deductions that gave rise to the NOL. In this proceeding, the NOL was caused by accelerated depreciation for tax purposes of public utility assets and other deductions associated with the revenues and expenses included in the transmission revenue requirement.²⁷ AEP East's upside-down, backwards, and inside-out ratemaking treatment of NOL ADIT is therefore not consistent with the matching principle of the Commission's tax normalization requirements, the Commission's Stand-Alone Method, and the Commission's benefits and burdens test.

D. AEP East applies a prohibited Separate Return Methodology in making its ratemaking adjustments associated with NOL Carryforwards ADIT.

In an attempt to dispute the Joint Customer Group's positions regarding the use of a Separate Return Methodology, AEP East shifts the focus to instances where it removes certain non-jurisdictional items from the income tax allowance and follows an approach generally consistent with the Commission's Stand-Alone Method to develop an income tax allowance for cost-of-service based on the revenues and costs entering into the jurisdictional rate.²⁸ The Joint Customer Group has not disputed in this proceeding AEP East's removal of actual ADIT amounts reported in the FERC Form 1 associated with revenues and expenses that are excluded from the

²⁷ Note that NOL ADIT not associated with the revenues and expenses included in the revenue requirement would not be included in rate base and would not be relevant for ratemaking purposes.

²⁸ Hodgson Affidavit at 15-16.

transmission revenue requirement. Rather, the Joint Customer Group specifically disputes AEP East's rate treatment for NOL ADIT that includes as inputs to the transmission formula rate ADIT ratemaking adjustments that increase rate base, do not exist on the AEP East's accounting books and tax records, have already been realized through inclusion in AEP's consolidated income tax return, and resulted in tax benefits that should accrue to the benefit of ratepaying customers as part of transmission formula rate calculations.

The Joint Customer Group disputes AEP East's Separate Return Method for computing NOL carryforwards ADIT because it ignores the fact that AEP East elected to participate in the filing of AEP's consolidated federal income tax returns and fails to recognize the tax savings benefits AEP East realized from participating in the filing of those consolidated returns. Rather, AEP East computes its ratemaking adjustments based on a separate return basis ignoring the benefits it realizes from participating in the filing of consolidated federal income tax returns.²⁹

The Commission has explained that use of a Separate Return Method ignores the consolidated tax return and reflects in the tax allowance none of the tax-reducing benefits the consolidated tax group realizes from participating in the filing of a consolidated federal income tax return like AEP's. It is on this basis that the Joint Customer Group concludes that AEP East's treatment of NOL carryforwards ADIT ratemaking adjustments is based on a Separate Return Method that employs the fiction that AEP East does not realize tax benefits from participating in the filing of a consolidated federal income tax return.³⁰ The Commission should not be distracted by irrelevant adjustments to the income tax allowance unrelated to NOL ADIT, such as those related to the non-jurisdictional items noted above. AEP East's own description of its proposed

²⁹ Nicholas Affidavit at 50.

³⁰ Opinion No. 173, 23 FERC at 61,852.

income tax allowance demonstrates that it reflects a prohibited Separate Return Methodology due to the ratemaking adjustments for NOL carryforwards ADIT and NOL carryforwards deficient ADIT.³¹

E. Commission precedent cited by the Joint Customer Group demonstrates that the Commission has addressed the principles at issue in this proceeding numerous times.

The Joint Customer Group cited Commission precedent demonstrating several principles relevant to this proceeding. First, the Commission has allowed ADIT liability to be included in rate base where the ADIT was associated with the depreciation of assets included in a pipeline's revenue requirement.³² Second, upon the deemed sale of assets under section 338(h)(10) of the Internal Revenue Code ("IRC"), the Commission ruled that the ADIT liability was no longer appropriately included in rate base because the tax liability had become payable.³³ In *Koch Gateway*,³⁴ the ADIT liability was settled and paid in the filed income tax return and no longer existed on the accounting or income tax books. The Commission found that the ADIT liability should be removed from rate base because the deferred tax liability became due and payable and was already paid to the IRS, so the tax liability no longer existed.³⁵ Accordingly, AEP East should not be allowed to include separate return NOL carryforwards ratemaking adjustments that result in ADIT additions to rate base for NOL carryforwards ADIT associated with accelerated tax depreciation after the depreciation deductions have been used to offset consolidated taxable income and no longer exist on AEP East's books and income tax records.

³¹ Joint Customer Group Affidavit of Steven Hunt Exh. FCC-0002 at 12-14 ("Hunt Affidavit").

³² *Id.* at 21-23.

³³ *Id.*

³⁴ *Id.* at 21 (citing *Koch Gateway Pipeline Co.*, 74 FERC ¶ 61,088, at 61,275-6 (1996) ("Koch Gateway I"), *reh'g denied*, 75 FERC ¶ 61,132, at 61,463-4 (1996) ("Koch Gateway II").

³⁵ *Koch Gateway II*, 75 FERC ¶ 61,132 at 61,463.

F. AEP East’s concern regarding a potential income tax normalization violation is not supported by the facts.

AEP East confuses the issue of application of the IRS’s income tax normalization requirements by citing Private Letter Rulings (“PLR”) that are not applicable to AEP East’s facts and circumstances. AEP East summarized several PLRs, arguing that “[t]he PLRs all stated that if a NOLC is the result of accelerated depreciation, the NOLC DTA must be included in ratemaking in order to follow a normalization method of accounting. These PLRs confirm that a normalization violation would exist if the NOLC DTA was not included in rate base.”³⁶ AEP East argues further that the goal of this normalization rule is to ensure rate base is not reduced by amounts of deferred tax liabilities (“DTL”) associated with accelerated depreciation deductions not yet realized in the filed income tax return. AEP East concludes that the NOL must be included in rate base to offset the portion of DTL not yet used to reduce taxable income in the income tax return.

With regard to the NOL in the current proceeding, AEP East has, however, already realized the income tax benefits of accelerated tax depreciation to the extent the NOL caused by accelerated depreciation has been included in the AEP consolidated federal income tax return, used to reduce taxable income, and the resulting tax savings realized. Once the NOL sourced by accelerated tax depreciation has been included and utilized in the consolidated income tax returns, the normalization concern in the referenced PLRs has been resolved. AEP East misses the mark, arguing that absent its proposed erroneous implementation of the Commission’s Stand-Alone Method, it would face a normalization violation. It would be incorrect and illogical for an income tax normalization violation to be associated with NOL carryforwards ADIT where the related income tax deductions have been fully utilized and realized on AEP’s consolidated federal tax

³⁶ Hodgson Affidavit at 10.

returns. That is, once AEP receives the tax benefit of the accelerated depreciation tax deductions through the inclusion of NOL deductions in AEP's consolidated federal income tax returns, the normalization concern discussed in the PLRs is resolved. AEP East's claims with respect to potential violations have no merit.

A fundamental error in AEP East's position regarding the risk of normalization violations is the belief that the source of the NOL carryforwards is determined by the source of the taxable income that it is applied against in the consolidated income tax return, rather than the source of the tax deductions that caused the NOL. Under the IRS normalization rules, the amount of the NOL caused by accelerated tax depreciation deductions is determined using the "With-and-Without" test. In this proceeding, the NOL at issue are for the most part caused by accelerated tax depreciation deductions and, as of December 31, 2020, all of AEP East's consolidated NOL carryforwards resulting from AEP East accelerated tax depreciation deductions had been fully utilized on the AEP consolidated federal tax returns and reduced consolidated federal taxable income. With this understanding, the inclusion of deductions for NOL carryforwards in a tax return causes the benefits associated with accelerated depreciation to be realized.

AEP East argues that "the IRS has ruled in several PLRs that in order to avoid a violation of the normalization requirements of IRC Section 168(i)(9) and Treasury Regulation Section 1.167(l)-1, it is necessary to include in rate base the deferred tax asset ('DTA') resulting from a NOLC, given the inclusion in rate base of the full amount of the deferred tax liability resulting from accelerated tax depreciation."³⁷ However, AEP East fails to put the IRS rulings in proper context and to appropriately apply those rulings to this proceeding. The IRS rulings apply to circumstances where NOL carryforwards ADIT associated with accelerated depreciation

³⁷ AEP East Answer at 24.

deductions have not been utilized on tax returns filed with a taxing authority and the resulting ADIT is not applied as an adjustment to rate base. That is not the fact pattern here. The separate return NOL carryforwards ADIT invented by AEP East in this proceeding is caused by accelerated depreciation that has already been utilized by inclusion in the consolidated income tax return, where the full benefits associated with the deferred tax liability for depreciation have already been realized. The fact pattern here differs from the fact patterns in the IRS rulings and permits the NOL ADIT to be excluded from rate base without risk of a normalization violation.

To further support its position, AEP East claims that PLRs issued by the IRS concluded that to avoid a normalization violation, the reserve for deferred taxes for the period used in determining tax expense in the cost of service must consider instances in which taxes are deferred due to accelerated tax payments.³⁸ AEP East also argues that the IRS rulings did not specifically address tax sharing payments. However, the PLRs cited by AEP East pertain to the inclusion in rate base of taxes that are in fact deferred. In contrast, AEP East's NOL ADIT is no longer "deferred" once it is included in a tax return and offsets taxable income. The NOL has been realized and utilized, resulting in it no longer being "deferred." Accordingly, there would be no need for the IRS to consider whether the deferred tax was associated with a tax sharing payment. Additionally, the absence of mention of a tax sharing payment in a statement on the application for a PLR has no bearing on any IRS normalization policy or precedent.

Under the IRS's normalization requirements and PLR determinations, the reserve for deferred taxes associated with accelerated tax depreciation, including the deferred taxes on an NOL: (1) should be included in rate base only if applicable to deferred tax items that remain deferred and are associated with accelerated tax deductions, and (2) do not include deferred taxes

³⁸ *Id.* at 9.

for a NOL sourced by accelerated tax depreciation if no longer deferred, once realized through the income tax return. AEP East would have the Commission believe that it must consider items of deferred tax in rate base that are not actually deferred for accounting or income tax purposes and may have never been deferred at all.³⁹

G. AEP East’s ratemaking adjustments to compute deficient ADIT do not comply with Order No. 864.

AEP East disputes the Joint Customer Group’s position that the AEP East Companies’ implementation of the Separate Return Method violates Order No. 864 due to their implementation of the Separate Return Method in years prior to the Tax Cuts and Jobs Act of 2017. AEP East asserts that the Joint Customer Group’s position rests on two faulty premises: (1) that the Commission specifically approved remeasured ADIT balances in the Order No. 864 compliance process, and (2) that the remeasurement can only occur once. The Joint Customer Group clearly explained that AEP East’s remeasurement of deficient ADIT is inconsistent with Order No. 864 because the order did not allow for measurements of deficient ADIT based on ratemaking adjustments or other amounts that are not on the accounting or tax books.

The Joint Customer Group also explained that AEP East’s implementation of the Separate Return Method for NOL carryforwards ADIT should have been presented to the Commission during the Order No. 864 proceedings, since AEP East was pursuing this change in methodology while AEP East’s Order No. 864 compliance filing was being evaluated by the Commission. AEP East failed to explain in its Order No. 864 compliance filing its separate return NOL carryforwards ADIT method and the resulting ADIT ratemaking adjustments for Account 1901001, as well as related ADIT deficiency ratemaking adjustments for Accounts 2821001 and 2831001. Only after

³⁹ For example, where the NOL of one AEP East utility generated in tax year 2022 is used to offset the taxable income of an affiliate in the same tax year, the NOL would have never been reported as a deferred tax asset in Account 190 in 2022 for FERC Form 1 reporting purposes.

making its Order No. 864 compliance filing did AEP East implement its separate return NOL carryforwards ratemaking adjustments.

H. AEP East implemented separate return NOL carryforwards ratemaking adjustments on its own initiative and that ratemaking change was not requested by the Joint Customer Group during the 2019 Rate Year Review.

AEP East asserts the origin of its implementation of the Separate Return Method stems from the 2019 Rate Year formula rate review.⁴⁰ This assertion is not relevant to the issue before the Commission here. During the 2019 Rate Year formula rate review, the Joint Customer Group made inquiries regarding the treatment of NOL ADIT associated with amended AEP consolidated federal tax returns. It was unclear from the parties' discussions whether AEP East's accounting entries related to the amended federal tax returns were consistent with the FERC Stand-Alone Method based on the limited information provided. The Joint Customer Group elected to defer the discussion of the issue to future reviews so as to understand the issue further and present a fully supported challenge to the Commission, if necessary.

The Joint Customer Group's inquiry and concern for proper application of the FERC Stand-Alone Method during the 2019 Rate Year formula rate review did not ask AEP East to implement what is now before the Commission. Neither was AEP East's proposed ratemaking adjustment formally proposed and vetted during the 2019 Rate Year formula rate review. In addition, the NOL ADIT issue before the Commission now is different from the issue of concern during the 2019 Rate Year review. The Commission should focus on whether AEP East's separate return NOL carryforwards ADIT ratemaking adjustments for the 2021 Rate Year are consistent with the filed tariff and Commission policy and disregard AEP East's inaccurate and irrelevant statements.⁴¹

⁴⁰ Duffy Affidavit at 7.

⁴¹ AEP East Answer at 3, 10.

III. CONCLUSION

WHEREFORE, for the foregoing reasons, the Joint Customer Group respectfully renews its request that the Commission issue an order: (1) prohibiting AEP East from (a) using its Separate Return Methodology, (b) including ADIT related to rate refunds in rate base, or (c) including ADIT associated with CIAC in rate base; (2) requiring further that AEP East issue refunds, with interest, for all overcharges beginning with the 2021 Rate Year; and (3) granting such further relief as the Commission may deem appropriate.

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Dated: May 9, 2023

CERTIFICATE OF SERVICE

I hereby certify that I have on this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Columbus, Ohio this 9th day of May, 2023.

/s/ Gerit F. Hull

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