186 FERC ¶ 61,033
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Willie L. Phillips, Acting Chairman;
Allison Clements and Mark C. Christie.

Appalachian Power Company	Docket Nos.	ER17-405-000
AEP Appalachian Transmission Company Inc.		ER17-406-000
American Municipal Power, Inc., *et al.* v. Appalachian Power Company *et al.*, and AEP Appalachian Transmission Company Inc., *et al.*		EL23-51-000

ORDER ON FORMAL CHALLENGE AND COMPLAINT AND DIRECTING A COMPLIANCE FILING

(Issued January 18, 2024)

1. On May 25, 2022, AEP East Transmission Companies (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.) filed annual informational filings in Docket No. ER17-406-000 that detail the true-up calculations of the charges for the 2021 rate year under their transmission formula rates in the PJM Interconnection, L.L.C. (PJM) Open Access Transmission Tariff (Tariff).[1]

2. On May 25, 2022, as revised on May 27, 2022, AEP East Operating Companies (Appalachian Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company, and Wheeling Power Company) filed annual informational filings in Docket No. ER17-405-000 that detail the true-up calculations of the charges for the 2021 rate year under their transmission formula

[1] PJM, OATT ATT H-20A, OATT Attachment H-20A - AEPTCo (1.1.0) (Protocols); PJM, OATT ATT H-20B - Part I, OATT Attachment H-20B - AEPTCo - Part I (7.0.0) (Formula Rate Template).

rates in the PJM Tariff. The order refers to AEP East Operating Companies and AEP East Transmission Companies as AEP East.[2]

3. On March 8, 2023, in Docket Nos. ER17-405 and ER17-406, pursuant to sections 206, 306, and 309 of the Federal Power Act (FPA),[3] American Municipal Power, Inc., Blue Ridge Power Agency, Indiana Municipal Power Agency, Mishawaka Utilities, Old Dominion Electric Cooperative, and Wabash Valley Power Association, Inc. (together, Joint Customers), filed a formal challenge and complaint regarding the formula transmission service rates that have been charged by the AEP East Operating Companies and the AEP East Transmission Companies for rate years 2021 and 2022 (Formal Challenge and Complaint). On March 14, 2023, Joint Consumers refiled the Complaint in Docket No. EL23-51.

4. As discussed below, we grant in part, the Formal Challenge, and direct AEP East to submit a compliance filing within 60 days of the date of this order. We also find that we need not address the alternative Complaint as it raises the same arguments as in the Formal Challenge.

I. <u>Background</u>

A. <u>Formal Challenge and Complaint</u>

5. Following AEP East's 2022 Annual Update, Joint Customers submitted a Preliminary Challenge on January 7, 2022. In the Formal Challenge and Complaint, Joint Customers allege that AEP East improperly: (1) changed methods for treating accumulated deferred income taxes (ADIT) related to net operating losses;[4] (2) inappropriately included ADIT related to rate refunds in rate base; and (3) inappropriately

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[2] The terms AEP East Operating Companies and AEP East Transmission Companies refer to the shared tariffs filed in in Attachment H-14 and H-20 of the PJM Tariff, respectively. PJM, OATT ATT H-14A, OATT Attachment H-14A – AEP East (5.1.0) (Protocols); PJM, OATT ATT H-14B Part I, OATT Attachment H-14B Part I - AEP East Companies (9.0.0) (Formula Rate Template). The Formula Rate consists of the formula rate templates and formula rate implementation protocols, which are substantially the same for the AEP East Transmission Companies and AEP East Operating Companies.

[3] 16 U.S.C. §§ 824e, 825e, & 825h.

[4] A net operating loss is defined: "When an entity has more tax savings associated with all of its available deductions than income" (Formal Challenge and Complaint at 10).

included ADIT associated with contributions in aid of construction (CIAC) in the AEP East 2021 annual transmission revenue requirement (ATRR).

B. ADIT and Net Operating Losses

6. Deferred tax liabilities and assets are known as ADIT. ADIT balances are accumulated on the regulated books and records of such regulated companies based on the requirements of the Uniform System of Accounts (USofA).[5] ADIT arises from timing differences between the method of computing taxable income for reporting to the Internal Revenue Service (IRS) and the method of computing income for regulatory accounting and ratemaking purposes.[6] That is, a utility's accumulated deferred tax liabilities reflect tax dollars collected from customers but not yet paid by the utility, while accumulated deferred tax assets reflect tax dollars paid by the utility but not yet collected from customers in rates.

7. Deferred tax assets are also created when there is a carryover of net operating losses that are available to offset income earned in future tax years. A net operating loss for income tax purposes results when an entity has not realized the cash benefits or tax savings associated with all of its available tax deductions. Depending on the year in which the net operating loss occurred, the net operating loss may be carried back to prior tax years to offset taxable income or carried forward to future tax years and used to reduce taxable income in those future tax years.[7]

8. A net operating loss carryforward is created when tax deductions exceed taxable income, and the associated net operating loss cannot be carried back to reduce taxable income in tax years prior to the year the net operating loss originated. When a net operating loss is carried forward, an ADIT asset must be recorded in Account 190, until the net operating loss is used to reduce taxable income in the future. As the net operating loss is used in future tax years to offset future taxable income, the ADIT asset is reduced

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[5] *See* Definition of Accounts 182.3 and Account 254, 18 C.F.R. pt. 101 (2022) (*Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act*).

[6] *See Acct. & Ratemaking Treatment of Accumulated Deferred Income Taxes & Treatment Following the Sale or Ret. of an Asset*, 165 FERC ¶ 61,115, at P 3 (2018); 18 C.F.R. § 35.24(d)(2) (2020).

[7] *See Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking & Income Tax Purposes*, Order No. 144, FERC Stats. & Regs. ¶ 30,254 at 31,522, 31,530 (1981) (cross-referenced at 15 FERC ¶ 61,133), *order on reh'g*, Order No. 144-A, FERC Stats. & Regs. ¶ 30,340 (1982) (cross-referenced at 18 FERC ¶ 61,163); 18 C.F.R. § 35.24(d)(1).

by the amount of the net operating loss utilized on the tax return times the currently-enacted tax rate.

9. The Internal Revenue Code allows a holding company system to file consolidated federal income tax returns.[8] American Electric Power Company, Inc. (AEP) files a consolidated tax return for its companies, including the AEP East Companies. Filing a consolidated tax return allows that loss to offset income received by other member companies for purposes of calculating group taxable income. To the extent the group cannot fully utilize the tax benefit of net operating losses in the year they are generated, the group can utilize them as net operating loss carryforwards in following years.

10. Within the AEP consolidated tax group, group members (including AEP East) are compensated at the time their net operating loss, or the net operating loss carryforward, is used to offset income generated by another group member in the consolidated tax return.

C. Opinion No. 173

11. In Opinion No. 173, the Commission addressed the methodology for allocating the tax liability or savings realized by a group filing a consolidated tax return.[9] To determine the income taxes attributable to the individual members of a consolidated group, the Commission uses a "benefits and burdens" test, which allocates those tax benefits to offset expenses whose burden was borne by the individual member's ratepayers.[10]

12. The Commission explained that, under this so-called "stand-alone" allocation method, a utility's "tax allowance should not be based on the activities of others in the affiliated group but instead, like other costs, should be based on the activities of the [entity] itself."[11] In this regard, the Commission explained that "the test is whether the expenses that generate the deduction are used to determine the jurisdictional service's

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[8] *Columbia Gulf Transmission Co.*, Opinion No. 173, 23 FERC ¶ 61,396, at n.3 (*Columbia Gulf*), *reh'g denied*, 24 FERC ¶ 61,258 (1983), *aff'd sub. nom. City of Charlottesville v. FERC*, 774 F.2d 1205 (D.C. Cir. 1985).

[9] *Columbia Gulf*, 23 FERC ¶ 61,396.

[10] *See City of Charlottesville v. FERC*, 774 F.2d at 1217 (assigning tax benefits (deductions) attributable to expenses whose burden was borne by the ratepayers requires inquiry as to whether the customers of a regulated entity contributed to the expenses which created the loss deductions of the affiliate in the consolidated tax group).

[11] *Columbia Gulf*, 23 FERC at 61,857 (internal quotations omitted).

rates," and where they are, it then allocates to the jurisdictional service those deductions which were generated by expenses incurred in providing that service.[12]

13. The Commission explained that, despite the similar terminology, the "stand-alone" allocation method is different from the "separate return" method; the latter methodology assumes that the tax allowance should be equal to the tax the jurisdictional utility would pay if it filed a separate return. A separate return method ignores the consolidated tax return and reflects in the tax allowance none of the tax reducing benefits the group realizes from filing a consolidated tax return.[13]

II. Notice and Responsive Pleadings

14. Notice of the Formal Challenge and Complaint in Docket Nos. ER17-405-000 and ER17-406-000 was published in the *Federal Register*, 88 Fed. Reg. 17,564 (Mar. 23, 2023), with interventions or protests due on or before April 7, 2023. A notice of intervention was filed by the Indiana Utility Regulatory Commission.

15. Notice of the Complaint in Docket No. EL23-51-000 was published in the *Federal Register*, 88 Fed. Reg. 20,162 (Apr. 5, 2023), with interventions or protests due on or before April 11, 2023. Timely motions to intervene were filed by Monitoring Analytics, LLC and Buckeye Power, Inc.

16. On March 17, 2023, AEP East requested an extension of the 30-day comment period, from April 7, 2023 to April 21, 2023. On March 28, 2023, the Commission extended the comment date to and including April 23, 2023. On April 6, 2023, the Commission issued an errata clarifying that Docket No. EL23-51-000 also had an extended comment date to and including April 23, 2023.

17. On April 24, 2023, AEP East filed an answer to the Formal Challenge and Complaint. On May 10, 2023, Joint Customers filed an answer to AEP East's April 24 Answer. On May 25, 2023, AEP East filed an answer to Joint Customers' Answer.

III. Discussion

A. Procedural Matters

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214, the timely, unopposed motions to intervene and notice of

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[12] *Id.*

[13] *Id.* at 61,852.

intervention serve to make the entities that filed them parties to the respective proceedings.

19. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2), prohibits an answer to an answer unless otherwise ordered by the decisional authority. We accept Joint Customers' and AEP East's answers because they have provided information that assisted us in our decision-making process.

B. Substantive Matters

1. ADIT Treatment Related to Net Operating Losses and Net Operating Loss Carryforwards

a. Formal Challenge

20. Joint Customers argue that beginning with the 2021 rate year, AEP East implemented, for ratemaking purposes, a new method applicable to ADIT related to net operating losses. Joint Customers allege that AEP East erroneously describes this change as switching from a consolidated basis to a stand-alone basis.[14] Joint Consumers contend that the change unjustly and unreasonably inflates AEP East's combined ATRR for 2021 by $55,885,496 million.[15]

21. Joint Customers allege that AEP East's stand-alone net operating loss ADIT method is a prohibited separate-return methodology. Joint Customers explain that the prohibited separate-return method is where "the tax allowance would equal the tax the jurisdictional service would pay on its projected revenues less the deductions that would be shown on its return," because "[a] separate return policy . . . ignores the consolidated tax return and reflects in the tax allowance none of the tax reducing benefits the group realizes from filing a consolidated tax return."[16] Joint Customers contend that AEP East's new methodology embodies the separate return method because AEP East claims that its ratemaking adjustments should be made to effect stand-alone treatment of net operating losses by including ADIT assets for net operating losses that would not have been used to reduce taxable income on a hypothetical, separate return basis. Joint Customers explain that AEP East entered ratemaking adjustments for Accounts 190 (Accumulated Deferred Income Taxes), 282 (Accumulated Deferred Income Taxes – Other Property), and 283 (Accumulated Deferred Income Taxes – Other) for net operating losses on Worksheet B-1 and Worksheet B-2 that reduce the ADIT balances

[14] Formal Challenge and Complaint at 2.

[15] *Id*. at 17.

[16] *Id.* at 12-13 (citing Opinion No. 173, 23 FERC at 61,848).

used as reductions to rate base, thereby causing increases in rate base, the return component of the transmission revenue requirement, and the income tax allowance computed on the return component, relative to amounts permitted under the stand-alone allocation method.[17] Joint Customers argue that AEP East's ratemaking-only adjustments result in a higher revenue requirement and fail to properly assign the benefits of a consolidated tax return applicable to AEP East's transmission customers.[18]

22. According to Joint Customers, the AEP East companies participate in a tax sharing agreement. Joint Customers assert that a company with a loss receives a current payment from the holding company to the extent that the loss is offset by affiliate income within the consolidated group.[19] Joint Customers argue that, as of December 31, 2020, AEP East's net operating losses had been claimed and fully utilized on AEP's consolidated tax returns and that AEP East received tax sharing cash payments from AEP affiliates for the affiliates' use of AEP East's net operating loss.[20]

23. Joint Customers contend that AEP East's method erroneously ignores those tax sharing cash payments AEP East realized from AEP affiliates for the affiliates' use of AEP East's net operating loss on the AEP consolidated tax returns.[21] Joint Customers argue that under the Commission's stand-alone allocation method, the results of the consolidated tax return are not ignored.[22]

i. <u>AEP East April 24 Answer</u>

24. AEP East states that its ADIT adjustments are not done as if each of the AEP East Companies filed a separate return. Instead, AEP East states that under the stand-alone allocation method, AEP East companies derive their taxable income from all Commission-jurisdictional revenues and cost of service, consistent with Opinion No. 173.[23] AEP East states that since the issuance of Opinion No. 173, the Commission has

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[17] *Id.* at 13.

[18] *Id.* at 13-14.

[19] *Id.*, Nicholas Aff. at 28-29.

[20] Nicholas Aff. at 62-63.

[21] *Id.*

[22] *Id.* at 63.

[23] AEP East April 24 Answer at 18.

repeatedly emphasized the propriety of the stand-alone methodology, including for electric utilities.[24]

25. AEP East explains that the AEP East companies exclude non-jurisdictional costs that would be included in a separate return, and that some of its companies have business divisions that are non-jurisdictional and therefore do not impact customer rates.[25] AEP East provides the example of an AEP East company, IMPCo, which operates Lakin Water Transportation, a non-jurisdictional entity whose costs are not paid by transmission customers. AEP East explains that when Lakin impacts IMPCo's tax liability in a particular year, such an impact would not be considered in deriving the appropriate stand-alone net operating loss and net operating loss carryforwards, whereas it would be under a separate return methodology. AEP East explains that they opt to use the 2022 annual projection and 2021 true-up, because no revenues or expenses from an affiliate were included in the revenue requirement of an AEP East Company, and as prescribed by the Commission, exclude the gains or losses related to other activities that would appear on the financial statements of other affiliate companies.

26. AEP East explains its methodology for deriving the stand-alone method.[26] AEP East explains that it first identifies the total population of the utility's revenues and expenses. Second, AEP East asserts that it identifies the taxable income or loss generated by those revenues and expenses. Finally, AEP East determines the extent to which that taxable income or loss was associated with revenues and expenses included in the utility's revenue requirement.

27. AEP East argues that Joint Customers seem to suggest that each individual AEP East company should consider the tax sharing payments made or received by the company under AEP's tax sharing agreement. AEP East argues that such an approach has been rejected by the Commission. AEP East contends that, as the Commission explained in *Columbia Gulf*, such tax sharing payments should not be considered because "to treat the amounts allocated to members for tax purposes as the member's actual tax costs for ratemaking purposes would mean the tax allowance of a regulated member of an

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[24] *Id.* at 6 (citing *S. Nat. Gas Co.*, 23 FERC ¶ 61,397, at 61,879-80 (1983); *Potomac Edison Co*., 23 FERC ¶ 61,398, at 61,881 (1983) (stating in addition that "Opinion No. 173 applies with equal force to electric utilities as it does to gas pipelines"); *Sys. Energy Res., Inc.*, Opinion No. 375 (*SERI*), 60 FERC ¶ 61,131 (applying Opinion No. 173 to System Energy), order on reh'g, 61 FERC ¶ 61,031 (1992).

[25] AEP East April 24 Answer at 18-19.

[26] *Id.* at 20.

affiliated group would be determined by the election of the group."[27] According to AEP East, the court explained further that because "the internal allocation in no way affects rates, there is, under the Commission's test, no burden entitling ratepayers to corresponding tax benefits."[28] AEP East contends that under the Commission's benefits and burdens test, tax sharing payments are not a benefit to customers.[29]

28. In addition, AEP East contends that the IRS normalization rules do not consider inter-company tax sharing payments as advocated by Joint Customers because the Internal Revenue Code does not require tax sharing payments, a particular methodology for tax sharing payments, or provide the consequences of tax sharing payments. AEP East argues that to rely on those payments to determine the appropriate net operating loss and net operating loss carryforward on a stand-alone basis would be inconsistent with the IRS normalization requirements and would likely lead to a normalization violation.[30]

ii. Joint Customers May 10 Answer

29. Joint Customers answer that AEP East's assertion that Worksheet WS B ADIT & ITC permit AEP East to adjust the FERC Form No. 1 ADIT balances based on "Company records" are incorrect because Worksheet WS B ADIT & ITC, Note 1, specifically defines the term "Company records" as "[o]n this worksheet, 'Company Records' refers to AEP's tax forecast and accounting ledger." Accordingly, Joint Customers contend that the definition of "Company records" in the tariff does not include AEP East's ratemaking adjustments described above, which violates the filed-rate doctrine.[31]

30. Joint Customers claim that AEP East's separate return methodology on net operating loss carryforwards, and related formula rate entries, are not included in the AEP East Companies' accounting ledgers; nor are they reported in the AEP East Companies' FERC Form 1. Joint Customers maintain that AEP East's method results in improper and unauthorized inputs to the transmission Formula Rate ADIT Worksheets B,

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[27] *Id.* at 22-23 (citing *Columbia Gulf*, 23 FERC at 61,864).

[28] *Id.* at 23 (citing *City of Charlottesville v. FERC*, 774 F.2d at 1218).

[29] *Id.*

[30] *Id.* at 23-26.

[31] Joint Customers May 10 Answer at 9.

B-1, and B-2 that are not included in the AEP East Companies' accounting books or income tax records.[32]

31. Joint Customers further argue that AEP East improperly interprets and applies the Opinion No. 173 benefits and burdens test. Joint Customers contend that 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 net operating loss. Joint Customers state that AEP East must determine the underlying source of the tax loss or deductions that gave rise to the net operating losses. Joint Customers allege that in this proceeding, the net operating loss 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.[33]

32. Joint Customers dispute AEP East's separate return method for computing net operating loss carryforwards 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 associated tax savings benefits. Further, Joint Customers contend that AEP East should not be allowed to include separate return net operating loss carryforward ratemaking adjustments that result in ADIT additions to rate base for net operating loss 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.[34]

33. Joint Customers contend that the IRS income tax normalization requirements cited by AEP East are not applicable to the facts and circumstances of this proceeding.[35] Joint Customers contend that AEP East has since realized the income tax benefits of accelerated tax depreciation to the extent the net operating loss caused by accelerated depreciation has been included in the AEP consolidated federal income tax return and used to reduce taxable income. Joint Customers maintain that once the net operating loss caused 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.[36]

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[32] *Id.* at 11.

[33] *Id.* at 13-14.

[34] *Id.* at 16.

[35] *Id.* at 17.

[36] *Id.* at 17.

34. Joint Customers state that in this proceeding, the net operating losses at issue are primarily caused by accelerated tax depreciation deductions and, as of December 31, 2020, these deductions had been fully utilized on the AEP consolidated federal tax returns and reduced consolidated federal taxable income. As such, the Joint Customers argue that the inclusion of deductions for net operating loss carryforwards in a tax return causes the benefits associated with accelerated depreciation to be realized. Joint Customers explain that the IRS rulings apply to circumstances where net operating loss carryforwards ADIT associated with accelerated depreciation deductions have not been utilized on tax returns filed with a taxing authority.[37] Joint Customers assert that the resulting ADIT is not applied as an adjustment to rate base. Joint Customers argue that this permits the net operating loss ADIT to be excluded from rate base without risk of a normalization violation.[38]

35. Joint Customers contend that AEP East's implementation of the separate return method violates Order No. 864 due to their use of the separate return method in years prior to the Tax Cuts and Jobs Act of 2017. Joint Customers contend that only after making its Order No. 864 compliance filing did AEP East implement its separate return net operating loss carryforwards ratemaking adjustments.[39]

36. Joint Customers contend that they did not ask AEP East to implement what is now before the Commission. Further, the Joint Customers contend that the net operating loss ADIT issue before the Commission is different from the issue of concern during the 2019 rate year review. Joint Customers conclude that the Commission should focus on whether AEP East's ADIT ratemaking adjustments for the 2021 rate year are consistent with the filed tariff and Commission policy.[40]

iii. AEP East May 25 Answer

37. In response to the Joint Customers' argument that AEP East may not include any entries on Worksheets B-1 and B-2 that are not sourced from AEP's tax forecast and accounting ledger, AEP East states that its entries on Worksheets B-1 and B-2 are sourced from AEP's accounting ledgers, its books, and records and that they are consistent with the worksheets' requirements.[41] AEP East also states that on both this

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[37] *Id* at 18-19.

[38] *Id* at 18-19.

[39] *Id.* at 20.

[40] *Id.* at 21.

[41] AEP East May 25 Answer at 5-7.

filing and the AEP West filing, Joint Customers do not cite a single legal authority supporting their claim that AEP East cannot implement the stand-alone policy in the existing formula and claim that Joint Customers recognize that AEP East could make such changes without a formula rate modification.[42] AEP East argues that this leaves no basis for the Commission to find that AEP East violated the filed rate when it implemented the stand-alone methodology without a formula rate modification.

38. AEP East then responds to three separate arguments by Joint Customers that AEP East has not properly implemented the stand-alone methodology.[43] First, AEP East claims that it was Joint Customers that focused on the source of the net operating loss carryforward and affiliated companies' taxable income in evaluating an appropriate net operating loss carryforward and that AEP East demonstrated that such payments should not impact the appropriate net operating loss for an individual utility. Second, AEP East states that Joint Customers do not rebut the argument that the current benefit of tax deductions associated with expenses in the cost of service rates is limited to the gross taxable revenues in those same rates.[44] AEP East argues that its approach follows the Commission's guidance in Opinion No. 173 to ensure that the benefits and burdens are not increased or decreased by tax gains or losses of an affiliate, if the gains or losses are not included in the utility's cost of service.[45] Third, AEP East argues that its approach appropriately matches the benefits and burdens on a stand-alone basis because, as explained by D.C. Circuit, "[t]he theoretical tax liability for the pipeline's net income may never be reflected on anyone's actual tax bill, since it may be offset by losses of the parent and other affiliates . . . [is] no obstacle to the [stand-alone methodology], neither in theory nor in economic reality."[46]

39. AEP East also rebuts Joint Customers' assertion that the Commission should not be concerned about a potential IRS normalization violation, explaining that the principle from previous IRS proceedings is that the IRS requires "consistency with respect to the assumptions used for the computation of tax expense, depreciation expense, deferred taxes, and rate base of the regulated company" and that as such there is substantial risk

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[42] *Id.* at 6-7 (citing AEP East April 24 Answer at 14).

[43] *Id.* at 7-9.

[44] *Id.* at 8 (citing Ex. AEP-0001 at 9).

[45] *Id.* at 8-9 (citing Ex. AEP-0001 at 9).

[46] *Id.* at 9 (citing *City of Charlottesville*, 774 F.2d at 1215).

that Joint Customers' proposed ratemaking treatment is not in conformity with IRS normalization requirements.[47]

iv. <u>Commission Determination</u>

40. We grant Joint Customers' Formal Challenge as to the disputed ADIT inputs to the Formula Rate adjustments. We find that AEP East fails to demonstrate the justness and reasonableness of its adjustments to its ADIT inputs to rate base for the 2021 rate year to implement its new method for allocating net operating loss carryforward ADIT.[48]

41. AEP East's ADIT balances are inputs to its Formula Rate, which ultimately determine AEP East's transmission rate for the 2021 rate year. To implement its new methodology for allocating net operating loss carryforward ADIT, AEP East performed adjustments to its ADIT allocations on its ADIT Worksheets B-1 and B-2, which provide for itemization of amounts in each ADIT account and allocation of each item for inclusion in the ADIT inputs to rate base in the Formula Rate. Under AEP East's Formula Rate, AEP East bears the burden of demonstrating the justness and reasonableness of the rate in any formal challenge proceeding.[49] Therefore, while Worksheets B-1 and B-2 provide AEP East flexibility with respect to how ADIT amounts are itemized and individual items are allocated, AEP East bears the burden to demonstrate that the allocation of ADIT for inclusion in the ADIT inputs to rate base in the Formula Rate are just and reasonable. As discussed below, we find that AEP East's new methodology for allocating net operating loss carryforward ADIT for each of the AEP East companies for ADIT inputs to rate base in the Formula Rate does not satisfy the Commission's benefits and burdens test, which assigns to the utility's ratepayers those tax benefits attributable to expenses borne by the utility's ratepayers. Therefore, we find AEP East's adjustments to its ADIT inputs to rate base for the 2021 rate year to implement its new method for allocating net operating loss carryforward ADIT result in

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[47] *Id.* at 9-11.

[48] For subsequent rate years, *see* PJM, OATT ATT H-20A, OATT Attachment H-20A – AEPTCo, § 4(k) (1.1.0) (AEP East Transmission Companies); PJM, OATT ATT H-14A, OATT Attachment H-14A – AEP East, § 4(k) (5.1.0) (AEP East Operating Companies).

[49] PJM, OATT ATT H-20A, OATT Attachment H-20A – AEPTCo, § 5(f); PJM, OATT ATT H-14A, OATT Attachment H-14A – AEP East, § 5(f) (stating that "In any Formal Challenge proceeding concerning a given year's Annual Update . . . AEP shall demonstrate the justness and reasonableness of the rate resulting from its application of the Formula Rate.").

unjust and unreasonable allocation of ADIT for its ADIT inputs to rate base in the Formula Rate.[50]

42. AEP East states that it utilizes the stand-alone allocation method, but as discussed below, its methodology fails to account for the tax benefits it has utilized. Under the stand-alone method, the utility files consolidated tax returns, which expressly take into account the tax reducing benefits the consolidated group realizes by filing such a return. For example, when an individual utility has a net operating loss carryforward, it is generally added to rate base. When the utility is part of a corporate family, the utility may receive the benefit of the tax loss realized on a consolidated tax return, resulting in a decrease in rate base, thus, benefiting the customers. A stand-alone allocation method, in effect, looks beneath the single consolidated tax liability and analyzes each of the deductions used to reduce the group's tax liability to determine the deductions applicable to each jurisdictional service. The stand-alone allocation method then allocates to each jurisdictional service those deductions that were generated by expenses incurred in providing that service.[51]

43. By contrast, the Commission has explained that a separate return policy ignores the consolidated tax return and reflects in the tax allowance none of the tax reducing benefits the group realizes from filing a consolidated tax return.[52] As the Commission explained in *Columbia Gulf*, a separate return tax calculation is not the same as a stand-alone tax calculation.[53] AEP East has failed to account for the tax benefits related to the AEP consolidated federal income tax return and has not appropriately included those benefits when calculating its net operating loss carryforward for ratemaking purposes.[54] That is, AEP East failed to consider reducing its net operating losses with its proportionate share of those tax benefits, resulting in inappropriate ADIT input adjustments that increase transmission rates.[55]

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[50] *See City of Charlottesville v. FERC*, 774 F.2d at 1217.

[51] *Columbia Gulf*, 23 FERC at 61,852-53.

[52] *Id.* at 61,852.

[53] *Id*. at 61,852-53.

[54] *See* AEP East April 24 Answer at 10-11, 22-23; Hodgson Aff. at 10-21.

[55] ADIT balances recorded in Accounts 281 (ADIT—Accelerated Amortization Property), 282 (ADIT—Other Property), and 283 (ADIT—Other) are subtracted from rate base to reflect the fact that that this portion of rate base is not financed by investor funds. Opinion No. 144, FERC Stats. & Regs. ¶ 30,254 at 31,539, *reh'g denied*, Order

44. AEP East evaluates the federal income tax results of each AEP East company separately by determining the income and expenses that are considered in the ratemaking of an AEP East company, but excluding tax benefits realized on a consolidated basis.[56] As such, AEP East retains net operating loss carryforwards in its rates as if the tax benefits realized from filing on a consolidated basis did not occur, and thus it inappropriately includes ratemaking adjustments in its 2022 Annual Update that ultimately increase its transmission rates. Therefore, we find that AEP East fails to demonstrate that its proposed method results in allocation of ADIT for its ADIT inputs to rate base in the Formula Rate that provides transmission customers tax benefits in proportion to their burdens.[57]

45. Further, in *SERI*, the Commission found that the tax savings realized from the filing of a consolidated tax return by Entergy, which fully utilized its subsidiary, System Energy's, interest deductions, must be fully assigned to System Energy's ratepayers. Specifically, the Commission applied its benefits and burdens test from *Columbia Gulf* and affirmed that tax benefits must follow burdens.[58] The Commission found that System Energy's ratepayers bear the interest expense used as a tax deduction on the consolidated return; therefore, System Energy's ratepayers must receive the tax benefit of those interest deductions.[59] That is, under the benefits and burdens test, if deductions based on costs included in jurisdictional company rates are used against income generated by affiliates to reduce tax liability on the consolidated return, the associated benefit of the deduction must be included in jurisdictional rates. Here, like System Energy, the AEP East Companies' ratepayers should receive the full benefit of the tax savings realized by the AEP East companies based on costs included in jurisdictional rates. Instead, AEP East denies its ratepayers those benefits, which is inconsistent with the benefits and burdens test.

46. Further, the Commission determined in *SERI* that the tax sharing agreements among affiliates did not follow the Commission's benefits and burdens test, and therefore the tax sharing payments under those agreements were not determinative in setting the taxes reflected in ratemaking.[60] That is, the threshold issue in the benefits and burdens

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No. 144-A, FERC Stats. &Regs. ¶ 30,340, *aff'd, Pub. Sys. v. FERC*, 709 F.2d 73.

[56] *See* AEP East April 24 Answer at 11, 17-19.

[57] *See Columbia Gulf*, 23 FERC at 61,861.

[58] *SERI*, 60 FERC at 61,475.

[59] *Id.* at 61,476.

[60] *Id.* at 61,475.

test is whether ratepayers are given the benefit of tax reduction resulting from the deductible expenses in their rates.[61] As discussed above, we find that AEP East's rate adjustments do not meet the Commission's benefits and burdens test.

47. Moreover, AEP East does not dispute that each AEP East company had fully utilized all of its federal net operating loss carryforwards on the AEP consolidated tax return as of December 31, 2020. In other words, AEP East had used up all of its net operating loss carryforwards as of December 31, 2020,[62] therefore no net operating loss ratemaking adjustments for the 2021 rate year are necessary or appropriate.

48. Accordingly, we direct AEP East to submit a compliance filing, within 60 days of the date of this order, detailing all of the calculations of the Formula Rate billings for the 2022 Annual Update, revised to reflect the exclusion of the disputed input net operating loss adjustments, as well as calculations of interest. In accordance with section 6 of the Protocols, we also direct AEP East to provide refunds with interest on all amounts improperly collected for the 2021 rate year, and for such refunds to "be reflected as adjustments in the Annual Update for the next Rate Year."[63]

49. Finally, we note that Joint Customers also argue that AEP East's change in methodology violates the filed rate and Order No. 864.[64] We agree with Joint Customers that AEP East fails to support the allocation of ADIT for inclusion in the ADIT inputs to rate base in the Formula Rate for the 2021 rate year. We therefore need not address whether the term "Company Records" would have permitted this adjustment.

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[61] *Id.*

[62] Formal Challenge and Complaint, Nicholas Aff. at 28; Joint Customers May 10 Answer at 3-4.

[63] PJM, OATT ATT H-14A, OATT Attachment H-14A – AEP East, § 6 (5.1.0); PJM, OATT ATT H-20A, OATT Attachment H-20A – AEPTCo, § 6 (1.1.0).

[64] *Pub. Util. Transmission Rate Changes to Address Accumulated Deferred Income Taxes*, Order No. 864, 169 FERC ¶ 61,139 (2019), *order on reh'g & clarification*, Order No. 864-A, 171 FERC ¶ 61,033 (2020).

2. ADIT Treatment Related to Rate Refunds

a. Formal Challenge

50. Joint Customers assert that AEP East has inappropriately included ADIT assets related to rate refunds – and the associated excess and deficient ADIT – in rate base.[65] Joint Customers explain that cases involving deferred tax assets and deferred tax liabilities as an adjustment to rate base rely on a comparison of when the utility actually remits the money to the taxing authority and when the utility actually recovers the money associated with the tax expense from ratepayers.[66] Joint Customers claim that regardless of whether AEP East utilizes functional books or an allocator, the templates are meant to functionalize ADIT and exclude ADIT items that are non-applicable or non-utility from the transmission Formula Rate and that it is unjust and unreasonable for AEP East to recover from ratepayers a rate base return on a deferred tax asset that exists only because AEP East over-recovered money from ratepayers, since that over-recovery is excluded from rate base.

51. Joint Customers instead argue that AEP East should include amounts related to these ADIT items in the transmission column of each of the respective 2021 operating company and transmission company Formula Rate templates despite a Commission determination in a similar case involving affiliates of AEP East that these ADIT amounts should be excluded.[67] Joint Customers continue that AEP East's Formula Rate templates return the refunds ratably over the year in which they are returned, which results in a lower rate recovery and taxable income and that the utility will be made whole as the revenue reduction to effect the refund is offset concurrently with the income tax allowance recovered in excess of actual income taxes payable, consistent with typical income tax normalization. Joint Customers state that there is no point at which AEP East will have to finance any of the deferred tax asset or the money necessary to fund the

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[65] Formal Challenge and Complaint at 17-19.

[66] Formal Challenge and Complaint at 18-19 (citing *Ariz. Pub. Serv. Co.*, 25 FERC ¶ 61,092, at 61,309 (1983) ("The issue, however, is not whether the proceeds were contributed by the ratepayers, but whether they were contributed by the investors."); *see id.* (quoting *Distrigas of Mass. Corp.*, 18 FERC ¶ 63,036, at 65,112 (1983) (initial decision) ("Time-honored precedent recognizes a utility's right to earn a fair return on investor-contributed capital (rate base). It follows then that a utility is not entitled to earn a return on that portion of rate base financed by sources other than the owner's capital."))).

[67] Formal Challenge and Complaint at 17-20 (citing *Sw. Power Pool, Inc.*, 178 FERC ¶ 61,208, at PP 64-65 (2022)).

return, other than interest owed on the refunds, which is indisputably the shareholders' burden.

52. Joint Customers state that AEP East does not include the balance of the refunds that generate the ADIT as a rate base credit even though these funds are, by definition, ratepayer-contributed capital.[68] Joint Customers argue that the provision for rate refunds is recorded using accounts that do not affect the computation of other components of the wholesale transmission cost of service, further rendering AEP East's proposed treatment to include the associated excess or deficient ADIT in the cost of service inappropriate because it does not adequately match costs with benefits. Joint Customers assert that the Commission should require AEP East to exclude these excess and deficient ADIT amounts from the Formula Rate and issue refunds, including interest,[69] dating back to the original error in the Formula Rate and that the combined revenue requirement impact for all of AEP East for this issue for the 2021 annual transmission revenue requirement is $106,798.

b. AEP East April 24 Answer

53. AEP East acknowledges that the Commission required certain affiliated transmission-owning companies in Southwest Power Pool, Inc. (AEP West) to remove ADIT associated with provisions for rate refunds, but argues that AEP West uses different formula rate templates wherein the ADIT items are allocated on an individual basis, rather than allocated based on the transmission functional books as they are for AEP East.[70] AEP East explains that the treatment of ADIT related to rate refunds grew out of a negotiated settlement to which Joint Customers were a party.[71] AEP East claims that the settlement contemplated a Formula Rate that utilizes balances for ADIT to be included in rate base based on the transmission functional books, rather than

[68] Formal Challenge and Complaint at 20-21.

[69] Joint Customers argue that while AEP East will have to pay interest on the refunds in addition to the refunds themselves, the interest rates applicable to the rate refunds are substantially lower than AEP East's rate of return applied to its rate base and it is unreasonable for AEP East to earn a return on the deferred tax asset while ratepayers earn only the FERC interest rate on the related liability.

[70] AEP East April 24 Answer at 30-31 (citing *Sw. Power Pool, Inc.*, 178 FERC ¶ 61,208 at P 65; *see* Worksheets B-1 and B-2; *see also* Duffy Aff. at 3-4).

[71] *Id.* at 30-31 (*See PJM Interconnection, L.L.C.*, 163 FERC ¶ 61,053, at P 1 (2018) (accepting a settlement filed on December 14, 2017 in Docket Nos. ER17-405 and ER17-406)). AEP East notes that all members of Joint Customers, aside from Mishawaka Utilities is a party to the settlement.

functionalizing ADIT regardless of whether the AEP East Companies utilize functional books or allocates ADIT items.

c. Commission Determination

54. We grant Joint Customers' Formal Challenge on the ADIT related to rate refunds. We find that because the underlying refund amounts associated with the ADIT asset recorded in Account 190 are not included in rate base, the associated ADIT asset and excess or deficient ADIT should not be included either.[72] The related ADIT must be *excluded* if the associated refund amounts are *excluded* from rate base. We direct AEP East Operating Companies and AEP East Transmission Companies to exclude the ADIT asset that is related to refund amounts that are excluded from rate base. We direct AEP to submit a compliance filing, within 60 days of the date of this order, detailing all of the calculations of the revised Formula Rate billings for the 2020 and 2021 Annual Updates as well as calculations of interest. We also direct, in accordance with section 6 of the Protocols, refunds with interest on all amounts improperly collected for the 2019 and 2020 rate years, and for such refunds to "be reflected as adjustments in the Annual Update for the next Rate Year."[73]

3. ADIT Treatment Related to Contributions in Aid of Construction

a. Formal Challenge

55. Joint Customers assert that AEP East has inappropriately included ADIT associated with CIAC in the AEP East 2021 ATRR for the respective AEP East Operating Companies and AEP East Transmission Companies and thus overstated the overall transmission revenue requirement for AEP East by $934,161.[74] According to Joint Customers, the CIAC ADIT amounts are related to customer-funded projects where a third-party requested that the utility perform work, and where CIAC is paid either up front, or at certain milestones, according to agreements between the utility and the third

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[72] Although the excess or deficient ADIT is included in the formula rate template, there is no evidence of the underlying asset. *See, e.g.,* PJM, OATT ATT H-14B Part I, OATT Attachment H-14B Part I, Worksheet B-2.

[73] PJM Interconnection, L.L.C., Intra-PJM Tariffs, OATT ATT H-14A, OATT Attachment H-14A - AEP East, § 6 (5.1.0) (AEP East Operating Companies). PJM Interconnection, L.L.C., Intra-PJM Tariffs, OATT ATT H-20A, OATT Attachment H-20A – AEPTCo, § 6 (1.1.0) (AEP East Transmission Companies).

[74] Formal Challenge and Complaint at 21.

party requesting the work, and are generally for the sole benefit of the requesting third party.

56. Joint Customers argue that Commission policy requires that if the contributor of CIAC makes that contribution to gain services from which the contributor benefits, then the contributor should pay the full cost of its contribution, including its tax effect.[75] Additionally, Joint Customers state that because AEP East functionalizes ADIT to rate base, ADIT is only included in rate base in proportion to the underlying assets, liability, expenses or revenues and thus it is inappropriate to include CIAC ADIT in rate base when those assets are effectively excluded from transmission rates. Joint Customers claim that such treatment is implemented on Worksheets WS B-1 and WS B-2 in each of the AEP East Operating Companies' and AEP East Transmission Companies' Formula Rate templates, where there are Columns D and E that are labeled Non-applicable/Non-utility where some of the CIAC ADIT amounts are labeled as distribution CIAC, even though such costs should be excluded because all CIAC-related ADIT included in the transmission Formula Rates is impermissible and because the underlying costs do not relate to the transmission function.

b. <u>AEP East April 24 Answer</u>

57. AEP East responds that the treatment of ADIT related to CIAC grew out of the negotiated settlement.[76] Additionally, AEP East argues that it was not the intent of the settlement that such ADIT would be excluded from rate base, but rather, the settlement contemplated that AEP East would use the transmission functional books to determine what ADIT is used in the Formula Rate calculation.[77]

c. <u>Commission Determination</u>

58. Although AEP East notes that CIAC ADIT is functionalized to transmission, it is unclear from the record whether the underlying CIAC (e.g., asset) is similarly functionalized to transmission, how AEP East accounts for CIAC on its books, and whether these practices are consistent with Commission precedent.[78] Additionally, the

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[75] Formal Challenge and Complaint at 22-23 (citing *Trailblazer Pipeline Co.*, 55 FERC ¶ 61,050, at 61,150 (1991)).

[76] AEP East April 24 Answer at 31-32.

[77] AEP East April 24 Answer at 32 (*See* Worksheets B-1 and B-2; *see also* Duffy Aff. at 3-4).

[78] *See Ameren Ill., Co.,* 162 FERC ¶ 61,025 (2018); *see also*, *Midcontinent Indep. Sys. Operator, Inc.,* 168 FERC ¶ 61,093 (2019).

settlement approved by the Commission does not explicitly mention CIAC. Accordingly, we direct AEP East to further explain the mechanics of how it includes CIAC-related ADIT and excess or deficient ADIT in its Formula Rate. We also direct AEP East to demonstrate who the contributors or the customers of the CIACs are, such as whether the facilities under the CIAC agreements are open access network transmission facilities, distribution facilities, or generator interconnection facilities, and why network integration transmission service customers would be allocated excess or deficient tax amounts for expenditures on facilities which may not be used for open access transmission service. Finally, we direct AEP East to further explain the interaction of any crediting mechanism with CIAC-related ADIT and excess and deficient ADIT.[79] We direct AEP East to include this information in the compliance filing ordered below.

4. Complaint

a. Joint Customers Complaint

59. Joint Customers state that if for any reason the Commission finds that the Joint Customers' Formal Challenge is outside the scope reserved for formal challenges under the Formula Rate, then the Commission should evaluate AEP East's Formula Rate under FPA section 206.[80] Joint Customers request that the Commission issue an order that (1) prohibits AEP East from using the separate return method for net operating loss carryforwards ADIT; (2) prohibits AEP East from including ADIT related to rate refunds in rate base; and (3) prohibits AEP East from including ADIT associated with CIAC in rate base.[81]

b. AEP East April 24 Answer

60. AEP East argues that the Commission should dismiss the Complaint as procedurally invalid and unsupported because it does not meet the requirements of FPA section 206 and the related Commission's rules. AEP East argues that Joint Customers fail to identify any action or inaction that is the subject of the Complaint and for failing to identify what aspect of the Formula Rate that Joint Customers contend is unjust and unreasonable.[82]

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[79] *See*, *e.g.*, *PJM Interconnection, L.L.C.*, 177 FERC ¶ 61,085, at P 101 (2021).

[80] Formal Challenge and Complaint at 24-25.

[81] *Id.* at 26.

[82] AEP East April 24 Answer at 32-33.

c. **Commission Determination**

61. Joint Customers request that the Commission evaluate AEP East's Formula Rate under FPA section 206 if the Commission finds that Joint Customers' Formal Challenge is outside the scope reserved for formal challenges under the Formula Rate. The parties do not dispute that Joint Customers' Formal Challenge is within the scope reserved for formal challenges under the Formal Rate. We agree. As such, we need not address the alternative Complaint as it raises the same arguments as in the Formal Challenge.

The Commission orders:

(A) Joint Customers' Formal Challenge is hereby granted in part, as discussed in the body of this order.

(B) We direct AEP East Operating Companies and AEP East Transmission Companies to exclude the ADIT asset that is related to refund amounts that are excluded from rate base, and direct AEP East to submit a compliance filing, within 60 days of the date of this order.

(C) We direct AEP East to submit a further compliance filing explaining the CIAC-related ADIT calculations within 60 days of the date of this order, as discussed in the body of this order.

By the Commission.

(S E A L)

Debbie-Anne A. Reese,
Acting Secretary.

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