

STATE OF TENNESSEE

Office of the Attorney General



**JONATHAN SKRMETTI**  
ATTORNEY GENERAL AND REPORTER

P.O. BOX 20207, NASHVILLE, TN 37202  
TELEPHONE (615) 741-3491  
FACSIMILE (615) 741-2009

July 5, 2024

Kelly Cashman-Grams  
c/o Ms. Tory Lawless, Docket Manager  
Tennessee Public Utility Commission  
502 Deaderick Street, 4<sup>th</sup> Floor  
Nashville, Tennessee 37242-0001

**Electronically Filed in TPUC Docket  
Room on July 5, 2024 at 1:37 p.m.**

Re: Tennessee Public Utility Commission, Docket No. 24-00028, *Tennessee Water Service, Inc. Petition for Approval of its 2024 Annual Rate Review Filing Pursuant to Tenn. Code Ann. § 65-5-103(d)(6) and Request for Rate Structure Modification*

Dear Ms. Cashman-Grams:

On July 1, 2024, the Consumer Advocate filed the Testimony of David N. Dittmore. There are a couple of corrections that are needed. First, on page 3, we referenced a \$2.91 monthly service charge decrease. This amount should be \$1.67 to match the table referenced later in the testimony. The other correction is the incorrect NOL balances on the top of page 8 and the explanation of same. We have corrected this portion to reflect the correct NOL balances with the corrected explanation.

Attached please find the Corrected Testimony of David N. Dittmore which replaces the previously filed testimony on July 1, 2024, in its entirety. The Consumer Advocate requests that this letter be filed in this Docket. Thank you.

Sincerely,

A handwritten signature in blue ink that reads "Shilina B. Brown".

Shilina B. Brown  
Senior Assistant Attorney General

cc: Ryan Freeman, Esq.

**IN THE TENNESSEE PUBLIC UTILITY COMMISSION  
AT NASHVILLE, TENNESSEE**

<b>IN RE:</b>	)	
	)	
<b>TENNESSEE WATER SERVICE, INC.</b>	)	
<b>PETITION FOR APPROVAL OF ITS 2024</b>	)	<b>Docket No. 24-00028</b>
<b>ANNUAL RATE REVIEW FILING</b>	)	
<b>PURSUANT TO TENN. CODE ANN.</b>	)	
<b>§ 65-5-103(d)(6) AND REQUEST FOR RATE</b>	)	
<b>STRUCTURE MODIFICATION</b>	)	

---

**CORRECTED TESTIMONY OF**

**DAVID N. DITTEMORE**

---

July 5, 2024

## Table of Contents

I.	BACKGROUND .....	1
II.	PURPOSE OF TESTIMONY .....	2
III.	EXECUTIVE SUMMARY .....	3
IV.	NET OPERATING LOSS COMPONENT OF ADIT .....	4
	A. THEORETICAL BASIS FOR RATE BASE INCLUSION .....	4
	B. TWS' NOL BALANCE IS NOT VERFIABLE .....	7
V.	REVENUE REQUIREMENT RECOMMENDATION .....	9
VI.	APPLICATION OF REVENUE EXCESS .....	11
VII.	RECOVERY OF 2019 DEFERRED OPERATING LOSSES .....	12
VIII.	AMORTIZATION PERIOD FOR ARM FILING COSTS .....	13
IX.	TWS RATE DESIGN PROPOSAL .....	14

1 I. Background

2 **Q1. PLEASE STATE YOUR NAME AND OCCUPATION FOR THE RECORD.**

3 **A1.** My name is David N. Dittmore. I am a self-employed consultant working in the utility  
4 regulatory sector.

5 **Q2. PLEASE PROVIDE A SUMMARY OF YOUR BACKGROUND AND**  
6 **PROFESSIONAL EXPERIENCE.**

7 **A2.** I received a Bachelor of Science Degree in Business Administration from the University  
8 of Central Missouri in 1982. I am a Certified Public Accountant licensed in Oklahoma  
9 (#7562). I was previously employed by the Kansas Corporation Commission (“KCC”) in  
10 various capacities, including Managing Auditor, Chief Auditor, and Director of the  
11 Utilities Division. I was self-employed as a utility regulatory consultant for approximately  
12 four years, primarily representing the KCC staff in regulatory issues. I also participated in  
13 proceedings in Georgia and Vermont, evaluating issues involving electricity and  
14 telecommunications regulatory matters.

15 Additionally, during this time frame, I performed a consulting engagement for Kansas Gas  
16 Service (“KGS”), my subsequent employer. For eleven years, I served as Manager and  
17 subsequently Director of Regulatory Affairs for KGS, the largest natural gas utility in  
18 Kansas, serving approximately 625,000 customers. KGS is a division of One Gas, a natural  
19 gas utility serving about two million customers in Kansas, Oklahoma, and Texas. I joined  
20 the Tennessee Attorney General's Office in September 2017 as a Financial Analyst. In July  
21 2021, I began my consulting practice.

1 I have been a Board Member of the Financial Research Institute (University of Missouri).  
2 I have also been a member of the NARUC Subcommittee on Accounting, the Vice-Chair  
3 of the Accounting Committee of the National Association of State of Utility Consumer  
4 Advocates (“NASUCA”), and an active participant in NASUCAs’ Natural Gas and Water  
5 Committees.

6 Overall, I have thirty years of experience in public utility regulation. I have presented  
7 testimony as an expert witness on many occasions. Attached as Exhibit DND-1 is a  
8 detailed overview of my background.

9 **Q3. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE THE**  
10 **TENNESSEE PUBLIC UTILITY COMMISSION (“TPUC” OR THE**  
11 **“COMMISSION”)?**

12 **A3.** Yes. I have submitted testimony in many TPUC dockets.

13 **Q4. ON WHOSE BEHALF ARE YOU APPEARING?**

14 **A4.** I am appearing on behalf of the Consumer Advocate Division of the Tennessee Attorney  
15 General’s Office (“Consumer Advocate”).

16 **II. Purpose of Testimony**

17 **Q5. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

18 **A5.** The purpose of my testimony is to support the recommendation of the Consumer Advocate  
19 in this matter.

20 **Q6. WHAT WAS THE SCOPE OF YOUR WORK IN THIS DOCKET?**

1 **A6.** The scope of my work in this Docket included reviewing the application, testimony and  
2 supporting schedules provided by Tennessee Water Service (“TWS”), issuing discovery,  
3 analyzing data provided by the Company, and researching prior Commission orders.

4 **III. Executive Summary**

5 **Q7. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.**

6 **A7.** As a result of my review, I am supporting the following recommendations:

- 7 • Future recognition of Net Operating Loss (“NOL”) assets should be based on  
8 providing a reconcilable TN-specific NOL balance and validating that TWS’  
9 parent company, Corix, has an NOL at the corporate level.
- 10 • The portion of TWS’ Accumulated Deferred Income Tax (“ADIT”) Liability  
11 related to the NOL tax asset should be removed from Rate Base in the historical  
12 base period.
- 13 • The historic period revenue excess is \$10,145, while the attrition period revenue  
14 excess is \$15,567.
- 15 • Based upon the revenue excess outlined in my Exhibits, I recommend the  
16 monthly service charges be reduced by \$1.67.
- 17 • The Commission should approve the ten-year amortization period applicable to  
18 2019 Operating Losses, consistent with similar Amortization periods adopted  
19 for the 2017/2018 Operating Losses.
- 20 • The Commission should permit the Company proposal to amortize rate case  
21 costs over a three-year period.
- 22 • The Company’s proposed rate design change is reasonable and should be  
23 adopted.
- 24 • Due to the rate design change wherein usage above 2,000 gallons per month is  
25 billed at a higher rate, the period between meter read dates should not exceed  
26 33 days.

27 **Q8. ARE YOU SPONSORING EXHIBITS ASSOCIATED WITH YOUR TESTIMONY?**

28 **A8.** Yes. I am sponsoring the following Exhibits:

29 Exhibit DND-1: Professional Background  
30

1 Exhibit DND-2: Federal Energy Regulatory Commission (FERC) Order, Docket EL  
2 23-51-000 issued January 18, 2024  
3

4 Exhibit DND-3: Rate Base – Historic and Attrition Period  
5

6 Exhibit DND-3.1: Rate Base Adjustment No. 1  
7

8 Exhibit DND-3.2: Response to Consumer Advocate DR No. 1-9  
9

10 Exhibit DND-4: Revenue Deficiency - Historic and Attrition Period  
11

12 Exhibit DND-5: Income Statement – Historic and Attrition Period  
13

14 Exhibit DND-6: Income Taxes – Historic and Attrition Period  
15

16 Exhibit DND-7: Capital Structure – Identical for Historic and Attrition Period  
17

18 Exhibit DND-8: Required Return – Historic and Attrition Period

19 **IV. Net Operating Loss Component of ADIT**

20 A. Theoretical Basis for Rate Base Inclusion

21 **Q9. PLEASE BEGIN BY DEFINING ADIT AND THE IMPLICATIONS ON THE**  
22 **CALCULATION OF UTILITY REVENUE REQUIREMENTS.**

23 **A9.** ADIT is the net balance of deferred tax assets and liabilities recorded on a utility's books  
24 pursuant to Generally Accepted Accounting Principles ("GAAP"). These balances account  
25 for the differences in the computation of taxable income for Internal Revenue Service  
26 ("IRS") purposes, and taxable income determined for financial reporting purposes and  
27 ratemaking. These differences must be accounted for on the utility's financial records and  
28 have implications for ratemaking.

**Q10. WHAT ACCOUNTS FOR THE DIFFERENCES BETWEEN TAXABLE INCOME IDENTIFIED FOR PURPOSES OF IRS TAX FILINGS AND TAXABLE INCOME FOR FINANCIAL REPORTING PURPOSES?**

**A10.** The largest distinction in how taxable income is defined between the two methods is the application of accelerated tax depreciation rates provided for in the Internal Revenue Code. Depreciation expense reflected in financial and ratemaking records is based upon more conservative straight-line depreciation rates adopted by state utility regulatory agencies. Beyond the application of accelerated (tax) depreciation rates and straight-line depreciation rates (book), the IRS generally defines taxable income on a cash basis, while taxable income for financial reporting purposes is defined on an accrual basis, consistent with the comprehensive application of accrual accounting. The concept of accrual accounting requires that a revenue be recorded at the time it is earned or an expense recorded when it is incurred. For IRS reporting purposes, revenue is reported when cash is received, and an expense is reported when cash is paid.

**Q11. IS INCOME TAX EXPENSE BUILT INTO THE RATEMAKING CALCULATION BASED UPON INCOME TAXES PAID TO THE IRS AND THE TENNESSEE DEPARTMENT OF REVENUE?**

**A11.** No. Income Taxes paid are lower than Income Tax expense reflected on a company's books and records, and that higher level of expense is included in the ratemaking formula. Essentially, ratepayers incur an amount of Income Tax expense greater than the corresponding payments the utility makes to taxing authorities. This difference between Income Tax expenses reflected on a utility's financial records and Income Taxes paid results in the recording of ADIT, a liability. This liability reflects amounts charged to



1 Income Tax expense that will theoretically be paid at some future date. The liability is a  
2 source of cost-free capital for the utility and is reflected as a reduction to Rate Base in the  
3 ratemaking formula.

4 **Q12. WHAT IS A NOL?**

5 **A12.** NOL occurs when taxable income is negative, when tax deductions exceed taxable  
6 revenue. This means that tax payments were reduced to zero; however, not all the  
7 deductions incorporated into the liability resulted in a cash benefit for the utility. Absent  
8 the recording of the NOL, the ADIT balance would overstate the source of cash available  
9 to the utility to finance its operations.

10 **Q13. WHAT IS A NOL IMPLICATION ON A UTILITY'S ADIT BALANCE?**

11 **A13.** A NOL is a tax asset that otherwise reduces the ADIT liability.

12 **Q14. HOW IS A NOL TREATED FOR RATEMAKING PURPOSES?**

13 **A14.** The treatment of the NOL for ratemaking is somewhat controversial and can involve  
14 affiliate transactions between the jurisdictional utility and its parent company. Simply the  
15 NOL component of an ADIT balance may be evaluated in any number of ways. In this  
16 Docket, I am recommending that the Commission adopt principles by which it should  
17 evaluate the NOL component of an ADIT balance for ratemaking purposes. I recommend  
18 the Commission adopt principles consistent with those of FERC in Docket EL 23-51-000.  
19 I have attached the order, identified as Exhibit DND-2.

20 **Q15. CAN YOU SUMMARIZE THE FINDINGS OF FERC AS THEY RELATE TO**  
21 **RECOGNIZING THE NOL IN THE RATE BASE?**

1 **A15.** Yes. While the order is quite detailed, FERC found that to the extent a jurisdictional utility  
2 has a NOL used within a consolidated tax return, the NOL should not be reflected as a Rate  
3 Base component. That is, if a consolidated tax return is filed and the NOL for the subject  
4 utility is used to reduce the taxable income of the parent entity that NOL should be excluded  
5 from Rate Base.<sup>1</sup>

6 **Q16. WHAT IS YOUR RECOMMENDATION CONCERNING HOW NOL'S SHOULD**  
7 **BE TREATED FOR RATEMAKING PURPOSES?**

8 **A16.** NOL balances should be eligible for ratemaking treatment if they meet the following  
9 conditions:

- 10 1. The subject utility has a verifiable and traceable net operating loss that results  
11 from utility operations.
- 12 2. If a consolidated return is filed, the parent company must also have a verifiable  
13 net operating loss accumulated as of the end of the test period. If the  
14 jurisdictional utility's operating loss has been used to benefit the parent  
15 corporation in reducing its taxable income, the NOL balance has been utilized  
16 and should not be reflected in Rate Base of the jurisdictional utility.
- 17 3. The NOL on the jurisdictional utility's books must be exclusive to regulated  
18 operations. To the extent an NOL is in whole or in part the result of unregulated  
19 tax losses, the NOL balance should not be included in Rate Base.

20 B. TWS' NOL Balance Is Not Verifiable

21 **Q17. DOES THE TWS NOL MEET THE THREE CRITERIA ABOVE?**

22 **A17.** No. The Company has indicated that its parent Corix is in a Net Operating Loss position.  
23 However, the TWS book balances were not traceable or verifiable as required in the second  
24 point. The third point related to non-regulated operations is not applicable to TWS;

---

<sup>1</sup> See Paragraph 44, page 15.

1           however, I wanted to mention it as it could be applicable to other Tennessee jurisdictional  
2           utilities.

3   **Q18. HAVE YOU REVIEWED THE NOL BALANCE TWS SEEKS TO INCLUDE IN**  
4   **RATE BASE IN THIS PROCEEDING?**

5   **A18.** Yes. The average NOL balance in the historical test period was \$79,022, while the year-  
6           end balance included in the attrition period was \$76,516. These balances are comprised of  
7           federal NOL and state NOL components.<sup>2</sup>

8   **Q19. DID YOU NOTE ANOMALIES IN THE NOL DATA?**

9   **A19.** Yes. The response to Consumer Advocate DR No. 1-18 indicates that TWS had positive  
10          taxable income of \$119,243 and \$107,734 in 2022 and 2023, respectively. Thus, I would  
11          have expected to see a commensurate reduction in the NOL balance, approximating the  
12          composite tax rate applied to the taxable income. This portion of the NOL would be used  
13          to offset taxable income in each of those years. The IRS permits corporations to use NOL  
14          balances to offset future tax obligations. Therefore, the NOL asset should be reduced by  
15          the tax obligation relieved due to the previously generated operating loss. The asset  
16          balance associated with the federal NOL should have been reduced by over \$20,000 yearly  
17          due to applying the composite state/federal tax rate to that year's taxable income, each of  
18          which were in excess of \$100,000. The NOL asset did decline over these two years by  
19          approximately \$5 thousand, significantly less than the expected decline when applying the  
20          composite tax rate including 21% for federal taxes and 6.5% for Tennessee excise tax.

---

<sup>2</sup> See response to Consumer Advocate DR No. 1-9, replicated as Exhibit DND-3.2.

1 As a result, I do not have confidence in the accuracy of the NOL component of the  
2 Company's ADIT balance, and I recommend its removal from the Rate Base. The  
3 Company has not provided a verifiable and traceable NOL balance in this proceeding.

4 **Q20. DOES THE PROCEDURAL SCHEDULE ASSOCIATED WITH ARM FILINGS,**  
5 **SUCH AS THIS ONE, ALLOW THE TIME FOR THE UTILITY TO CORRECT**  
6 **ACCOUNTING DATA?**

7 **A20.** No. The schedules associated with ARM filings are extremely tight. It is the utility's  
8 responsibility to ensure its data's accuracy before submission within an ARM filing.

9 **V. Revenue Requirement Recommendation**

10 **Q21. PLEASE IDENTIFY THE REVENUE REQUIREMENT YOU ARE SUPPORTING**  
11 **IN THIS PROCEEDING.**

12 **A21.** I have calculated excess revenue in the historical test period of \$10,145 and a revenue  
13 excess of \$10,145 in the attrition period, as identified in Exhibit DND-4. TWS supported  
14 an excess revenue calculation of \$2,337.<sup>3</sup> As discussed above, I support one adjustment in  
15 this proceeding: eliminating the NOL balance within the ADIT liability. This adjustment  
16 accounts for the difference in excess revenue calculation I am supporting compared to the  
17 Company's. The NOL adjustment has also impacted the calculation of Income Tax  
18 Expense in the historic base period.

---

<sup>3</sup> See TWS Exhibit 1, Schedule C.

1 The schedules identified above, specifically Exhibits DND-3 through DND-8, set forth the  
2 various components of the revenue requirement calculation I support. Exhibits DND 3.1  
3 and 3.2 provide support for the NOL adjustment proposed in this case.

4 **Q22. IS THE CALCULATED REVENUE EXCESS BASED UPON THE HISTORIC**  
5 **BASE PERIOD RESULTS OR DOES IT INCORPORATE THE ATTRITION**  
6 **PERIOD?**

7 **A22.** My recommendation incorporates the results of the historic base period but does not  
8 incorporate the attrition period forecast.

9 **Q23. WHY HAVE YOU NOT INCORPORATED THE ATTRITION PERIOD RESULTS**  
10 **IN RECOMMENDING THE REVENUE EXCESS IN THIS CASE?**

11 **A23.** The combination of two factors has caused me to limit my rate reduction proposal to the  
12 results of the historical base period. It is important to keep in mind that if I had incorporated  
13 the attrition period results into the calculation the proposed rate reduction would have been  
14 larger than my current proposal.<sup>4</sup> Therefore my proposal to not incorporate the attrition  
15 period results produces a lower rate reduction that would otherwise occur.

16 The Company is operating under a Stipulation and Agreement in which they cannot raise  
17 rates during the first two ARM filings. The present filing is the first of the two filings  
18 subject to the rate case. The attrition period results are an estimate, and especially so under  
19 the provisions of the Company's ARM, which are driven to some extent by using three-  
20 year averages. The attrition period forecast will be trued-up in the Company's next filing.

21 To the extent the attrition period forecast turns out to be too conservative, any revenue

---

<sup>4</sup> Incorporating anticipated attrition period results would have reduced rates \$15,568, rather than the recommended \$10,145.

1 requirement excess occurring in 2024 will be reflected in the results of the next ARM.  
2 However, if such forecasts turn out to be more favorable than the actual results, the  
3 Company would be precluded from recovery of those deficiencies. For this reason, I  
4 recommend in this unique situation that the rate reduction be limited to the results of the  
5 historic period.

6 **VI. Application of Revenue Excess**

7 **Q24. WHAT DOES THE TWS TARIFF CALL FOR IN THE EVENT THE**  
8 **COMMISSION DETERMINES THERE IS EXCESS REVENUE WITHIN AN**  
9 **ARM REVIEW?**

10 **A24.** The tariff requires that any over-earnings will result in a reduction in rates.<sup>5</sup>

11 **Q25. HOW DO YOU PROPOSE TO MODIFY RATES RESULTING FROM THE**  
12 **EXCESS REVENUE?**

13 **A25.** I propose reducing the monthly service charge so that it is spread evenly across all  
14 customers within the system.

15 **Q26. WHAT WOULD THE MONTHLY RATE IMPACT BE IF THE COMMISSION**  
16 **DETERMINES A RATE REDUCTION IS APPROPRIATE?**

17 **A26.** The table below calculates the \$1.67 decrease in the monthly service charge:

18 *[Intentionally Blank, Table on Next Page]*

---

<sup>5</sup> TWS Application, TPUC Docket No. 24-00028, Exhibit 1, Schedule G, Sheet 13, (April 30, 2024).

		Table 1		
		Rate Design Associated with 2023 Excess Earnings		
Line No.		Annual	Monthly	Source
1	Revenue Excess	\$ (10,145)	\$ (845)	Exhibit DND-4
2	Less: Company Proposed Rate Reduction	\$ (578)	\$ (48)	TWS Schedule 1, Exhibit C
3	Net Reduction in Base Rates	\$ (9,567)	\$ (797)	
4	Total 2023 Residential Bills	5,696	474.67	TWS Schedule B-1
5	Total 2023 Fire Service Bills	36	3	TWS Schedule B-1
6	Total Monthly Customers		477.67	
7	Reduction in Monthly Rate		\$ (1.67)	Line 3 / Line 6

**Q27. CAN YOU EXPLAIN YOUR RATE DESIGN PROPOSAL?**

**A27.** Yes. As mentioned above, I have calculated an attrition period revenue excess of \$10,145 as set forth in Exhibit DND-4. I subtracted the Company's proposed rate reduction of \$578 from this amount to determine the incremental rate reduction I am supporting. I then calculated the monthly excess revenue

**VII. Recovery of 2019 Deferred Operating Losses**

**Q28. WHAT IS THE COMPANY PROPOSING REGARDING THE RECOVERY OF DEFERRED OPERATING LOSSES?**

**A28.** The Company seeks approval to amortize its operating losses for October 2018 – December 2019 over a ten-year period and recover such costs in rates.<sup>6</sup>

**Q29. CAN YOU PROVIDE BACKGROUND INFORMATION REGARDING THE COMPANY'S REGULATORY ASSETS ASSOCIATED WITH DEFERRED LOSSES?**

<sup>6</sup> *Testimony of Phillip J. Drennen*, p. 6, TPUC Docket No. 24-00028, (April 30, 2024).

1   **A29.** In the Company’s last base rate case, TPUC Docket No. 19-00028, the Commission  
2           authorized the Company to defer its operating losses from October 1, 2018, through  
3           December 31, 2019. Previously in TRA Docket No. 17-00108,<sup>7</sup> the Commission adopted  
4           a regulatory asset allowing TWS to defer operating losses beginning January 1, 2017,  
5           through filing its next rate proceeding, with the termination date later defined as September  
6           30, 2018.<sup>8</sup>

7   **Q30. WHAT IS YOUR POSITION REGARDING THE COMPANY’S REQUESTED**  
8           **TEN-YEAR AMORTIZATION OF ITS OCTOBER 2018 – DECEMBER 2019**  
9           **OPERATING LOSSES?**

10 **A30.** I agree with the Company that it should use a ten-year amortization period to expense  
11           deferred operating losses from October 1, 2018 through December 31, 2019. This  
12           amortization period is consistent with that adopted by the Commission for deferred losses  
13           in the earlier period.

14                           **VIII. Amortization Period for ARM Filing Costs**

15 **Q31. WHAT IS THE COMPANY SEEKING REGARDING THE AMORTIZATION OF**  
16           **REGULATORY COSTS INCURRED IN ITS ANNUAL RATE MECHANISM**  
17           **(“ARM”) DOCKET?**

18 **A31.** The Company seeks approval for a three-year amortization of its incurred costs in  
19           processing its ARM, in TPUC Docket No. 23-00046.<sup>9</sup>

---

<sup>7</sup>       *Petition of Tennessee Water Service for Approval of an Interim Emergency Wildfire Restoration Surcharge and other relief*, Commission Order, p. 10, TRA Docket No. 17-00108, (February 21, 2018).

<sup>8</sup>       *Petition of Tennessee Water Service Inc. for Adjustment of Rates and Charged, and other relief*, Commission Amended Order, p. 28, TPUC Docket No. 19-00028, (March 9, 2020).

<sup>9</sup>       *Id.*



1 **Q32. WHAT IS YOUR RECOMMENDATION CONCERNING THE COMPANY'S 3-**  
2 **YEAR AMORTIZATION PROPOSAL OF REGULATORY COSTS?**

3 **A32.** The 3-year amortization proposal is reasonable, and I recommend its adoption by the  
4 Commission.

5 **IX. TWS RATE DESIGN PROPOSAL**

6 **Q33. CAN YOU PROVIDE AN OVERVIEW OF THE COMPANY'S RATE DESIGN**  
7 **PROPOSAL?**

8 **A33.** Yes. The Company seeks to reimplement block usage rates. Under its proposal, the  
9 Company seeks to expand the volume that is covered under the service charge from 1,000  
10 gallons to 2,000. That is, under the TWS proposal, customers would not incur a volumetric  
11 charge on usage of 2,000 gallons per month. Usage over 2,000 gallons per month would  
12 be billed at inclining rates. The proposed volumetric charges are as follows:<sup>10</sup>

13	<b>0 – 2,000 gallons:</b>	<b>\$0</b>
14	<b>2,001 – 6,000 gallons:</b>	<b>\$16.93 per thousand gallons</b>
15	<b>6,001 – 12,000 gallons:</b>	<b>\$19.98 per thousand gallons</b>
16	<b>Over 12,000 gallons:</b>	<b>\$22.88 per thousand gallons</b>

17 Currently, all volumes of over 1,000 per month are billed at the rate of \$14.95 per thousand  
18 gallons. The Company also seeks a reduction in the monthly service charge of \$.04/month.  
19 The impact of this proposal is to reduce the charges to low-volume customers by increasing  
20 the volumes exempt from the volumetric charges. Higher volume users will pay more  
21 under the Company's proposed rate design.

---

<sup>10</sup> The three private fire customers would experience rates similar to those outlined here; a slight reduction in the service charge, with an increase in the volumetric rate.

1 **Q32. WHAT IS YOUR RECOMMENDATION REGARDING THE COMPANY’S RATE**  
2 **DESIGN PROPOSAL?**

3 **A32.** I support the Company’s proposal as it encourages conservation while being revenue-  
4 neutral, including the slight reduction in rates proposed by the Company.

5 **Q33. GIVEN THE PROPOSED SERVICE CHARGE REDUCTION IDENTIFIED**  
6 **ABOVE, WHAT IS YOUR NET SERVICE CHARGE APPLICABLE TO**  
7 **RESIDENTIAL AND FIRE SERVICE CUSTOMERS?**

8 **A33.** The Company proposes service charges of \$49.96 and \$35.77 for its Residential and Fire  
9 Service customers, respectively. I am proposing a monthly decrease of \$1.67 for each  
10 customer type, resulting in rates of \$48.29 and \$34.10, respectively.

11 **Q34. DO YOU HAVE ANY OTHER RECOMMENDATIONS SURROUNDING THE**  
12 **COMPANY’S RATE DESIGN PROPOSAL?**

13 **A34.** Yes. The Company currently uses a third-party contractor to perform manual meter reads.  
14 I obtained the 2023 meter read dates in response to Consumer Advocate DR No. 1-3 to  
15 determine whether these reads are obtained at approximate 30-day intervals. Consistent  
16 meter reads become important when moving to an inclining block rate design based upon  
17 monthly usage.

18 **Q35. PLEASE EXPLAIN WHY CONSISTENT METER READ PERIODS ARE MORE**  
19 **IMPORTANT WITH AN INCLINING BLOCK RATE STRUCTURE.**

20 **A35.** Assume that one billing period is extended by 36 days. This increased usage period  
21 (beyond the standard month) could result in a higher level of billed usage when applied at

1 a higher volumetric rate than would otherwise occur if the usage had been determined based  
2 upon 30 days consumption.

3 **Q36. DO YOU HAVE A RECOMMENDATION AFTER REVIEWING THE TWS**  
4 **METER READ DATES?**

5 **A36.** Yes. I recommend the Commission require tariff language indicating that meter read dates  
6 shall not be any longer than 33 days from the prior reading. This period strikes a balance  
7 between protecting ratepayers from higher volumetric rates simply due to an unusually  
8 long period between meter read dates and providing some flexibility to the Company in  
9 operating a small, somewhat rural water system.

10 **Q37. DOES THIS CONCLUDE YOUR TESTIMONY?**

11 **A37.** Yes. I reserve the right to amend my testimony if new information becomes available.

IN THE TENNESSEE PUBLIC UTILITY COMMISSION  
AT NASHVILLE, TENNESSEE

IN RE:

TENNESSEE WATER SERVICE, INC.  
PETITION FOR APPROVAL OF ITS  
2024 ANNUAL RATE REVIEW FILING  
PURSUANT TO TENN. CODE ANN.  
§ 65-5-103(d)(6) AND REQUEST FOR  
RATE STRUCTURE MODIFICATION

DOCKET NO. 24-00028

AFFIDAVIT

I, David N. Dittmore, on behalf of the Consumer Advocate Division of the Attorney General's Office hereby certify that the attached Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Division.

David N. Dittmore  
DAVID N. DITTEMORE

Sworn to and subscribed before me

This 27 day of June, 2024

Terra Allen  
NOTARY PUBLIC



My Commission Expires: 1/31/2027

David Dittamore

Experience

**Areas of Specialization**

Approximately thirty-years experience in evaluating and preparing regulatory analysis, including revenue requirements, mergers and acquisitions, utility accounting and finance issues and public policy aspects of utility regulation. Presented testimony on behalf of my employers and clients in natural gas, electric, telecommunication and transportation matters covering a variety of issues.

Self-Employed; **Consultant July 1 - Current**; Responsible for providing evaluation of utility ratemaking issues on behalf of clients. Prepare analysis and expert witness testimony.

Tennessee Attorney General's Office; **Financial Analyst September, 2017 – June 2021**; Responsible for evaluation of utility proposals on behalf of the Attorney General's office including water, wastewater and natural gas utility filings. Prepare analysis and expert witness testimony documenting findings and recommendations.

Kansas Gas Service; **Director Regulatory Affairs 2014 - 2017; Manager Regulatory Affairs, 2007 - 2014**

Responsible for directing the regulatory activity of Kansas Gas Service (KOS), a division of ONE Gas, serving approximately 625,000 customers throughout central and eastern Kansas. In this capacity I have formulated strategic regulatory objectives for KOS, formulated strategic legislative options for KOS and led a Kansas inter-utility task force to discuss those options, participated in ONE Gas financial planning meetings, hired and trained new employees and provided recommendations on operational procedures designed to reduce regulatory risk. Responsible for the overall management and processing of base rate cases (2012 and 2016). I also played an active role, including leading negotiations on behalf of ONE Gas in its Separation application from its former parent, ONEOK, before the Kansas Corporation Commission. I have monitored regulatory earnings, and continually determine potential ratemaking outcomes in the event of a rate case filing. I ensure that all required regulatory filings, including surcharges are submitted on a timely and accurate basis, I also am responsible for monitoring all electric utility rate filings to evaluate competitive impacts from rate design proposals.

Strategic Regulatory Solutions; 2003 -2007

**Principal**; Serving clients regarding revenue requirement and regulatory policy issues in the natural gas, electric and telecommunication sectors

Williams Energy Marketing and Trading; 2000-2003

**Manager Regulatory Affairs**; Monitored and researched a variety of state and federal electric regulatory issues. Participated in due diligence efforts in targeting investor owned electric utilities for full requirement power contracts. Researched key state and federal rules to identify potential advantages/disadvantages of entering a given market.

MCI WorldCom; 1999 - 2000

**Manager, Wholesale Billing Resolution;** Manage a group of professionals responsible for resolving Wholesale Billing Disputes greater than \$50K. During my tenure, completed disputes increased by over 100%, rising to \$150M per year.

Kansas Corporation Commission; 1984- 1999

**Utilities Division Director** - 1997 - 1999; Responsible for managing employees with the goal of providing timely, quality recommendations to the Commission covering all aspects of natural gas, telecommunications and electric utility regulation; respond to legislative inquiries as requested; sponsor expert witness testimony before the Commission on selected key regulatory issues; provide testimony before the Kansas legislature on behalf of the KCC regarding proposed utility legislation; manage a budget in excess of \$2 Million; recruit professional staff; monitor trends, current issues and new legislation in all three major industries; address personnel issues as necessary to ensure that the goals of the agency are being met; negotiate and reach agreement where possible with utility personnel on major issues pending before the Commission including mergers and acquisitions; consult with attorneys on a daily basis to ensure that Utilities Division objectives are being met.

**Asst. Division Director** - 1996 - 1997; Perform duties as assigned by Division Director.

**Chief of Accounting** 1990 - 1995; Responsible for the direct supervision of 9 employees within the accounting section; areas of responsibility included providing expert witness testimony on a variety of revenue requirement topics; hired and provided hands-on training for new employees; coordinated and managed consulting contracts on major staff projects such as merger requests and rate increase proposals;

**Managing Regulatory Auditor, Senior Auditor, Regulatory Auditor** 1984 - 1990; Performed audits and analysis as directed; provided expert witness testimony on numerous occasions before the KCC; trained and directed less experienced auditors on-site during regulatory reviews.

Amoco Production Company 1982 - 1984

**Accountant** Responsible for revenue reporting and royalty payments for natural gas liquids at several large processing plants.

#### **Education**

- B.S.B.A. (Accounting) Central Missouri State University
- Passed CPA exam; (Oklahoma certificate # 7562) - Not a license to practice

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).<sup>1</sup>

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

---

<sup>1</sup> 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).

Docket No. ER17-405-000, *et al.*

- 2 -

rates in the PJM Tariff. The order refers to AEP East Operating Companies and AEP East Transmission Companies as AEP East.<sup>2</sup>

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),<sup>3</sup> 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. Background**

### **A. Formal Challenge and Complaint**

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;<sup>4</sup> (2) inappropriately included ADIT related to rate refunds in rate base; and (3) inappropriately

---

<sup>2</sup> 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.

<sup>3</sup> 16 U.S.C. §§ 824e, 825e, & 825h.

<sup>4</sup> 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).<sup>5</sup> 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.<sup>6</sup> 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.<sup>7</sup>

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

---

<sup>5</sup> 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*).

<sup>6</sup> 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).

<sup>7</sup> 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.<sup>8</sup> 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.<sup>9</sup> 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.<sup>10</sup>

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.”<sup>11</sup> 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

---

<sup>8</sup> *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).

<sup>9</sup> *Columbia Gulf*, 23 FERC ¶ 61,396.

<sup>10</sup> *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).

<sup>11</sup> *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.<sup>12</sup>

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.<sup>13</sup>

## **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

---

<sup>12</sup> *Id.*

<sup>13</sup> *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.<sup>14</sup> Joint Consumers contend that the change unjustly and unreasonably inflates AEP East's combined ATRR for 2021 by \$55,885,496 million.<sup>15</sup>

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."<sup>16</sup> 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

---

<sup>14</sup> Formal Challenge and Complaint at 2.

<sup>15</sup> *Id.* at 17.

<sup>16</sup> *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.<sup>17</sup> 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.<sup>18</sup>

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.<sup>19</sup> 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.<sup>20</sup>

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.<sup>21</sup> Joint Customers argue that under the Commission's stand-alone allocation method, the results of the consolidated tax return are not ignored.<sup>22</sup>

**i. AEP East April 24 Answer**

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.<sup>23</sup> AEP East states that since the issuance of Opinion No. 173, the Commission has

---

<sup>17</sup> *Id.* at 13.

<sup>18</sup> *Id.* at 13-14.

<sup>19</sup> *Id.*, Nicholas Aff. at 28-29.

<sup>20</sup> Nicholas Aff. at 62-63.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 63.

<sup>23</sup> AEP East April 24 Answer at 18.

repeatedly emphasized the propriety of the stand-alone methodology, including for electric utilities.<sup>24</sup>

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.<sup>25</sup> 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.<sup>26</sup> 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

---

<sup>24</sup> *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).

<sup>25</sup> AEP East April 24 Answer at 18-19.

<sup>26</sup> *Id.* at 20.

affiliated group would be determined by the election of the group.”<sup>27</sup> 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.”<sup>28</sup> AEP East contends that under the Commission’s benefits and burdens test, tax sharing payments are not a benefit to customers.<sup>29</sup>

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.<sup>30</sup>

**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.<sup>31</sup>

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,

---

<sup>27</sup> *Id.* at 22-23 (citing *Columbia Gulf*, 23 FERC at 61,864).

<sup>28</sup> *Id.* at 23 (citing *City of Charlottesville v. FERC*, 774 F.2d at 1218).

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 23-26.

<sup>31</sup> 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.<sup>32</sup>

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.<sup>33</sup>

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.<sup>34</sup>

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.<sup>35</sup> 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.<sup>36</sup>

---

<sup>32</sup> *Id.* at 11.

<sup>33</sup> *Id.* at 13-14.

<sup>34</sup> *Id.* at 16.

<sup>35</sup> *Id.* at 17.

<sup>36</sup> *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.<sup>37</sup> 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.<sup>38</sup>

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.<sup>39</sup>

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.<sup>40</sup>

**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.<sup>41</sup> AEP East also states that on both this

---

<sup>37</sup> *Id* at 18-19.

<sup>38</sup> *Id* at 18-19.

<sup>39</sup> *Id.* at 20.

<sup>40</sup> *Id.* at 21.

<sup>41</sup> 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.<sup>42</sup> 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.<sup>43</sup> 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.<sup>44</sup> 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.<sup>45</sup> 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."<sup>46</sup>

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

---

<sup>42</sup> *Id.* at 6-7 (citing AEP East April 24 Answer at 14).

<sup>43</sup> *Id.* at 7-9.

<sup>44</sup> *Id.* at 8 (citing Ex. AEP-0001 at 9).

<sup>45</sup> *Id.* at 8-9 (citing Ex. AEP-0001 at 9).

<sup>46</sup> *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.<sup>47</sup>

**iv. Commission Determination**

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.<sup>48</sup>

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.<sup>49</sup> 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

---

<sup>47</sup> *Id.* at 9-11.

<sup>48</sup> 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).

<sup>49</sup> 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.<sup>50</sup>

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.<sup>51</sup>

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.<sup>52</sup> As the Commission explained in *Columbia Gulf*, a separate return tax calculation is not the same as a stand-alone tax calculation.<sup>53</sup> 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.<sup>54</sup> 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.<sup>55</sup>

---

<sup>50</sup> See *City of Charlottesville v. FERC*, 774 F.2d at 1217.

<sup>51</sup> *Columbia Gulf*, 23 FERC at 61,852-53.

<sup>52</sup> *Id.* at 61,852.

<sup>53</sup> *Id.* at 61,852-53.

<sup>54</sup> See AEP East April 24 Answer at 10-11, 22-23; Hodgson Aff. at 10-21.

<sup>55</sup> 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.<sup>56</sup> 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.<sup>57</sup>

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.<sup>58</sup> 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.<sup>59</sup> 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.<sup>60</sup> That is, the threshold issue in the benefits and burdens

---

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

<sup>56</sup> See AEP East April 24 Answer at 11, 17-19.

<sup>57</sup> See *Columbia Gulf*, 23 FERC at 61,861.

<sup>58</sup> *SERI*, 60 FERC at 61,475.

<sup>59</sup> *Id.* at 61,476.

<sup>60</sup> *Id.* at 61,475.

test is whether ratepayers are given the benefit of tax reduction resulting from the deductible expenses in their rates.<sup>61</sup> 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,<sup>62</sup> 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."<sup>63</sup>

49. Finally, we note that Joint Customers also argue that AEP East's change in methodology violates the filed rate and Order No. 864.<sup>64</sup> 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.

---

<sup>61</sup> *Id.*

<sup>62</sup> Formal Challenge and Complaint, Nicholas Aff. at 28; Joint Customers May 10 Answer at 3-4.

<sup>63</sup> 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).

<sup>64</sup> *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.<sup>65</sup> 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.<sup>66</sup> 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.<sup>67</sup> 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

---

<sup>65</sup> Formal Challenge and Complaint at 17-19.

<sup>66</sup> 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.”))).

<sup>67</sup> 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.<sup>68</sup> 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,<sup>69</sup> 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.<sup>70</sup> 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.<sup>71</sup> 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

---

<sup>68</sup> Formal Challenge and Complaint at 20-21.

<sup>69</sup> 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.

<sup>70</sup> 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).

<sup>71</sup> *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.<sup>72</sup> 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."<sup>73</sup>

**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.<sup>74</sup> 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

---

<sup>72</sup> 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.

<sup>73</sup> 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).

<sup>74</sup> 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.<sup>75</sup> 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. AEP East April 24 Answer**

57. AEP East responds that the treatment of ADIT related to CIAC grew out of the negotiated settlement.<sup>76</sup> 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.<sup>77</sup>

**c. Commission Determination**

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.<sup>78</sup> Additionally, the

---

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

<sup>76</sup> AEP East April 24 Answer at 31-32.

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

<sup>78</sup> *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.<sup>79</sup> 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.<sup>80</sup> 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.<sup>81</sup>

##### **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.<sup>82</sup>

---

<sup>79</sup> See, e.g., *PJM Interconnection, L.L.C.*, 177 FERC ¶ 61,085, at P 101 (2021).

<sup>80</sup> Formal Challenge and Complaint at 24-25.

<sup>81</sup> *Id.* at 26.

<sup>82</sup> 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 Formula 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.

Document Accession #: 20240118-3021

Filed Date: 01/18/2024

Document Content(s)

ER17-405-000.docx.....1

Tennessee Water Service  
Docket 24-00028  
2024 ARM Filing

Exhibit DND-3

Rate Base and Rate of Return  
Consumer Advocate

Line No.	Description	Historic Period Per Books	Historic Period Adjustment	Per TWS Historic Period As Adjusted	Per CA To Remove NOL ADIT	Historic Period As Adjusted	Per TWS Attrition Period Under Present Rates	CA Adj to Remove 12/31/23 NOL Balance	CA Pro-Forma Attrition Period	Proposed Increase/ (Decrease)	Attrition Period Under Proposed Rates
		[A]	[B]	[C]			[E]			[F]	[G]
1	Net Operating Income	148,969	(178)	148,791	(520)	148,271	147,155	5,263	152,419	(432)	151,987
2	Gross Plant In Service	3,204,626	(89,726)	3,114,899		3,114,899	3,204,626		3,204,626		3,204,626
3	Accumulated Depreciation	(504,326)	21,557	(482,769)		(482,769)	(504,326)		(504,326)		(504,326)
4	Net Plant In Service	2,700,300	(68,169)	2,632,130		2,632,130	2,700,300		2,700,300	-	2,700,300
5	Cash Working Capital	30,857	-	30,857		30,857	36,615		36,615		36,615
6	Contributions In Aid of Construction	(647,037)	28,464	(618,573)		(618,573)	(647,037)		(647,037)		(647,037)
7	Accumulated Deferred Income Tax:	(61,104)	10,368	(50,736)	(79,022)	(129,758)	(61,104)	(76,516)	(137,620)		(137,620)
8	Non-Current Asset	8,165	(8,165)	-		-	8,165		8,165		8,165
9	Excess Deferred Taxes	(66,291)	(868)	(67,158)		(67,158)	(64,695)		(64,695)		(64,695)
10	Deferred Charges	321,711	6,974	328,685		328,685	268,981		268,981		268,981
11	Regulatory Liability	(359,183)	(2,730)	(361,913)		(361,913)	(352,889)		(352,889)		(352,889)
12	Total Rate Base	1,927,417	(34,126)	1,893,291		1,814,269	1,888,336	(76,516)	1,811,820	-	1,811,820
13	Return on Rate Base	7.73%		7.86%		8.17%	7.79%		8.41%		8.39%

Tennessee Water Service  
Docket 24-00028  
2024 ARM Filing

Exhibit DND-3.1

ADIT Adjustment to Remove NOL Asset

Line No.	Item	12/31/22 Balance	12/31/23 Balance	Average	Source
1	Federal NOL Component of ADIT	\$ 64,056	\$ 65,387	\$ 64,721	Response to CA 1-9
2	State NOL Component of ADIT	\$ 17,473	\$ 11,129	\$ 14,301	Response to CA 1-9
3	Average NOL Balance in Test Period Rate Base	\$ 81,528	\$ 76,516	\$ 79,022	
		Attrition Period Adjustment		Historic Base Period Adjustment	

Tennessee Water Service  
Docket 24-00028  
2024 ARM Filing

Exhibit DND 3.2

Source: Response to CA 1-9

ADIT Components

Natural Account	Account Description	2020 Provision to Return	2021 Current Year Activity	2021 Reg Liability (Gross-Up) Amort	Water Service Corporation n ADIT Allocation	12/2021 Balance	2021 Provision to Return	2022 Current Year Activity	Reclass ADIT that belongs to Water Service Corporation	2022 Reg Liability (Gross-Up) Amort	Water Service Corporation n ADIT Allocation	12/2022 Balance	2022 Provision to Return	2023 Current Year Activity	2023 Reg Liability (Gross-Up) Amort	Water Service Corporation n ADIT Allocation	12/2023 Balance
4367	ADIT - FEDERAL	(1,079.00)	(1,236.00)	(543.60)	297.00	17,150.09	(4.00)	(1,125.00)	(567.00)	(543.77)	1,224.45	16,134.77	(98.00)	(1,110.00)	(289.20)	318.20	14,955.77
4375	ADIT - FEDERAL - DEFERRED RATE C.	(338.00)	4,052.00			(20,151.43)		4,053.00				(16,098.43)		(410.00)		667.69	(15,840.74)
4377	ADIT - FEDERAL - DEFERRED CHARGES		5,236.00		1.17	10,745.66		5,233.00			4.84	15,983.50		5,233.00			21,216.50
4383	ADIT - FEDERAL - ORGANIZATIONAL COST		13.00			129.48						129.48	13.00	13.00			155.48
4385	ADIT - FEDERAL - BAD DEBT RESERVE		227.00			323.57		(188.00)				135.57		(142.00)			(6.43)
4371	ADIT - FEDERAL - TAXABLE CIAC					4,041.86						4,041.86					4,041.86
4387	ADIT - FEDERAL - DEPRECIATION	(85.00)	(8,955.00)		35.41	(125,731.53)	14.00	(8,447.00)			145.99	(134,018.54)		(8,305.00)		47.71	(142,275.83)
4389	ADIT - FEDERAL - NOL	(200.00)	903.00			62,697.63	(152.00)	1,510.00				64,055.63	(3.00)	1,333.00		1.25	65,386.88
255001	Deferred Federal Tax Liabilities	(1,702.00)	240.00	(543.60)	333.58	(50,794.67)	(142.00)	1,036.00	(567.00)	(543.77)	1,375.28	(49,636.16)	(88.00)	(3,388.00)	(289.20)	1,034.85	(52,366.51)
						(50,794.67)						(49,636.16)					(52,366.51)
		check				0.00	check					0.00	check				0.00

Natural Account	Account Description	2020 Provision to Return	2021 Current Year Activity	2021 Reg Liability (Gross-Up) Amort	Water Service Corporation n ADIT Allocation	12/2021 Balance	2021 Provision to Return	2022 Current Year Activity	Reclass ADIT that belongs to Water Service Corporation	2022 Reg Liability (Gross-Up) Amort	Water Service Corporation n ADIT Allocation	12/2022 Balance	2022 Provision to Return	2023 Current Year Activity	2023 Reg Liability (Gross-Up) Amort	Water Service Corporation n ADIT Allocation	12/2023 Balance
4417	ADIT - STATE	(469.00)	(374.00)	(180.00)	151.71	4,965.27	(1.00)	(372.00)	(209.00)	(179.99)	662.57	4,865.85	(32.00)	(367.00)	(95.76)	81.29	4,452.38
4425	ADIT - STATE - DEFERRED RATE CASE		1,341.00		(0.07)	(7,335.58)		1,341.00				(5,994.58)		(136.00)		154.10	(5,976.48)
4427	ADIT - STATE - DEFERRED CHARGES		1,733.00		(0.14)	3,757.07		1,732.00				5,489.07		1,732.00			7,221.07
4433	ADIT - STATE - ORGANIZATIONAL COST		4.00			44.00						44.00	4.00	4.00			52.00
4435	ADIT - STATE - BAD DEBT RESERVE		40.00			66.47		(62.00)				4.47		(47.00)			(42.53)
4421	ADIT - STATE - TAXABLE CIAC					1,444.40						1,444.40					1,444.40
4437	ADIT - STATE - DEPRECIATION	(46.00)	(3,662.00)		(11.40)	(20,220.09)	6.00	(3,397.00)			44.84	(23,566.25)		(3,451.00)		(0.07)	(27,017.32)
4439	ADIT - STATE - NOL	952.00	(4,298.00)			23,936.04	725.00	(7,189.00)			0.66	17,472.70	14.00	(6,346.00)		(11.98)	11,128.72
255002	Deferred State Tax Liabilities	437.00	(5,216.00)	(180.00)	140.10	6,657.58	730.00	(7,947.00)	(209.00)	(179.99)	708.07	(240.34)	(14.00)	(8,611.00)	(95.76)	223.34	(8,737.76)



**Tennessee Water Service  
Docket 24-00028  
2024 ARM Filing**

**Exhibit DND-4**

**Revenue Deficiency Calculation**

<b>Line No.</b>	<b>Description</b>	<b>CA Test Period As Adjusted</b>		<b>Source</b>
1	Historic/Attrition Period Operating Income:			
2	Total Present Rate Operating Revenues	<u>538,536</u>	615,863	Exhibit DND-5/TWS Exhibit 1; Schedule B
3	<u>Less Deductions:</u>			
4	Operations and Maintenance Expenses	312,666	365,892	Exhibit DND-5/TWS Exhibit 1; Schedule B, total of Maintenance and General Exp.
5	Depreciation and Amortization	30,663	53,199	"
6	Taxes Other than Income	12,646	18,719	"
7	Annual True-Up Rate Adjustment		(10,145)	Line 19
8	Income Taxes	<u>34,290</u>	<u>35,780</u>	Exhibit DND-6; Line 14 + Line 18
9	Total Deductions	<u>390,265</u>	<u>463,444</u>	Sum Lines 4 - 8
10	Historic/Attrition Period Operating Income	<u>148,271</u>	<u>152,419</u>	Line 2 - Line 9
	Excess or Deficiency Calculation:			
11	Rate Base	1,814,269	1,811,820	Exhibit DND-3, Line 12
12	Rate of Return	<u>7.77%</u>	<u>7.77%</u>	Exhibit DND-8
13	Operating Income Requirement	140,969	140,778	Line 11 * Line 12
14	Less: Historic/Attrition Period Operating Income	<u>148,271</u>	<u>152,419</u>	Exhibit DND-5; Line 45
15	Earnings (Excess) or Deficiency	(7,302)	(11,641)	Line 13 - Line 14
16	Revenue Conversion Factor	<u>1.337392</u>	<u>1.337392</u>	Exhibit DND-7, Line 13
17	Gross Revenue (Excess) or Deficiency	(9,766)	(15,568)	Line 15 * Line 16
18	Carrying Charge - Rate of Return / 2	<u>3.89%</u>		Exhibit DND-8
19	Annual True-Up Rate Adjustment	<u>(10,145)</u>		Line 17 * (1+ Line 18)

## Exhibit DND-5

3/ The CA adjustments to TWS data include the Test Period Deficiency, Interest Expense and Taxes

Tennessee Water Service  
Docket 24-00028  
2024 ARM Filing

Exhibit DND-6

Income Taxes - Historic Base Period and Attrition Period

Line No.	Description	Historic Period			Attrition Period	
		Per TWC	CA Adjustment	Exhibit DND-5, except where otherwise noted	Exhibit DND-5, except where otherwise noted	CA Pro-Forma
				CA Pro-Forma	CA Pro-Forma	
		Historic Period As Adjusted [A]			Attrition Period Under Present Rates [B]	Attrition Period Under Proposed Rates
1	Operating Revenues	\$ 538,536		\$ 538,536	\$ 615,863	\$ 605,718
2						
3	Operating Deductions:					
4	Maintenance expenses	216,024		216,024	269,367	269,367
5	General expenses	96,643		96,643	96,525	96,525
6	Depreciation expense	46,417		46,417	69,488	69,488
7	Annual True-Up Rate Adjustment	-		-	(10,145) 3/	(10,145)
8	TOTI	12,646		12,646	18,719	18,719
9	Amortization of ITC	(49)		(49)	(49)	(49)
10	Amortization of CIAC	(15,705)		(15,705)	(16,240)	(16,240)
11	Interest expense	47,711	(1,991)	45,720 1/	45,658 2/	45,658
12	Total Operating Deductions	403,686		401,695	473,322	473,322
13	State Taxable Income (Line 1 minus Line 12)	134,850		136,841	142,541	132,396
14	State Excise Tax (Line 13 multiplied by 6.5%)	8,765	129	8,895	9,265	8,606
15	Federal Taxable Income (Line 13 minus Line 14)	126,085		127,947	133,276	123,790
16	Federal Income Tax Calculation (Line 17 multiplied by 21%)	26,478		26,869	27,988	25,996
17	EDIT Amortization	(1,473)		(1,473)	(1,473)	(1,473)
18	Total Federal Income Tax (Line 16 plus Line 17)	25,005	391	25,396	26,515	24,523
19	Net Amount (Line 15 minus Line 18)	101,080		102,551	106,761	99,267
20	Add: Interest Expense	47,711		45,720	45,658	45,658
21	Operating Income for Return (Line 19 plus Line 20)	148,791		148,271	152,419	144,925
22	1/ CA Interest Expense - Test Period					
23	CA Pro-Forma Rate Base	1,814,269				
24	Wtd Cost of Debt	2.5200%				
25	Pro-Forma Interest Expense	45,720				
26	2/ CA Interest Expense - Attrition Period					
27	CA Pro-Forma Rate Base	1,811,820				
28	Wtd Cost of Debt	2.5200%				
29	Pro-Forma Interest Expense	45,658				
30	3/ Exhibit DND-4					

**Tennessee Water Service  
Docket 24-00028  
2024 ARM Filing**

**Tax Gross-Up/Retention Factor**

**Exhibit DND-7**

**Consumer Advocate**

[E]

**Retention Factor:**

4	Total revenue	1.000000
5	Forfeited Discounts	<u>(0.014773)</u>
6	Revenue Factor (L12 - L13)	1.014773
7	Bad Debt (L14 * 0.2452%)	<u>0.002488</u>
8	Balance (L14 - L15)	1.012285
9	State excise tax (L16 x 6.5%)	<u>0.065799</u>
10	Balance (L16 - L17)	0.946486
11	Federal income tax (L18 x 21%)	<u>0.198762</u>
12	Retention Ratio (L18 - L19)	<u><u>0.747724</u></u>
13	Retention Factor (1 / L20)	1.337392

**Tennessee Water Service**  
**Docket 24-00028**  
**2024 ARM Filing**

**Exhibit DND-8**

**Capital Structure**

Capital Structure Adopted in Docket 23-00046

<b>Line No.</b>	<b>Description</b>	<b>Capitalization Ratio</b>	<b>Embedded Cost</b>	<b>Overall Cost Rate</b>
		(a)	(c)	(d)
1	Debt	50.00%	5.04%	2.52%
2	Equity	50.00%	10.50%	5.25%
3	Total	100.00%		7.77%