BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission's Investigation of the Financial Impact of the Tax Cuts and Jobs Act of 2017 on Regulated Ohio Utility Companies.	**)** **)** **)** **)**	**Case No. 18-47-AU-COI**

POST-HEARING BRIEF OF OHIO POWER COMPANY

INTRODUCTION

Ohio Power Company ("AEP Ohio" or the "Company") has participated in this generic industry proceeding and has also initiated a separate company-specific proceeding to address the issues relating to the Tax Cut Jobs Act of 2017 (TCJA), Case No. 18-1007-EL-UNC (18-1007 case). AEP Ohio is undertaking settlement efforts in that case in an attempt to explore a consensus solution for TCJA issues involving the Company's retail rates. In addition, as chronicled in its reply comments (filed March 7, 2018), AEP Ohio has already comprehensively updated its rider tariffs and rates to appropriately reflect TCJA impacts. AEP Ohio submits this brief in order to preserve its positions in this docket but believes all ratemaking issues should be addressed in 18-1007 or future rate proceedings apart from this generic investigation. Although AEP Ohio addresses the specific issues raised in written testimony and through the evidentiary hearing, the Company more broadly reserves all of its positions raised in its Application for Rehearing and comments.

For purposes of this briefing, there are six important items that AEP Ohio asks the Public Utilities Commission of Ohio ("Commission") to clarify and address as part of its merit decision in this case, each of which is set forth in greater detail below. First, the Commission should

clarify that the accounting directive in its January 10, 2018 Entry ("January 10 Entry") extends to costs and revenues associated with retail rates. Second, the Commission should clarify that its accounting directive is not a ratemaking order and is without prejudice to ratemaking that will be implemented in utility-specific rate proceedings. Third, the Commission should avoid single-issue ratemaking and incorporate a revenue sufficiency test to the extent the Commission implements ratemaking ahead of future base rate proceedings. Fourth, the Commission should ensure that the solutions adopted to reflect TCJA impacts comply with normalization accounting requirements. Fifth, the Commission should not require carrying charges on TCJA impacts that are implemented in 2018. Finally, AEP Ohio requests that the Commission ensure that any updates to pole attachment rates to reflect tax changes are done only as part of a comprehensive application of the FCC- approved pole attachment rate formula.

ARGUMENT

I. Any deferrals arising from this proceeding should be limited to costs relating to jurisdictional retail rates only.

It is axiomatic that the Commission only has jurisdiction over retail rates. Ohio law and federal law are both clear and unequivocal about this point. By definition and as a matter of law, therefore, the Commission's January 10 Entry in this case lawfully extends only to costs and revenues associated with retail rates. That should be explicitly clarified by the Commission's decision in this case.

Under Ohio law, the Commission's regulatory and ratemaking jurisdiction extends only to retail service provided in Ohio. R.C. 4905.03 and R.C. 4905.05. And the statute relied upon by the Commission to establish the accounting deferral, R.C. 4905.13, does not purport to extend beyond the scope of retail rates. As a related matter, the Commission is a creature of statute and can exercise only the authority conferred upon it by the General Assembly. *In re Application of*

Ohio Power Company, 140 Ohio St.3d 509, 2014-Ohio-4271, 20 N.E.2d 699, ¶ 42. In sum, there is no basis in Ohio law to support any conclusion that the Commission's directive could possibly extend to total Company operations beyond those costs and revenues associated with retail rates.

Conversely, it would be unlawful and preempted if the Commission's accounting directive extended to wholesale rates and revenues since the Federal Energy Regulatory Commission (FERC) has exclusive regulatory jurisdiction over wholesale rates. Under the Federal Power Act (FPA), 16 U.S.C. § 791 *et seq.*, FERC has "exclusive authority to regulate 'the sale of electric energy at *wholesale* in interstate commerce.'" (Emphasis added.) *Hughes v. Talen Energy Marketing, LLC*, __ U.S. __, 136 S. Ct. 1288, 1292, 194 L.Ed.2d 414 (2016) ("*Talen*"), quoting 16 U.S.C. § 824(b)(1). The line between wholesale electricity sales (which are FERC's exclusive province) and retail electricity sales (which belong to the states) is clearly drawn. "A wholesale sale is defined as a 'sale of electric energy to any person for resale.'" *Talen*, 136 S. Ct. at 1292, quoting 16 U.S.C. § 824(d).

In sum, the Commission's accounting directive must be limited to only include in the deferrals tax impacts associated with utility retail rate components subject to the Commission jurisdiction and their Commission approved retail rate plans.

II. Accounting deferrals are separate from ratemaking and must be without prejudice to ratemaking, with the latter occurring only in utility-specific rate proceedings.

The Commission's accounting orders are distinct from its substantive ratemaking authority under R.C. Chapter 4909. *See, e.g. Elyria Foundry Co. v. Pub. Util. Comm.*, 114 Ohio St.3d 305, 2007-Ohio-4164, 871 N.E.2d 1176, ¶ 19. The ratemaking effect of an accounting order typically must be reviewed and determined in a later rate proceeding. *Id.*; *Consumers' Counsel v. Pub. Util. Comm.*, 63 Ohio St.3d 522, 524-525, 589 N.E.2d 1267 (1992). The impacts of the TCJA on utility rates will vary based upon the unique circumstances and rate

structure of each utility. Consistent with Ohio law, Staff witness Borer believes the accounting deferral for tax liability is separate from – and without prejudice to – ratemaking determinations. (Tr. at 139-140.) Stated differently, Mr. Borer agreed that the accounting decision does not determine the outcome of the ratemaking decision. (*Id.* at 140.)

Moreover, were the Commission's accounting directive intended to exercise ratemaking authority in some fashion, the Commission's January 10 Entry would deprive AEP Ohio of due process and violate the prohibition against retroactive ratemaking, in addition to violating R.C. 4905.13. *See, e.g., Lucas Cty. Commrs. v. Pub. Util. Comm.*, 80 Ohio St.3d 344, 348, 686 N.E.2d 501 (1997) (recognizing that "utility ratemaking * * * is prospective only. * * * Retroactive ratemaking is not permitted under Ohio's comprehensive statutory scheme").

For all these reasons, the Commission cannot retroactively establish rates as of January 1, 2018 – especially since the required hearing under R.C. 4905.13 did not occur until July 10, 2018. The Commission should not prejudge the substantive ratemaking impact of the TCJA or affirmatively require that amounts utilities record as a deferred liability now either will or will not be returned to customers in the future. Rather, at a minimum, the Commission should apply a revenue sufficiency test (as further described below) in determining the extent to which the regulatory liability associated with TCJA impacts should be reflected in base rates.

III. To the extent that the regulatory liability encompasses federal income tax expense savings, such a deferral should not be reflected in rates until the utility has a comprehensive base rate proceeding; at a minimum, if rate relief is implemented in advance of a base rate proceeding, the Commission should avoid single-issue ratemaking for FIT expenses and incorporate a revenue sufficiency test.

With respect to base rates that were established under R.C. 4909, the Commission is not permitted to unilaterally engage in single-issue ratemaking or change base rates without following the statutory process required in R.C. Chapter 4909. Although the General Assembly

has delegated authority to the Commission to set just and reasonable rates for public utilities under its jurisdiction, it has done so by providing a detailed, comprehensive and, as construed by the Ohio Supreme Court, mandatory ratemaking formula under R.C. 4909.15 and an EDU's base rates may only be established through a full cost of service study in a base rate proceeding. *Columbus Southern Power Co. v. Pub. Util. Comm.*, 67 Ohio St.3d 535, 537-538, 620 N.E.2d 835 (1993).

If expenses rise, an EDU cannot raise base rates until it establishes the need to do so in a base rate proceeding that follows the process and requirements of R.C. 4909. Had the recent tax law change resulted in a tax increase, the Company has little doubt that this same principle would have been enforced against EDUs in response to any attempt to use the tax increase as a basis for single-issue ratemaking of base rates. Indeed, OCC witness Willis could not agree that OCC would support establishment of a regulatory asset in the future corollary scenario when taxes are increased. (Tr. at 114-116.) But Staff witness Borer recommends using the same five-part test when considering accounting directives in response to a future tax increase. (Tr. at 144-145.) Likewise, it would be unreasonable and unlawful for the Commission to unilaterally force base rate reductions based on a single expense reduction. Only upon investigation, hearing, and determination that existing rates of public utility are unjust or unreasonable, can the Commission establish new rates to be substituted for existing rates and the new rates shall have prospective effect only. *Lucas County Comm'rs v. Pub. Util. Comm.*, 80 Ohio St.3d 344, 686 N.E.2d 501 (1997).

At a minimum, if the Commission is considering a requirement to adjust base rates ahead of a base rate case, it should include a revenue sufficiency test – consistent with the five factors of consideration used by the Commission in deciding whether to permit a regulatory asset

deferral mechanism. *See In the matter of the Application of Duke Energy Ohio for Approval to Change Accounting Methods,* Case No. 17-2118-GA-AAM, Finding and Order (Apr. 18, 2018). As Staff witness Borer testified, the five-factor test from the *Duke Energy Ohio* case is not a strict test but is "a framework for evaluating deferrals so that there's some sort of standard that could be applied" to decide whether an accounting deferral should be adopted. (Tr. at 137.) Staff witness Borer does not believe the five-factor test has been used in deciding whether to adopt a regulatory liability (the factors have previously been used to consider whether to establish regulatory assets). (*Id*. at 138.) Of course, the January 10 Entry did not evaluate the need to do an accounting deferral using the factors. But Staff does recommend applying the factors as clarified in Mr. Borer's testimony to the deferral question in this case. (*Id*.)

Staff witness Borer agreed that the five factors are factual in nature and subjective in their application – but admitted that Staff "did not do any in-depth analysis to actually calculate what we would assume the tax savings to be for each of the electric utilities." (*Id*. at 145.) Mr. Borer indicated that Staff would do that analysis as to the three buckets of tax impacts (tax expense savings, normalized excess accumulated deferred income taxes (ADIT) and unprotected excess ADIT) "when the Commission gets an order on how to measure the tax savings so we can appropriately do our analysis." (*Id*. at 146.) So although Staff appears to be taking the deferral issue one step at a time and moving forward incrementally over time (with its evaluate remaining incomplete as of the time of the evidentiary hearing), the Commission's January 10 Entry and the April 25, 2018 Second Entry on Rehearing seem to send mixed signals in this regard. In the Second Entry on Rehearing, the Commission indicated:

> In the January 10, 2018 Entry, we did not determine the actual amount to be returned to customers for any utility. However, the Commission intends that all tax impacts resulting from the TCJA will be returned to customers, whether through this proceeding or

> through a case-by-case determination for each affected utility; and the deferred liability for each utility should remain in place until this has been accomplished.

Second Entry on Rehearing at 4. It is not clear how the Commission can simultaneously indicate that it did not determine the amount to be returned but it has determined that all tax impacts will be "returned to customers." Obviously, the latter point addressed rates – and did so in violation of the legal requirements outlined above. Of course, this issue will only become ripe when (and if) the Commission enforces its intention through a final rate order.

AEP Ohio witness Allen recommended that the Commission either take a comprehensive review of each utility's costs to determine how cost changes (including but not limited to the tax reduction) affect the Company's ability to earn its authorized rate of return. (AEP Ohio Ex. 1 at 5-6.) Thus, Mr. Allen recommends (consistent with factor one of the five-part test) that the Commission perform a utility-specific revenue sufficiency test before imposing a regulatory liability based on the tax rate change. Mr. Allen also recommended that the accounting and ratemaking issues associated with the TCJA should be addressed in a Company-specific proceeding, which for AEP Ohio is Case No. 18-1007-EL-UNC. AEP Ohio witness Allen stated his view that "I think it's appropriate to look at it in a company by company type case so that we can look at all the financial issues that are before a specific company as well as how any of the ADITs have been created over time and looking at the totality of the rates that exist for the customers of those specific companies." (Tr. at 19-20.) If the Commission addresses such issues generically without allowing for company-specific results, there could be unintended negative consequences. For example, "[i]f the Commission were to require the companies to as they pass it back in a lump sum or a very short period of time, it would require the company to obtain financing rapidly without a -- without being able to evaluate the most optimal time to issue that

debt in the market scenario to fund such a refund, that that could have a long lasting impact on the company and its customers." (Tr. at 19.) Further, "with regard to flowing back any unprotected excess ADIT, looking at the cash flows of the company to ensure that the period of time that those ADIT balances are passed back to customers doesn't cause cash flow issues that could lower the credit ratings of the company which could ultimately result in increased debt cost that would be borne by customers in future rates." (Tr. at 21.)

Staff witness Borer addressed issues surrounding whether the first factor in the five-factor deferral test should incorporate a revenue sufficiency component as recommended by AEP Ohio witness Allen. Regarding Mr. Borer's statement in his testimony (Staff Ex. 1 at 7) that a tax rate decrease means an operating income increase for utilities "all else being equal" – Mr. Borer agreed that "all else may not be equal when you look at current revenues and costs." (Tr. at 147-148.) Indeed, he indicated that Staff is willing to entertain as a reasonable and fair application in factor one that current revenues and the sufficiency to those should be measured, for example, current earnings or whether the revenue requirement as authorized in the prior rate case is being collected. (*Id*. at 144.)

In implementing its January 10 Entry, the Commission should clarify and adjust its accounting directive in a manner that confirms to R.C. Chapter 4909 and case law precedent. At a minimum, the Commission should incorporate a revenue sufficiency component. That approach would not only be consistent with AEP Ohio witness Allen's testimony, but also would be consistent with Staff's testimony as clarified at the hearing.

IV. The accounting and ratemaking treatment associated with tax reform must comply with normalization requirements.

It was undisputed in direct testimony and at the hearing that federal law requires protected excess ADIT to be amortized over "the remaining life of the property which gave rise

to the reserve for deferred taxes" based on the average rate assumption method (ARAM). (AEP Ohio Ex. 1 at 3; *see also* OEG Ex. 1 at 6-7; OCC Ex. 1 at 7; OCTA Ex. 1 at 14; TCJA Subtitle C, Part I, Sec. 13001(d)(3)(B).) Indeed, numerous parties, including OCC witness Willis, recommended that the Commission direct Ohio utilities to flow protected excess ADIT back to customers according to IRS timelines in order to avoid a normalization violation caused by protected excess ADIT being amortized too quickly. (*Id*.; Tr. at 16-18.) The penalties for a normalization violation are severe: (1) currently payable income tax is increased by the amount by which protected excess ADIT was reduced more rapidly than permitted under ARAM, and (2) a utility is unable to claim accelerated depreciation for income tax purposes. 20 U.S.C. § 50(d)(2); IRC § 168(f)(2). Given the potential penalties and the parties' agreement with regard to protected excess ADIT, the Commission should ensure that its orders with respect to protected excess ADIT direct utilities to amortize protected excess ADIT consistent with normalization requirements.

V. Carrying charges need not be applied to the regulatory deferral.

The Commission should reject OCC witness Willis's recommendation that utilities be ordered to accrue carrying costs on their deferred tax balances until the full amount of the deferred tax liability is returned to customers. (*See, e.g.*, OCC Ex. 1 at 6-7.) To the extent that tax savings associated with the reduction in the corporate federal income tax rate already are being returned to customers or otherwise will be returned this year, carrying charges are not appropriate because the period the deferred tax liability is in place is not greater than twelve months. *See, e.g., In the Matter of the Application of Ohio Power Company for Authority to Establish a Standard Service Offer Pursuant to R.C. 4928.143, in the Form of an Electric Security Plan*, Case No. 13-2385-EL-SSO, *et al.*, Opinion and Order at 55 (Feb. 25, 2015) (ordering that "carrying charges [on a regulatory asset] should only accrue on deferred costs that

remain unrecovered for a period longer than 12 months"). At hearing, OCC witness Willis could not explain any reason why a regulatory asset and a regulatory liability should be treated any differently with regard to carrying costs. (Tr. at 124.) Carrying charges should not accrue on the any portion of the deferrals that is credited to customers this year.

It would also be inappropriate to apply carrying costs to the deferred excess ADIT tax liabilities, which will be credited to customers over a longer period. As AEP Ohio witness Allen explained:

> [T]hose balances historically were an offset to rate base or an offset to the DIR calculation. So they're the same credits that were historically included in rates, and they're still currently being used as an offset in [AEP Ohio's] DIR calculations.
> So to apply a carrying charge to either one of those balances would *' * * result in customers receiving two benefits from those: One through the DIR mechanism and the separate through a carrying charge on that balance that they're already receiving a benefit from. So * * * to help clarify, when the excess ADIT balances were recharacterized at the end of December of 2017, the method that [AEP Ohio] used ensured that the same ADIT balances that would have existed prior to the TCJA in the [its] ADIT balances [were] included in the DIR, * * * and there was * * * no increase in the DIR revenue requirement.

(Tr. at 22-23.) For these reasons, the Commission should decline to apply carrying costs to utilities' deferred tax liabilities established pursuant to the Commission's January 10, 2018 Entry.

VI. Pole attachment rates should only be updated to reflect tax savings as part of a comprehensive update of pole attachment rates under the FCC-approved formula.

OCTA witness Kravtin opines that third-party pole attachment rates "should not be adversely affected" by the Commission's direction to utilities to create deferred tax liabilities, or by other TCJA-related utility accounting changes. (OCTA Ex. 1 at 10.) It should go without saying that the inverse is also true. Pole attachers should not simply receive benefits of tax

reform in the abstract, divorced from the application of the FCC-approved pole attachment formula rate set forth in 47 C.F.R. 1.1409 and the Commission's rate setting process set forth in Ohio Adm.Code 4901:1-3-04(D). The Commission should decline OCTA's invitation to circumvent the application of those standards to each utility's individual pole attachment rates in favor of a blanket update to all pole attachment rates in this generic proceeding. (*See* OCTA Ex. 1 at 8.)

Any change in a utility's pole attachment rates to reflect tax savings necessarily requires an individualized application of the pole attachment rate formula, however. Ohio Adm.Code 4901:1-3-04(D)(2)-(3). Ms. Kravtin herself agreed at the hearing that OCTA is "not suggesting the Ohio Commission or any Commission change the formula" but, rather, that the appropriate amount of ADIT be included in the formula <u>when it is applied</u>. (Tr. at 87-88.) Thus, the Commission should direct that any updates to pole attachment rates to reflect tax savings must occur in the context of a comprehensive update of the entire formula rate, and not on an individual rate component basis. AEP Ohio submits that such individualized undertakings would be more appropriate in utility-specific proceedings, and not a part of this generic industry-wide investigation.

CONCLUSION

AEP Ohio requests that the Commission incorporate the positions outlined above into its merit decision in this case.

Respectfully submitted,

/s/ Steven T. Nourse
Steven T. Nourse (0046705)
Counsel of Record
Christen M. Blend (0086881)
American Electric Power Service Corporation
1 Riverside Plaza, 29th Floor
Columbus, Ohio 43215
Telephone: (614) 716-1608
Fax: (614) 716-2950
Email: stnourse@aep.com
cmblend@aep.com

Counsel for Ohio Power Company

CERTIFICATE OF SERVICE

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing *Post-Hearing Brief of Ohio Power Company* was sent by, or on behalf of, the undersigned counsel to the following parties of record this 13th day of August 2018, via electronic transmission.

/s/ Steven T. Nourse
Steven T. Nourse

EMAIL SERVICE LIST

Amy.Spiller@duke-energy.com; campbell@whitt-sturtevant.com; cdunn@firstenergycorp.com bbingaman@firstenergycorp.com; Bryce.mckenney@occ.ohio.gov; cdunn@firstenergycorp.com; cmblend@aep.com; christopher.healey@occ.ohio.gov; cmooney@ohiopartners.org; dsawmiller@nrdc.org; dstinson@bricker.com; Dressel@carpenterlipps.com; Elizabeth.Watts@duke-energy.com; fdarr@mwncmh.com; gkrassen@bricker.com; glpetrucci@vorys.com; Jeanne.Kingery@duke-energy.com; jkylercohn@BKLlawfirm.com; jfinnigan@edf.org; joliker@igsenergy.com; Josephclark@nisource.com; Kathy.L.Buckley@verizon.com; Kevin.moore@occ.ohio.gov;	Bojko@carpenterlipps.com; kboehm@BKLlawfirm.com; leslie.kovacik@toledo.oh.gov; mfleisher@elpc.org; whitt@whitt-sturtevant.com; mpritchard@mwncmh.com; mkurtz@BKLlawfirm.com; mlozich@securustechnologies.com; mnugent@igsenergy.com; Michael.schuler@aes.com; mleppla@theoec.org; mwhelan@egas.net; neil.waggoner@sierraclub.org; paul@carpenterlipps.com; randall.griffin@aes.com; glover@whitt-sturtevant.com; selisar@mwncmh.com; sasloan@aep.com; sseiple@nisource.com; stnourse@aep.com; trhayslaw@gmail.com; william.wright@ohioattorneygeneral.gov; Zachary.Woltz@occ.ohio.gov;

Summary: Brief - Post-Hearing Brief of Ohio Power Company electronically filed by Mr. Steven T Nourse on behalf of Ohio Power Company