COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, NOVEMBER 24, 2020

APPLICATION OF

APPALACHIAN POWER COMPANY

CASE NO. PUR-2020-00015

For a 2020 triennial review of its base rates, terms and conditions pursuant to § 56-585.1 of the Code of Virginia

FINAL ORDER

On March 31, 2020, Appalachian Power Company ("Appalachian" or "Company") filed an application ("Application") with the State Corporation Commission ("Commission"), pursuant to Code § 56-585.1 A 3 and the Commission's Rules Governing Utility Rate Applications and Annual Informational Filings,[1] for a triennial review of the Company's rates, terms and conditions for the provision of generation, distribution and transmission services. Pursuant to Code § 56-585.1 A 8, the "Commission's final order regarding such triennial review shall be entered not more than eight months after the date of filing."

On April 13, 2020, the Commission issued an Order for Notice and Hearing that, among other things, established a procedural schedule, directed the Company to provide public notice of its Application, and permitted interested persons to file written or electronic comments on the Application or to participate in this proceeding as a respondent.

The following filed notices of intent to participate as a respondent: Office of the Attorney General's Division of Consumer Counsel ("Consumer Counsel"); Steel Dynamics, Inc. ("SDI"); Virginia Municipal League ("VML") and Virginia Association of Counties ("VACo") Appalachian Power Company Steering Committee ("VML/VACo Steering Committee");

[1] 20 VAC-5-201-10 *et seq.*

Walmart Inc. ("Walmart"); Appalachian Voices ("Environmental Respondent"); Sierra Club; Old Dominion Committee for Fair Utility Rates ("Committee"); The Kroger Co. ("Kroger"); and Virginia Poverty Law Center ("VPLC").

The hearing in this matter was convened via Skype for Business, with no party present in the Commission's physical courtroom, on September 14, 15, 16, 17, and 18, 2020. All parties and the Commission's Staff ("Staff") participated in the hearing. The Commission received testimony from one public witness, in addition to written and electronic public comments in this proceeding. The participants subsequently filed post-hearing briefs on October 16, 2020.[2]

NOW THE COMMISSION, upon consideration of this matter, is of the opinion and finds as follows.[3]

EARNED RETURN

Code § 56-585.1 A 1 directs as follows: "Pursuant to subsection A of § 56-585.1:1, the Commission shall conduct a review for a Phase I Utility in 2020, utilizing the three successive 12-month test periods beginning January 1, 2017, and ending December 31, 2019."[4] The Commission must determine the Company's earned return for this three-year period and then

[2] On October 23, 2020, Staff filed an unopposed Motion to Reopen the Record to File Corrected Exhibit, which we hereby grant.

[3] The Commission has fully considered the evidence and arguments in the record supporting and opposing the positions of all participants. *See also Board of Supervisors of Loudoun County v. State Corp. Comm'n*, 292 Va. 444, 454 n.10 (2016) ("We note that even in the absence of this representation by the Commission, pursuant to our governing standard of review, the Commission's decision comes to us with a presumption that it considered all of the evidence of record.") (citation omitted).

[4] Appalachian is the Phase I Utility under the terms of Code § 56-585.1 A 1. Code § 56-585.1:1 similarly states that "reviews of the utility's rates for generation and distribution services shall resume for a Phase I Utility in 2020, with the first such proceeding utilizing the three successive 12-month test periods beginning January 1, 2017, and ending December 31, 2019."

compare that to a 140 basis point band around Appalachian's currently approved return on equity ("ROE") of 9.42%.[5]

If the earned return is "more than 70 basis points" *above* 9.42% (*i.e.*, greater than 10.12%), then "70 percent of the amount of such earnings" above 10.12% "shall be credited to customers' bills."[6] If the earned return is "more than 70 basis points" *below* 9.42% (*i.e.*, less than 8.72%), then the Commission "shall order increases to the utility's rates necessary to provide the opportunity to fully recover the costs of providing the utility's services and to earn not less than such fair combined rate of return, using the most recently ended 12-month test period as the basis for determining the amount of the rate increase necessary."[7]

As previously explained and implemented by the Commission, in order to determine earned return, "the Commission must make determinations on specific earnings adjustments related thereto."[8] Determining the utility's earned return as required by statute "is not simply a calculation of entries as booked by the utility during the [historical] period."[9] Rather, "the earned return under this regulatory statute must represent a utility's reasonable earned return, on a

---

[5] *See* Code §§ 56-585.1 A 8 and 56-585.1:1 C 3. *See also Application of Appalachian Power Company, For the determination of the fair rate of return on common equity to be applied to its rate adjustment clauses*, Case No. PUR-2018-00048, Doc. Con. Cen. No. 181120212, Final Order (Nov. 7, 2018) ("*2018 Appalachian ROE Order*").

[6] Code § 56-585.1 A 8 b.

[7] Code § 56-585.1 A 8 a.

[8] *Application of Virginia Electric and Power Company, For a 2015 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia*, Case No. PUE-2015-00027, 2015 S.C.C. Ann. Rept. 299, 300, Final Order (Nov. 23, 2015) ("*VEPCO 2015 Biennial Review*").

[9] *Application of Appalachian Power Company, For a 2014 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia*, Case No. PUE-2014-00026, 2014 S.C.C. Ann. Rept. 392, 393, Final Order (Nov. 26, 2014) ("*APCo 2014 Biennial Review*"); *VEPCO 2015 Biennial Review*, 2015 S.C.C. Ann. Rept. at 300.

regulatory basis," for the period under review.[10] Thus, "to calculate earned return (which is generally net income divided by common equity), the Commission must determine the Company's reasonable revenues, expenses, and rate base for the historical" period, and this, "by necessity, requires the Commission to rule on regulatory earnings adjustments proposed by both the utility and other participants in the case."[11]

Appalachian asserts, as it did in its 2014 historical earnings review, that the Commission is prohibited by statute from making certain earnings adjustments as part of such review. In rejecting such assertion, the Commission explained in that case as follows:

> Section 56-585.1 in no manner requires the Commission to include unreasonable items in determining the earned return thereunder. The [historical] review is not a summation of previously-approved or booked items but, rather, is a review of the utility's actual performance during the prior [period]. As explained by the Supreme Court of Virginia, in order to determine earned return under this statute, the Commission must perform a "retrospective review" of the utility's "performance during the [] successive 12-month periods immediately prior to such review[]."[12]

Accordingly, in order to calculate the Company's earned return for purposes of Code § 56-585.1, the Commission must determine Appalachian's reasonable revenues, expenses,

---

[10] *VEPCO 2015 Biennial Review*, 2015 S.C.C. Ann. Rept. at 300.

[11] *APCo 2014 Biennial Review*, 2014 S.C.C. Ann. Rept. at 393; *VEPCO 2015 Biennial Review*, 2015 S.C.C. Ann. Rept. at 300.

[12] *APCo 2014 Biennial Review*, 2014 S.C.C. Ann. Rept. at 393 (citing *Virginia Elec. and Power Co. v. State Corp. Comm'n*, 284 Va. 726, 730, 736 (2012) (affirming the first order under Code § 56-585.1 in which the Commission made specific earnings adjustments – over the objection of the utility – which were necessary to determine the utility's reasonable earned return for the historical period under review)). In addition, we note that Code § 56-585.1 D specifically authorizes the Commission to

> determine, during any proceeding authorized or required by this section, the reasonableness or prudence of any cost incurred or projected to be incurred, by a utility in connection with the subject of the proceeding. A determination of the Commission regarding the reasonableness or prudence of any such cost shall be consistent with the Commission's authority to determine the reasonableness or prudence of costs in proceedings pursuant to the provisions of Chapter 10 (§ 56-232 et seq.).

and rate base for 2017, 2018, and 2019. This necessity, which the Commission has consistently applied in implementing its statutory responsibility in historical earnings reviews under this statute, results (as set forth below) in regulatory accounting adjustments that both increase and decrease the Company's earned return for the triennial period. In this regard, the Commission makes the findings listed below, which we conclude are reasonable and supported by evidence in the record.[13]

2019 Asset Impairments

In 2011, the Company decided to retire its Sporn, Kanawha River, Glen Lyn 5, Glen Lyn 6, and Clinch River 3 generating units in 2015.[14] In 2012, the Company informed PJM Interconnection, L.L.C. ("PJM"), of this decision.[15] Appalachian's 2010 depreciation study reflected retirement dates for these facilities between 2015 and 2019.[16] Upon retirement in 2015, these facilities would have been in service from 54 to 71 years.[17]

In 2014, Appalachian confirmed that the Company viewed these upcoming 2015 retirements as "normal" retirements and included them in a new depreciation study filed in its

---

[13] The Commission has not applied in this proceeding House Bill 528, which amended Code § 56-585.1 and became effective July 1, 2020. 2020 Va. Acts ch. 662. This amendment became effective *after* the initiation of the instant case and does not contain an express provision that it is to operate retroactively. *See, e.g., Washington v. Commonwealth of Virginia*, 216 Va. 185, 193 (1975) ("The general rule is that statutes are prospective in the absence of an express provision by the legislature. Thus when a statute is amended while an action is pending, the rights of the parties are to be decided in accordance with the law in effect when the action was begun, unless the amended statute shows a clear intention to vary such rights.") (citation omitted); *Town of Culpeper* v. *Virginia Elec. and Power Co.*, 215 Va. 189, 194 (1974) ("[T]he general rule is that statutes are to be construed to operate prospectively only unless a contrary intention is manifest and plain.") (citation omitted).

[14] *See, e.g.*, Ex. 100 (Welsh) at 13, Appendix B at 82.

[15] *See, e.g., id.*, Appendix B at 80.

[16] *See, e.g., id.* at 13-14.

[17] *See, e.g., id.* at 14.

2014 biennial review proceeding.[18] Due to pending federal regulations that were expected to impact the Company's generating facilities, the Commission found that a new depreciation study should not be adopted at that time but, rather, should be addressed in the Company's statutorily required 2016 biennial review after the issuance of those federal regulations.[19]

In 2015, the General Assembly enacted legislation that canceled Appalachian's 2016 biennial review.[20]

In May 2015, the Company retired these units as planned.[21] Appalachian also ceased booking any depreciation for these units at that time.[22] The Company's July 2015 accounting memorandum documenting these retirements again confirmed that: (1) none of these units "were reported as probable of abandonment;" and (2) until a "final rate order addressing recovery of these costs," the retirements "will be treated as normal retirements."[23] Appalachian also did not conclude that the assets may be unrecoverable and did not record an impairment of the units' remaining net book value.[24]

---

[18] *See, e.g., id.* at 14, 22, Appendix B at 82.

[19] *See, e.g., id.* at 15; *APCo 2014 Biennial Review*, 2014 S.C.C. Ann. Rept. at 405.

[20] *See* 2015 Va. Acts ch. 6; Code § 56-585.1:1.

[21] *See, e.g.*, Ex. 100 (Welsh) at 15, Appendix B at 82; Ex. 132 (Allen Rebuttal) at 3.

[22] *See, e.g.*, Ex. 100 (Welsh) at 16-17; Ex. 132 (Allen Rebuttal) at 3; Tr. 934-35, 974; Ex. 104 (Retired Units Net Book Value Over Time).

[23] *See, e.g.*, Ex. 100 (Welsh), Appendix B at 82.

[24] The Company's accounting policy regarding potential asset impairments is further described in American Electric Power, Inc.'s ("AEP") 2015 annual financial report:

> In accordance with the requirements of "Property, Plant, and Equipment" accounting guidance, the Registrants evaluate long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of any such assets may not be recoverable. . . . If the carrying amount is not recoverable, the Registrants record an impairment to the extent that the fair value of the asset is less than its book value. . . . For

In 2016, the Company continued to report that "[t]hese plants were normal retirements and not abandonments" and did not record an impairment.[25] As to the remaining cost recovery for these units, Appalachian further reported that it "intends to address the need for an increase in its Virginia depreciation rates in March 2020, as part of its 2018-2019 Virginia biennial filing."[26]

In 2017 and 2018, the Company similarly reported that "[t]hese plants were normal retirements at the end of their depreciable lives," and that "recovery of the remaining Virginia net book value for the retired plants will be considered in the [Commission's] 2020 triennial review of [Appalachian's] generation and distribution base rates."[27] Again, the Company did not, at that time, record an impairment of the remaining net book value of the retired plants.

In 2018, the General Assembly enacted legislation that transformed Appalachian's 2020 biennial review (2018-2019) into the instant triennial review (2017-2019).[28] That legislation also amended Code § 56-585.1 A 8 as follows:

> In any ~~biennial~~ *triennial* review proceeding, *for the purposes of reviewing earnings on the utility's rates for generation and distribution services*, the following utility generation and distribution costs not proposed for recovery under any other subdivision of this subsection, as recorded per books by the utility for financial reporting purposes and accrued against income, shall be attributed to the test periods under review *and deemed fully recovered in the period recorded*: costs associated with asset impairments related to early retirement determinations made by the

---

regulated assets, the earnings impact of an impairment charge could be offset by the establishment of a regulatory asset, if rate recovery is probable.

See, e.g., Ex. 100 (Welsh) at 21-22, Appendix B at 29.

[25] *See, e.g., id.*, Appendix B at 36.

[26] *Id.*

[27] *See id.*, Appendix B at 41, 46.

[28] *See* 2018 Va. Acts ch. 296; Code § 56-585.1 A 1.

> utility ~~prior to December 31, 2012,~~ for utility generation ~~plant~~ *facilities fueled by coal, natural gas, or oil ....*[29]

In December 2019, Appalachian fundamentally changed course in its treatment of these assets and recorded these retired units as an asset impairment.[30] The Company states it impaired these assets because it concluded, *for the first time*, that the remaining costs of the units were no longer "probable of future recovery."[31] Prior to this moment, as noted above, the Company had regularly treated these units as normal retirements that were probable of future recovery.[32] Appalachian asserts that the "main factor driving" its new conclusion was the 2018 statutory amendments quoted above.[33] The Company acknowledges it recorded the impairment when it discovered that its earnings over the triennial period were sufficient to cover the unamortized costs of the retired units.[34] Appalachian also states it considered 2018 correspondence from Staff indicating that these units should be dealt with in the instant proceeding.[35]

As a legal matter, the Company also asserts that the Commission has no discretion to review its December 2019 decision to book these units as an asset impairment.[36] As set forth above, however, since the onset of earnings reviews under Code § 56-585.1, the Commission's orders have consistently explained the difference between (1) the discretion that the Commission

---

[29] 2018 Va. Acts ch. 296 (changes as noted in original).

[30] *See, e.g.*, Ex. 100 (Welsh) at 17-18; Ex. 132 (Allen Rebuttal) at 4.

[31] *See, e.g.*, Ex. 132 (Allen Rebuttal) at 4, 10-11.

[32] *See also* Appalachian's Post-hearing Brief at 12-13.

[33] *Id.* at 13.

[34] *See, e.g., id.* at 13-14.

[35] *See, e.g., id.* at 13.

[36] *See, e.g., id.* at 15-16.

must exercise in determining the utility's reasonable earned return on a regulatory accounting basis, and (2) statutorily required outcomes resulting from the Commission's findings. In every historical earnings review under this statute, the Commission has necessarily been required to rule on the reasonableness of the utility's regulatory accounting entries, along with other proposed regulatory adjustments from both the utility and case participants. Once the Commission exercises that discretion, the statute dictates certain outcomes.

The Company's recorded 2019 impairment is no different in this regard. That is, (1) if the Commission finds that the Company's decision to record these assets as an impairment was reasonable on a regulatory accounting basis, then (2) the statute dictates how such costs are treated for purposes of the instant case. We again, however, reject Appalachian's assertion that the statute prohibits the Commission from exercising the first step and considering the reasonableness of the Company's regulatory accounting actions as part of our statutory obligations in an historical earnings review under Code § 56-585.1.

As a factual matter, we find Appalachian has not established that it was reasonable to conclude in December 2019 that the remaining costs of these retired units were no longer probable of future recovery. The Commission has never held that recovery of the undepreciated balance for these units would be disallowed. We also note that Staff has likewise never proposed disallowance of these costs.[37]

Staff further illustrates that the Commission has previously authorized regulatory asset treatment for significant depreciation reserve deficiencies such as those attendant to the retired

[37] *See, e.g.*, Tr. 936.

units, which also would make such costs probable of future recovery.[38] The Company, however, did not seek such treatment from this Commission prior to abruptly concluding that cost recovery was no longer probable.[39] Moreover, Staff has never opposed such treatment for these costs and, to the contrary, proposes regulatory asset treatment as part of the instant case.[40] The Commission thus further finds it was not reasonable to conclude, for regulatory accounting purposes, that future recovery was not probable before potential avenues for such recovery had been reasonably explored.

The Commission also finds that the 2018 amendments to Code § 56-585.1 A 8, quoted above, did not make these costs no longer probable of future recovery. Those amendments speak to how certain impaired assets are treated in calculating the utility's earnings as part of an historical review. As noted by Staff, the pre-2018 version of this statute also permitted the Company to attribute the costs of impaired assets to historical periods under review.[41] Code § 56-585.1 A 8, however, does not (both before and after the 2018 amendments) in any manner prohibit the future recovery of, nor serve to impair, previously unimpaired assets.

The Commission similarly rejects the circularity of the Company's argument herein. Appalachian admits it impaired these assets because it "saw that it could expense the $88 million in Virginia jurisdictional costs of the Retired Units against its 2017-2019 earnings" under

---

[38] *See, e.g.*, Ex. 100 (Welsh) at 26-27; *Application of Washington Gas Light Company and Shenandoah Gas Division of Washington Gas Light Company, For general increase in natural gas rates and charges and approval of performance-based rate regulation methodology pursuant to Va. Code § 56-235.6*, Case No. PUE-2002-00364, 2003 S.C.C. Ann. Rept. 383, 388-89, Final Order (Dec. 18, 2003) ("*WGL 2003 Final Order*").

[39] *See also* Ex. 132 (Allen Rebuttal) at 4, 8 ("[T]he Company has not requested recovery of these costs related to the Retired Units under any other recovery mechanism.").

[40] *See, e.g.*, Ex. 100 (Welsh) at 24-28.

[41] *See, e.g.*, Staff's Post-hearing Brief at 8-9, 13-14.

Code § 56-585.1 A 8.[42] The Company then argues that once expensed, Code § 56-585.1 A 8 makes these units no longer probable of future recovery.[43] Again, while the statute dictates the regulatory *outcome* of reasonably impaired assets, it neither required the Company to book this expense nor created an asset impairment. It was Appalachian's intentional act to impair these units, not the statute, that caused these costs to be no longer probable of future recovery. And it is that act that we find the Company has not established as reasonable.

Finally, the Commission finds that Staff's correspondence to the Company in 2018 – whereby Staff opposed including these units in Appalachian's 2017 depreciation study but, rather, indicated that the remaining costs of these units could be addressed in the instant proceeding – is not sufficient to justify Appalachian's decision to record an asset impairment.[44] Staff's position did not make these costs no longer probable of future recovery.[45] To the contrary, Staff's position confirmed that recovery thereof had not been denied and could be addressed in the instant case.[46] Moreover, Staff's position that these costs could be addressed in this triennial review was consistent with the Company's own regulatory reporting where, as noted above, Appalachian confirmed in 2016 that these were normal retirements for which the Company would address cost recovery in its March 2020 filing herein.

---

[42] *See, e.g.*, Appalachian's Post-hearing Brief at 13.

[43] *See, e.g.*, Ex. 132 (Allen Rebuttal) at 8; Appalachian's Post-hearing Brief at 14.

[44] *See, e.g.*, Ex. 100 (Welsh), Appendix B at 1 ("Staff...recommends that the Company track depreciation related to the 2015 Retirements separately...[and] address its proposed accounting and ratemaking treatment of the 2015 Retirements in the Company's next triennial review.").

[45] *See, e.g., id.*

[46] In addition, Staff's position illustrates that regulatory assets not included in a depreciation study remain recoverable assets.

In sum, the Commission finds that the Company has not met its burden to establish it was reasonable to conclude that these costs were no longer probable of future recovery and record such as an asset impairment in December 2019. This finding increases the Company's triennial review earnings by $83,206,505.[47]

Depreciation Expense

As with other expenses, the Company has the burden to establish that its depreciation expenses during the historical period were reasonable for purposes of determining its reasonable earned return in this proceeding. The Commission finds that Appalachian has not met this burden. Rather, we find that Appalachian's 2017 Depreciation Study, as modified by Staff, represents reasonable expenses in this regard and, thus, shall be implemented as of the December 31, 2017 study date.[48] We likewise find that Staff's related regulatory accounting and depreciation treatment for the retired units discussed above – including removing such from the depreciation study, implementing a 10-year straight-line amortization from date of retirement, and creating a regulatory asset – is reasonable and based on sound professional judgment.[49]

Contrary to the Company's allegation, it is well settled that such findings do not represent a change in rates or retroactive ratemaking. As this Commission explained over 15 years ago, the utility has the burden to establish the reasonableness of its claimed depreciation expenses, including its decision *not* to update its depreciation study therefor.[50] If the utility has not met

---

[47] *See, e.g.*, Staff's Post-hearing Brief at 18.

[48] *See, e.g., id.* at 21-23; Ex. 100 (Welsh) at 35-36; Tr. 941-42, 946-47.

[49] *See, e.g.*, Ex. 100 (Welsh) at 24-27; Tr. 938-39, 987, 1011. *See also WGL 2003 Final Order*, 2003 S.C.C. Ann. Rept. at 389. In addition, based on these findings the unamortized balance of the retired units shall also be reflected in rate base. *See, e.g.*, Ex. 100 (Welsh) at 24-25.

[50] *See WGL 2003 Final Order*, 2003 S.C.C. Ann. Rept. at 389. *See also* Ex. 100 (Welsh) at 38-39.

that burden, then the Commission must implement a reasonable depreciation expense as of a prior depreciation study date, which also may include the establishment of a regulatory asset for a significant reserve deficiency.[51] Moreover, the Commission has previously explained that a "change in costs must be recorded in the appropriate accounting period coincident with the change; this is true for depreciation expense as well as other costs."[52] On a regulatory accounting basis, it is accepted practice for new depreciation expenses to be implemented as of an historical depreciation study date, and for such to occur separate from a change in the rates charged to customers.[53]

The Commission also rejects Appalachian's assertion that these findings unlawfully change base rates for prior periods where they were otherwise frozen by Code §§ 56-585.1 or 56-585.1:1. As noted above, the Supreme Court of Virginia has affirmed the legality of the Commission's consistent regulatory accounting practice of establishing reasonable depreciation expenses and regulatory assets as ordered herein, including the Commission's explanation of why such does not constitute a retroactive change in rates.[54] In addition, the Court has more recently

---

[51] *See, e.g., WGL 2003 Final Order*, 2003 S.C.C. Ann. Rept. at 389; Ex. 100 (Welsh) at 26-27.

[52] *Application of Washington Gas Light Company and Shenandoah Gas Division of Washington Gas Light Company, For general increase in natural gas rates and charges and approval of performance-based rate regulation methodology pursuant to Va. Code § 56-235.6,* Case No. PUE-2002-00364, 2004 S.C.C. Ann. Rept. 329, 331, Order on Reconsideration (Jan. 23, 2004) ("*WGL 2004 Order on Reconsideration*"), *aff'd Washington Gas Light Company v. State Corporation Commission*, Record No. 040878, 2004 WL 7331918 (Va. Oct. 8, 2004) (unpublished) ("*2004 WGL Opinion*").

[53] *See, e.g., WGL 2003 Final Order*, 2003 S.C.C. Ann. Rept. at 389; *WGL 2004 Order on Reconsideration*, 2004 S.C.C. Ann. Rept. at 331; *2004 WGL Opinion* (unpublished) ("The Commission...did not err in requiring WGL to implement new depreciation rates as of the date immediately following the most recent depreciation study."); Ex. 100 (Welsh) at 37-39, Appendix B at 20-21 (excerpt from the National Association of Regulatory Utility Commissioners, *Public Utility Depreciation Practices*); Tr. 939-43.

[54] *2004 WGL Opinion* (unpublished) ("The Commission did not err in treating [WGL's] depreciation reserve deficiency as a regulatory asset and subjecting the asset to an earnings test. This accounting adjustment did not

affirmed the Commission's subsequent explanation that the "rates" established or otherwise frozen by statute are limited to the specific "'rates' which are allowed to be charged by an electric utility" to its customers during the historical period (*i.e.*, not individual expenses, revenues, or earnings from such period).[55] Approving reasonable expenses for the historical period in determining the reasonable earned return, as the Commission has always done, is not a change in "rates" under these statutes.

The Company was not prevented from reasonably implementing new depreciation rates during the triennial period under review. As noted above, in 2014 the Commission ordered Appalachian to file a depreciation study in its 2016 biennial review due to pending federal regulations. The General Assembly subsequently canceled that biennial review.[56] The Company, however, knew that it was continuing to carry a significant, and growing, depreciation reserve deficiency.[57] Nothing prohibited Appalachian from seeking or implementing reasonable depreciation expenses once the General Assembly canceled the 2016 biennial review, or from requesting regulatory asset treatment for a significant reserve deficiency.[58]

Finally, although Appalachian has the burden to establish the reasonableness of its triennial expenses, it appears to place that burden on the Commission or its Staff in this instance. The Company took the risk that its triennial depreciation expenses, if not updated to address

---

constitute a retroactively applied rule and fell within the Commission's 'reasonably wide area of legislative discretion' in setting rates that are just and reasonable." (citation omitted)).

[55] *Virginia Elec. and Power Co. v. State Corp. Comm'n*, 284 Va. at 736. The Court subsequently repeated that "the term 'rates' as used in this statute refers to the rates that a utility is authorized to charge." *Id.* at 742.

[56] *See* Code § 56-585.1:1 (2015 Va. Acts ch. 6).

[57] *See, e.g.*, Ex. 100 (Welsh) at 36; Ex. 121 (Cash Rebuttal) at 4.

[58] *See, e.g.*, Ex. 100 (Welsh) at 26-27; Tr. 1241; *WGL 2003 Final Order*, 2003 S.C.C. Ann. Rept. at 388-89.

significant ongoing deficiencies, would be found unreasonable. The obligation is not on Staff. We approve Staff's effort, however, in requesting an updated depreciation study during the triennial period when it appeared evident that Appalachian was not going to prepare one on its own accord after the General Assembly canceled the 2016 biennial review.[59] This effort provided the Company with, among other things, an additional opportunity to implement revised depreciation schedules, prior notice of Staff's position regarding reasonable depreciation during this period, and an opportunity to initiate a case to resolve any disagreements; Appalachian, however, chose to wait until the instant proceeding to address this issue.[60]

These findings decrease the Company's triennial review earnings as follows: (1) the 2017 Depreciation Study as approved herein decreases earnings by $20,136,598; (2) the 10-year amortization of the retired units decreases earnings by $20,064,639; and (3) updating rate base for the unamortized balance of the retired units decreases earnings by $8,265,753.[61]

Joint-Use Assets

Joint-Use Assets are information technology assets that are jointly utilized by, and commonly benefit, multiple AEP-affiliated companies, including Appalachian.[62] In the Company's 2014 biennial review, the Commission's Final Order directed that "these Joint-Use

---

[59] *See, e.g.*, Ex. 100 (Welsh) at 33-34; Ex. 109 (Letter from Scott C. Armstrong to David A. Davis, dated October 2, 2017); Tr. 945-47.

[60] *See, e.g.*, Ex. 100 (Welsh) at 33, Appendix B at 8-9; Ex. 121 (Cash Rebuttal) at 3.

[61] *See, e.g.*, Staff's Post-hearing Brief at 18, 23. In addition, the Commission has considered the participants' varied requests regarding implementation of Appalachian's *next* depreciation study. We find that the Company should implement its 2019 Depreciation Study as of the study date, incorporating only the specific revisions recommended by Staff. The Commission concludes that the record in this case supports this finding and results in reasonable depreciation expenses. *See, e.g.*, Staff's Post-hearing Brief at 49-52; Appalachian's Post-hearing Brief at 35-36.

[62] *See, e.g.*, Ex. 3 (Lysiak Direct) at 4; Ex. 98 (Carr) at 2.

Assets should be on AEP Service Company's [("AEPSC")] books, and that [Appalachian] should pay an appropriate facilities charge to [AEPSC]."[63]

In response to the Company's petition for reconsideration and clarification on this issue, the Commission authorized the Company "to comply with [this requirement] through ratemaking adjustments that are *functionally equivalent* to excluding the [Appalachian] Virginia share of future Joint-Use Assets on the Company's books and requiring such assets to be recorded on the books of [AEPSC]."[64] Thus, as an alternative to moving these Joint-Use Assets to AEPSC's books, the Commission authorized Appalachian to make regulatory accounting adjustments that achieve the same end result.[65]

The Company, however, failed to comply with the Commission's orders on this matter. Appalachian neither moved these Joint-Use Assets onto AEPSC's books, nor made functionally equivalent adjustments that would achieve the same end result for regulatory earnings analyses.[66] Accordingly, we approve Staff's recommended earnings test adjustments related to Joint-Use Assets necessary to comply with the Commission's orders in the 2014 biennial review. In addition, contrary to the Company's allegation, implementing a reasonable regulatory accounting adjustment necessary to remedy Appalachian's failure to comply with the Commission's orders is

---

[63] *APCo 2014 Biennial Review*, 2014 S.C.C. Ann. Rept. at 406.

[64] *Application of Appalachian Power Company, For a 2014 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia*, Case No. PUE-2014-00026, 2015 S.C.C. Ann. Rept. 209, 210, Order on Petition for Reconsideration and Clarification (Feb. 3, 2015) (emphasis added). The Company did not appeal the Final Order or the Order on Petition for Reconsideration and Clarification.

[65] *See, e.g.*, Ex. 98 (Carr) at 3.

[66] *See, e.g., id.* at 3-4.

in no manner retroactive ratemaking.[67] This finding increases the Company's triennial review earnings by $3,580,276.[68]

Incentive Compensation

The Commission has consistently found that incentive plan expenses not benefitting a utility's customers should not be included in the utility's annual expenses for earnings test purposes.[69] We continue to make such finding and remove the following incentive plan expenses, as recommended by Staff, which the Company has not established benefit customers: (1) hypothetical expenses for 2017 that were not actually incurred;[70] (2) expenses related to the strategic initiative plan that are above 100% of target, as well as metrics that are above 100% of target or were not shown to benefit Virginia jurisdictional customers;[71] and (3) payroll tax expense associated with incentive plan costs disallowed herein.[72] This finding increases the

[67] *See, e.g.*, Appalachian's Post-hearing Brief at 46.

[68] *See, e.g.*, Staff's Post-hearing Brief at 38. The Commission does not herein address proposed adjustments to Rider TRR (involving tax credits for excess deferred income taxes as discussed by Appalachian and Staff). Any proposed adjustments thereto can be addressed, if raised, in a separate proceeding for Rider TRR.

[69] *See, e.g., APCo 2014 Biennial Review*, 2014 S.C.C. Ann. Rept. at 393; *Application of Virginia Electric and Power Company, For a 2013 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia*, 2013 S.C.C. Ann. Rept. 371, 373; *Application of Appalachian Power Company, For a 2011 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia*, Case No. PUE-2011-00037, 2011 S.C.C. Ann. Rept. 477, 483 n.52, Final Order (Nov. 30, 2011).

[70] *See, e.g.*, Ex. 65 (Kaufman) at 20; Ex. 98 (Carr) at 5. Consistent with Commission precedent, we find that incentive plan expenses exceeding a payout ratio of 100% do not benefit customers and should not be included in the earnings test. *See, e.g.*, Ex. 65 (Kaufman) at 15, 17; Ex. 98 (Carr) at 5. We further find that such annual expenses exceeding 100% of target in 2018 or 2019, which did not benefit customers, should not be treated as if they were incurred and recorded in 2017. *See, e.g.*, Tr. 583-84.

[71] *See, e.g.*, Ex. 65 (Kaufman) at 15-20.

[72] *See, e.g., id.* at 21.

Company's triennial review earnings by (1) $745,156, (2) $1,843,772, and (3) $191,825, respectively, for a total of $2,780,753.[73]

Cost and Balance of Long-Term Debt

The Commission must determine Appalachian's cost of capital, which includes its cost and balance of long-term debt, in order to calculate earned return. The Commission finds that the cost and balance of long-term debt, as recommended by Staff, shall be used for this purpose. Staff's proposed methodology is reasonable, fully compensates the Company for its debt-related costs, and, moreover, is consistent with longstanding Commission precedent.[74]

Specifically, to determine the annualized dollar costs for each debt security, the effective rate shall be multiplied by the net amount of the debt outstanding.[75] This methodology accounts for the time value of money by returning the cumulative amount of issuance cost incurred against principal over time (before it must be repaid) and provides recovery of all debt-related costs.[76] In addition, we agree with Staff that the balance of long-term debt in the capital structure needs to include unamortized gains or losses on reacquired debt that was not refunded by the Company.[77] These findings increase the Company's triennial review earnings by $4,809,600.[78]

---

[73] *See, e.g.*, Staff's Post-hearing Brief at 35, List of Issues – Appendix to Staff's Brief.

[74] *See, e.g.*, Staff's Post-hearing Brief at 41-43.

[75] *See, e.g.*, Ex. 80 (Pippert) at 36; Tr. 727-28.

[76] *See, e.g.*, Ex. 81 (Effective Cost of Debt Example); Ex. 82 (Pippert's revision of Hawkins Reb. Exh. 1); Tr. 729-32. Moreover, we find that Appalachian's proposed methodology inflates its annualized cost of debt by applying the effective rate to the higher face amount of the debt. *See, e.g.*, Ex. 82 (Pippert's revision of Hawkins Reb. Exh. 1); Tr. 727-28.

[77] *See, e.g.*, Ex. 80 (Pippert) at 35.

[78] *See, e.g.*, Ex. 101 (Corrected); Staff's Post-hearing brief at Appendix. In addition, the Commission admits Ex. 87 into the record, objections to which were taken under advisement during the hearing.

Coal Inventory

As explained in Appalachian's 2014 biennial review, under long-standing regulatory practice the Commission permits the Company to include coal inventory in rate base and earn a return thereon.[79] The Commission further explained, however, that only a reasonable coal inventory amount will be included in rate base for this purpose.[80] Thus, "the Company will need to establish that it did not inventory unreasonable amounts of coal" during the historical review period and "will need to show that its actions to manage such inventory were reasonable based on the specific factual circumstances relevant to" that period.[81]

The Commission finds that the Company has established it acted reasonably in managing its coal inventory during the triennial period.[82] As a result, based on the specific facts of this case, we find that it is reasonable to use Appalachian's actual coal inventory for determining earned return in this proceeding. Thus, the Commission denies the requests by Consumer Counsel and Staff to reduce the amount of coal inventory in rate base during the triennial period, which Staff calculates would increase the Company's triennial earnings result by approximately $2.5 million.[83]

---

[79] *APCo 2014 Biennial Review*, 2014 S.C.C. Ann. Rept. at 397.

[80] *Id.* at 396.

[81] *Id.* at 397.

[82] *See, e.g.*, Ex. 24 (Jeffries) at 8; Ex. 117 (Jeffries Rebuttal) at 3, 6-7; Tr. 167-68; Appalachian's Post-hearing Brief at 50-52.

[83] Staff's Post-Hearing Brief at 30-31.

Inter-Company Power Agreement

Appalachian has executed an Inter-Company Power Agreement ("ICPA") with affiliated companies through which, among other things, it purchases power for its Virginia jurisdictional customers. Because the ICPA is with affiliated interests, the Company is statutorily prohibited from entering into such contract "until it shall have been filed with and approved by the Commission."[84] The Commission approved Appalachian's entry into the current version of the ICPA in 2011, and prior to that in 2004. Both approvals were subject to the requirement that any purchases made by Appalachian under the ICPA are at the "lower of" (a) the affiliate's actual cost, or (b) the market price of non-affiliated power.[85] Consumer Counsel asserts that the Company incurred triennial expenses under the ICPA that were greater than market price and, as a result, Appalachian's triennial expenses should be decreased accordingly.

During the triennial period, Appalachian's *energy* costs under the ICPA were approximately $49 million below comparable market energy costs.[86] Consumer Counsel, however, asserts that Appalachian's ICPA *capacity* costs during this period were significantly greater than market cost such that, even considering energy cost savings, the Company's triennial

[84] Code § 56-77.

[85] *Application of Appalachian Power Company, For consent to and approval of an extension and modification of an existing Amended and Restated Inter-Company Power Agreement with Ohio Valley Electric Corporation and other affiliates pursuant to Chapter 4 of Title 56 of the Code of Virginia*, Case No. PUE-2011-00058, 2011 S.C.C. Ann. Rept. 509, Order Granting Approval (Aug. 3, 2011); *Application of Appalachian Power Company, For consent to and approval of an Extension and Modification of an existing Inter-Company Power Agreement, Modification No. 1 to an Extension and Modification of an existing Inter-Company Power Agreement, and Termination of First Supplementary Transmission Agreement with Ohio Valley Electric Corporation and other affiliates pursuant to Title 56, Chapter 4 of the Code of Virginia*, Case No. PUE-2004-00095, 2004 S.C.C. Ann. Rept. 510, Order Granting in Part Petition for Reconsideration (Dec. 23, 2004).

[86] *See, e.g.*, Ex. 32 (Vaughan Direct), Sched. 1; Appalachian's Post-hearing Brief at 74.

expenses should be decreased by $30.8 million.[87] In reaching this conclusion, Consumer Counsel compared ICPA capacity costs to PJM capacity costs.[88]

Based on the instant record, the Commission finds that it is not reasonable to compare ICPA capacity costs during the triennial period to PJM capacity costs for purposes of the instant earnings review.[89] The ICPA provides for long-term capacity, whereas the PJM costs are for short-term capacity.[90] We find that comparison to PJM capacity costs does not provide a reasonable basis to disallow expenses in this particular instance.[91] Accordingly, the Commission denies Consumer Counsel's request to decrease Appalachian's triennial expenses by $30.8 million.

Accumulated Deferred Income Taxes

The Commission approves Staff witness Morgan's three recommendations regarding the Company's treatment of Accumulated Deferred Income Taxes ("ADIT"): (1) the level of ADIT shall be consistent with the Pre-paid Pension/Other Post-Employment Benefit asset included in rate base; (2) West Virginia ADIT related to the 2015 Retired Units shall be excluded; and

[87] *See, e.g.*, Consumer Counsel's Post-hearing Brief at 64-77.

[88] *See, e.g.*, Ex. 59 (Norwood) at 11.

[89] *See, e.g.*, Appalachian's Post-hearing Brief at 72-73.

[90] *See, e.g.*, Ex. 128 (Vaughan Rebuttal) at 2.

[91] For the limited purpose of this proceeding, we find that it is reasonable to compare the ICPA capacity costs to the 2011 Benchmark Study presented by the Company. *See, e.g., id.* at 2-4 and Rebuttal Sched. 1. The Commission also herein admits Ex. 36 (objections to which were taken under advisement during the hearing) for the limited purpose of cross-examining the witness thereon, not for the testimony included therein.

(3) ADIT shall be included in rate base consistent with Staff witness Welsh's depreciation proposals.[92] This finding decreases the Company's triennial review earnings by $2,325,994.[93]

Lead-Lag Study

The Commission approves the following Staff recommendations regarding Appalachian's lead-lag study: (1) in the income statement portion, reductions to Revenue Lag days, Other O&M Lead days, and Fuel and Deferred Fuel Lead days; and (2) in the balance sheet portion, adjustments to reflect the average balance for each year during the earnings test and to remove capital improvements associated with the Company's Dresden generating station rate adjustment clause.[94] This finding increases the Company's triennial review earnings by $449,836.[95]

Renewable Energy Certificates

The Commission approves Staff's adjustment to remove expenses for Renewable Energy Certificates associated with off-system sales; these expenses should be accounted for in the Company's fuel factor with the other costs and revenues associated with off-system sales.[96] This finding increases the Company's triennial review earnings by $274,703.[97]

Clinch River

The Commission approves Staff's adjustment to remove depreciation expense and rate base related to certain Clinch River coal assets retired in 2016 but inadvertently not removed

---

[92] *See, e.g.*, Ex. 18 (Morgan) at 4; Staff's Post-hearing Brief at 35-36.

[93] *See, e.g.*, Staff's Post-hearing Brief at 36.

[94] *See, e.g.*, Ex. 65 (Kaufman) at 12-14, Appendix A at 28-31.

[95] *See, e.g.*, Staff's Post-hearing Brief at 40.

[96] *See, e.g.*, Ex. 98 (Carr) at 8.

[97] *See, e.g.*, Staff's Post-hearing Brief at 40.

from plant in service until 2017.[98] This finding increases the Company's triennial review earnings by $186,644.[99]

Plant Held for Future Use

The Commission approves Staff's exclusion of certain distribution plant held for future use not expected by the Company to be used and useful within four years.[100] This finding increases the Company's triennial review earnings by $139,321.[101]

Property Tax Expense

As explained by Staff, certain adjustments to property tax expense must be made to reflect adjustments approved herein related to net plant and accumulated depreciation. These adjustments increase the Company's triennial review earnings by $1,925,039.[102]

Amos and Mountaineer

Sierra Club recommended disallowance of certain capital expenditures incurred during the triennial review period for the Company's Amos and Mountaineer coal-fired generating facilities. Subsequently, Appalachian and Sierra Club filed a Stipulation, whereby Appalachian agreed to perform specific analyses of these two facilities for inclusion in its next integrated resource plan, and Sierra Club withdrew its recommended disallowance.[103] In addition, Staff

---

[98] *See, e.g.*, Ex. 100 (Welsh) at 48 n.59.

[99] *See, e.g.*, Staff's Post-hearing Brief at 40.

[100] *See, e.g.*, Ex. 100 (Welsh) at 48 n.59.

[101] *See, e.g.*, Staff's Post-hearing Brief at 40.

[102] *See, e.g.*, Ex. 100 (Welsh) at 51; Staff's Post-hearing Brief at 35.

[103] Stipulation signed by Sierra Club and Appalachian (filed Sep. 11, 2020). *See also* Sierra Club's Post-hearing Brief at 3-6; Appalachian's Post-hearing Brief at 121.

witness Pratt identified two additional evaluation criteria for such analyses, to which the Company did not object.[104] The Commission approves both the Stipulation and Staff's recommended additional criteria.

Interest synchronization

Consumer Counsel explains that if the Commission approves lower rate base levels herein than proposed by Appalachian, it results in lower synchronized interest expense and higher income tax expense.[105] The Commission agrees and has reflected such in the results of the instant earnings analysis set forth immediately below.

Test Period Earnings and Earned Return

Based on our findings in this case, Appalachian earned an ROE of 9.48% during the 2017-2019 triennial review period. As noted above, the fair rate of return for purposes of this proceeding is 9.42%. Thus, for the 2017-2019 triennial period under review, Appalachian earned 6 basis points above the fair ROE, which equates to approximately $1,992,987 in excess earnings for such period.

Statutory Outcome

Pursuant to Code § 56-585.1 A 8, customers do not receive a refund of any excess earnings because Appalachian's earned return was not "more than 70 basis points" above 9.42% (*i.e.*, greater than 10.12%).[106] Similarly, because Appalachian did not earn "more than 70 basis

[104] *See, e.g.*, Staff's Post-hearing Brief at 77-78.

[105] *See, e.g.*, Consumer Counsel's Post-hearing Brief at 58-59.

[106] Code § 56-585.1 A 8 b.

points" below 9.42% (*i.e.*, less than 8.72%), the alternate directive in Code § 56-585.1 A 8 to "order increases to the utility's rates" is likewise inapplicable.[107]

The Company asserts that the latter outcome – *i.e.*, no prospective rate increase – "cannot be reconciled with the protections afforded by the federal and state Constitutions."[108] Appalachian, however, advises that "[t]he Commission need not entangle itself in such a controversy."[109] Specifically, according to the Company, the Commission can avoid such entanglement by agreeing with (and thereby necessarily giving greater weight to) the Company's proffered "evidence in the record" in order "to determine that Appalachian earned below its authorized return during the Earnings Test Period and is thus eligible for a rate increase under the Code."[110]

The Company also alleges that Staff's regulatory earnings adjustments are "deliberately engineered to block the Commission from granting a rate increase...."[111] In rejecting this claim,

---

[107] Code § 56-585.1 A 8 a. Because the statutory outcome does not result in a prospective change in rates, the Commission does not herein address issues related thereto and likewise need not address the treatment of regulatory assets, for potential future rate purposes, as part of the instant historical earnings review. Similarly in this regard, the Commission does not herein address Consumer Counsel's request for a ruling – "without prejudice" – on Appalachian's advanced metering infrastructure ("AMI") replacement program. Consumer Counsel's Post-hearing Brief at 77. Consumer Counsel notes that the Company previously petitioned for specific approval thereof, but then withdrew its request upon concluding it was not yet meeting the Commission's prudency requirements for such a program. *See, e.g.,* Tr. 119. In response, Appalachian states that it has developed a plan to maximize the benefits of AMI, and that by inducing customers to shift usage, these programs will reduce costs for all retail customers by: (1) lowering Appalachian's PJM capacity requirement; (2) lowering transmission costs allocated to the Company; (3) lowering the allocation of costs to the Company's Virginia jurisdiction; and (4) lowering marginal fuel and market energy costs. *See, e.g.,* Ex. 21 (Castle Direct) at 21-22. As this issue represents approximately 38 basis points and, thus, does not change the statutory outcome of the instant triennial review, any findings on this matter *without prejudice* is not necessary.

[108] Appalachian's Post-hearing Brief at 7.

[109] *Id.* at 10.

[110] *Id.* at 10-11. In this particular statement, it is unclear whether the Company is referencing Code § 56-585.1 A 2 g, a specific petition under which was not included in its Application.

[111] *Id.* at 8.

Staff states that it "proposed many changes to the Company's Earnings Test analysis, some of which result in a higher earned return and some of which result in a lower earned return," and that "Staff's recommendations are all consistent with proper ratemaking and Commission precedent."[112]

As explained above, and as with every prior earnings review under this statute, the Commission has necessarily exercised its discretion to make findings on the reasonableness of the Company's expenses and revenues during the triennial period. Once the reasonable earned return is determined, the next steps attendant to this case are dictated by statute. The Commission recognizes that the public interest is not well served if a utility is permitted to charge its customers more than necessary to earn a reasonable return. Likewise, the public interest is also not well served if a utility is unable to earn a reasonable return.[113] We must reject, however, the Company's invitation to abdicate the Commission's statutory duty and discretion in this proceeding by purposefully giving greater weight to certain evidence in an effort to engineer Appalachian's desired historical earnings result. We further note that our findings herein are well within the constitutional standards set forth in, among other pertinent cases, the decisions of the United States Supreme Court in *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n of West Virginia et al.*, 262 U.S. 679 (1923), *Federal Power Comm'n et al. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), and *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

[112] Staff's Post-hearing Brief at 7.

[113] Among other things, such could result in higher borrowing costs or hinder the provision of reasonably adequate service.

FAIR RATE OF RETURN ON COMMON EQUITY

The Commission must determine in this triennial review the Company's fair ROE pursuant to the requirements set forth in Code § 56-585.1 A 2. This ROE will be used for rate adjustment clauses approved under Code §§ 56-585.1 A 5 and A 6, and for Appalachian's next triennial review.[114]

In determining a fair ROE, the Commission must follow the directives set forth in Code § 56-585.1 A 2 and "may use any methodology to determine such [ROE] it finds consistent with the public interest."[115] We herein employ the same process repeatedly used by the Commission in approving a fair ROE under this statute; we first determine the market cost of equity, and then establish a peer group majority ROE.

Market Cost of Equity

Company witness McKenzie calculated Appalachian's cost of equity to be between 9.2% and 10.3%, or 9.3% to 10.4% after incorporating an adjustment to account for the impact of common equity flotation costs, and determined that, taking into account Appalachian's specific risks and requirements for financial strength, an ROE of 9.9% represents Appalachian's cost of equity.[116] Consumer Counsel witness Woolridge calculated Appalachian's market cost of equity to be between 7.6% and 8.85% and determined that 8.75% represents Appalachian's market cost of equity.[117] Staff witness Pippert calculated Appalachian's market cost of equity to be between

[114] *See, e.g.*, Code §§ 56-585.1 A 2 and A 8 a.

[115] Code § 56-585.1 A 2 a.

[116] *See, e.g.*, Ex. 29 (McKenzie Direct) at 13.

[117] *See, e.g.*, Ex. 52 (Woolridge) at 4.

8.0% and 9.0% and determined that establishing the Company's cost of equity at the midpoint of 8.5% was appropriate.[118]

The Commission recognizes that "[t]here is no single scientific correct rate of return."[119] Based on the evidence herein, the Commission finds that a market cost of equity within a range of 8.3% to 9.3% fairly represents the actual cost of equity in capital markets for companies comparable in risk to Appalachian seeking to attract equity capital. We find that a market cost of equity of 8.3% to 9.3% is supported by reasonable proxy groups, growth rates, discounted cash flow ("DCF") methods, and risk premium analyses.

The Commission further concludes, under the circumstances of this case and for purposes of implementing Code § 56-585.1:1, that approving a specific ROE of 9.2% from this range is "consistent with the public interest" under Code § 56-585.1 A 2 a and reasonably balances the interests of the Company, its customers, and its investors. The Company's currently approved ROE is 9.42%. We find that lowering such ROE to 9.2% at this time is supported by the concept of gradualism in ROE determinations. The Commission finds that an ROE of 9.2% is fair and reasonable, supported by evidence in the record, and satisfies the following constitutional standards as stated by Staff witness Pippert: "maintenance of financial integrity, the ability to attract capital on reasonable terms, and earnings commensurate with returns on investments of comparable risk."[120]

---

[118] *See, e.g.*, Ex. 80 (Pippert) at 21.

[119] *Commonwealth ex rel. Div. of Consumer Counsel v. Potomac Edison Co.*, 233 Va. 165, 171 (1987) (quoting *Central Tel. Co. of Va. v. State Corp. Comm'n*, 219 Va. 863, 874 (1979)).

[120] Ex. 80 (Pippert) at 23.

Conversely, the Commission finds that Appalachian's proposed cost of equity represents neither the actual cost of equity in the marketplace nor a reasonable ROE for the Company. We find that Appalachian's proposed market cost of equity is not supported by reasonable growth rates, DCF methods, or risk premium analyses. For example, Mr. McKenzie relied on unreasonably high projected earnings per share growth rates for his DCF analysis, which upwardly skews his results.[121] Mr. McKenzie's resulting analyses were also inflated by his asymmetric exclusion of utilities from his DCF analysis that are below his low-end threshold of 6.8%.[122] The Company also inappropriately relies on a mix of actual and projected interest rates in his risk premium analysis.[123] The Commission has explicitly rejected the use of projected interest rates in prior cases, stating that inclusion of these projected rates inflates the results of the utility's risk premium analysis.[124]

Peer Group Majority ROE

Code §§ 56-585.1 A 2 a and b require the Commission to establish a peer group majority ROE as follows:

> a. The Commission may use any methodology to determine such return it finds consistent with the public interest, but for applications received by the Commission on or after January 1, 2020, such return shall not be set lower than the average of either (i) the returns on common equity reported to the Securities and Exchange Commission for the three most recent

[121] *See, e.g.,* Ex. 29 (McKenzie Direct) at 35.

[122] *See, e.g., id.* at 45. Mr. McKenzie asserts that, in theory, results at the high end of the range should also be excluded but claims that in this case "no such values exist." *Id.* at 46.

[123] *See, e.g., id.* at 50.

[124] *See, e.g., 2018 Appalachian ROE Order* at 5; *Application of Appalachian Power Company, For the determination of the fair rate of return on common equity to be applied to its rate adjustment clauses*, Case No. PUE-2016-00038, 2016 S.C.C. Ann. Rept. 393, 395, Final Order (Oct. 6, 2016); *Application of Aqua Virginia, Inc., For an increase in rates*, Case No. PUE-2014-00045, 2016 S.C.C. Ann. Rept. 206, 209, Final Order (Jan. 7, 2016); *Application of Appalachian Power Company, For an increase in electric rates*, Case No. PUE-2006-00065, 2007 S.C.C. Ann. Rept. 321, 327, Final Order (May 15, 2007).

annual periods for which such data are available by not less than a majority, selected by the Commission as specified in subdivision 2 b, of other investor-owned electric utilities in the peer group of the utility subject to such triennial review or (ii) the authorized returns on common equity that are set by the applicable regulatory commissions for the same selected peer group, nor shall the Commission set such return more than 150 basis points higher than such average.

b. In selecting such majority of peer group investor-owned electric utilities for applications received by the Commission on or after January 1, 2020, the Commission shall first remove from such group the two utilities within such group that have the lowest reported or authorized, as applicable, returns of the group, as well as the two utilities within such group that have the highest reported or authorized, as applicable, returns of the group, and the Commission shall then select a majority of the utilities remaining in such peer group. In its final order regarding such triennial review, the Commission shall identify the utilities in such peer group it selected for the calculation of such limitation. For purposes of this subdivision, an investor-owned electric utility shall be deemed part of such peer group if (i) its principal operations are conducted in the southeastern United States east of the Mississippi River in either the states of West Virginia or Kentucky or in those states south of Virginia, excluding the state of Tennessee, (ii) it is a vertically-integrated electric utility providing generation, transmission and distribution services whose facilities and operations are subject to state public utility regulation in the state where its principal operations are conducted, (iii) it had a long-term bond rating assigned by Moody's Investors Service of at least Baa at the end of the most recent test period subject to such triennial review, and (iv) it is not an affiliate of the utility subject to such triennial review.

As reflected in prior Commission orders on ROE, the above statute – although highly prescriptive in numerous respects – also requires the Commission to exercise its reasonable discretion on specific matters not addressed or otherwise limited in this statutory grant of authority. The Commission must exercise such discretion in determining a peer group majority ROE, which establishes the ROE floor. For this purpose, the Commission has consistently found

that it is reasonable and rational to exercise such discretion in a manner that supports the actual market cost of equity found fair and consistent with the public interest based on the record.[125]

The Commission must first identify the specific utilities that comprise the peer group under the above statute. Company witness McKenzie, Consumer Counsel witness Woolridge, and Staff witness Lee identify the same statutory peer group of 12 utilities, which we likewise find complies with the above statute.[126]

The Commission must next determine the earned return for each utility in the peer group, which will then be used in calculating the peer group majority's average earned return.[127] Such calculation can be based on either year-end common equity or average common equity,[128] and the choice is left to the Commission's discretion.[129] The Commission has previously found that it

---

[125] *See, e.g., Application of Virginia Electric and Power Company, For the determination of the fair rate of return on common equity pursuant to § 56-585.1:1 C of the Code of Virginia*, Case No. PUR-2019-00050, 2019 S.C.C. Ann. Rept. 400, 404, Final Order (Nov. 21, 2019) ("*2019 DEV ROE Order*").

[126] *See, e.g.*, Ex. 29 (McKenzie Direct) at 75, Schedule 13 at 5; Ex. 79 (Lee) at 5; Ex. 52 (Woolridge) at 109.

[127] To calculate ROE for a peer group utility under the statute, "net income available for common shareholders is divided by common shareholders' equity." Ex. 79 (Lee) at 11.

[128] *Id.*

[129] The Commission has previously explained that, "[a]s with selecting the peer group majority, if the General Assembly wanted the Commission to apply a particular approach or methodology in calculating peer group returns, it could have directed as such; it did not. Indeed, as with the Commission's previous observation in establishing the peer group majority ROE, 'the lack of a particular evaluation methodology for [calculating peer group ROEs] directly contrasts with the very specific criteria prescribed by the General Assembly in other parts of § 56-585.1 A 2 of the Code.'" *2019 DEV ROE Order*, 2019 S.C.C. Ann. Rept. at 405 n.56 (quoting *Application of Virginia Electric and Power Company, For a 2011 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia*, Case No. PUE-2011-00027, 2011 S.C.C. Ann. Rept. 456, 463 n.62, Final Order (Nov. 30, 2011)).

is reasonable to use *either* year-end equity or average equity for this purpose,[130] and we find that there is evidence in this proceeding supporting the use of both methods.[131]

In exercising its statutory discretion on this issue, the Commission has consistently chosen the calculation method that better supports the market cost of equity found fair and consistent with the public interest.[132] Consistent therewith, the Commission will use year-end equity to calculate the peer group's earned return in this case. As a result, the five-member peer group majority that the Commission herein selects had an average earned return of 8.73%, which is near the midrange of the market cost of equity range found fair and reasonable above.[133] The Commission continues to conclude, as we have in prior cases, that establishing the peer group majority ROE in this manner is reasonable, has a rational basis, and does not violate any constitutional or statutory provision.

The General Assembly has recently added an additional step to this process.[134] In addition to calculating the selected peer group majority's average *earned* return, the Commission

---

[130] *2018 Appalachian ROE Order* at 6 ("Based on the record herein, the Commission finds that it is reasonable to calculate the statutory peer group floor using either average or year-end common equity.").

[131] *See, e.g.*, Ex. 79 (Lee) at 5; Ex. 52 (Woolridge) at 109.

[132] *See, e.g., 2019 DEV ROE Order*, 2019 S.C.C. Ann. Rept. at 406.

[133] The peer group majority comprises the following five companies: Georgia Power; Entergy Mississippi; Duke Energy Progress; Louisville Gas & Electric; and Kentucky Utilities. *See* Ex. 79 (Lee) at 5. The Commission also notes that, in this instance, use of average equity would not alter the 9.2% ROE approved in this case; using average equity results in the same five companies above and a statutory peer group floor of 9.02%. *See, e.g., id.*

[134] *See* 2020 Va. Acts ch. 1108. The Commission notes that like House Bill 528, discussed above, this amendment did not become effective until *after* the Company filed its Application. Unlike House Bill 528, however, the General Assembly directed that this particular statute shall apply retroactively to "applications received by the Commission on or after January 1, 2020." *Id.*; Code § 56-585.1 A 2 a.

must also calculate the average *authorized* return for that same selected peer group majority.[135] Then, the Commission must choose either the selected peer group majority's average (i) earned, or (ii) authorized, return as the statutory ROE floor in this proceeding. The average *authorized* return for the same selected five peer group majority is approximately 9.9%.[136] Thus, in continuing to exercise the Commission's delegated discretion in a manner that supports the actual market cost of equity found fair and consistent with the public interest, we choose the peer group majority's average *earned* return as the statutory ROE floor in this instance.

In sum, the Commission concludes that the fair ROE in this proceeding for Appalachian is 9.2%, which is above the selected peer group majority ROE floor of 8.73%. The Commission finds that the ROE approved herein is supported by the record, is fair and reasonable to the Company within the meaning of the Code, permits the attraction of capital on reasonable terms, fairly compensates investors for the risks assumed, enables the Company to maintain its financial integrity, is consistent with the public interest, and satisfies all applicable statutory and constitutional standards.

[135] The Commission must determine "the average of ... the *authorized* returns on common equity that are set by the applicable regulatory commissions for the *same selected peer group*" majority used to calculate the average earned return immediately above. Code § 56-585.1 A 2 a (emphasis added).

[136] *See, e.g.*, Ex. 79 (Lee) at 14; Ex. 29 (McKenzie Supplemental Direct) at 6, Schedule 15 at 1.

TARIFF ADJUSTMENTS

The Company proposes specific tariff-related changes as part of this proceeding.[137] Accordingly, the Commission makes the findings listed below, which we conclude are reasonable and supported by evidence in the record.[138]

Monthly Service Charge

The Company seeks to increase its Residential Basic Service Charge, which collects customer-related fixed costs, from $7.96 to $14.00. Having been persuaded by evidence and arguments opposing this change, the Commission denies this request.[139]

Winter Heating Block Rate

The Company proposes to implement declining winter block rates for residential customers. Having been persuaded by evidence and arguments opposing this change, the Commission denies this request.[140]

Smart Demand and Smart Time of Use

The Commission approves Appalachian's proposed voluntary rates schedules, Residential Smart Demand and Residential Smart Time of Use.[141] In addition, as recommended by Staff, the

---

[137] Although this triennial review does not result in an overall change in base rates, the Code still permits Appalachian to "propose an adjustment to one or more tariffs that are revenue neutral to the utility." Code § 56-585.1 A 3.

[138] The Commission reaches the conclusions herein without consideration of Ex. 91, objections to which were taken under advisement during the hearing.

[139] *See, e.g.,* Staff's Post-hearing Brief at 70-72; Consumer Counsel's Post-hearing Brief at 88-90; VPLC's Post-hearing Brief at 3-4, 7; Environmental Respondent's Post-hearing Brief at 21-24; Sierra Club's Post-hearing Brief at 1-2, 9-10.

[140] *See, e.g.,* Staff's Post-hearing Brief at 72; Consumer Counsel's Post-hearing Brief at 90-91; VPLC's Post-hearing Brief at 5-7; Environmental Respondent's Post-hearing Brief at 26-28. The Commission also finds that it is reasonable not to adopt Environmental Respondent's alternative rate design proposal in this regard.

[141] *See, e.g.,* Ex. 1 (Application) at 18-19; Ex. 38 (Walsh) at 9, 17-20.

Company shall evaluate the effectiveness of these two tariff offerings and report the findings in its next triennial review proceeding.[142]

Small General Service

The Company proposes to increase the customer charge for the Small General Service (Secondary Service) Rate Schedule. Having been persuaded by evidence and arguments opposing this change, the Commission denies this request.[143]

Coal Amortization Rider

Appalachian describes its proposed Coal Amortization Rider ("Rider CAR") as a "savings account" that will reduce the remaining plant balances of the Amos and Mountaineer coal plants "if, at some point in the future, [the Company] cannot use these resources to serve its Virginia customers[,]" thus "minimizing large remaining balances and generational subsidies."[144] Appalachian also asserts that Rider CAR could be approved with a zero revenue requirement, and then the Company subsequently could seek approval to recover specific revenues thereunder.[145]

The Commission finds that it is not appropriate to create a separate rider, at this time, to address a situation that may or may not occur.[146] For example, if the expected service lives of these units materially change, the depreciation impacts could be addressed through subsequent

---

[142] *See, e.g.*, Staff's Post-hearing Brief at 73-74.

[143] *See, e.g., id.* at 74-75.

[144] Ex. 1 (Application) at 12-13.

[145] *See, e.g.*, Appalachian's Post-hearing Brief at 79.

[146] *See, e.g.*, Staff's Post-hearing Brief at 61; VML/VACo Steering Committee's Post-hearing Brief at 14-15; Committee's Post-hearing Brief at 18-19; Consumer Counsel's Post-hearing Brief at 87-88; Environmental Respondent's Post-hearing Brief at 24-26; Sierra Club's Post-hearing Brief at 6-9.

regulatory accounting and ratemaking.[147] In addition, our finding herein does not preclude the Company from subsequently requesting a specific recovery mechanism or rider for these costs if a material change occurs.[148]

Partial Stipulation

Appalachian, Staff, Kroger, SDI, and Walmart filed a Partial Stipulation, which provided for resolution of issues related to: (1) Rate Schedules GS, MGS, LGS, OL, and ATOD; (2) Riders DRS, EDR, SBS, NMS, DIR, DRS RTO Capacity, RPR, ERCRS, and T-RAC; (3) AMI Opt-Out Charges; and (4) Terms and Conditions of Service.[149] The Commission approves the resolution of these issues as set forth in the Partial Stipulation.

Cost Allocation and Revenue Apportionment

As to class cost of service and revenue apportionment, the Commission finds that it is reasonable not to shift costs or reapportion revenues among service functions or customer classes at this time in the various manners proposed herein,[150] wherein such changes could result in detrimental rate impacts on residential and other customer classes,[151] and when rates would not otherwise be changing as part of the instant case.

---

[147] *See, e.g.*, Ex. 100 (Welsh) at 47.

[148] The Commission is not herein ruling on any legal or factual issues that may be raised attendant to any such request.

[149] Partial Stipulation and Motion to Accept Partial Stipulation (Sep. 14, 2020).

[150] *See, e.g.*, Ex. 8 (Fischer Direct) at 2-12; Ex. 37 (Spaeth Direct) at 2-7 and (MMS) Schedule 1; Ex. 129 (Spaeth Rebuttal) at 2, 9; Committee's Post-hearing Brief.

[151] *See, e.g.*, Ex. 1 (Application) at Schedule 40C; Ex. 21 (Castle Direct) at 6-8; and Ex. 39 (Baron) at 15-16 (Tables 2 and 3) (illustrating the directions in which costs would be shifted upon reallocation and reapportionment).

ENVIRONMENTAL JUSTICE

Staff witness Carr testified that "[i]n recognition of the importance of environmental justice and [recent] General Assembly actions, Staff propounded several interrogatories to the Company regarding environmental justice considerations contained in its Application and business processes," but that "[u]fortunately, the Company objected to each of these interrogatories."[152] Appalachian asserts that it opposed Staff's inquiries because, among other things, the recent Environmental Justice Act[153] was enacted after it filed its Application in this matter.[154]

Notwithstanding the Company's objections, Staff confirmed that it "will continue its environmental justice inquiries of [Appalachian] and other Virginia utilities in other formal and informal venues going forward."[155] During the hearing Company President and Chief Operating Officer, Christian T. Beam, testified that Appalachian considers environmental justice on an ongoing basis and "would be welcome to having any discussion with the Staff or the Commissioners in that matter, and how do we adapt that to the overall operation of the Company."[156]

The Commission strongly supports Staff's efforts in this regard and trusts that the Company will follow through on Mr. Beam's commitment to coordinate discussions with Staff on how Appalachian addresses environmental justice issues in the Company's operations.

---

[152] Ex. 98 (Carr) at 10.

[153] 2020 Va. Acts. chs. 1212 and 1257.

[154] Appalachian's Post-hearing Brief at 120.

[155] Ex. 98 (Carr) at 11.

[156] Tr. 1029-30.

Accordingly, IT IS ORDERED THAT:

(1) The Company's Application is granted in part and denied in part as set forth in this Final Order.

(2) The Company shall comply with the directives set forth in this Final Order.

(3) The Company shall forthwith file revised tariffs and terms and conditions of service and supporting workpapers with the Clerk of the Commission and with the Commission's Divisions of Energy Regulation and Utility Accounting and Finance, as necessary to comply with the directives and findings set forth in this Final Order. The Clerk of the Commission shall retain such filing for public inspection in person and on the Commission's website: scc.virginia.gov/pages/Case-Information.

(4) This case is dismissed.

A COPY hereof shall be sent electronically by the Clerk of the Commission to all persons on the official Service List in this matter. The Service List is available from the Clerk of the Commission.