COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

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

REPORT OF D. MATHIAS ROUSSY, JR., HEARING EXAMINER

November 17, 2022

Appalachian Power Company ("APCo" or "Company") appealed to the Supreme Court of Virginia ("Court") the decision of the State Corporation Commission ("Commission") on the Company's earnings during 2017 through 2019 that are used to determine whether the electric rates paid by APCo's customers change. While the Commission approved no rate increase, the Court's Opinion[1] requires the Commission to conduct further proceedings that will increase rates.[2] More specifically, the Court's decision: (1) creates a $37 million regulatory asset that customers must pay for; and (2) triggers a statutory requirement for a Commission decision on the going-forward rate case, where the evidentiary record supports increased base rates.

The amount by which APCo's base rates should be increased is disputed. For the case participants that presented comprehensive accounting testimony, APCo recommends a going-forward revenue requirement increase of $40.6 million, the Commission's Staff ("Staff") recommends $28.4 million, and the Office of the Attorney General's Division of Consumer Counsel ("Consumer Counsel") recommends $12.9 million. These amounts all assume that the $37 million regulatory asset created by the Court's Opinion would be recovered over three years, which I find is a reasonable period that aligns with the statutory triennial review schedule. Based on the record developed in the initial phase of this proceeding, I recommend Staff's going-forward revenue requirement increase of $28.4 million.

Had the rate increase now required by the Court been approved by the Commission in 2020, APCo would have collected more revenue from higher rates. To address this under-collection, APCo proposes a rate rider that would be in place for 16 months. I find that the proposed rider should be revised, with the amounts used to calculate the reduced rider subject to further Staff verification. Additionally, Consumer Counsel has identified concerns about double-recovery that should be addressed.

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[1] *Appalachian Power Company v. State Corporation Commission, et al.*, Record No. 210391, Slip Opinion (Aug. 18, 2022) ("*APCo 2022*" or "Court's Opinion," as applicable). The Court decided that the Commission must charge against APCo's 2019 earnings an $88.3 million impairment that APCo entered on its financial books on December 31, 2019, for power plants that retired in 2015, regardless of whether APCo's entry was reasonable.

[2] The Court understood its decision would increase rates. *See, e.g., APCo 2022,* Slip Opinion at 43 (Mims, S.J., and Powell, J., dissenting) ("The majority's holding also takes away the Commission's ability to protect rate payers from potentially unreasonable accounting practices that will result in rate increases. Now that [APCo] will be permitted to allocate all the asset impairment costs for the retired units in 2019, [APCo]'s earnings for the triennial review period will be lowered to such an extent that the Commission will be required to conduct a going-forward rate case and [APCo] will be entitled to raise its rates.").

RELEVANT PROCEDURAL HISTORY

On November 24, 2020, the Commission issued a Final Order in this triennial review docket. On March 26, 2021, the Commission issued an Order on Reconsideration.

On August 18, 2022, the Court issued an Opinion that affirmed in part, and reversed in part, certain contested rulings in this matter. The Court remanded this triennial review case for further proceedings consistent with the Court's Opinion.[3]

On August 22, 2022, the Commission issued an Order Initiating Remand Proceedings ("Remand Procedural Order") that, among other things, directed APCo to file proposed interim rates for (a) base rates going forward, and (b) a rider designed to collect revenues not collected from January 1, 2021, through September 30, 2022.

The Remand Procedural Order directed that APCo, Staff, and "any party choosing to participate in these remand proceedings shall submit a combined issues matrix on the outstanding disputed going-forward issues as of the close of the evidentiary record in the underlying case, adjusted for the rulings in the Court's Opinion. No new positions shall be submitted regarding earnings test adjustments, going-forward accounting adjustments, or rate design."[4] On September 23, 2022, APCo, Consumer Counsel, Staff, VML/VACo APCo Steering Committee ("VML/VACo"), and the Old Dominion Committee for Fair Utility Rates ("Committee") filed a combined issues matrix that, among other things, identified outstanding disputed going-forward issues on remand and the filing participants' positions, if any, on such issues ("Combined Issues Matrix").

The Remand Procedural Order also, among other things, allowed the participants that previously submitted an earnings test and going-forward revenue requirement to submit a revised earnings test and going-forward revenue requirement for the rate year beginning January 1, 2021. The Commission made clear that any such filing "shall be based on the established evidentiary record in this case and the participant's stated positions in this proceeding on going-forward adjustments as of the date of the Order on Reconsideration."[5] On September 23, 2022, APCo, Consumer Counsel, and Staff filed revised earnings test results, going-forward revenue requirements, and supporting testimony (collectively, "Remand Testimony").[6]

On September 30, 2022, the Commission issued an Order that assigned this matter to a Hearing Examiner to conduct further proceedings, including the preparation of a report containing the Hearing Examiner's findings and recommendations in this matter pertaining to the going-forward rate year review remanded to the Commission by the Court. The Order reiterated the limited scope of these remand proceedings:

> These proceedings shall be limited to a going[-]forward rate year review in accordance with the Court's directive. No evidence is to

[3] *APCo 2022*, Slip Opinion at 39.
[4] Remand Procedural Order at 2.
[5] *Id.* at 1.
[6] Consumer Counsel did not file revised earnings test results.

be considered on the earnings tests reviewed and ruled upon in the underlying proceedings and subsequent appeal, apart from adjustments necessary to incorporate the Court's rulings and calculate the going-forward revenue requirement.[7]

On October 5, 2022, a Hearing Examiner's Ruling scheduled a hearing for the limited purpose of receiving the Remand Testimony and for argument on any legal issues potentially within the limited scope of the remand proceedings. Given the limited scope of the remand hearing, the compressed timeframe necessary to conclude this case in a timely manner, and the number of participants in this case, the Hearing Examiner's Ruling scheduled the remand hearing as a virtual hearing.

On October 28, 2022, APCo filed a Motion to Exclude Potential Exhibits ("Motion"). On October 31, 2022, a Hearing Examiner's Ruling provided for any response(s) to the Motion to be filed on an expedited basis. On November 1, 2022, Consumer Counsel and VML/VACo filed responses. Consumer Counsel's filing also contained a cross-motion to exclude part of APCo's remand testimony.

On November 2, 2022, the remand hearing was convened, as scheduled, using Microsoft Teams. Noelle J. Coates, Esquire, Timothy E. Biller, Esquire, and James G. Ritter, Esquire, appeared on behalf of APCo. John L. Walker, III, Esquire, represented VML/VACo. William T. Reisinger, Esquire, represented the Virginia Poverty Law Center ("VPLC"). William C. Cleveland, Esquire, represented Appalachian Voices. Timothy G. McCormick, Esquire, represented the Committee. C. Meade Browder, Jr., Esquire, Charles M. Burton, Jr., Esquire, and John E. Farmer, Jr., Esquire, represented Consumer Counsel. Staff was represented by Frederick D. Ochsenhirt, Esquire, and Raymond L. Doggett, Jr., Esquire.[8] At the hearing, the Remand Testimony was admitted, subject to cross-examination, and the case participants had the opportunity to provide closing arguments. The re-opening of the record was limited to the scope of the remand proceedings delineated by the Remand Procedural Order. A request by Consumer Counsel to offer or proffer potential evidence beyond the scope of the remand proceedings,[9] which was the subject of APCo's Motion, was denied.[10]

SUMMARY OF THE REMAND TESTIMONY

APCo filed the remand testimony of **William K. Castle**, Director of Regulatory Services – VA/TN for APCo; **A. Wayne Allen**, Accounting Senior Manager for American Electric Power Service Company ("AEPSC"); and **Katharine I. Walsh**, Director – Regulated Pricing and Analysis for AEPSC.

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[7] Order at 2.

[8] The following parties elected not to participate in the hearing: The Kroger Company; Steel Dynamics, Inc.; The Sierra Club; and Walmart Inc.

[9] The potential evidence related to the retirement date assumed for depreciation rates. Section B.4 of this Report's Analysis below addresses APCo's argument that this issue was already decided by the Commission's Final Order in this case.

[10] Tr. at 1258-63. VML/VACo requested the opportunity to make comments and note objections regarding Consumer Counsel's Motion. Tr. at 1341 (Walker). As specified below, all case participants have the opportunity to file comments on this Report.

Mr. Castle identified the interim rates implemented by APCo pursuant to the Remand Procedural Order. The Company's interim rates were designed to implement a rate increase of $94.7 million on an annual basis, consisting of: (1) a $40.6 million base rate increase; and (2) $72.1 million in uncollected revenues, from January 1, 2021, through September 30, 2022, associated with the above annual base rate increase. This amount, if recovered over 16 months as proposed by APCo, is approximately $54.1 million on an annual basis. Mr. Castle indicated that the impact of these interim rates on the monthly bill of a residential customer with monthly usage of 1,000 kilowatt-hours is an increase of $8.55, or 6.7%.[11]

To recover the uncollected revenues, APCo proposes using a new Rider R.C.R., which would work similar to the Company's existing Rider T.R.R. Mr. Castle explained that the 16-month period to recover uncollected revenues was proposed so that the associated rider would terminate prior to any new rates that might be implemented after the upcoming triennial review.[12] Mr. Castle recognized that the proposed 16-month period for Rider R.C.R. overlaps with the upcoming triennial review. He testified that he does not currently know how the Company plans to treat the Rider R.C.R. revenues in the upcoming triennial review filing.[13] In his opinion, the revenues that Rider R.C.R. would recover are not under-recoveries, they are revenues that APCo would have collected had the Commission ruled how the Court would have preferred.[14]

As identified in the Combined Issues Matrix, Mr. Castle identified the three disputed going-forward ratemaking issues totaling $12.2 million on an annual basis. While these issues were litigated in the instant case, the Commission did not decide them, as a change in base rates was not ordered.[15]

Should the Commission order refunds of interim rate recoveries, Mr. Castle requested at least 60 days (after the Commission ruling) to provide such refunds. He also requested confirmation that bill credits can be issued to all eligible current customers and that customers who have closed their accounts only need to be refunded if they are owed more than $1.00.[16]

Mr. Castle advised the Commission that the increase in base rates will accelerate the return of unprotected excess accumulated deferred income taxes to customers, which may necessitate the imposition of a 0% rate in Rider T.R.R. sooner than the Company indicated in an April 5, 2022 filing in Case No. PUR-2018-00054.[17]

Mr. Allen described and listed the changes to the 2017-2019 earning test that are necessary due to the Court's Opinion in *APCo 2022*. These include reversing the regulatory asset the Commission established for the costs of the retired coal units, attributing the

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[11] Ex. R135 (Castle remand) at 2.

[12] *Id.* at 2-3. R.C.R. stands for "rate case recovery"; T.R.R. stands for "tax rate reduction." *Id.* at attached proposed tariff sheet no. 1-2.

[13] Tr. at 1298-1300 (Castle).

[14] Tr. at 1308 (Castle).

[15] Ex. R135 (Castle remand) at 3.

[16] *Id.* at 3-4. Mr. Castle noted that credits are issued in the form of a pre-paid credit card. *Id.* at 4.

[17] *Id.* at 4.

Company's full write-off of these units to 2019, and making associated adjustments.[18]

After making only the changes necessary to implement the Court's Opinion, Mr. Allen provided a schedule showing that the Company earned a revised combined rate of return on common equity for the 2017-2019 triennial review period of 7.945% (2017 - 11.600%; 2018 - 9.355%; and 2019 - 3.095%). Because the revised combined earnings are more than 70 basis points below the Company's authorized ROE of 9.42% for this period (*i.e.*, 8.72%), he identified two implications: (1) the ability to increase going-forward base rates; and (2) the ability to record a regulatory asset for the deferral and amortization of certain incurred costs up to an amount that increases the earned return to 8.72%.[19]

Mr. Allen discussed the categories of costs for which Code § 56-585.1 A 8 provides deferred recovery due to the revised earnings calculation. He provided the Company's calculation of a $37.0 million regulatory asset that will now be deferred and recovered. He proposed amortization of this regulatory asset over three years beginning January 2021, at an annual amount of $12.3 million.[20]

Mr. Allen identified the remaining going-forward adjustments on which APCo and Staff disagree, as discussed below in Section B of this Report's Analysis.[21] Mr. Allen explained that, with Staff's consent, APCo used Staff's workpapers and methodologies to eliminate the potential for different results in the calculations due to the impact going-forward differences have on taxes, interest expense, and cash working capital.[22]

Mr. Allen testified that APCo does not yet have a plan for how it will reflect the revenues recovered through Rider R.C.R. in the 2021 and 2022 earnings test that APCo will file in the upcoming triennial review filing.[23]

Ms. Walsh explained the rate design for the interim base rates implemented by APCo effective October 1, 2022. Her rate design is based in part on her understanding that the Final Order in this case prohibits any realignment of functional revenue and does not allow any increase to the basic customer charges. She allocated the Company's proposed $40.6 million increase[24] to the generation and distribution functions based on the current revenue spread between the two functions. She then applied the generation and distribution increases uniformly to base rates. She testified that, other than the treatment of the basic customer charges, her proposal is similar to the method APCo recently used to decrease all base rates for tax reform. With her rate design, both base generation and distribution revenue increased by 5.96%, with

[18] Ex. R136 (Allen remand) at 2-5.
[19] *Id.* at 5-6 and attached Remand Sched. 1.
[20] *Id.* at 6-7 and attached Remand Sched. 1.
[21] *Id.* at 8-9. Ms. Walsh identified the same issues. Ex. R137 (Walsh remand) at 3.
[22] Ex. R136 (Allen remand*)* at 9-10. Mr. Allen indicated that while APCo relied on Staff's workpapers due to the unique nature of the remand proceeding and to minimize issues, the Company reserves the right to use different methodologies in future proceedings. *Id.* at 10-11.
[23] Tr. at 1312-13 (Allen).
[24] Ms. Walsh sponsored the Company's fully adjusted rate of return statement that includes the Company's proposed revenue requirement. Ex. R137 (Walsh remand) at attached Remand Sched. 1.

generation base rates all increased by 5.96% and distribution base rates, excluding customer charges, increased by 7.78%.[25]

Ms. Walsh explained how the Company calculated the level of revenue required for collection through the proposed Rider R.C.R. After designing the Company's proposed increase to base rates using the percentages described above, she applied the increases to the actual base rate revenue collected from customers spanning January 1, 2021, through August 31, 2022, with an estimate included for the month of September 2022. As calculated by APCo, the difference between the actual base rate revenue collected and the amount the Company would have collected is $72.1 million.[26]

Ms. Walsh also explained how she designed the proposed Rider R.C.R. rates. She calculated separate generation (7.45%) and distribution (9.74%) Rider R.C.R. percentages based on the higher level of generation and distribution base rate revenue effective October 1, 2022. This is the same methodology used to design the Company's Rider T.R.R., except that the distribution percentage for the proposed Rider R.C.R. does not apply to basic service charges.[27] Rider R.C.R. does not attempt to go back and recalculate individual customer bills.[28]

Ms. Walsh calculated the overall impact of the Company's proposed base rate increase and Rider R.C.R. rates. A residential customer using 1,000 kilowatt hours will see a monthly bill increase of $8.55, or 6.7%. Using current annualized revenue at 12 months-ended August 2022, the proposed base rate increase will be an approximate 3% increase in total revenue. Including the proposed Rider R.C.R. (which will expire in 16 months) increases the total revenue impact to approximately 6.9%.[29]

Ms. Walsh acknowledged that because the proposed Rider R.C.R. revenue requirement assumes approval of APCo's position on the remaining contested issues, Rider R.C.R. would have to be adjusted down if the Commission does not adopt the Company's position.[30]

She confirmed that APCo's actual base rate generation and distribution, non-rate adjustment clause recoveries specifically for calendar year 2021 were not included in her testimony, but that figure could be provided.[31] Ms. Walsh testified that her proposed Rider R.C.R. methodology did not attempt to compare the initial proposed rate year revenue requirement from the Application, which included a proposed $65 million increase, and actuals.[32]

Consumer Counsel presented the remand testimony of **Ralph Smith**, of Larkin and Associates, PLLC.[33]

[25] *Id.* at 3-4 and attached Remand Sched. 2.
[26] *Id.* at 4 and attached Remand Sched. 2, p. 2.
[27] *Id.*
[28] Tr. at 1321 (Walsh).
[29] Ex. R137 (Walsh remand) at 4-5.
[30] Tr. at 1316 (Walsh).
[31] Tr. at 1318 (Walsh).
[32] Tr. at 1319-20 (Walsh).
[33] Ex. R138 (Smith remand).

Mr. Smith presented his proposed rate year revenue requirement of $12.864 million.[34] He identified four differences between his recommended rate year revenue requirement and APCo's: (1) coal inventory; (2) major storm damage costs; (3) Ohio Valley Electric Corporation ("OVEC") demand charges; and (4) the depreciation rate for the Amos power plant.[35] All of these issues are discussed below in Section B of this Report's Analysis.

Mr. Smith testified that if Rider R.C.R. is approved as designed, the earnings test for 2021 and 2022 in the upcoming triennial review will need to reflect the revenues Rider R.C.R. is designed to recover to ensure there is not a double-recovery of amounts related to 2021 and 2022. He is concerned about an opportunity for gamesmanship in which the Company shows under-earnings in a particular period but then actually collects revenues that relate to that period in a different period. He described such a result as earnings manipulation that would be unfair to customers. He also recognized that the Company's upcoming earnings test could show over-recoveries in these years even without Rider R.C.R. He is not convinced Rider R.C.R. is necessary.[36]

Staff presented the remand testimony of **Sean M. Welsh**, Manager with the Commission's Division of Utility Accounting and Finance.

Mr. Welsh explained some of the background to this case and the associated appeal. He explained, among other things, that the Commission's Final Order calculated a 9.48% earned return for 2017-2019, which did not allow for any customer refund or rate change.[37] Mr. Welsh presented revised earnings test results that reflect the Court's Opinion. Staff's revised earnings are the same as those provided by APCo witness Allen: a revised combined rate of return on common equity for the 2017-2019 triennial review period of 7.945% (2017 - 11.600%; 2018 - 9.355%; and 2019 - 3.095%).[38]

Mr. Welsh identified two consequences from the fact that the revised combined rate of return in the earnings test is lower than 8.72%. First, Code § 56-585.1 A 8 (a) directs the Commission to order increases to base rates necessary to provide the opportunity to fully recover the costs of providing the utility's services and to earn a fair combined rate of return. Second, Code § 56-585.1 A 8 directs that certain costs be deferred and recovered over future periods to the extent such costs, together with the utility's other costs, revenues, and investments, cause the utility's earned return to fall below 8.72%. Like APCo, Staff calculated a $37.0 million regulatory asset associated with these deferred costs, which Staff proposes to amortize over three years beginning January 1, 2020.[39]

Mr. Welsh sponsored Staff's recommended $28.4 million going-forward revenue requirement. He identified the differences between Staff's position and APCo's position, which

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[34] *Id.* at update matrix; Tr. at 1324 (Smith).
[35] Ex. R138 (Smith remand) at 7-10, update matrix; Tr. at 1323-24 (Smith); Tr. at 1283 (Burton).
[36] Tr. at 1326-29 (Smith).
[37] Ex. R139 (Welsh remand) at 2.
[38] *Id.* at 4-7 and attached Statement I – Remand Filing.
[39] *Id.* at 4-5, 7 and attached Statement II – Remand Filing, p. 45 (Adj. No. 53). $37.0 million is the $27.8 million amount grossed up for taxes. *Id.* at 7.

are discussed in the Analysis below.[40]

Mr. Welsh testified that, on a regulatory basis, the revenue from Rider R.C.R. should be placed in the earnings test for the years 2021 and 2022, but the specifics of how that is accomplished can be determined in the upcoming triennial review.[41]

ANALYSIS

There is no dispute about the effect *APCo 2022* has on the earnings test calculations on remand. For the going-forward revenue requirement, the Combined Issues Matrix identified a $28.4 million revenue requirement that was uncontested between APCo and Staff and three disputed evidentiary issues with an associated revenue requirement totaling $12.2 million. Consumer Counsel's Remand Testimony identified two additional issues that Consumer Counsel indicated remain in dispute. Section A of this Analysis discusses the uncontested earnings test calculation and going-forward revenue requirement issues. Section B analyzes the five issues that the Combined Issues Matrix or Consumer Counsel indicated remain in dispute. Section C addresses the uncollected revenues and APCo's proposal to collect this amount through Rider R.C.R.

A. Uncontested Earnings Test Calculation and Going-Forward Revenue Requirement Issues

APCo and Staff agree that once the earnings test incorporates the Court's Opinion, the Company's combined regulatory earnings during 2017 through 2019 become 7.95%.[42] Staff and APCo recognize that, based on this level of earnings, Code § 56-585.1 A directs the Commission to order a going-forward rate increase.[43] Code § 56-585.1 A 8 states in part as follows:

> If the Commission determines as a result of such triennial review that, ... [t]he utility has, during the test period or periods under review, considered as a whole, earned ... for any test period commencing ... after December 31, 2013, for [APCo], more than 70 basis points below a fair combined rate of return on its generation and distribution services, as determined in subdivision 2, ... 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....[44]

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[40] *See, e.g.*, Ex. R139 (Welsh remand) at 7-8.
[41] This includes revenues not collected until after 2022. Tr. at 1332 (Welsh).
[42] Ex. R136 (Allen remand) at 5 and attached Remand Sched. 1; Ex. R139 (Welsh remand) at 5 and attached Statement 1 – Remand Filing.
[43] Ex. R139 (Welsh remand) at 5; Ex. R136 (Allen remand) at 6. Consumer Counsel also recognizes that the Court's decision triggers "a going-forward rate increase, if needed." Tr. at 1288 (Burton).
[44] Code § 56-585.1 A 8 a (2020). Effective July 1, 2020, this language now includes consideration of whether certain revenue reductions caused earnings below the level identified in the statute. 2020 Va. Acts chs. 1193, 1194.

Based on the level of earnings resulting from the Court's Opinion, Staff, APCo, and Consumer Counsel recognize that Code § 56-585.1 A 8 allows the Company to defer approximately $37 million for recovery over an amortization period to be determined by the Commission.[45] Code § 56-585.1 A 8 provides special ratemaking treatment for certain categories of costs:

> In any 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 utility for utility generation facilities fueled by coal, natural gas, or oil or for automated meter reading electric distribution service meters; costs associated with projects necessary to comply with state or federal environmental laws, regulations, or judicial or administrative orders relating to coal combustion by-product management that the utility does not petition to recover through a rate adjustment clause pursuant to [Code § 56-585.1 A 5 e]; costs associated with severe weather events; and costs associated with natural disasters.

Code § 56-585.1 A 8 provides further details about this special rate treatment, including the following (with emphasis added).

> *Such costs shall be deemed to have been recovered from customers through rates for generation and distribution services in effect during the test periods under review unless such costs, individually or in the aggregate,* together with the utility's other costs, revenues, and investments to be recovered through rates for generation and distribution services, *result in the utility's earned return on its generation and distribution services for the combined test periods under review* ..., for any test period commencing ... after December 31, 2013, for a Phase I Utility, *to fall more than 70 basis points below the fair combined rate of return authorized under subdivision 2 for such periods. In such cases, the Commission shall, in such triennial review proceeding, authorize deferred recovery of such costs and allow the utility to amortize and recover such deferred costs over future periods as determined by the Commission. The aggregate amount of such deferred costs shall not exceed an amount that would,* together with the utility's other costs, revenues, and investments to be recovered through

[45] Ex. R136 (Allen remand) at 6-7 and attached Remand Sched. 2; Ex. R139 (Welsh remand) at 7; Ex. R138 (Smith remand) at update matrix and attached Ex. LA-3R, Schedule OAG-11; Tr. at 1323 (Smith).

> rates for generation and distribution services, *cause the utility's earned return* on its generation and distribution services ..., for any test period commencing ... after December 31, 2013, for a Phase I Utility, *to exceed the fair rate of return authorized under subdivision 2 less 70 basis points.* Nothing in this section shall limit the Commission's authority, pursuant to the provisions of Chapter 10 (§ 56-232 et seq.), including specifically § 56-235.2, following the review of combined test period earnings of the utility in a triennial review, for normalization of nonrecurring test period costs and annualized adjustments for future costs, in determining any appropriate increase or decrease in the utility's rates for generation and distribution services pursuant to subdivision 8 a or 8 c.

For the $37.0 million regulatory asset that results from these provisions and the Court's Opinion, APCo, Consumer Counsel, and Staff propose a three-year amortization, beginning January 1, 2021.[46] I find a three-year period is reasonable and appropriately aligns with the statutory triennial review schedule, which, among other things directs any rate change resulting from the upcoming triennial review to be implemented no later than 60 days after the final order in that proceeding.[47] However, for the reasons discussed below in Section C, I find that beginning the amortization period on January 23, 2021 (rather than January 1, 2021) aligns better with the Commission's prior implementation of rate changes under this statutory framework.

B. Contested Going-Forward Revenue Requirement Issues

Based on the revised earnings test results discussed above, the Code directs the Commission to "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...."[48] The Code provides further as follows:

> Nothing in this section shall limit the Commission's authority, pursuant to the provisions of Chapter 10 (§ 56-232 et seq.), including specifically § 56-235.2, following the review of combined test period earnings of the utility in a triennial review, for normalization of nonrecurring test period costs and annualized adjustments for future costs, in determining any appropriate increase or decrease in the utility's rates for generation and distribution services pursuant to subdivision 8 a or 8 c.[49]

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[46] Ex. R136 (Allen remand) at 7; Ex. R139 (Welsh remand) at 7 and Adj. No. 53 (page 45 of attached documents); Tr. at 1323 (Smith).

[47] Code § 56-585.1 A 8 d ("The Commission's final order regarding such triennial review shall be entered not more than eight months after the date of filing, and any revisions in rates or credits so ordered shall take effect not more than 60 days after the date of the order.").

[48] Code § 56-585.1 A 8.

[49] *Id.*

The contested issues identified by APCo, Staff, and/or Consumer Counsel are addressed below.

1. Coal Inventory

APCo recovers the cost of coal burned as fuel to generate electricity through the Company's fuel factor. In base rates, the Commission has allowed APCo to include a coal inventory cost as a rate base component, providing a return for the Company.[50] For prospective base rates in the instant case, the case participants disagree on the quantity (tons) of coal – but not the price – that should be used to calculate this rate base component.[51] The Combined Issues Matrix indicates that the revenue requirement impact of this dispute is approximately $0.6 million.

To establish the coal inventory included in the going-forward rate base, APCo proposed using the maximum daily burn rate. Using the maximum daily burn rate for 25 days at Amos and 30 days at Mountaineer, APCo calculated a coal inventory quantity of 1,049,345 tons.[52] APCo characterized the coal inventory quantity built into rate base as a "target" that, if set using the maximum daily burn rate, would be consistent and would avoid the need for adjustments.[53] In contrast, using an average burn rate makes the "inventory target" volatile each year and "may not account for the coal needed in inventory to support coal consumption during peak or heavier use periods of the year."[54] APCo asserted that the Commission's established policy of using an average burn should be reconsidered because declining coal consumption can cause inventory levels to be higher than planned.[55] The average amount of coal consumption has decreased over the years.[56] However, despite increasing diversification, Amos and Mountaineer are still called on for maximum load generation for significant periods of time.[57] APCo provided data showing that during 2017, 2018, and 2019, Mountaineer's 35-day maximum coal consumption was 392,707, 410,282, and 433,734 tons, respectively. During the same years, Amos's maximum coal consumption was 752,922, 744,614, and 759,092 tons, respectively.[58] APCo asserted that energy diversification and declining economics for coal plants have made coal generation more unpredictable.[59] This volatility has made coal purchasing decisions and inventory management more difficult.[60] APCo asserted that using an average burn places APCo's coal units "at risk."[61]

Instead of using a maximum daily burn rate, Consumer Counsel proposed using a 35-day allowance at average daily burn, or 787,305 tons.[62] Consumer Counsel witness Smith calculated

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[50] *See, e.g.*, November 24, 2020 Final Order at 19 ("[U]nder long-standing regulatory practice the Commission permits the Company to include coal inventory in rate base and earn a return thereon.").

[51] The price is not disputed. *See, e.g.*, Ex. 70 (Smith) at 53; Ex. 68.

[52] *See, e.g.*, Ex. 24 (Jeffries direct) at 10. All of the quantities discussed in this section are on a total Company basis.

[53] Ex. 24 (Jeffries direct) at 10. Ms. Jeffries pointed out that Staff and Consumer Counsel recommended different quantities using 35-day averages. Ex. 117 (Jeffries rebuttal) at 3.

[54] Ex. 24 (Jeffries) at 11.

[55] Tr. at 162-63 (Jeffries).

[56] Ex. 117 (Jeffries rebuttal) at 1.

[57] APCo's Brief at 54.

[58] Ex. 69.

[59] APCo's Brief at 48; Ex. 117 (Jeffries rebuttal) at 2.

[60] Ex. 117 (Jeffries rebuttal) at 2.

[61] APCo's Brief at 48.

[62] Ex. 70 (Smith) at 53-55; Ex. R138 (Smith remand) at attached Ex. LA-3R, p. 5.

this amount by: (1) calculating a rate year amount of tons based on monthly consumption in 2019 except for low consumption months in 2019, which he replaced with corresponding months of higher consumption in either 2018 or 2020; (2) dividing the rate year amount by 365 to calculate an average daily consumed amount of tons; then (3) multiplying the average daily consumed amount by 35 days.[63] Mr. Smith believes a 35-day allowance provides "a bit of a cushion, since no single month has more than 31 days."[64] He testified that "[b]asing the allowance for coal inventory on an appropriately calculated 35 days of adjusted average daily burn is sufficient to provide for reliable generation during each month of a triennial review for a prospective ratemaking period, and recognizes that the level of actual generation of coal burn varies during the year."[65] Consumer Counsel expressed concern about the level of coal inventory APCo has carried in recent years, asserting that "the Commission needs to send a corrective signal to the Company in light of the Company's continued actual practice of maintaining excessive coal inventory levels."[66] Consumer Counsel made clear that its recommendation is focused on the amount of coal upon which APCo is allowed to earn a return, and is not a recommendation to disallow the recovery of any cost associated with coal.[67]

Similar to Consumer Counsel, Staff proposed using a 35-day allowance at average daily burn. Staff's proposed coal inventory quantity of 728,420 tons differs from Consumer Counsel's quantity because the first steps in their calculations differ. Staff (1) took the monthly average of coal consumed during December 2018 through December 2019, excluding October 2019; (2) divided that monthly average by 365 days to get an average daily burn (tons); then (3) multiplied the average daily burn by 35 days.[68] Staff witness Kaufmann agreed that the process of forecasting coal usage over a period of years is very complex.[69] He testified that Staff's use of an average does not mean APCo will or should maintain the average level every month of the year. Rather, there will be months when APCo's coal inventory is above and below average.[70] Staff made clear that its position would not limit the Company to a coal inventory level at any given time, nor was Staff recommending how APCo should manage its coal inventory.[71] According to Mr. Kaufmann, the use of a full-load burn rate, as proposed by APCo, does not reflect declining trends in APCo's use of coal.[72]

Consumer Counsel and Staff both indicated that the use of a 35-day allowance at average daily burn is consistent with Commission precedent in the *2011 Biennial Review Order* and the *2014 Biennial Review Order*.[73]

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[63] *See, e.g.*, Ex. R138 (Smith remand) at attached Ex. LA-3R, p. 5; Tr. at 657 (Smith).
[64] Tr. at 657 (Smith).
[65] Tr. at 622 (Smith).
[66] Consumer Counsel's Brief at 20.
[67] *Id.*
[68] Ex. 68. Staff excluded October 2019 because the coal consumed in this month was unusually low compared to the other months. Tr. at 585-86 (Kaufmann).
[69] Tr. at 590 (Kaufmann).
[70] Tr. at 587 (Kaufmann).
[71] Staff's Brief at 55.
[72] Ex. 65 (Kaufmann) at 7 (showing average monthly coal consumption decreased every year during 2015-2019).
[73] Staff's Brief at 54-55; Consumer Counsel's Brief at 20-22 (citing *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.

As the case participants have recognized, in both of APCo's biennial reviews[74] the Commission used a 35-day allowance at an average daily burn rate for purposes of calculating the rate year revenue requirement.[75] I find that a quantity using an average burn rate, as proposed by Staff and Consumer Counsel, reasonably reflects the monthly variation in coal consumption, including periods of high and low consumption, consistent with Commission precedent. Compared to a maximum-burn quantity, an average-burn quantity is also more consistent with the use of an average price, as proposed in the instant case by APCo, Staff, and Consumer Counsel.[76] To be clear, the quantity of coal assumed for inclusion in rate base – whether calculated using an average or maximum-burn rate – does not limit APCo's ability to manage its coal inventory, much less require such management to be at the ratemaking level. No one has suggested that the $52.69/ton average coal price that APCo, Consumer Counsel, and Staff all propose for calculating this rate base component somehow limits APCo to purchasing coal at that price, and the same is true for the associated quantity used to calculate the relevant return.[77] Based on the record, I recommend Staff's coal inventory allowance, which I find is reasonable and consistent with Commission precedent.

2. Severe Weather Event Expense

APCo proposed including in the prospective rate calculation $10.9 million of expense associated with "severe weather events."[78] This proposed amount is the Virginia jurisdictional three-year (2017, 2018, 2019) historic average of such expense.[79] APCo described major storms as a "consistent part" of the Company's business.[80] APCo contended that all known and expected costs need to be included in prospective rates to enable APCo to earn not less than its allowed return.[81]

Ann. Rep. 477, Final Order (Nov. 30, 2011) ("*2011 Biennial Review Order*"); *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. Rep. 392, Final Order (Nov. 26, 2014) ("*2014 Biennial Review Order*")).

[74] These 2011 and 2014 biennial reviews were the Company's last two base rate proceedings prior to the current triennial review.

[75] *2014 Biennial Review Order*, 2014 S.C.C. Ann. Rep. at 405 ("[W]e continue to find – as we did for projecting a reasonable going-forward amount in APCo's 2011 case – that the Company's coal inventory targets should reflect average burn rates and a thirty-five day supply of coal."); *2011 Biennial Review Order*, 2011 S.C.C. Ann. Rep. at 487-88 ("We find that, consistent with Commission precedent and as recommended by Staff and Consumer Counsel, it is reasonable for coal inventory included in rate base to reflect average burn rates – as opposed to maximum burn rates – and a thirty-five-day supply of coal. We further conclude ... that it is reasonable to adjust average coal consumption upward in this instance 'to remove the unusually low monthly burns that occurred in September, October and November of 2010.' ... APCo has not established that such treatment has previously, or will in the future, expose the Company or its customers to risks of plant curtailments or shut downs due to a lack of coal, and we expect that the Company shall continue to meet its public service obligations in this regard.").

[76] *See, e.g.*, Ex. 24 (Jeffries direct) at 10 (proposing a price of $52.69 per ton); Ex. 70 (Smith) at 53; Ex. 68 (showing the $52.69 price is the average price from December 2018 through December 2019).

[77] Moreover, if APCo does not prudently manage its coal inventory, the Company may risk a disallowance through the fuel factor and/or base rates.

[78] Ex. R136 (Allen remand) at 8. The record includes references to these costs as major storm costs, which the Company indicates are synonymous with "severe weather event" expenses. Ex. 25 (Wright direct) at 27.

[79] Ex. R136 (Allen remand) at 8. The amount at issue is only for expense and not costs that would be capitalized to plant in service. Tr. at 335 (Kollen).

[80] Tr. at 1027 (Beam).

[81] Tr. at 1229 (Castle).

Staff, Consumer Counsel, VML/VACo, and the Committee all opposed this proposal because of the special ratemaking treatment that Code § 56-585.1 A 8 provides these costs. For example, as explained by Committee witness Kollen:

> If the Company's earned return pursuant to the "earnings test" in ... Code § 56-585.1 A 8 is above the threshold, then it is deemed to have recovered such costs in that manner. If the Company's earned return is below the threshold, then it may defer and seek to recover the amount necessary to bring its earnings up to the threshold and then recover the costs from ratepayers in a future proceeding and recover its costs in that manner. In either circumstance, the Company recovers its costs.[82]
>
> Through the statutory framework, the Company is protected on the downside through the ability to defer any earnings deficiency as a regulatory asset, and then recover it in subsequent rate proceedings.[83]

As explained by Staff witness Welsh, Code § 56-585.1 A 8 "ensures the Company will never go below its approved ROE band due to these costs combined with the rest of its cost of service. [APCo] may defer any amount up to the total underearnings incurred in order to bring them back into the ROE range."[84]

Citing the *2014 Biennial Review Order* and the *Dominion 2013 Biennial Review Order*,[85] Consumer Counsel asserted that "[t]he Commission should not upset its well-established precedent on treatment of major storm costs for prospective ratemaking...."[86] In the *2014 Biennial Review Order*, the Commission denied a request similar to APCo's proposal in the instant case, concluding as follows:

> [U]nder the current statutory framework for biennial reviews, it is no longer appropriate to include an estimated cost of future major storm damage in operating expenses for prospective ratemaking. Section 56-585.1 A 8 allows APCo to defer and recover costs associated with "severe weather events" under certain circumstances. This statute provides APCo the opportunity to

[82] Ex. 48 (Kollen) at 23.
[83] Tr. at 336 (Kollen).
[84] Tr. at 956 (Welsh). *See also* Tr. at 1000 (Welsh).
[85] *See 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*, Case No. PUE-2013-00020, 2013 S.C.C. Ann Rep. 371, 377, Final Order (Nov. 26, 2013) ("*Dominion 2013 Biennial Review Order*") ("We find that major storm damage expense shall not be included as a normalized expense for ratemaking. Section 56-585.1 A 8 ... allows Dominion to defer and recover costs associated with 'severe weather events' under certain circumstances. Since the Company equates major storm damage expense to 'severe weather events,' the statute ensures that Dominion has an opportunity to recover these costs; thus, we find that a normalized expense is not required for ratemaking purposes.").
[86] Consumer Counsel's Brief at 18. *See also* Ex. 70 (Smith) at 49-50.

> recover these costs. Thus, we find that major storm damage expense should not be included as a normalized expense for ratemaking and should be removed from the prospective rate year.[87]

The Committee, VML/VACo, and Staff also argued that this precedent should be upheld.[88]

APCo argued that its position in the instant case would not violate the holding of the *2014 Biennial Review Order* because in that case the Code prevented the Commission from changing APCo's rates and required another rate review in two years.[89] APCo also asked the Commission to "revisit" this precedent,[90] contending that its logic is "flawed" because "[i]f in setting [prospective] rates, major storm costs are presumed to be zero, the Company will only be able to fully recover its costs, all other things equal, in the unlikely case that storm costs are zero for three years straight."[91] APCo described prospective ratemaking without these costs as a "handicap on the Company's ability to fully recover its costs."[92] APCo contended that the bottom of the band identified by Code § 56-585.1 A 8 is not the Company's "allowed return."[93] APCo argued further that excluding such costs from prospective ratemaking can "forc[e] [a] convoluted and limited recovery of these necessary and prudent costs."[94]

The relevant statutory language is shown above in Section A of this Report's Analysis. The Combined Issues Matrix indicates that the revenue requirement impact of this disputed issue is approximately $11.1 million.

APCo's severe weather event expense varied significantly during the three earnings test years. APCo booked $0.65 million of such expense in 2017, $25.1 million in 2018, and $10.4 million in 2019.[95] The 2017 level of such expense was approximately 2.6% – or about one-fortieth – of the 2018 level. Under traditional ratemaking, the unpredictable timing and level of such expense could warrant either a normalizing adjustment (like the one proposed by APCo), or they could warrant deferred cost recovery after such costs are incurred at known levels (like the Commission approved in 2011 for APCo[96] and consistent with the *2014 Biennial Review Order*). Such approaches, among others, could be part of a rate determination that provides a utility the opportunity to recover its costs plus a fair return, depending on the circumstances of a case. In the instant case, the Commission's analysis is not limited to ratemaking "business as usual," as the triennial review laws must be considered and applied.

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[87] *2014 Biennial Review Order*, 2014 S.C.C. Ann. Rep. at 405.
[88] *See, e.g.*, Staff's Brief at 52-54; Committee's Brief at 16-17; VML/VACo's Brief at 7.
[89] APCo's Brief at 25.
[90] Ex. 133 (Castle rebuttal) at 14.
[91] Ex. 21 (Castle direct) at 11.
[92] Ex. 133 (Castle rebuttal) at 14.
[93] Tr. at 1228-29 (Castle).
[94] APCo's Brief at 27.
[95] *See* Ex. 1 at Filing Schedule 32. Based on the ratemaking adjustments proposed by case participants, these appear to be total company figures.
[96] *See 2011 Biennial Review Order*, 2011 S.C.C. Ann. Rep. at 485; *Application of Appalachian Power Company, For a statutory 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-2009-00030, 2010 S.C.C. Ann. Rep. 308, 315, Final Order (July 15, 2010).

Increasing prospective rates in a triennial review by including an estimated level of an unpredictable future expense, as proposed by APCo, would increase the likelihood of over-recovery. Staff indicated that adopting APCo's proposal under the triennial review framework could also lead to double-recovery – once as built into base rates and a second time through recovery as a regulatory asset if APCo's earnings fall short of the Company's approved ROE range.[97] These risks to customers appear, in my opinion, unnecessary and potentially inappropriate for a category of costs: (1) the utility has a unilateral right to charge against its regulatory earnings[98] up to the amount that causes earning calculations to fall to the Company's fair return less 70 basis points; and (2) for which the Commission can be required to allow deferred recovery in prospective rates,[99] up to the amount that does not cause APCo's earnings to exceed the fair return less 70 basis points.

Given the significance of APCo's unilateral authority to reduce earnings[100] and the explicit requirement for deferred cost recovery through prospective rates, I disagree with APCo's suggestion that excluding an estimate of such expense from prospective rates presumes these costs will be zero. To the contrary, rejection of APCo's proposal would recognize that any such costs, if not deemed recovered by statute, play a significant role in the rates APCo charges. In the instant case, the special statutory treatment of these costs contributes to both a rate increase and deferred cost recovery. There will be very real revenue impacts on the Company, and bill impacts on customers, from severe weather event expense. Such impacts are presumably among the considerations the Commission understood when it recognized – nearly a decade ago – that the current statutory framework ensures APCo and Dominion have an opportunity to recover severe weather event expense. That the statutory provisions of Code § 56-585.1 A 8 are tied to the level that is 70 basis points below APCo's fair rate of return does not change my conclusion. This level is the express limit on the utility benefits provided in the statute. This specified limit is not a new development, as it has always been used for these specific provisions, including at the time of the *2014 Biennial Review Order* and the *Dominion 2013 Biennial Review Order*.[101]

For the foregoing reasons, while the Commission has the authority to either maintain or revise its established policy, I recommend the Commission maintain its current policy and adopt the position that Consumer Counsel, VML/VACo, the Committee, and Staff share on this issue.

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[97] Staff's Brief at 54 (citing Tr. at 953-54 (Welsh)).

[98] *See, e.g.*, APCo's Brief at 15 ("Nor is there a requirement in [Code § 56-585.1 A 8] or elsewhere in the Code that [APCo] seek approval from the Commission to exercise this statutory right."); Code § 56-585.1 A 8 ("...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 severe weather events....").

[99] Code § 56-585.1 A 8 ("In such cases, the Commission shall, in such triennial review proceeding, authorize deferred recovery of such costs and allow the utility to amortize and recover such deferred costs over future periods as determined by the Commission....").

[100] This utility authority can trigger rate increases and deferred cost recovery and can also negate customer refunds and prospective rate decreases that might otherwise be required. *See, e.g., Dominion 2013 Biennial Review Order*, 2013 S.C.C. Ann. Rep. at 374. APCo's assertions about its ability to recover its costs assuming "all other things are equal" seem to overlook, among other things, the revenue implications of these outcomes.

[101] 2013 Va. Acts ch. 2 (showing, in addition to the fair return less 70 basis point cut-off for APCo, that the cut-off for Dominion under these provisions has always been fair return less 50 basis points).

3. Short-Term Incentive Compensation Plan

For purposes of establishing a going-forward revenue requirement, APCo recommended including short-term incentive compensation expense at the Company's target level. APCo emphasized that Staff did not argue that APCo's total compensation cost in this case (including base pay and incentive compensation) was unreasonably high or that such total compensation was not comparable to the market-competitive level.[102] APCo explained that its incentive compensation and the associated funding are directly correlated to retaining employees at market-competitive levels. If APCo's total compensation does not remain competitive, APCo and customers are at risk of losing the skilled labor necessary for providing safe, reliable service.[103] APCo provided data comparing APCo's compensation for five physical and crafts positions against market compensation reported in an external survey. As shown by APCo, most of these positions are compensated below, but within 10% of, the market average.[104]

Staff recommended that incentive compensation exclude certain items that do not have any impact on Virginia ratepayers. Staff proposed removing, from the earnings test and going-forward revenues requirements, short-term incentive compensation attributed to activities such as investment in competitive merchant power plants, which are not rate-regulated, and investment in AEP's grid modernization asset measures, which did not take place in Virginia.[105] Staff also proposed removing the payroll tax associated with these items.[106]

APCo acknowledged that some of the programs within the strategic initiatives category of costs in short-term incentive compensation are not rate regulated and serve internal business interests. However, APCo contended that these strategic initiatives do benefit Virginia ratepayers by funding APCo's labor force. APCo further asserted that eliminating certain strategic initiative metrics within its short-term incentive compensation plan ignores the benefits of a diversified funding program.[107]

In 2011, the Commission increased, from 50% to 100%, the amount of incentive plan expenses included in the going-forward revenue requirement. In doing so, the Commission found that APCo established that its total compensation costs – which include incentive plan costs – are reasonable and result in compensation that is not higher than, and is comparable to, the market competitive level.[108] The Commission also noted that ratepayers should not bear incentive plan expenses that exceed a payout ratio of 100%, the benefits of which accrue to shareholders.[109] In 2014, the Commission limited incentive plan expenses to a payout ratio of 100%, finding it unreasonable for ratepayers to pay expenses exceeding this payout ratio.[110]

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[102] Ex. 127 (Kaiser rebuttal) at 4.
[103] *Id.* at 5.
[104] *Id.* at 6. For one job, APCo's total compensation is 2.0% higher than the compensation level from external survey data. *Id.*
[105] *See, e.g.*, Ex. 65 (Kaufmann) at 17-19, 21.
[106] Ex. 98 (Carr) at 6.
[107] APCo's Brief at 91-92.
[108] *2011 Biennial Review Order*, 2011 S.C.C. Ann. Rep. at 483.
[109] *Id.* at 483, n.52.
[110] *2014 Biennial Review Order*, 2014 S.C.C. Ann. Rep. at 393, 407.

APCo argued that the *2011 Biennial Review Order* and *2014 Biennial Review Order*, "[t]aken together, ... approve of [APCo's] incentive plan expenses provided the Company does not seek to recover more than 100% of its overall target costs."[111] Staff asserted that removing from short-term incentive compensation amounts that do not benefit Virginia ratepayers is consistent with the principle of the Commission's prior orders.[112] Staff witness Kaufmann framed Staff's adjustment as an issue of whether shareholders or ratepayers should pay certain short-term incentive compensation expenses, and not a matter of the short-term incentive compensation APCo chooses to pay its employees.[113]

The Combined Issues Matrix indicates that the revenue requirement impact of this disputed issue is approximately $0.5 million.

In my opinion, it is not reasonable for Virginia ratepayers to pay short-term incentive compensation that is calculated based in part on incentives attributed to unregulated and/or out-of-state activities that do not benefit Virginia ratepayers. Accordingly, I recommend the Commission adopt Staff's position on this issue. However, should the Commission determine this issue based on the overall compensation level, the record would support APCo's position.

4. Amos Depreciation Date

Consumer Counsel recommended that depreciation expense in the rate year revenue requirement assume a 2040 retirement date for the Amos generation facility, rather than the 2032/2033 dates included in APCo's depreciation study approved in this case.[114] Consumer Counsel's adjustment would decrease depreciation expense by approximately $27.7 million and increase rate base by approximately $32.4 million.[115] Consumer Counsel argued that this issue remains in dispute because the Commission did not address it for purposes of the going-forward rate analysis.[116] In support of this position, Consumer Counsel pointed to the following language in the Commission's Final Order in this proceeding:

> Because the statutory outcome does not result in a prospective change in rates, the Commission does not herein address issues related thereto....[117]

However, APCo argued that the Commission's Final Order did resolve this issue,[118] citing the following finding:

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[111] APCo's Brief at 90.
[112] Tr. at 584 (Kaufmann).
[113] Tr. at 579-80, 585 (Kaufmann).
[114] *See, e.g.*, Ex. 70 (Smith) at 64-66; Ex. 59 (Norwood) at 24-28; Consumer Counsel's Brief at 59-64. During the remand proceedings, VML/VACo expressed support for this adjustment and for expanding the evidentiary scope of the remand proceedings for this particular issue. *See, e.g.*, Tr. at 1337, 1340-41 (Walker). It did not appear that VML/VACo previously took a position on this ratemaking adjustment, based on my review of the record.
[115] Ex. R138 (Smith remand) at attached Ex. LA-3R, p.9, and Ex. LA-2R, p. 2 (showing a $3.1 million revenue requirement increase for the $32.4 million rate base increase).
[116] Tr. at 1283-84 (Burton). On this issue, a request by Consumer Counsel to offer or proffer potential evidence beyond the scope of the remand proceedings, which was the subject of APCo's Motion, was denied. Tr. at 1258-63.
[117] Final Order at 25, n.107.
[118] Tr. at 1268 (Coates); Tr. at 1354-55 (Ritter).

> 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.[119]

APCo pointed out that the study date of the 2019 Depreciation Study is January 1, 2020, and therefore the above finding by the Commission could not pertain to the earnings test in this case, which covered 2017-2019.[120]

Since the Commission decided that the 2019 Depreciation Study, with assumed 2032/2033 retirement dates for Amos, results in reasonable depreciation expense and should be implemented January 1, 2020, it appears the Commission already resolved this issue for purposes of prospective depreciation expense.

5. OVEC Demand Charges

For both the earning test and prospective ratemaking, Consumer Counsel recommended that the Commission reduce demand charges from its affiliate, OVEC, to PJM Interconnection, LLC ("PJM"), capacity auction price levels.[121] In support of this recommendation, Consumer Counsel asserted, among other things, that APCo did not demonstrate that its OVEC demand charges are lower than the market, that the filed-rate doctrine does not prevent the Commission from requiring affiliates to meet such a market test, and that PJM capacity auction prices are an appropriate market comparison.[122]

APCo opposed Consumer Counsel's recommendation and the Commission's Final Order addressed this issue as follows:

> [APCo] 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." The Commission approved [APCo]'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 [APCo] under the ICPA are at the "lower of" (a) the affiliate's actual cost, or (b) the market price of non-affiliated power. Consumer Counsel asserts that the Company incurred triennial expenses under the

[119] Final Order at 15, n.61.
[120] Tr. at 1355 (Ritter).
[121] Ex. 59 (Norwood) at 7-14; Ex. 70 (Smith) at 66-67.
[122] *See, e.g., id.;* Consumer Counsel's Brief at 64-77; Tr. at 497-524 (Norwood).

> ICPA that were greater than market price and, as a result, [APCo]'s triennial expenses should be decreased accordingly.
>
> During the triennial period, [APCo]'s energy costs under the ICPA were approximately $49 million below comparable market energy costs. Consumer Counsel, however, asserts that [APCo]'s ICPA capacity costs during this period were significantly greater than market cost such that, even considering energy cost savings, the Company's triennial expenses should be decreased by $30.8 million. In reaching this conclusion, Consumer Counsel compared ICPA capacity costs to PJM capacity costs.
>
> 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. The ICPA provides for long-term capacity, whereas the PJM costs are for short-term capacity. We find that comparison to PJM capacity costs does not provide a reasonable basis to disallow expenses in this particular instance. Accordingly, the Commission denies Consumer Counsel's request to decrease [APCo]'s triennial expenses by $30.8 million.[123]

The Commission affirmed this decision on reconsideration[124] and *APCo 2022* upheld the Commission's decision on this issue.[125]

For prospective ratemaking, Consumer Counsel's recommendation would remove approximately $15.1 million in OVEC demand charges.[126] Consumer Counsel asserted this issue remains in dispute for going-forward rates.[127] APCo disagreed.[128]

I agree with Consumer Counsel that the Commission appears to have resolved this issue only for the earnings test, and not for the going-forward revenue requirement. I also agree with Consumer Counsel that the Commission can apply different standards to earnings test and prospective rate determinations.[129] However, based on my review of the record developed on this issue, the evidence and analysis that supported the Commission's decision on the earnings test (shown above) support a similar conclusion on the going-forward revenue requirement. For this reason, I do not recommend Consumer Counsel's proposed adjustment.

[123] Final Order at 20-21 (citations and emphasis omitted).
[124] Order on Reconsideration at 19-22.
[125] *APCo 2022*, Slip Opinion at 38.
[126] Ex. R138 (Smith remand) at attached Ex. LA-3R, Schedule OAG-15.
[127] Tr. at 1284-85 (Burton).
[128] *See, e.g.*, Tr. at 1294 (Coates).
[129] Tr. at 1285 (Burton).

C. Collection of Uncollected Revenues

In addition to interim going-forward base rates, the Remand Procedural Order directed APCo to file interim rates for a rider designed to collect revenues not collected from January 1, 2021, through September 30, 2022. In compliance with this directive, APCo proposed Rider R.C.R., which is designed to collect $72.1 million in uncollected revenues based on APCo's proposed $40.6 million base rate increase. This amount, if recovered over 16 months as proposed by APCo, is approximately $54.1 million on an annual basis.[130] As directed by the Remand Procedural Order, APCo's proposed Rider R.C.R. and increased base rates have been in effect, on an interim basis subject to refund, since October 1, 2022.

Regarding Rider R.C.R., the Committee indicated the Commission should seriously consider its options when considering the prudency of a retroactive rider.[131] The Committee urged the Commission to limit the rate increase to what is necessary to comply with the Court's Opinion.[132]

In implementing the Court's Opinion, Appalachian Voices recognized the remand proceedings in this case involve discrete issues. But Appalachian Voices urged the Commission to exercise any discretion it may have to the greatest extent possible in this proceeding to limit the rate increase to only what is absolutely necessary due to the Court's Opinion. Appalachian Voices indicated that other issues can be litigated in the upcoming triennial review.[133]

VML/VACo asserted that the Rider R.C.R. revenue requirement has not been the subject of discovery, expert review, or responsive testimony.[134] For this reason, and given the current financial difficulties and the impact of recent rate requests, VML/VACo asserted that it would be more reasonable and prudent for past revenue collection numbers to be analyzed and addressed in the 2023 triennial review.[135] VML/VACo believes this approach would promote reasonableness, fairness, and prudence and would give the parties an adequate opportunity to analyze the numbers through the usual course of discovery, expert review, and expert testimony.[136]

VPLC asserted that Rider R.C.R. is inappropriate and inconsistent with Virginia law. More specifically, VPLC argued that Rider R.C.R. is retroactive ratemaking, which is generally not permitted in Virginia, and is without: (1) notice of potential retroactive ratemaking; and (2) evidence of actual costs or expenses during this time period. VPLC believes Rider R.C.R. is not required by *APCo 2022*. According to VPLC, the relevant costs and expenses can be considered in the upcoming triennial review, which would be the appropriate time for the Commission to consider whether APCo under-recovered during the relevant period.[137] VPLC urged the Commission to take all steps that it can to ensure the rate increase is no more than what

[130] Ex. R135 (Castle remand) at 2.
[131] Tr. at 1278 (McCormick).
[132] Tr. at 1347 (McCormick).
[133] Tr. at 1345-46 (Cleveland).
[134] Tr. at 1340 (Walker).
[135] Tr. at 1272, 1337 (Walker).
[136] Tr. at 1340 (Walker).
[137] Tr. at 1274-76 (Reisinger).

is reasonable and necessary. VPLC indicated that without knowing APCo's historic costs and revenues, we do not know whether Rider R.C.R. is necessary. VPLC believes this would be a gratuitous rate increase that would come at the worst time for low-income customers.[138]

Consumer Counsel expressed concern about the lack of clarity on how the revenue from Rider R.C.R. will be treated in the upcoming triennial review. Since the triennial review statutes provide a remedy for under-earnings, and the results of the earnings test for 2020, 2021, and 2022 in the upcoming triennial review are currently unknown, it appears to Consumer Counsel that the backward-looking Rider R.C.R. may be a discretionary rate increase.[139] Consumer Counsel would strongly oppose Rider R.C.R. if all revenues it is designed to recover are not imputed into the 2021 and 2022 earnings test because it could lead to an illegal double-recovery.[140] For that reason, Consumer Counsel recommended conditioning any Rider R.C.R. approval on the requirement that its revenues be imputed into the 2021 and 2022 earnings test.[141]

Staff witness Welsh testified that, on a regulatory basis, the revenue from Rider R.C.R. should be placed in the earnings test for the years 2021 and 2022, but the specifics of how that is accomplished can be determined in the upcoming triennial review.[142]

APCo opposed deferring consideration of under-collections until the upcoming triennial. APCo argued, among other things, that:

> [I]t's almost unbelievable.... [W]ith respect to the Commission, we're here today because the Commission misapplied the law and the Supreme Court sent this case back so that we could correct that mistake; that's not a criticism of the Commission. And we very much appreciate how the Commission is trying to implement the Court's ruling and put this case behind us. That's exactly what we want to do as well. But that is the reason why we're here today. And any suggestion that we should delay this even longer is outrageous. And we also think it would violate the pretty clear instruction from the Supreme Court.[143]

In my view, some of the arguments questioning the need for Rider R.C.R. or suggesting that remand issues could be deferred to the 2023 triennial review misunderstand the Commission's legal responsibility in the remanded 2020 triennial review proceedings required by the Court's Opinion in *APCo 2022*. Rider R.C.R. is intended to address the legal error identified in *APCo 2022* by allowing the Company to recover revenues that it would have collected but for the legal error. This discrete and largely mathematic undertaking is fundamentally different than the comprehensive regulatory accounting evaluation that will occur in the 2023 triennial review. While some case participants have described Rider R.C.R. as

[138] Tr. at 1344 (Reisinger).
[139] Tr. at 1286-87 (Burton). Consumer Counsel clarified that it was not arguing that Rider R.C.R. was legally prohibited. Tr. at 1352 (Burton).
[140] Tr. at 1352 (Burton).
[141] *Id.*
[142] This includes revenues not collected until after 2022. Tr. at 1332 (Welsh).
[143] Tr. at 1359 (Ritter).

unlawful or discretionary, it does not seem legally advisable that the Commission conclude the remanded 2020 triennial review case without attempting to remedy the legal error that prompted the remand. To be sure, the Court's remand was a general one without specific instructions. However, I view this judicial choice simply as the Court's recognition of where its expertise ends (legal interpretation) and where the Commission's primary expertise and authority begins (ratemaking).

While mindful of ratepayer impacts, I do not share VPLC's view about notice in this case. The Court has remanded the 2020 triennial review case back to the Commission for the further proceedings necessary to resolve the Application and conclude this case. The total revenues that APCo proposes on remand are less than the total revenues that the noticed rates proposed by the Application would have produced over the relevant period. Proof of notice of the Application was made a part of the record without objection.[144]

To calculate the revenue requirement of Rider R.C.R., APCo applied its proposed base rate increase percentages (generation and distribution) to the actual base rate revenue collected from customers spanning January 1, 2021, through August 31, 2022, with an estimate included for the month of September 2022. The difference between this base rate revenue collection amount and the amount the Company would have collected, based on its proposed going-forward revenue requirement, is $72.1 million.[145] While I do not recommend APCo's specific going-forward increase percentages or the resulting $72.1 million figure, I generally find the methodology used to calculate Rider R.C.R. is reasonable. To determine the actual impact of the legal error that must be addressed on remand, it is appropriate to use actual base rate revenue collected by APCo, during the relevant period, as the baseline. Increasing that actual generation and distribution revenue by the appropriate going-forward percentages reasonably replicates what APCo would have collected but for the identified legal error.

When finalizing the Rider R.C.R. rates and any associated refunds, I recommend two updates to the Rider R.C.R. calculation that would, in my view, make the calculation more accurate. First, I recommend that the Company be required to update its estimated revenue for the month of September 2022 to an actual amount. The proposed Rider R.C.R. was calculated using 20 months of actual revenue and an estimate for September 2022. As discussed above, actual revenue collected by APCo is the appropriate baseline for determining what the Company would have collected during the relevant period.

Second, I recommend that the updated revenue baseline for Rider R.C.R. reflect the effective date the Commission finds it would have approved for a base rate increase. The Company's baseline figure assumes that a base rate increase would have gone into effect on January 1, 2021. However, the Code provides the Commission with discretion to implement any base rate increase up to 60 days after the date of a triennial review final order.[146] Since the relevant Final Order was issued on November 24, 2020, the statutory window for implementing

[144] Ex. 2; Tr. at 77.
[145] Ex. R137 (Walsh remand) at 4 and attached Remand Sched. 2, p. 2.
[146] Code § 56-585.1 A 8 d ("The Commission's final order regarding such triennial review shall be entered not more than eight months after the date of filing, and any revisions in rates or credits so ordered shall take effect not more than 60 days after the date of the order.").

the rate increase extends from that date through January 23, 2021. In the instant case, the second sentence of the Application appears to expect that any increase would not have taken effect until 60 days after the order.[147] Similarly, APCo plans for Rider R.C.R. to end January 31, 2024, specifically "so that the rider will terminate prior to new rates that may result from the 2023 [t]riennial [review] being implemented."[148] In other words, APCo expects that any rate change resulting from the 2023 triennial review would not take effect until 60 days after the Commission's order. This expectation is consistent with past experience. When the Commission approved a base rate increase for APCo in 2011, the Commission made the increase effective for service rendered 60 days after its order.[149] Accordingly, for purposes of calculating Rider R.C.R., I find an assumed effective date of January 23, 2021, better replicates what would have happened but for the legal error that must be remedied.

An updated revenue baseline to calculate Rider R.C.R. – that uses the actual amount for September 2022 and removes January 1, 2021, through January 22, 2021, as recommended above – can be incorporated in the compliance filing directed by the Commission in this case for purposes of setting final rates and issuing the associated refunds. Rider R.C.R. will also need to be reduced should the Commission approve a going-forward revenue requirement that is less than the Company's proposed $40.6 million revenue requirement. I recommend that APCo file a revised Rider R.C.R. and supporting calculations[150] and that Staff be directed to verify these calculations and the underlying actual revenues to ensure they reflect the actual amounts for the relevant period. However, the Commission can direct the compliance filing process it determines is appropriate under these circumstances.

I agree with Consumer Counsel that the lack of clarity on how Rider R.C.R. revenues will be treated in the earnings test in the upcoming triennial review appears to raise a concern about potential double-recovery that should be addressed in the instant case. If the Rider R.C.R. revenues – which are attributable to 2021 and 2022 – are not accounted for in the 2021 and 2022 earnings test, APCo's regulatory earnings for these two years will be lower. And, as this case illustrates, the implications of relatively lower earnings test results on rates can be significant. In the upcoming triennial review, a regulatory adjustment would presumably be needed to account for these revenues in 2021 and 2022 because they will mostly be collected after 2022. Since regulatory adjustments can be contested, one concern is that base rates could increase as a result of 2021 and 2022 under-collections that Rider R.C.R. will, in fact, be collecting.[151] I recommend addressing this issue in the instant case to eliminate any uncertainty in this regard. For example, approval of Rider R.C.R. could be conditioned on a requirement for the Company to impute all Rider R.C.R. revenues into the 2021 and 2022 earnings test.[152] As an alternative or

[147] Ex. 1 (Application) at 1 ("The Code also requires the Commission to enter a final order on this Application within eight months from its filing (by November 30, 2020), with any revisions in rates to take effect 60 days after the order (by February 1, 2021).").
[148] Ex. R135 (Castle remand) at 2-3.
[149] *2011 Biennial Review Order*, 2011 S.C.C. Ann. Rep. at 491.
[150] APCo witness Walsh filed the calculations supporting Rider R.C.R., as proposed. Ex. R137 (Walsh remand) at attached Remand Scheds.
[151] Under the triennial review laws, regulatory earnings levels can also affect whether customers receive refunds or rate decreases.
[152] Tr. at 1352 (Burton).

complementary safeguard, Rider R.C.R. could remain subject to refund until the Commission has completed the earnings test in the upcoming triennial review.

Finally, while APCo indicated that Rider R.C.R. will terminate January 31, 2024, there is no expiration date in the proposed tariff.[153] Instead, the proposed tariff appears to contemplate that further Commission action would be required to discontinue the rider.[154] I recommend the Commission determine how Rider R.C.R. will conclude and that the tariff reflect such determination. Rather than a fixed expiration date, I recommend an approach similar to what the Commission approved for Rider T.R.R., which automatically resets to zero upon reaching the amount targeted by the rider.[155]

FINDINGS AND RECOMMENDATIONS

Based on the Code and the record developed in this proceeding, I find that:

1. After making only the changes necessary to implement the Court's Opinion, the Company earned a revised combined rate of return on common equity for the 2017-2019 triennial review period of 7.945% (2017 - 11.600%; 2018 - 9.355%; and 2019 - 3.095%);

2. The revised earnings resulting from the Court's Opinion are at a level that requires the Commission to increase APCo's base rates and allow deferred recovery of a $37.0 million regulatory asset pursuant to Code § 56-585.1 A 8;

3. Amortizing the $37.0 million regulatory asset over three years beginning January 24, 2021, is reasonable and aligns with the statutory triennial review schedule;

4. Staff's recommended going-forward revenue requirement of $28.4 million is reasonable and would provide an increase to APCo's rates that is necessary to provide the opportunity for the Company to fully recover the costs of providing service and to earn not less than such fair combined rate of return;

5. The revenue baseline used to calculate Rider R.C.R should be updated to (a) use the actual revenue amount for September 2022 and (b) remove revenues from January 1, 2021, through January 22, 2021;

6. Rider R.C.R. must be reduced if the Commission approves a going-forward revenue requirement that is less than the Company's proposed $40.6 million revenue requirement;

7. While the Commission can direct the compliance filing process it determines is appropriate under these circumstances, for Rider R.C.R. APCo should file a revised tariff and supporting calculations and Staff should be directed to verify these calculations and the underlying actual revenues to ensure they reflect the actual amounts for the relevant period;

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[153] Ex. R135 (Castle remand) at 2-3 and attached proposed tariff sheet no. 63.
[154] *Id.* at attached proposed tariff sheet no. 63 ("The [percentage increase factors] will remain in effect until modified or discontinued by the Virginia State Corporation Commission.").
[155] *See, e.g.*, Ex. R135 (Castle remand) at 4.

8. Approval of Rider R.C.R. should ensure double-recovery cannot occur. For example, Rider R.C.R could: (a) be conditioned on a requirement for the Company to impute all Rider R.C.R. revenues into the 2021 and 2022 earnings test; and/or (b) remain subject to refund until the Commission has completed the earnings test in the upcoming triennial review; and

9. While APCo has indicated that Rider R.C.R. will terminate January 31, 2024, APCo's proposed Rider R.C.R. tariff language indicates the Commission would need to take further action to discontinue the rider.

Accordingly, **I RECOMMEND** the Commission enter an order that:

1. ***FINDS*** the Company earned a 7.945% combined rate of return on common equity for the 2017-2019 triennial review period;

2. ***APPROVES*** a going-forward revenue requirement increase of $28.4 million for APCo's base generation and distribution rates, which includes deferred recovery of the statutory regulatory asset amortized over three years;

3. ***DIRECTS*** APCo to file revised tariffs reflecting a $28.4 million going-forward revenue requirement increase for base generation and distribution rates;

4. ***GRANTS*** conditional approval of a revised Rider R.C.R. that: (a) reflects a $28.4 million going-forward base rate revenue requirement increase; (b) removes from its actual revenue baseline any revenues from January 1, 2021, through January 22, 2021; (c) updates the estimate of September 2022 revenues to actual revenues for the actual revenue baseline; and (d) includes tariff language indicating that Rider R.C.R. automatically resets to zero upon reaching the amount targeted by the rider;

5. ***CONDITIONS*** approval of the revised Rider R.C.R. on a requirement for the Company to impute all Rider R.C.R. revenues into the 2021 and 2022 earnings test; and/or ***MAINTAINS*** the revised Rider R.C.R. as an interim rate subject to refund until the Commission has completed the earnings test in the upcoming triennial review;

6. ***DIRECTS*** customer refunds of base rate and Rider R.C.R. recoveries from interim rates exceeding the revised tariff rates approved by the Commission; and

7. ***DIRECTS*** Staff to ensure the revised rates filed by APCo comply with this order, including verification of the Rider R.C.R. calculations and the underlying actual revenues.

COMMENTS

Staff and parties are advised that, pursuant to Rule 5 VAC 5-20-120 C of the Commission's Rules of Practice and Procedure and Code § 12.1-31, any comments on this Report must be filed on or before December 1, 2022. In accordance with the directives of the Commission's *COVID-19 Electronic Service Order*[156] the parties are encouraged to file electronically. If not filed electronically, an original and fifteen (15) copies must be submitted in writing to the Clerk of the Commission, c/o Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been sent by electronic mail to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

D. Mathias Roussy, Jr.
Hearing Examiner

Document Control Center is requested to send a copy of the above Report to all persons on the official Service List in this matter. The Service List is available from the Clerk of the State Corporation Commission, c/o Document Control Center, 1300 East Main Street, Tyler Building, First Floor, Richmond, VA 23219.

[156] *Commonwealth of Virginia, ex rel State Corporation Commission, Ex Parte: Electronic service among parties during COVID-19 emergency,* Case No. CLK-2020-00007, Doc. Con. Cen. No. 200410009, Order Requiring Electronic Service (April 1, 2020) ("*COVID-19 Electronic Service Order*").