

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC JOINT APPLICATION OF AMERICAN)
ELECTRIC POWER COMPANY, INC., KENTUCKY)
POWER COMPANY AND LIBERTY UTILITIES CO. FOR)
APPROVAL OF THE TRANSFER OF OWNERSHIP AND)
CONTROL OF KENTUCKY POWER COMPANY)

Case No. 2021-00481

REBUTTAL TESTIMONY OF
JAMES X. LLENDE
ON BEHALF OF KENTUCKY POWER COMPANY

**REBUTTAL TESTIMONY OF
JAMES X. LLENDE ON BEHALF OF
KENTUCKY POWER COMPANY
BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY**

CASE NO. 2021-00481

TABLE OF CONTENTS

| <u>SECTION</u> | <u>PAGE</u> |
|--|--------------------|
| I. INTRODUCTION | 1 |
| II. BACKGROUND | 1 |
| III. PURPOSE OF REBUTTAL TESTIMONY | 2 |
| IV. AFTER-TAX ACCOUNTING GAIN AND AEP’S EXPECTED BENEFIT | 3 |
| V. TAX SHARING AGREEMENT | 7 |
| VI. CONCLUSION..... | 9 |

**REBUTTAL TESTIMONY OF
JAMES X. LLENDE ON BEHALF OF
KENTUCKY POWER COMPANY
BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY**

CASE NO. 2021-00481

I. INTRODUCTION

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is James X. Llend. I am the Senior Vice President of Tax for American Electric
3 Power Service Corporation (“AEPSC”), a wholly owned subsidiary of American Electric
4 Power Company, Inc. (“AEP”), the parent company of Kentucky Power Company
5 (“Kentucky Power” or the “Company”). My business address is 1 Riverside Plaza,
6 Columbus, Ohio 43215.

7 **Q. DID YOU OFFER DIRECT TESTIMONY IN THIS PROCEEDING?**

8 A. No.

II. BACKGROUND

9 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
10 **BUSINESS EXPERIENCE.**

11 A. I graduated with a Bachelor of Science and Master of Accountancy degrees from the
12 University of South Florida. I am a Certified Public Accountant in the State of Florida. I
13 started my career with PricewaterhouseCoopers (“PwC”) and was promoted to various
14 levels of responsibilities up to Senior Manager of Tax. In 2002, I accepted a position with
15 Exelon as Director-Tax and also held the positions of Director-External Reporting and
16 Director-Corporate Finance during my tenure. In 2010, I returned to PwC when I accepted
17 the position of Director-Tax. In 2012, I accepted the position of Senior Director-Tax with
18 NextEra Energy. In 2017, I accepted the position of Vice President of Tax with AEPSC.

1 I was promoted to my current position in 2022. I have oversight responsibilities over
 2 matters of regulated tax ratemaking at AEPSC.

III. PURPOSE OF REBUTTAL TESTIMONY

3 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

4 A. The purpose of my rebuttal testimony is to rebut the Direct Testimony of Lane Kollen filed
 5 on behalf of the Office of the Attorney General of the Commonwealth of Kentucky and
 6 The Kentucky Industrial Utility Customers, Inc. (jointly, “AG/KIUC”, or individually,
 7 “AG” and “KIUC”). Specifically, I (1) correct Witness Kollen’s mischaracterization of
 8 the benefit AEP expects to realize as a result of the proposed transfer and (2) demonstrate
 9 why Witness Kollen’s analysis of the company’s tax sharing agreement and the increased
 10 financing costs due to the loss of AEP reimbursement of tax effects of net operating losses
 11 (“NOL”) is flawed and should not be relied upon by the Commission in deciding this case.
 12 I also discuss AEP’s activity regarding the Internal Revenue Service’s (“IRS”)
 13 normalization rules and the historic ratemaking treatment of the AEP tax sharing agreement
 14 reimbursements.

15 **Q. ARE YOU SPONSORING ANY EXHIBITS?**

16 A. I am sponsoring the following rebuttal exhibit:

| <u>EXHIBIT</u> | <u>DESCRIPTION</u> |
|----------------|--|
| EXHIBIT JXL-R1 | AEP Parent Impact of Kentucky Power Sale – Estimated After-Tax Accounting Gain |

IV. AFTER-TAX ACCOUNTING GAIN AND AEP'S EXPECTED BENEFIT

1 **Q. PLEASE DESCRIBE THE BENEFIT AEP EXPECTS TO REALIZE AS A RESULT**
2 **OF THE PROPOSED TRANSFER.**

3 A. As reflected in Exhibit JXL-R1, line 13, AEP's estimate of its after-tax accounting gain
4 related to the sale of Kentucky Power is estimated at \$40 million. This estimated after-tax
5 accounting gain calculation properly considers both book and tax consequences of the sale
6 for AEP, establishing it as an appropriate measure of the benefit AEP expects to realize as
7 a result of the proposed transfer.

8 **Q. ON PAGE 6, LINES 7 THROUGH 8 OF HIS TESTIMONY, WITNESS KOLLEN**
9 **REFERS TO THE, "...BENEFIT OF THE \$585 MILLION PREMIUM...THAT**
10 **AEP WILL RECEIVE IN EXCESS OF THE PER BOOKS COMMON EQUITY**
11 **FOR THE COMPANY." PLEASE DESCRIBE THE "BENEFIT" REFERRED TO**
12 **BY WITNESS KOLLEN.**

13 A. The "benefit" of \$585 million represents Witness Kollen's calculation of *Liberty Utility*
14 *Co.'s* ("Liberty") expected acquisition premium related to Kentucky Power.¹ Witness
15 Kollen acknowledges that, "[t]he transaction expenses *include the acquisition premium*
16 *or goodwill and other expenses incurred to complete the transaction through the closing*
17 *date. The Applicants have agreed that these costs will be recorded on Liberty's accounting*
18 *books*, not on the Company's [Kentucky Power's] accounting books, and that they will not
19 be charged to the Company's customers."²

20 In summary, Mr. Kollen's alleged \$585 million figure is *not* representative of an amount
21 that AEP "will receive." Mr. Kollen's alleged \$585 million "benefit" represents the

¹ Kollen Test. At 3:20-4:7.

² *Id.* at 17:8-12 (emphasis added).

1 acquisition premium, or goodwill, that Witness Kollen expects to be recorded on Liberty's
2 accounting books as a result of the proposed transaction, and excluded from Kentucky
3 Power customer rates.³

4 **Q. IS LIBERTY'S ACQUISITION PREMIUM EQUIVALENT TO THE BENEFIT**
5 **AEP EXPECTS TO REALIZE AS A RESULT OF THE TRANSFER?**

6 A. No. Liberty's acquisition premium, estimated by Witness Kollen to be \$585 million, has
7 no relationship to AEP's expected benefit. As further supported below, it also fails to
8 account for items of important business substance to AEP, including (1) current cash taxes
9 due and payable and (2) amounts related to estimated working capital, capital expenditure,
10 and transaction costs per the sale agreement.

11 **Q. IS THE AMOUNT OF LIBERTY'S ACQUISITION PREMIUM RELEVANT TO**
12 **THE JOINT APPLICANTS' REQUEST FOR APPROVAL OF THIS SALE**
13 **TRANSACTION?**

14 A. No. Liberty Witness Eichler's Rebuttal Testimony addresses this issue further.

15 **Q. IS THE AMOUNT OF AEP'S ESTIMATED AFTER-TAX ACCOUNTING GAIN**
16 **RELEVANT TO THE JOINT APPLICANTS' REQUEST FOR APPROVAL OF**
17 **THIS SALE TRANSACTION?**

18 A. No. I have been advised by counsel that the Commission's inquiry into this matter, which,
19 pursuant to KRS 278.020(6) and (7), is whether Liberty has the financial, technical, and
20 managerial abilities to provide reasonable service and that the proposed acquisition is in
21 accordance with law, for a proper purpose, and consistent with the public interest. As

³ This is consistent with responses that AEP and Liberty provided to the following data requests submitted by KIUC, which Mr. Kollen reviewed and included as exhibits to his filed testimony in this matter: KIUC 1_50 subpart a. (Exhibit LK-23), KIUC 1_51 (Exhibit LK-8), and KIUC 1_77 subparts c. and d. (Exhibit LK-2).

1 indicated in response to Joint Applicants' Question 31, Mr. Kollen agrees, stating "the gain
2 or loss that AEP will report on its accounting books is irrelevant to the issues in this
3 proceeding."

4 **Q. ALTHOUGH HE LATER CONCEDED IN DISCOVERY THAT THE BENEFIT**
5 **TO AEP ASSOCIATED WITH THE TRANSACTION IS NOT RELEVANT, MR.**
6 **KOLLEN'S TESTIMONY NONETHELESS REFERRED TO IT IN FRAMING**
7 **THE PENALTY ARGUMENT IN HIS DIRECT TESTIMONY AND IMPLIED**
8 **THAT THE ACQUISITION PREMIUM WAS REFLECTIVE OF AEP'S GAIN.⁴**
9 **TO CLARIFY THE RECORD, PLEASE SUMMARIZE THE RESPECTS IN**
10 **WHICH MR. KOLLEN'S ACQUISITION PREMIUM CALCULATION IS NOT**
11 **REFLECTIVE OF AEP'S GAIN.**

12 A. Simply, the calculated acquisition premium expected for Liberty fails to account for items
13 of important business substance to AEP, including (1) current cash taxes now due and
14 payable of approximately \$450 million resulting from a sale of Kentucky Power and (2)
15 amounts related to estimated working capital, capital expenditure, and transaction costs per
16 the sale agreement of approximately \$70 million.⁵ The remaining approximately \$25
17 million difference between AEP's estimated after-tax accounting gain of \$40 million and
18 Mr. Kollen's calculation of Liberty's expected acquisition premium of \$585 million is
19 attributable to Mr. Kollen's use of rounded book equity and debt amounts in his calculation
20 of Liberty's acquisition premium related to Kentucky Power.

⁴ AG/KIUC Witness Baron's testimony also incorrectly characterizes the acquisition premium Mr. Kollen calculated as reflecting AEP's gain, asserting that "AEP will receive a very substantial acquisition premium when the acquisition is closed. To satisfy the public interest standard it is necessary for AEP to contribute a portion of this premium...." Baron Test. at 12:11-13.

⁵ AEP estimates working capital, capital expenditure and transaction costs per the sale agreement of \$70 million (See Exhibit JXL-R1 at line 3). In Mr. Kollen's calculation of Liberty's acquisition premium, this amount was not considered.

1 As I previously stated, AEP's estimated after-tax accounting gain of \$40 million detailed
2 at Exhibit JXL-R1 properly considers both book and tax consequences of the sale for AEP,
3 establishing it as an appropriate measure of the benefit AEP expects to realize as a result
4 of the proposed transfer.

5 **Q. PLEASE REVIEW THE COMPONENTS OF THE ESTIMATED AFTER-TAX**
6 **GAIN CALCULATION PROVIDED IN EXHIBIT JXL-R1.**

7 A. After the assumption of debt, working capital, and capital expenditure adjustments and
8 transaction costs, AEP expects to receive \$1.362 billion in net proceeds allocated to the
9 Kentucky Power portion of the sale. (See Exhibit JXL-R1 at line 4.) The book value of the
10 Kentucky Power assets sold to and liabilities assumed by Liberty were estimated at \$1.309
11 billion. (*Id.* at line 10.) The difference between the estimated net proceeds and the related
12 book value is a \$53 million before-tax gain. (*Id.* at line 11.) After income taxes, the
13 estimated accounting gain is \$40 million. (*Id.* at line 13.)

14 **Q. WHAT ARE THE MAIN COMPONENTS OF THE \$1.309 BILLION IN COST**
15 **BASIS FOR THE ASSETS AND LIABILITIES ASSUMED BY LIBERTY?**

16 A. The net Property, Plant and Equipment basis was \$2.174 Billion. (See Exhibit JXL-R1 at
17 line 5.) Regulatory assets and liabilities, net were \$348 million. (*Id.* at line 6.) Debt
18 assumed by Liberty was (\$1.227) billion. (*Id.* at line 8.) These amounts were derived from
19 Kentucky Power's general ledger based on balances as of December 31, 2021, and
20 incorporate estimated capital additions, depreciation expense, and amortization of excess
21 accumulated deferred federal income taxes through June 1, 2022. The corresponding
22 amounts recorded in Kentucky Power's general ledger through the test year ended March

1 31, 2020 were reviewed by the KPSC in Kentucky's most recent base rate case, Case No.
2 2020-00174.

3 **Q. WHAT OTHER ASSUMPTIONS OR ESTIMATES WERE NEEDED IN AEP'S**
4 **AFTER-TAX GAIN CALCULATION?**

5 A. AEP's calculation assumes a close of the transaction on June 1, 2022, and is subject to
6 change based on a number of factors including the timing of the close date and certain on-
7 going normal business activity by Kentucky Power impacting book cost basis prior to the
8 close of the transaction (e.g. capital expenditures, amortization of regulatory liabilities,
9 depreciation expense, etc.). No changes are expected that would add over \$500 million, or
10 even \$100 million, to the gain.

V. TAX SHARING AGREEMENT

11 **Q. DOES AEP HAVE A TAX SHARING AGREEMENT?**

12 A. Yes.

13 **Q. DO YOU AGREE WITH AG/KIUC WITNESS KOLLEN'S TESTIMONY (ON**
14 **PAGE 30) REGARDING HIS ANALYSIS OF HOW AEP'S TAX SHARING**
15 **AGREEMENT WORKS?**

16 A. No, I do not. AEP does not reimburse *each* member of the AEP affiliate group. Affiliate
17 companies with taxable income pay AEP their portion of the taxes due. AEP reimburses
18 only those affiliates who are in a taxable loss position for the year. This distinction is
19 important because if Kentucky Power has taxable income it will not receive a
20 reimbursement. The benefit of the reimbursement referred to by Mr. Kollen is dependent
21 first on the Company generating a taxable loss and second on the AEP consolidated
22 group being able to offset that loss with income from other AEP affiliates. The latest

1 financial forecast estimates the Company will generate taxable income starting in 2024
2 and as a result a benefit will no longer be available from the tax sharing agreement.

3 Liberty Witness Michael D. McCuen further supports this assertion.

4 **Q. HAS AEP IDENTIFIED ANY ISSUES WITH THE RATEMAKING**
5 **TREATMENT OF THE AEP TAX SHARING AGREEMENT BENEFIT**
6 **DISCUSSED BY WITNESS KOLLEN?**

7 A. Yes. AEP recently identified an issue between the IRS' normalization rules and the
8 historic ratemaking treatment of the AEP tax sharing agreement reimbursements received
9 by the Company as described by Witness Kollen. For ratemaking purposes, the net
10 operating loss carryforward ("NOLC") attributable to accelerated tax depreciation should
11 be on a stand-alone basis ignoring the accounting impact of the reimbursements through
12 the tax sharing agreement to the deferred tax asset ("DTA"). Beginning in late 2020,
13 AEP operating companies, beginning with those referenced below, aligned their rate
14 filings with the normalization rules' consistency requirements.⁶ The stand-alone NOLC
15 DTA nullifies the benefit described by Witness Kollen and therefore makes his testimony
16 as to whether Liberty will provide a tax sharing allocation reimbursement to the
17 Company irrelevant.

⁶ 26 U.S.C. § 168(i)(9)(B)(i).

1 **Q. WHAT STEPS HAS AEP TAKEN TO ADDRESS THE IRS' NORMALIZATION**
2 **RULES AND THE HISTORIC RATEMAKING TREATMENT?**

3 A. Since identifying this normalization inconsistency, AEP has requested a DTA for a
4 NOLC on a stand-alone basis for all filings. The following AEP companies and state
5 jurisdictions have filed to include a stand-alone NOLC:⁷

- 6 • Southwestern Electric Power Company – TX, LA, and AR
- 7 • Public Service Company of Oklahoma – OK
- 8 • Indiana & Michigan Power Company – IN
- 9 • Kingsport Power Company – TN

10 AEP would expect to take a stand-alone NOLC position in Kentucky Power's next rate
11 case in the event that Kentucky Power continues to be owned by AEP.

VI. CONCLUSION

12 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

13 A. Yes, it does.

⁷ Southwestern Electric Power Company, and Public Service Company of Oklahoma, with AEP, have submitted private letter ruling requests to the IRS to affirm AEP's understanding of the stand-alone NOLC issue.

AEP Parent Impact of Kentucky Power Sale – Estimated After-Tax Accounting Gain

Below in \$ millions.

Estimations represent a June 1, 2022 close and are subject to change.

| Line # | | AEP Parent Impact | | |
|--------|---|-------------------|-------------------|-----------|
| | | KPCo | KTCo ¹ | Total |
| 1 | TOTAL PROCEEDS: | \$2,659 | \$187 | \$2,846 |
| 2 | Debt assumed | (\$1,227) | (\$65) | (\$1,292) |
| 3 | Adjust for working cap/capex/trans cost | (\$70) | (\$14) | (\$84) |
| 4 | Net proceeds at close | \$1,362 | \$108 | \$1,470 |
| | COST BASIS: | | | |
| 5 | Net PP&E | (\$2,174) | (\$167) | (\$2,341) |
| 6 | Regulatory assets and liabilities, net | (\$348) | \$8 | (\$340) |
| 7 | Other non-current assets | (\$45) | (\$1) | (\$46) |
| 8 | Debt assumed | \$1,227 | \$65 | \$1,292 |
| 9 | ARO and other Liabilities | \$31 | \$2 | \$33 |
| 10 | | (\$1,309) | (\$93) | (\$1,402) |
| 11 | Pre-tax gain/(loss) | \$53 | \$14 | \$67 |
| 12 | Tax expense | (\$13) | (\$4) | (\$17) |
| 13 | After tax gain/(loss) | \$40 | \$10 | \$50 |

¹AEP's sale of AEP Kentucky Transmission Company, Inc. ("KTCO") is not before the Commission in this proceeding.



KY Discovery Verification - Llende.docx

DocVerify ID: AE9D46B3-3AE6-47C3-9FDE-10ADFD9479F8
Created: March 17, 2022 04:52:45 -8:00
Pages: 1
Remote Notary: Yes / State: KY

This document is a DocVerify VeriVaulted protected version of the document named above. It was created by a notary or on the behalf of a notary, and it is also a DocVerify E-Sign document, which means this document was created for the purposes of Electronic Signatures and/or Electronic Notary. Tampered or altered documents can be easily verified and validated with the DocVerify veriCheck system. This remote online notarization involved the use of communication technology.

Go to www.docverify.com at any time to verify or validate the authenticity and integrity of this or any other DocVerify VeriVaulted document.

E-Signature Summary

E-Signature 1: James X Llende (JXL)

March 17, 2022 05:39:09 -8:00 [908F7F3DAF69] [167.239.221.107]
jxllende@aep.com (Principal) (Personally Known)

E-Signature Notary: Jennifer Young (JY)

March 17, 2022 05:39:09 -8:00 [D6E5626C11D9] [167.239.221.103]
jayoung1@aep.com
I, Jennifer Young, did witness the participants named above electronically sign this document.



VERIFICATION

The undersigned, James X. Llende, being duly sworn, deposes and says he is Senior Vice President of Tax for American Electric Power Service Corporation that he has personal knowledge of the matters set forth in the forgoing responses and the information contained therein is true and correct to the best of his information, knowledge and belief after reasonable inquiry.

James X. Llende
Signed on 2022/03/17 05:39:09 -8:00
James X. Llende

COMMONWEALTH OF KENTUCKY)
) Case No. 2021-00481
COUNTY OF BOYD)

Subscribed and sworn to before me, a Notary Public in and before said County and State, by James X. Llende, this 17 day of March 2022.


Notary Public

Notary ID Number: KYNP31964

My Commission Expires: 6/21/2025

JENNIFER A. YOUNG
ONLINE NOTARY PUBLIC
STATE AT LARGE KENTUCKY
Commission # **KYNP31964**
My Commission Expires Jun 21, 2025

Notarial act performed by audio-visual communication

AE9D46B3-3AE6-47C3-9FDE-10ADF9479F8 --- 2022/03/17 04:52:45 -8:00 --- Remote Notary

