EXHIBIT TPB - 3 - PROPOSED FRP

RECEIVED
DEC 1 3 2019
LA Public Service Commission

LOUISIANA PUBLIC SERVICE COMMISSION

DOCKET NO. U-XXXXX

SOUTHWESTERN ELECTRIC POWER COMPANY
EX PARTE

In Re: Review of Possible Modifications to SWEPCO's Formula Rate Plan as Extended in Docket No. U-32220

FORMULA RATE PLAN TERM SHEET

This Agreement is entered into between the Louisiana Public Service Commission ("LPSC" or "Commission") Staff (the "Staff"), and Southwestern Electric Power Company ("SWEPCO" or "Company") for the purpose of modifying SWEPCO's Formula Rate Plan ("FRP"), which was most recently amended by Commission Order No. U-32220 dated July 14, 2014 and extended through test year 2017 in Order No. U-32220-C, dated August 26, 2016 and in Order U-34200-A dated May 18, 2017. There are no other parties to this proceeding.

The provisions of this extended FRP for the 2020 through 2025 test years provides an administratively efficient methodology for promptly adjusting rates to reflect cost of service, thus providing benefits for Louisiana ratepayers.

The parties agree to propose the following settlement to the Louisiana Public Service Commission (the "LPSC" or "Commission"):

I. FORMULA RATE PLAN ALTERNATIVE REGULATION

1. SWEPCO shall be allowed to implement a Formula Rate Plan ("FRP") surcharge rider to annually adjust its rates to reflect changes in its costs and revenues.

2. The FRP is intended to simulate traditional cost of service regulation, but on an expedited and administratively simplified basis.

3. The FRP surcharge rider shall be extended for a period of five years, with the first rate change, if any, based on a test year ending December 31, 2020 effective for bills rendered on and after the first billing cycle of April 2021, subject to refund after the Commission's review is completed. Each subsequent rate change, if any, will be based on the test year ending December 31 of the prior year with the rate change becoming effective on or after the first billing cycle of April, subject to refund, of the filing year.

4. In the event the FRP is extended, Staff and SWEPCO will proceed under this FRP, but subject to the appropriate modification as approved by the Commission. The FRP may be renewed by the Commission, subject to agreement by SWEPCO, for subsequent periods. In the event that the FRP is not renewed, then the FRP surcharge rider last in effect will remain in effect until base rates are reset by the Commission.

5. The FRP shall operate as follows:

    a. SWEPCO shall file a report with the Commission on or before the date of the first billing cycle of April of each year, beginning in 2021, containing a computation of the Company's revenue requirement based on the immediately preceding calendar year, hereinafter referred to as the test year. The annual filing shall be referred to as the "annual FRP report."

    b. The FRP, for the full term of the FRP extension, will provide for an authorized, but not a guaranteed, Return on Common Equity ("ROE") at the midpoint of the ROE bandwidth (X.X%) with the upper and lower bands of +/- 50 basis points. The upper ROE band will be set at Y.Y% and the lower ROE band will be set at Z.Z%. The ROE range equal to and between the upper and lower bands shall be defined as the "Deadband".

    c. In the first review period which will set rates effective for bills rendered on and after the first billing cycle of April 2021 subject to refund pending the Commission's review, rates shall be established to allow the Company the opportunity to recover its revenue requirement using 100% of the difference between the 2020 test year earned return and the midpoint (authorized) ROE set forth in paragraph 5(c).

    d. In subsequent periods, if the calculated ROE for the test year is within the Deadband, there shall be no change to the level of rates.

    e. In subsequent periods, if the calculated ROE for the test year is less than the lower band, SWEPCO shall implement a prospective rate increase equal to 100% of the difference between the calculated ROE and the midpoint ROE.

    f. In subsequent periods, if the calculated ROE for the test year exceeds the upper band, SWEPCO shall implement a prospective rate reduction equal to 100% of the difference between the calculated ROE and the midpoint ROE.

    g. Any changes to the levels of authorized FRP revenues shall be allocated to each applicable rate schedule based on an equal percentage of applicable base revenue for all applicable test years.

h. SWEPCO shall file annual FRP reports with the Commission no later than the date of the first billing cycle of April of each year. These reports will be docketed and published for intervention. Upon the close of the intervention period, SWEPCO shall provide to the Parties (Commission Staff, including special counsel and consultants for the docketed proceedings, and all intervenors) all workpapers and supporting data relied upon to develop the reports. This shall include identification and explanation of all adjustments to the test year per books cost of service data. The Parties may request clarification and additional supporting data. The Parties shall have 150 days after the filing to review each report to ensure that it complies with the requirements of this stipulation and settlement, and to propose any corrections or other adjustments to the filing. SWEPCO shall have 15 days to review and resolve any differences between the original filing and the Parties' proposed corrections and other adjustments, if any. Any disputed issues not resolved between SWEPCO and the Parties on or before the end of this 15-day period shall proceed to administrative hearings pursuant to a schedule set forth by the assigned Administrative Law Judge to resolve the disputed issues. For each year, rate changes will be effective on the first billing cycle of April, subject to refund pending the Commission's review.

i. Changes to the level of FRP revenues, if any, shall become effective for bills rendered on or after the first billing cycle of April in the year the annual FRP report is filed. Should any disputed issues arise as set forth above, SWEPCO shall file new rate schedules with the Commission within 15 days after receipt of the Commission's final ruling should a further rate adjustment be necessary. Within 60 days after the receipt of the Commission's final ruling, SWEPCO shall determine the amount of the adjustment to the FRP Rider, if any, together with interest at the same Commission-approved interest rate applicable to SWEPCO's Fuel Adjustment Charge.

j. The FRP report quantifications shall be adjusted to account for each of the ratemaking adjustments detailed in Appendix A, attached to this Settlement Term Sheet, as well as any LPSC Orders from the settlement of prior test years that would impact the FRP report quantifications. Rate base quantifications shall be based upon December 31 balances for each test year except as adjusted by Appendix A. Operating income quantifications shall be based upon revenues and expenses for each test year except as adjusted by Appendix A. The calculated rate of return on common equity shall be based on year-end capital balances and debt and preferred equity costs for each test year except as adjusted by Appendix A.

k. **Environmental Cost Related Revenue Requirement -** If during the term of this FRP, there is a change in the law or regulation related to environmental issues or environmental compliance that increases the costs to SWEPCO, SWEPCO will have the right to request recovery of the prudent level of capital-related costs outside the FRP sharing mechanism. Nothing in this provision shall constitute pre-approval of the recovery of such increased costs.

l. **Energy Efficiency Related Revenue Requirement** - If during the term of this FRP, there is a change in law or regulation that adopts measures designed to increase the efficient use of electric energy by SWEPCO's Louisiana retail customers that results in increased costs to SWEPCO, SWEPCO shall have the right to request the recovery of the prudent level of such costs outside the FRP sharing mechanism. Nothing in this provision shall constitute pre-approval of the recovery of such increased costs.

6. In the event SWEPCO experiences extraordinary increases or decreases in costs having a net annual revenue requirement impact exceeding $5 million on a Louisiana retail jurisdictional basis, then either the Company or the Commission will address the ratemaking effects of such an extraordinary cost increase or decrease in the annual FRP proceedings unless the Company or the Commission initiates a separate proceeding. Such extraordinary increases or decreases in costs shall be limited to an event or events of force majeure beyond the reasonable and direct control of SWEPCO, including natural disaster, damage or unforeseeable loss of generating capacity, changes in regulation ordered by a regulatory body or other entity with appropriate jurisdiction, and orders or acts of civil or military authority. Both the Commission and SWEPCO would retain its normal procedural rights to participate in any such process or docket.

7. The FRP shall not preclude SWEPCO from proposing revisions to existing rate schedules or new rate schedules, such as, but not limited to experimental, developmental, and alternative rate schedules, to address competitive and other business needs.

II. SERVICE QUALITY IMPROVEMENT PLAN

8. SWEPCO shall abide by the terms of the Service Quality Improvement Program ("SQIP") approved by the LPSC on December 19, 2018 be extended for five years to run concurrent during the term of this FRP and is attached as Appendix B to this Settlement Term Sheet, subject to the adjustments as mutually agreed by the parties. . The parties agree that the SQIP is a significant component of the FRP.

9. The agreement set forth in this Settlement Term Sheet and attached Appendices does not address or compromise matters not encompassed in this docket.

10. Except as may be expressly stated otherwise in this Settlement Term Sheet and attached Appendices, this settlement agreement is without prejudice and will not be considered precedential or binding on either party or the Commission with respect to any issues that may be raised in any other existing or subsequent proceedings, and the settlement of the rate of return issue shall not be considered precedential for any other proceeding.

WHEREFORE, this Settlement Agreement, as set forth in this Settlement Term Sheet and attached Appendices, is executed by the Louisiana Public Service Commission Staff and Southwestern Electric Power Company, this day of ________ .

____

By Staff Counsel for the
Louisiana Public Service Commission

____

By Counsel for
Southwestern Electric Power Company

APPENDIX A
LPSC Docket No. U-

SOUTHWESTERN ELECTRIC POWER COMPANY

FRP TEST YEAR RATEMAKING ADJUSTMENTS

The actual (per book) data for each test year shall be adjusted to reflect the following specific ratemaking adjustments to rate base, operating income, and rate of return:

<u>Ratemaking Adjustments – Rate Base</u>

The following rate base adjustments shall be made for each test year to the extent they remain applicable:

1. Use the end of test year balances for EPIS, accumulated depreciation, and ADIT rate base components, including new CWIP project additions to EPIS over $10 million on a total company basis, such as a new transmission line or power plant. Provide consistent treatment for EPIS, depreciation reserve and ADIT.

2. Use 13-month average for materials and supplies, and customer deposits rate base components.

3. Exclude all SFAS 143 ARO amounts including those in EPIS and accumulated depreciation, if any, and instead, continue to include salvage and cost of removal in depreciation rates and expense and accumulated depreciation.

4. Restate accumulated depreciation (and related depreciation ADIT) using Louisiana depreciation rates for depreciation expense purposes.

5. Use 13-month average for fuel inventories.

6. Remove specifically identifiable non-Louisiana jurisdiction deferred debits and credits, such as deferred fuel, and Texas regulatory assets and liabilities.

7. Include AFUDC adjustment to EPIS, accumulated depreciation and ADIT computed on a consistent basis.

8. Compute cash working capital in same manner as filed for 2005 test year, except that it shall exclude all non-cash expense items. Non-cash items include, but are not limited to, deferred income tax expense, deferred fuel expense, depreciation and amortization expense and return on common equity. Lead and lag days shall be updated to the latest study filed by SWEPCO before a regulatory commission and subject to review by the LPSC Staff.

9. Exclude prepayments due to interest, insurance and factoring from cash working capital using Staff methodology as in the original FRP approved by the LPSC on August 21, 2008 in Docket No. U-23327, Subdocket A.

10. Include 50 percent of non-AFUDC-bearing CWIP in rate base. Exclude 50% percent of non-AFUDC-bearing CWIP and all AFUDC-bearing CWIP from rate base. Compute non-AFUDC-bearing CWIP using a 13-month average for the test year.

11. Exclude ADIT amounts using Staff methodology as in the original FRP approved by the LPSC on August 21, 2008.

12. Eliminate rate base effects (costs or revenues) associated with any riders other than this Rider FRP, or other rate mechanisms, that SWEPCO may have in effect during the test year that recover specific costs.

13. AFUDC for ratemaking and accounting will reflect the FERC-required methodology and the LPSC-approved return on common equity.

Ratemaking Adjustments – Operating Income

The following operating income ratemaking adjustments shall be made for each test year to the extent they remain applicable:

1. The FRP Rate Adjustments in effect at the end of the test year under this Rider FRP shall be annualized for each test year using test year billing data.

2. The revenue and expense effects associated with any riders other than this Rider FRP, or other rate mechanisms, that SWEPCO may have in effect during the test year that recover specific costs are to be eliminated.

3. Include other revenues using methodology as agreed on in Staff and SWEPCO testimony in Docket No. U-23327, Subdocket A and as reflected in the original FRP-approved by the LPSC on August 21, 2008.

4. Do not annualize or normalize revenues or expenses, except for FRP rate changes, depreciation expense changes resulting from approved changes in depreciation rates, and depreciation expense related to discrete new CWIP project additions included in Rate Base Adjustment No. 1 and depreciation expense related to discrete EPIS retirements in excess of $10 million on a total Company basis that occurred during the test year.

5. Do not include post-test year adjustments except for statutory income tax changes, or as otherwise prescribed in this Term Sheet.

6. Annualize FRP rate change adjustment by including the annual impact of the increase or decrease received in the test year.

7. Exclude all SFAS 143 related expense entries due to the inclusion of salvage and cost of removal in depreciation rates and expense.

8. Reclassify receivables factoring expense from interest expense to operating expense.

9. Reclassify customer deposit interest expense to operating expense.

10. Include incentive compensation expense equal to 100% target payout level (regardless of whether such costs are incurred at SWEPCO or charged to SWEPCO by an affiliate, such as AEP Service Corporation). If the 100% target payout level includes a component tied to AEP financial performance, exclude 50% of the amount tied to AEP financial performance. This provision shall not be interpreted such that the AEP corporate multiplier eliminates incentive compensation.

11. Exclude 50 percent of long-term incentive compensation plan expense at 100% target payout level (regardless of whether such costs are incurred at SWEPCO or charged to SWEPCO by an affiliate, such as AEP Service Corporation).

12. Include credit line fees in operating expenses that are not included in cost of debt.

13. Specifically assign jurisdictional other taxes in same manner as SWEPCO filed its revenue requirement as in the original FRP.

14. Exclude other costs not recognized for ratemaking, including, but not limited to, charitable contributions, lobbying expenses, fines and penalties, and disallowances.

15. Exclude difference between SFAS 106 expense versus pay as you go (regardless of whether such costs are incurred at SWEPCO or charged to SWEPCO by an affiliate, such as AEP Service Corporation) pursuant to the Commission's Order No. U-20181 dated May 17, 1993.

16. Synchronize interest expense used for income tax expense by eliminating all actual interest expense and replacing it with an imputed interest expense equal to the test year rate base multiplied by the weighted embedded cost of short term and long term debt included in the overall rate of return for the test year.

17. Adjust federal and state income expense, deferred tax expense, and ADIT for the following:

    a. Effects associated with other adjustments set out in this Appendix A shall similarly and consistently be adjusted;

    b. All effects associated with the difference in the timing of transactions, where the underlying timing difference is eliminated, shall also be eliminated;

    c. The corporate state and federal income tax laws legally in effect on the date the annual FRP report is filed shall be reflected in the calculation of all income tax amounts; and any changes in the statutory federal income tax rate will be treated as a direct flowthrough item in the year the new tax rate is effective as long as the flowthrough complies with normalization rules.

    d. Any impact associated with a change in the corporate state and federal income tax rates between the time of the law's effective date and the effective date of the Company's FRP rider shall be recorded as a regulatory asset or liability and amortized in the applicable FRP report.

    e. Tax effects normally excluded in prior Commission Orders regarding SWEPCO for ratemaking purposes shall be eliminated.

18. The Company shall be allowed to recover through this Rider FRP, but outside the FRP sharing mechanism, the LPSC retail purchased capacity costs incurred pursuant to a new purchased power agreement ("PPA"), approved by the Commission and effective prior to the first billing cycle for the rate change month as prescribed above of the applicable filing year. The costs to be included shall be net of the reduction in capacity costs incurred pursuant to existing PPAs that will expire prior to the first billing cycle for the month of April of the filing year, and any other directly related offsets, and then only to the extent that such net costs exceed the amount of net purchased capacity costs included in the test year.

19. If any renewable resource is certified by the LPSC, the revenue requirement and related production tax credits will flow through the fuel clause until such time as the revenue requirement is included in the FRP rider.

Ratemaking Adjustments – Rate of Return

All capital components shall reflect the year-end balances for the test year, except a 13-month average shall be used for Short-Term Debt. In addition, all capital components and related costs shall reflect the following principles:

1. All Long-Term Debt issues shall reflect the balance net of a) unamortized debt discount, premium, and issuance expense and b) gains or losses on reacquired debt.

2. All Preferred Stock issues shall reflect the balance net of discount, premium and capital stock expense.

3. Short-Term Debt shall be included to the extent that short-term debt exceeds the corresponding 13-month CWIP balance in the calculation of AFUDC per the formula prescribed by the FERC. Short-Term debt may not be less than zero.

4. The cost rates to be applied for Short-Term Debt, Long-Term Debt, and Preferred Equity shall be the annualized cost rates at the end of the test year and shall include current maturities. The Long-Term Debt cost rates shall include the a) annualized amortization of debt discount premium and expenses; and b) annualized gain or loss on reacquired debt. The cost rate to be applied for Common Equity shall be the authorized Rate of Return on Common Equity.

Reclassifications

1. Revenues associated with SWEPCO's rates in the LPSC Retail, APSC, PUCT Retail, or FERC (Sales for Resale) jurisdictions, but included in Other Electric Revenue on a per book basis, shall be reclassified consistent with principles underlying the 2005 test year filing to the appropriate jurisdictional rate schedule revenue category.

Other

In addition to the preceding specific adjustments, there may from time to time be special cost or rate effects that occur during a test year that require adjustment of the test year cost data. Nothing in this Rider FRP shall preclude any Party from proposing such adjustments.