FILED
March 28, 2023
INDIANA UTILITY
REGULATORY COMMISSION

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED PETITION OF INDIANA MICHIGAN POWER COMPANY (I&M) FOR APPROVAL OF (1) ISSUANCE TO I&M OF CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY UNDER IND. CODE § 8-1-8.5-2 FOR THE ACQUISITION AND DEVELOPMENT THROUGH PURCHASE SALE AGREEMENTS (PSA) OF TWO SOLAR POWER GENERATING FACILITIES TO BE KNOWN AS LAKE TROUT, AND MAYAPPLE (CLEAN ENERGY PSA PROJECTS); (2) TO THE EXTENT NECESSARY, ISSUANCE OF AN ORDER PURSUANT TO IND. CODE § 8-1-2.5-5 DECLINING TO EXERCISE JURISDICTION UNDER. IND. CODE § 8-1-8.5-5(e) (3) APPROVAL OF EACH PSA PROJECT AS A CLEAN ENERGY PROJECT UNDER IND. CODE § 8-1-8.8-11; (4) APPROVAL OF TWO SOLAR RENEWABLE ENERGY PURCHASE AGREEMENTS FOR PROJECTS TO BE KNOWN AS ELKHART COUNTY AND SCULPIN (CLEAN ENERGY PPA PROJECTS) AS CLEAN ENERGY PROJECTS UNDER IND. CODE § 8-1-8.8-11; (5) ASSOCIATED TIMELY COST RECOVERY UNDER IND. CODE § 8-1-8.8-11 FOR ALL PSA AND PPA PROJECTS; AND (6) OTHER ACCOUNTING AND RATEMAKING AUTHORITY.	**CAUSE NO.** 45868

SUBMISSION OF DIRECT TESTIMONY OF
DAVID A. HODGSON

Applicant, Indiana Michigan Power Company (I&M), by counsel, respectfully submits the direct testimony of David A. Hodgson in this Cause.

Respectfully submitted,

Lauren Aguilar

Teresa Morton Nyhart (Atty. No. 14044-49)
Lauren Aguilar (Atty. No. 33943-49)
Barnes & Thornburg LLP
11 South Meridian Street
Indianapolis, Indiana 46204
Nyhart Phone: (317) 231-7716
Aguilar Phone: (317) 231-6474
Fax: (317) 231-7433
Nyhart Email: tnyhart@btlaw.com
Aguilar Email: laguilar@btlaw.com

Tammara D. Avant (Atty. No. 31466-49)
American Electric Power Service Corporation
101 W. Ohio St., Suite 1320
Indianapolis, Indiana 46204
Phone: (317) 508-9262
Email: tdavant@aep.com

Attorneys for
Indiana Michigan Power Company

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing was served this 28th day of March, 2023, by email transmission, hand delivery or United States Mail, first class, postage prepaid to:

T. Jason Haas
Indiana Office of Utility Consumer Counselor
Office of Utility Consumer Counselor
115 West Washington Street
Suite 1500 South
Indianapolis, Indiana 46204
infomgt@oucc.in.gov
thaas@oucc.in.gov

Jeffrey M. Peabody

Teresa Morton Nyhart (Atty. No. 14044-49)
Lauren Aguilar (Atty. No. 33943-49)
BARNES & THORNBURG LLP
11 South Meridian Street
Indianapolis, Indiana 46204

Nyhart Phone:	(317) 231-7716
Aguilar Phone:	(317) 231-6474
Fax:	(317) 231-7433
Nyhart Email:	tnyhart@btlaw.com
Aguilar Email:	laguilar@btlaw.com

Tammara D. Avant (Atty. No. 31466-49)
American Electric Power Service Corporation
101 W. Ohio St., Suite 1320
Indianapolis, Indiana 46204

Phone:	(317) 508-9262
Email:	tdavant@aep.com

Attorneys for INDIANA MICHIGAN POWER COMPANY

I&M Exhibit: _____

INDIANA MICHIGAN POWER COMPANY

PRE-FILED VERIFIED DIRECT TESTIMONY

OF

DAVID A. HODGSON

Content

DIRECT TESTIMONY OF DAVID A. HODGSON
ON BEHALF OF
INDIANA MICHIGAN POWER COMPANY

I. Introduction of Witness

Q1. Please state your name and business address.

My name is David A. Hodgson and my business address is American Electric Power, 1 Riverside Plaza, Columbus, OH 43215.

Q2. By whom are you employed and in what capacity?

I am employed by American Electric Power Service Corporation (AEPSC) as Director Tax Accounting & Regulatory.

Q3. What are your responsibilities as Director Tax Accounting & Regulatory?

As Director Tax Accounting & Regulatory, I am responsible for coordinating and developing state and federal tax data provided by the AEPSC Tax Department for use in regulatory proceedings.

Q4. Briefly describe your educational background and professional experience.

I graduated from The Ohio State University with a Bachelor of Science in Business Administration in Accounting. In 2000, I accepted a position with AEPSC as a Tax Analyst V. I was promoted from Tax Analyst IV to Tax Analyst I over the course of 2002–2009. In 2011, I was promoted to Sr. Tax Analyst, then to Tax Project Manager, and in 2013, to Tax Manager. I was promoted to Tax Accounting & Regulatory Support Manager in 2019, and in 2021, I was promoted to my current position. I have attended numerous tax, accounting, and regulatory seminars throughout my professional career.

Q5. Have you previously testified before any regulatory commissions?

Yes. I have filed testimony before the Oklahoma Corporation Commission on behalf of Public Service Company of Oklahoma and before the Public Utility Commission of Texas, the Louisiana Public Service Commission, and the Arkansas Public Service Commission on behalf of Southwestern Electric Power Company.

II. Purpose of Testimony

Q6. What is the purpose of your testimony?

The purpose of my testimony is to address the income tax implications of the Clean Energy Projects that Indiana Michigan Power Company (I&M or Company) is proposing to acquire through purchase and sale agreements (Clean Energy PSA Projects) that are the subject of this filing, including: (1) qualification for the federal Production Tax Credit (PTC); (2) accelerated tax depreciation; and (3) the Company's ability to utilize PTCs generated by the PSA Clean Energy Projects and the ability to transfer (or "monetize") those PTCs.

III. Federal Income Tax Credits

Q7. Do the Clean Energy PSA Projects meet the criteria to be qualifying facilities for the Investment Tax Credit and PTC?

Yes. The Clean Energy PSA Projects meet the criteria of being a qualifying facility that is eligible for either the Investment Tax Credit (ITC) or PTC. The Inflation Reduction Act of 2022 (IRA) provided the optionality for a qualifying facility to elect either the Investment Tax Credit (ITC) or PTC. It is expected that an election will be made for the Clean Energy PSA Projects to generate the PTC. The actual election of the PTC will occur with the filing of the federal income tax return for the tax year in which the Clean Energy PSA Projects are placed in service. The testimony of Company witness Williamson discusses the benefit to customers from this election.

Q8. Please provide a brief overview of the PTC.

The PTC is a general business credit under Internal Revenue Code (IRC) Section 38.[1] A taxpayer may claim a PTC for electricity produced by a qualifying facility as outlined under IRC Section 45. In the case of a facility using solar energy to produce electricity, a qualified facility is "any facility owned by the taxpayer which is originally placed in service after the date of the enactment of this paragraph and the construction of which begins before January 1, 2025."[2] The PTC is generally available for a 10-year period beginning on the date the qualifying facility is placed in service.

Q9. Can you please describe the differences between an ITC and a PTC?

Yes. Which both the ITC and PTC are credits intended to assist companies in developing renewable energy sources, there are three main distinct differences between the two credits. The first of these differences is the basis of each credit. The ITC is based on a percentage of the invested capital cost of a facility whereas the PTC is based on the production of electricity generated by a facility.

The second main difference between an ITC and a PTC is the number of years in which a credit is generated. An ITC is generated only one time and in the year the facility is placed in service. A PTC, on the other hand, is generated

[1]26 U.S.C. § 38(b)(8).

[2]26 U.S.C. § 45(d)(4).

each year for a 10-year period starting the year in which the facility is placed in service.

The last main difference between an ITC and a PTC are the restrictions imposed, or not imposed, by the IRC on passing the benefit of the credits to customers when the facility is public utility property. The IRC includes normalization rules that dictate how a utility may pass the benefit of an ITC to customers. Based on an irrevocable election made in the early 1970's, I&M may only provide the benefits of ITC on public utility property as a credit to the cost of service ratably over the regulatory depreciable life of the asset. The normalization rules however do not apply to PTC.

Q10. How is the amount of the PTC calculated?

As specified under IRC Section 45(a), the amount of the PTC for any taxable year is equal to a credit rate multiplied by the output of electricity produced by the taxpayer:

1. From qualified energy resources;
2. At a qualified facility during the 10-year period beginning on the date the facility was originally placed in service; and
3. Sold by the taxpayer to an unrelated person during the taxable year.

The credit rate used in the calculation is adjusted for inflation annually and as of the filing of this testimony is 2.75 cents per kilowatt hour (27.5 dollars per megawatt hour).[3]

Prior to passage of the IRA, Section 45 provided for a phase-out of the PTC based on the date on which construction of the facility began. The IRA, which was signed into law by President Biden on August 16, 2022, provides an

[3] United States, Internal Revenue Service. "Credit for Renewable Electricity Production and Publication of Inflation Adjustment Factors and Reference Prices for Calendar Year 2022; Correction. 87 Fed. Reg. 2704 (May 6, 2022). (https://www.federalregister.gov/documents/2022/05/06/2022-09695/credit-for-renewable-electricity-production-and-publication-of-inflation-adjustment-factor-and).

extension of the pre-IRA PTC framework as well as a transition to new technology-neutral Clean Electricity Production Credits and Clean Electricity Investment Credits.

The IRA modified the phase-out of the PTC that existed under prior law. The prior law phase-out of the PTC only applies to facilities that were placed in service before January 1, 2022. Subsequent to enactment of the IRA, a full (100%) PTC is available for qualifying facilities that are placed in service after December 31, 2021, if the facilities satisfy prevailing wage and apprenticeship requirements or are exempt from such requirements.[4] On November 30, 2022, the Internal Revenue Service (IRS) published Notice 2022-61 to provide initial guidance on the prevailing wage and apprenticeship requirements.[5] The IRA included a provision which states that projects that begin construction before the 60th day after the date the Secretary of Treasury issues the prevailing wage and apprenticeship regulations (60 Day Date) are exempt from meeting such requirements. Based on the date on which Notice 2022-61 was published, projects that began construction before January 29, 2023, are exempt from the prevailing wage and apprenticeship requirements if it meets the Continuous Efforts Requirement discussed later in my testimony. If a facility is not exempt from the prevailing wage and apprenticeship requirements and does not meet those requirements, a qualifying facility could only be eligible for a PTC at 20% of the full (100%) amount.

Q11. Please discuss the criteria for establishing the date on which construction of a facility begins for the PTC.

In Notice 2013-29, the IRS provided two methods that taxpayers may use to establish that construction of a qualified facility has begun (the "Begun

[4] 26 U.S.C. § 45(b)(6).

[5] Notice 2022-61 (https://www.federalregister.gov/documents/2022/11/30/2022-26108/prevailing-wage-and-apprenticeship-initial-guidance-under-section-45b6bii-and-other-substantially)

Construction Requirement"). A taxpayer only needs to satisfy one of the methods to establish that construction of a facility has begun in order to qualify for the credit. Under the first method, which is a facts and circumstances approach, a taxpayer may satisfy the Begun Construction Requirement by starting physical work of a significant nature ("Physical Work Test"). Under the second method, which is a safe harbor, the Begun Construction Requirement of a facility is satisfied upon the taxpayer paying or incurring five percent or more of the total cost of the facility (the "Five Percent Safe Harbor"). Both the Physical Work Test and the Five Percent Safe Harbor require that a taxpayer make continuous efforts to advance towards completion of the facility after it has begun construction (the "Continuous Efforts Requirement"). With the exception of land and property not integral to the facility, all costs properly included in the depreciable basis of the facility are considered in determining whether the Five Percent Safe Harbor has been met.

While the Continuous Efforts Requirement is a facts and circumstances test, the IRS has issued notices to provide a safe harbor for satisfying the requirement. Generally speaking, these notices provide that a facility will be considered to have satisfied the Continuous Efforts Requirement if the facility is placed in service in a calendar year that is a certain number of years after the calendar year during which construction of the facility began. Notice 2021-41[6] addressed those facilities that began construction during years 2016, 2017, 2018, or 2019, and provided that the Continuous Efforts Requirement will be satisfied if the facility is placed in service by the end of the year that is no more than six years after the year in which construction began, and those facilities that began construction during 2020, this six-year window is reduced to five years after the year in which construction began. For those facilities that began construction during 2021 and later, the window is further reduced to four years after the year

[6] Notice 2021-41 (https://www.irs.gov/pub/irs-drop/n-21-41.pdf).

in which construction began.[7] If a project began construction prior to the 60 Day Date but is not placed in service prior to the safe harbor deadline to meet the Continuous Efforts Requirement, it would have to satisfy the prevailing wage and apprenticeship requirements to be eligible for the full (100%) PTC unless the Continuous Efforts Requirement can be satisfied under the relevant facts and circumstances.

IRS Notices 2013-60[8] and 2014-46[9] also provide that if a facility consisting of more than tangible personal property is sold to an unrelated person after the Begun Construction Requirement is satisfied, the acquiring taxpayer may consider the work performed or amount paid by the unrelated transferor for purposes of satisfying the Physical Work Test or the Five Percent Safe Harbor. Thus, there is no requirement that a taxpayer own the facility at the time construction began in order to claim PTCs for the facility.

Q12. Do the Clean Energy PSA Projects qualify for the PTC and at what percent?

Yes. It is expected that the Clean Energy PSA Projects will be eligible for the PTC at a 100% level. The developers of the Clean Energy PSA Projects began construction prior to the 60 Day Date for purposes of the exemption from the prevailing wage and apprenticeship requirements. As a result, they would be eligible for the PTC at a 100% level by either meeting the prevailing wage and apprenticeship requirements or by being placed in service by December 31, 2025 to satisfy the Continuity Efforts Requirement to be exempt from the prevailing wage and apprenticeship requirements. Company witness Lozier discusses the construction timeline for the Clean Energy PSA Projects. Company witness Gaul discusses how the prevailing wage and apprenticeship

[7] Notice 2022-61 confirmed the four-year continuity safe harbor.

[8] IRS Notice 2013-60 (https://www.irs.gov/pub/irs-drop/n-13-60.pdf).

[9] IRS Notice 2014-46 (https://www.irs.gov/pub/irs-drop/n-14-46.pdf).

requirements are being addressed in the contracts to acquire the Clean Energy PSA Projects.

Q13. Does the potential exist for a renewable energy facility to qualify for more than the 100% PTC?

Yes. The IRA provides for "bonus" credits if a project meets certain criteria for either domestic content or for being located in an energy community. The bonus credit is 10% of the PTC that would otherwise be available without taking into account any other bonus credits. If a project satisfies either the domestic content or energy community requirements and would otherwise qualify for the PTC at 100%, it would therefore be eligible for the PTC at 110%. In addition, if a project satisfies both the domestic content and energy community requirements and would otherwise qualify for the PTC at 100%, it would be eligible for the PTC at 120%.

Q14. Will the Clean Energy PSA Projects qualify for bonus credits?

At this time, the Company is unable to determine with certainty whether the Clean Energy PSA Projects will qualify for bonus credits. The modeling of PTC from the Clean Energy PSA Projects and the associated revenue requirements do not include any assumption that the projects will be eligible for any bonus credits. The IRS has yet to issue necessary guidance to determine the criteria for qualifying for these bonus credits.

IV. Accelerated Tax Depreciation and Accumulated Deferred Federal Income Taxes

Q15. What is the tax recovery life for the assets comprising the Clean Energy PSA Projects?

The Modified Accelerated Cost-Recovery System (MACRS) is a tax depreciation system used to allow the capitalized cost of an asset to be recovered over a period via annual depreciation deductions. MACRS establishes the class lives over which property is depreciated under the IRC. The assets underlying the Clean Energy PSA Projects will primarily be comprised of property that is classified as five-year property under MACRS because it is equipment that uses solar energy to generate electricity.[10]

Q16. How does the five-year tax recovery life impact future accounting and ratemaking?

Because the Clean Energy PSA Projects will primarily be comprised of property that is classified as five-year property under MACRS, the assets will be depreciated more rapidly for tax purposes than for book purposes. For book purposes, the assets will be depreciated ratably over their 35-year book depreciable life. This difference in the timing of book and tax depreciation creates differences in the book and tax basis of the assets. This difference in basis makes it necessary to record deferred taxes for the future income tax liability that will be recognized as the timing difference between book and tax depreciation reverses. The accumulated deferred federal income taxes (ADFIT) generated by the Clean Energy PSA Projects will be included in the Company's weighted average cost of capital in future base cases, as cost-free capital.

---

[10] 26 U.S.C. § 168(e)(3)(B)(vi) with reference to §48(a)(3)(A).

V. Credit Limitations and Deferral of Cash Tax Benefits

Q17. Are there limitations on a taxpayer's ability to use PTCs to offset its annual income tax liability?

Yes. IRC Section 38(c) generally limits a taxpayer's use of General Business Credits (of which PTCs are a component) to 75% of the taxpayer's regular tax liability before applying any credits. Any General Business Credits unable to be utilized in offsetting regular tax in a given year may be carried forward and used to reduce regular tax liabilities in the succeeding 20 years or carried back to reduce regular tax liabilities in the preceding year.

Q18. How are tax credit carry forwards accounted for and what are the implications of the associated tax deferral?

As previously noted, General Business Credits that cannot be utilized in a given tax year due to Section 38(c) limitations may be carried forward and used, subject to limitation, to offset regular tax liability in the succeeding 20 years or carried back to reduce regular tax liabilities in the preceding year. Any credits not utilized after the 20-year carry forward period expire.

General Business Credits that are carried forward to be used to offset the tax liability in a future tax year are recognized as a deferred tax asset (DTA) on the balance sheet to the extent the taxpayer anticipates the ability to utilize the credits prior to their expiration. A DTA is part of the overall ADFIT generated by the Clean Energy PSA Projects and would be included in I&M's weighted average cost of capital as described earlier in my testimony.

Q19. Does I&M file a federal income tax return as part of a consolidated group?

Yes. I&M is included in the consolidated income tax return of American Electric Power and its subsidiaries (Consolidated Return Group).

Q20. Does AEP have the ability to sell the PTC generated by the Clean Energy PSA Projects rather than carry them forward or back?

Yes. The IRA enacted IRC §6418 to provide that a taxpayer may transfer certain income tax credits to an unrelated taxpayer. This provision applies to tax years beginning after December 31, 2022. The PTC is among the list of tax credits enumerated in the IRC as being eligible for transfer.[11] The legislation specifies that any amount paid by a taxpayer as consideration for a credit:

- Shall be required to be paid in cash;
- Shall not be includible in gross income of the transferring taxpayer; and
- Shall not be deductible by the transferee taxpayer.[12]

Q21. What impact would the transfer of tax credits have on the tax credit carryforward DTA?

To the extent that a tax credit is transferred to a third party, as provided for under §6418, it would no longer be available to carry forward to offset a future tax liability. Therefore, a tax credit carryforward DTA would not be established for the transferred credit.

Q22. Can you describe the process by which PTCs will be utilized?

Yes. The utilization of the PTCs generated by the Clean Energy PSA Projects will occur in three steps. In Step 1, the PTCs will be utilized to offset I&M's tax liability. This reduces the necessary cash payment up to its parent company for the liability. While it is anticipated to be an uncommon scenario, the utilization of credits in Step 1 could be limited in a scenario in which the credit utilization limitations under Section 38(c) for the Consolidated Return Group is less than the sum of the Step 1 utilization of credits for all companies within the group.

---

[11] 26 U.S.C. § 6418(f)(1)(A).

[12] 26 U.S.C. § 6418(b).

In Step 2, the PTCs would be used to offset the tax liability of the Consolidated Return Group. The ratio of the remaining PTCs after Step 1 to the total tax credits available for the Consolidated Return Group would be used to determine the extent of the PTCs generated by the Clean Energy PSA Projects would be used to offset the tax liability in this step. For example, if after Step 1 I&M had $10 of PTCs available to offset the Consolidated Return Group's tax liability and the other companies in the Consolidated Return Group had $90 of PTCs available, 10% of the credits used to offset the tax liability of the Consolidated Return Group would be from the Clean Energy PSA Projects ($10 I&M PTC divided by $100 total tax credit = 10%). To the extent that I&M's credits are used to offset the tax liability of the Consolidated Return Group, I&M would receive the full cash value of the PTC.

In Step 3, a determination would need to be made whether any remaining PTCs should be carried forward to offset a future tax liability or transferred to a third party.

Q23. Do you expect that PTCs generated by the Clean Energy PSA Projects will be transferred?

PTCs will be transferred to a third-party if it is appropriate to do so based on the facts and circumstances at the time. Based on the expected length of time between when PTCs are generated and the ability to utilize the PTCs to offset an income tax liability, it is anticipated that it may be beneficial to transfer all, or a portion, of the credits generated by the Clean Energy PSA Projects.

Q24. What facts and circumstances will weigh in any decision to transfer a tax credit or use it to offset a tax liability?

There are a couple factors that will weigh into any decision as to whether it is prudent and appropriate to transfer a PTC. The first factor is the ability to utilize the PTC to offset an income tax liability. If the tax credit can be used to offset an income tax liability, it would be prudent to retain the credit and receive a dollar-for-dollar benefit of the credit generated.

The second factor that will weigh into any decision to transfer a PTC is the net proceeds that could be obtained from a transfer of the tax credit. If the PTC is not able to be utilized in the same period that it is generated, the net proceeds from a transfer of the PTC would need to be greater than the present value of the future cash tax benefit from the PTC if it were not transferred.

Q25. What impact would a transfer of PTCs have on customers?

The impact of a transfer of the PTCs generated by the Clean Energy PSA Projects would be twofold. First, as I stated earlier in my testimony, a transfer of PTCs would mean that the PTC would no longer be available to offset a future income tax liability and therefore a tax credit carryforward DTA would not be established for the transferred credit. This would serve to decrease the revenue requirement, as a tax credit carryforward DTA would increase rate base and consequently increase the return on rate base.

The second impact to customers would be the discount associated with the transfer of the PTC. The discount is the difference between the value of the PTC and the net proceeds received from the transfer of the PTC. While it is not known at this time what the market price for the PTC will be or the costs to engage in such a transaction, it is certain that the net proceeds obtained from a transfer will be less than the full value of the PTC itself. To the extent that the PTCs generated by the Clean Energy PSA Projects are transferred, the net benefit received as a result of that transfer will be included as a reduction to tax expense in the cost of service as discussed by Company witness Williamson.

VI. Summary and Conclusions

Q26. Please summarize your testimony and provide any conclusions.

A PTC is a tax credit based on the output of electricity produced at a qualified facility. The PTC is generally available for a 10-year period beginning on the date the qualifying facility is placed in service. It is expected that the Clean Energy PSA Projects will be eligible for the PTC at a 100% level. The Clean Energy PSA Projects will primarily be comprised of property that is classified as five-year property under MACRS. The ADFIT generated by the Clean Energy PSA Projects will be included in the Company's weighted average cost of capital in future base cases, as cost-free capital. To the extent that the Consolidated Return Group is unable to utilize the PTC generated by the Clean Energy PSA Projects in the year they are generated, the facts and circumstances at the time will be taken into account to determine the most prudent use of those credits to determine whether they should be held to offset a future tax liability or should be sold to a third party.

Q27. Does this conclude your testimony?

Yes, it does.

VERIFICATION

I, David A. Hodgson, Director – Director Tax Accounting & Regulatory at American Electric Power Service Corporation, affirm under penalties of perjury that the foregoing representations are true and correct to the best of my knowledge, information, and belief.

Date: 03/23/2023

David A Hodgson

David A. Hodgson