

DIRECT TESTIMONY OF
JEFFREY B. BARTSCH
ON BEHALF OF
INDIANA MICHIGAN POWER COMPANY
IN MPSC CASE NO. U-12652

1 Q. Please state your name and business address.

2 A. My name is Jeffrey B. Bartsch. My business address is 1 Riverside Plaza,
3 Columbus, Ohio 43215.

4 Q. Please indicate by whom you are employed and in what capacity.

5 A. I am the Director of Tax Accounting for American Electric Power Service
6 Corporation (AEPSC), a wholly owned subsidiary of American Electric Power
7 Company, Inc. (AEP) the parent of Indiana Michigan Power Company (I&M). In
8 my present position, I report to the Vice-President – Tax of AEPSC.

9 Q. Please briefly describe your educational background and business experience.

10 A. I earned a Bachelor of Business Administration Degree in Accounting from Ohio
11 University in 1979. I am a Certified Public Accountant licensed in Ohio since
12 1981. I am also a member of the American Institute of Certified Public
13 Accountants. I was first employed by Arthur Andersen & Co. in 1979 in the
14 Audit section where I was assigned to various clients including those in the
15 electric utility industry. In 1985, I accepted a position with the Tax Department at
16 AEPSC. Since that time I have held various positions until 2000 when I was
17 promoted to my current position. As Director of Tax Accounting, my
18 responsibilities include oversight of the recordation of the tax accounting entries
19 and records of AEP and its subsidiaries, including I&M. I am also responsible for
20 coordinating the development of Federal tax data to be provided by the AEPSC

1 Tax Department in regulatory proceedings. Included in my responsibilities are
2 the recordation of all accounting entries and records related to Statement of
3 Financial Accounting Standards No. 109 (SFAS 109), "Accounting for Income
4 Taxes" and the associated regulatory assets and liabilities.

5 Q. Have you previously testified in any regulatory proceedings?

6 A. Yes. I have submitted testimony on various tax accounting and SFAS 109 Tax
7 Regulatory Asset issues in proceedings before both the Public Utilities
8 Commission of Ohio and the Public Utility Commission of Texas.

9 Q. What is the purpose of your testimony in this proceeding?

10 A. The purpose of my testimony is to support the projected costs relative to the
11 Industry Restructuring as specifically presented in Section J(5)(a) of AEP's
12 Restructuring Implementation Plan filed with the MPSC on October 2, 2000 with
13 regards to SFAS 109 Regulatory Assets.

14 Q. Are there any updates or modifications to sections of the October 2, 2000
15 Restructuring Implementation Plan that you are sponsoring?

16 A. Yes, the amounts have been updated using December 31, 2000 financial
17 information and are detailed on Exhibit A-___ (JBB-1), and Exhibit A-___ (JBB-
18 2)

19 Q. Were these exhibits prepared by you or under your supervision?

20 A. Yes.

1 Q. What was the source of data used in the preparation of the exhibits that you are
2 sponsoring?

3 A. Company Financial Statements, FERC Form No.1 Reports, and tax accounting
4 and depreciation system printouts as of December 31, 2000 and functional
5 generation and Michigan retail jurisdictional factors as provided by the
6 Regulatory Services Department were the sources of my data.

7 Q. Could you briefly describe SFAS 109 Regulatory Assets .

8 A. Regulatory assets exist as a result of past regulatory practices and would not exist
9 in the absence of regulation and their probable recovery through rates in the
10 future.

11 SFAS 109 Regulatory Assets are regulatory assets related to deferred income
12 taxes that were not recorded in the past due to regulatory practices in which the
13 current tax benefits of temporary book/tax differences were immediately passed-
14 through to rate payers This type of “flow-through” accounting was permitted
15 under Statement of Financial Accounting Standards No. 71, Accounting for the
16 Effects of Certain Types of Regulation (SFAS 71). SFAS 71 did not require the
17 recordation of deferred income tax liabilities, unless required under the Internal
18 Revenue Code, as long as recovery of these flowed-through current income tax
19 benefits was probable through the ratemaking process in a future period when the
20 temporary differences reverse causing an increase in the then current tax expense.
21 SFAS 109 required, starting in 1993, that “an enterprise shall recognize a deferred
22 tax liability or asset for all temporary differences” and that “regulated enterprises
23 that meet the criteria for application of FASB Statement No. 71, Accounting for

1 the Effects of Certain Types of Regulation, are not exempt from the requirements
2 of this statement. Specifically, this statement . . . requires recognition of a deferred
3 tax liability for tax benefits that are flowed through to customers when temporary
4 differences originate. . .” and “If, as a result of an action by a regulator, it is
5 probable that the future increase or decrease in taxes payable for ‘Deferred Tax
6 Liabilities’ will be recovered from or returned to customers through future rates, an
7 asset or liability is recognized for that probable future revenue or reduction in
8 future revenue pursuant to paragraphs 9-11 of Statement 71. That asset or liability
9 is a temporary difference for which a deferred tax liability or asset shall be
10 recognized.”

11 In this instance, the ratepayers’ obligation to repay the utility (and thus the
12 regulatory asset) existed prior to the issuance of SFAS 109, but SFAS 71
13 effectively allowed it to be netted against the deferred income tax liability. The
14 issuance of SFAS 109 had no impact on the ratepayers’ obligation to pay utilities
15 such amounts in the future, nor on the utilities’ obligations to pay the deferred
16 income tax liabilities to the government in the future. The issuance of SFAS 109
17 merely required that the existing regulatory asset that resulted from flow-through
18 rate treatment and the existing deferred income tax liability be separately
19 recognized in the financial statements.

20 Q. Has the Michigan Public Service Commission (MPSC) historically allowed the
21 recovery of SFAS 109 Regulatory Assets in setting rates?

22 A. Yes. Even before the issuance of SFAS 109, the MPSC allowed the reversal of
23 previously flowed-through tax benefits to be reflected in utility revenue

1 requirements in setting utility rates as the related tax benefit reversed and the
2 deferred income tax liability was repaid to the IRS. This regulatory treatment has
3 continued, and SFAS 109 has had no impact on the regulatory treatment of income
4 taxes. Based on this rate treatment, which provides for recovery of flowed-through
5 tax benefits when the temporary differences reverse, recovery of these amounts is
6 probable and the amounts qualify for recordation as regulatory assets.

7 Q. Briefly explain how the SFAS 109 Regulatory Assets as of December 31, 2000,
8 were determined.

9 A. The individual SFAS 109 Regulatory Assets for I&M are maintained in a detailed
10 tax accounting system, which was developed as a result of SFAS 109 being
11 implemented. At the inception of SFAS 109, a regulatory asset was established
12 on the balance sheet for all book/tax temporary differences that existed, but for
13 which no deferred income taxes were recorded on the books as a result of past
14 Commission orders and accounting practices. These balances have been updated
15 monthly since that initial date based on Schedule M and rate-based deferred tax
16 activity.

17 Q. Are these balances maintained on a functional and a jurisdictional basis?

18 A. No.

19 Q. How were the individual SFAS 109 Regulatory Asset items as of December 31,
20 2000, functionalized and jurisdictionalized to determine the Michigan retail
21 generation portion?

22 A. As shown on Exhibit A-____ (JBB-1), for non-property related items, the
23 Michigan retail generation portion of the regulatory assets was determined by

1 multiplying the total Company regulatory asset item, from the tax accounting
2 system as of December 31, 2000, by the appropriate generation and jurisdictional
3 allocation factors.

4 Q. How was the property related SFAS 109 Regulatory Asset for generation plant
5 allocated on a jurisdictional generation related basis?

6 A. Due to the complexity of the property accounts and the various temporary
7 differences and deferred taxes involved, the property related SFAS 109
8 Regulatory Asset for generation plant was allocated on a more detailed level.
9 This computation was performed by utilizing the principles contained in SFAS
10 109, in which the net book basis of generation plant (obtained from the Company
11 financial statements and FERC Form 1 Reports) is compared to the net tax basis
12 of generation plant (obtained from the Company tax depreciation system). The
13 difference between the book and tax basis represents the taxable temporary
14 difference, which will reverse in future years. This temporary difference was
15 multiplied by the current income tax rates to determine the amount of deferred
16 Federal income taxes (DFIT) required under SFAS 109. The difference between
17 the deferred income taxes required and the appropriate deferred income taxes
18 recorded on the books for ratemaking purposes represents the amount of
19 additional deferred income taxes that will be owed to the taxing authorities in the
20 future and must be collected through rates. This amount is then grossed-up, since
21 any amounts collected in rates will result in a future taxable event. The grossed-
22 up amount represents the SFAS 109 Regulatory Asset recorded on the books for
23 generation plant.

1 Q. How were deferred Federal income taxes for generation plant allocated to the
2 Michigan retail jurisdiction?

3 A. The deferred Federal income taxes for generation plant allocated to the Michigan
4 Retail Jurisdiction were derived from the Company tax accounting systems. For
5 items for which jurisdictional information exists, the historic per books Michigan
6 deferred income tax amounts were used. For items for which full-deferred tax
7 normalization exists in all jurisdictions, a jurisdictional allocation was made based
8 on factors provided by the Regulatory Services Department. For non-
9 depreciation, plant book/tax basis differences, the deferred income taxes were
10 then further allocated based on production plant ratios since these balances are not
11 maintained on a functional plant basis.

12 Q. How was the SFAS 109 Regulatory Asset related to state income taxes
13 calculated?

14 A. The calculation of the SFAS 109 State Income Tax Regulatory Asset was
15 performed essentially the same as explained above for Federal Income Taxes.
16 The total temporary book/tax difference was multiplied by the effective state
17 income tax rate for I&M as determined from the state income tax returns filed in
18 Indiana, West Virginia, Kentucky and Illinois. An allocation was then made to
19 the Michigan Retail Jurisdiction.

20 Q. What was the total SFAS 109 Regulatory Asset for Federal and State Income
21 Taxes estimated to be at December 31, 2000?

22 A. The Michigan Retail Generation amount is estimated to be \$34,384,000 as of
23 December 31, 2000 as shown on Exhibit A-____(JBB-1).

1 Q. Briefly describe how the projected SFAS 109 Regulatory Asset balances as
2 of December 31, 2001 were determined.

3 A. Balances at December 31, 2001 were determined in two separate ways. The
4 SFAS 109 Regulatory Asset balances as of December 31, 2000, were rolled
5 forward based on information available for actual account activity recorded
6 through February 28, 2001 in the tax accounting system. This activity level was
7 then extrapolated to estimate what the balances would be as of December 31,
8 2001 for items expected to trend on the recent activity. For items that are very
9 difficult to forecast and for which trending information is not available, the SFAS
10 109 Regulatory Asset balances as of February 28, 2001 were used as proxies for
11 projected December 31, 2001 balances. These projected balances are shown on
12 Exhibit A-___ (JBB-2).

13 Q. What was the total SFAS 109 Regulatory Asset for Federal and State Income
14 Taxes estimated to be at December 31, 2001?

15 A. The Michigan Retail Generation SFAS 109 Regulatory Asset amount is estimated
16 to be \$31,002,000 as of December 31, 2001, consisting of \$27,074,000 of Federal
17 Income Taxes and \$3,928,000 of State Income Taxes.

18 Q. How do you propose that these Regulatory Assets be recovered under AEP's
19 Restructuring Implementation Plan?

20 A. Recovery of these SFAS 109 Regulatory Assets will be addressed by Company
21 Witnesses DeLizio and Curry who sponsor the calculation of the surcharge
22 recovery factor and Section K.1.b. of the October 2, 2000 Restructuring
23 Implementation Plan, respectively.

- 1 Q. Does this conclude your direct testimony?
- 2 A. Yes.