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October 14, 2016

VIA eFILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265

Re: Pennsylvania Public Utility Commission

v.

**Metropolitan Edison Company
Pennsylvania Electric Company
Pennsylvania Power Company
West Penn Power Company
Docket Nos. R-2016-2537349, et al.**

Dear Secretary Chiavetta:

Enclosed for filing in the above-captioned consolidated proceedings is the **Reply Brief on behalf of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company (the "Companies")**.

As indicated on the attached Certificate of Service, copies of the Reply Brief will be served on Administrative Law Judge Mary D. Long and all parties.

Very truly yours,



Anthony C. DeCusatis

Enclosures

c: Per Certificate of Service (w/encls.)

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION :
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: :
v. : **Docket Nos. R-2016-2537349, et al.**
: :
METROPOLITAN EDISON COMPANY :
PENNSYLVANIA ELECTRIC COMPANY :
PENNSYLVANIA POWER COMPANY
WEST PENN POWER COMPANY

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served copies of the **Reply Brief on behalf of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company** on the following persons, in the manner specified below, in accordance with the requirements of 52 Pa. Code § 1.54.

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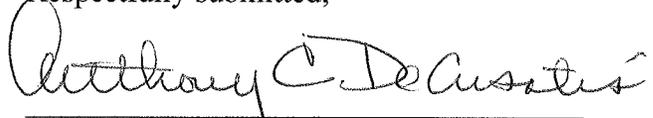
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Dated: October 14, 2016

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**METROPOLITAN EDISON COMPANY,
PENNSYLVANIA ELECTRIC COMPANY,
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Docket Nos. R-2016-2537349, et al.

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I. INTRODUCTION

Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company (“Penelec”), Pennsylvania Power Company (“Penn Power”) and West Penn Power Company (“West Penn”) (individually, a “Company” and, collectively, the “Companies”) submit this Reply Brief in response to the Office of Consumer Advocate’s (“OCA”) Main Brief on the issue reserved for decision in the settlements of the Companies’ base rate proceedings (“Settlements”). As more fully explained in the Companies’ Initial Brief filed on September 30, 2016 (“Initial Brief”) (pp. 4-5), the reserved issue pertains to the OCA’s proposal to amend the formula for calculating quarterly charges under the Distribution System Improvement Charge (“DSIC”) to deduct accumulated deferred income taxes (“ADIT”) from the original cost of “eligible property.”¹ The OCA contends its proposed revision is required by Section 1301.1(a),² which was added to the Public Utility Code by Act 40 of 2016 (“Act 40”)³ to eliminate the use of so-called consolidated tax adjustments (“CTA”) in calculating utility base rates.”⁴

Each of the Companies has established a DSIC that is set forth in virtually identical riders to their respective tariffs (“DSIC Rider”). The Pennsylvania Public Utility Commission (“PUC” or the “Commission”) approved the DSIC Rider by Orders entered on June 9, 2016,⁵ in which it

¹ “Eligible property” is defined in 66 Pa.C.S. § 1351.

² Hereafter, “Section” will refer to a section of the Pennsylvania Public Utility Code, unless otherwise stated or the context clearly indicates another reference is intended.

³ Act 40 was enacted on June 12, 2016 to become effective in sixty days (i.e., by August 11, 2016) for “all cases where the final order is entered after the effective date of this section.”

⁴ See Initial Brief, pp. 7-8 and n.21.

⁵ *Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge*, Docket No. P-2015-2508942 (June 9, 2016) (“Met-Ed DSIC Order”); *Petition of Pennsylvania Electric Company for Approval of a Distribution System Improvement Charge*, Docket No. P-2015-2508936 (June 9, 2016) (“Penelec DSIC Order”); *Petition of Pennsylvania Power Company for Approval of a Distribution System Improvement Charge*, Docket No. P-2015-2508931 (June 9, 2016) (“Penn Power DSIC Order”); *Petition of West Penn Power Company for Approval of a Distribution System Improvement Charge*, Docket No. P-2015-2508948 (June 9, 2016) (“West Penn DSIC Order”) (collectively, “Companies’ DSIC Orders”).

found and determined that the DSIC Rider fully conforms to the Model Tariff adopted in the Final Implementation Order for Act 11 of 2012,⁶ pursuant to Section 1353(b). As explained in the Companies' Initial Brief (pp. 4-5), Section 1353(b) requires every utility petitioning to establish a DSIC to file "an initial tariff that conforms with a model tariff adopted by the commission."⁷ Thus, while the object of the OCA's proposed revision in this case is the DSIC Rider, the OCA is, in fact, contesting the terms of the Model Tariff adopted by the Final Implementation Order.⁸ For this reason, among, others, the reserved issue is not properly within the scope of this consolidated base rate proceeding.⁹

The OCA is the only party contesting the DSIC Rider in this case, and the arguments set forth in the OCA's Main Brief largely track those presented in the testimony of its witness, Ralph C. Smith,¹⁰ to which the Companies responded in the rebuttal testimony of their witness, Richard A. D'Angelo.¹¹ To a very large extent, the arguments advanced by the OCA were fully addressed in the Companies' Initial Brief, and an extensive reanalysis is, therefore, not necessary. Consequently, this Reply Brief will address the principal errors and omissions in the OCA's Main Brief with references to the expanded discussion in the appropriate portions of the Companies' Initial Brief.

⁶ *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611 (Aug. 2, 2012) ("Final Implementation Order"), pp. 30-31 and Appendix A.

⁷ As a consequence, in every case where a utility has petitioned to establish a DSIC, the Commission has held that it is required to find, as a condition precedent to approving a DSIC, that the utility's initial tariff complies with its Model Tariff. *See* Initial Brief, pp. 17-18.

⁸ *Id.* at 27-32.

⁹ *Id.* at 10-11.

¹⁰ *See* OCA Statement No. 1, pp. 108-110.

¹¹ Companies' Statement No. 2-R, pp. 40-43.

II. SUMMARY OF ARGUMENT

For all the reasons set forth in the Companies' Initial Brief (pp. 10-11), the reserved issue is not within the scope of this base rate proceeding. Although the OCA contends that the DSIC Rider constitutes an existing rate and, as such, could conceivably be covered by the OCA's Complaints in this case,¹² the OCA has not provided any valid reason why the terms of the DSIC Rider – and more broadly, the terms of the Model Tariff, which is the real target of the OCA's arguments – should be considered here.

Given the procedural posture of this case, the Companies also addressed the substance of the OCA's arguments. As the Companies explained in their Initial Brief, Section 1301.1(a) does not apply to the DSIC for three principal reasons: (1) Act 40 was expressly designed solely to eliminate the use of CTAs and does not alter the elements of the DSIC formula prescribed in Section 1357 and applied in the Final Implementation Order;¹³ (2) Section 1301.1(a) applies only to base rates and not to adjustment clauses like the DSIC;¹⁴ and (3) even if Section 1301.1 were deemed to apply to more than just "base rates, the "final order" approving the DSIC was entered before the effective date of Act 40 and, pursuant to Section 1301.1(c)(2), the DSIC is excluded from the coverage of Section 1301.1(a).¹⁵ Finally, even if the DSIC were within the scope of Section 1301.1(a), nothing in Act 40 retroactively eliminated or diminished the Commission's discretion to determine *how* ADIT should be reflected in the DSIC. Consequently, Act 40 did not legislatively overrule *McCloskey v. Pa. P.U.C.*,¹⁶ which held that cumulative ADIT is

¹² OCA Main Brief, p. 7.

¹³ Initial Brief, pp. 20-22.

¹⁴ *Id.* at 22-27.

¹⁵ *Id.* 27-31.

¹⁶ 127 A.3d 860 (Pa. Cmwlth. 2015) ("*McCloskey*"). This case was an appeal from a Commission Order approving a DSIC for Columbia Gas of Pennsylvania, Inc. ("*Columbia*"). Similar issues were also decided against the OCA in

properly recognized in the DSIC through the earnings cap provision of the Model Tariff and, therefore, the Commission did not abuse its discretion to set just and reasonable rates when it determined that incremental ADIT associated with quarterly additions of “eligible property” need not be included in the calculation of quarterly charges under the DSIC.¹⁷

The OCA does not dispute that the legislative history of Act 40 clearly indicates it was intended to apply only to base rates. Instead, the OCA asserts the language of Act 40 is “clear and unambiguous” that ADIT must be reflected in calculating charges under adjustment clauses like the DSIC¹⁸ and, therefore, there is no need to consider rules of statutory interpretation set forth in Section 1921(c) of Pennsylvania’s statutory construction act.¹⁹

The OCA’s argument is based on a misreading of Section 1301.1. In particular, the OCA ignores the sentence that mentions “deferred taxes” in the context of “rate base.” The reference to “rate base” is a clear indication that Section 1301.1(a) applies only to base rates, for the reasons explained in detail in the Companies’ Initial Brief.²⁰ Additionally, the OCA did not even consider the term “final order” in Section 1301.1(c)(2), which is a formulation that is relevant only in the context of a base rate proceeding, as also explained in the Companies’ Initial Brief.²¹ Both of those textual references provide strong evidence *from within the four corners of Act 40* that it is intended, and designed, to apply *only* to base rates. In any event, those statutory terms, at a minimum, negate the OCA’s claim that Section 1301.1 is “clear and unambiguous” in its application to the DSIC and, therefore, the factors enumerated in Section 1921(c) of the statutory

an unreported opinion issued the same day in the OCA’s appeal from a Commission Order approving a DSIC for Little Washington Wastewater Company. *McCloskey v. Pa. P.U.C.*, No. 1358 C.D. 2014 (Nov. 3, 2015).

¹⁷ 127 A.3d at 870-871.

¹⁸ OCA Main Brief, p. 14.

¹⁹ 1 Pa.C.S. § 1921(c).

²⁰ Initial Brief, pp. 22-27.

²¹ *Id.* at 27-28.

construction law for ascertaining legislative intent need not be consulted. In short, because the OCA has no argument to counter the clear legislative history demonstrating that Act 40 applies only to the calculation of base rates, the OCA's only recourse is to ask the Administrative Law Judge and the Commission to simply ignore that vital piece of evidence in discerning legislative intent. There is no basis for the OCA's argument, which should be rejected.

The OCA's Main Brief does not address the Companies' argument that the "final order" approving the DSIC – i.e., the Final Implementation Order that adopted the Model Tariff – was entered before the effective date of Act 40. Indeed, even the Companies' DSIC Orders were entered before Act 40's effective date.²² While the OCA did not address this additional reason why Act 40 is not applicable to the DSIC, the OCA agrees with the Companies that the DSIC Rider itself is a "rate."²³ Given that acknowledgment and concession, the OCA has no grounds for disputing that the applicable "rate" – i.e., the DSIC mechanism that the Companies incorporated in the DSIC Rider – was established when the Commission adopted the Model Tariff. Consequently, Section 1301.1(c)(2) precludes the application of Act 40 to the DSIC even if Act 40 were deemed to apply to more than just base rates.

Finally, the OCA simply reiterates a position that was rejected previously by the Commission and by the Commonwealth Court in *McCloskey* by asserting that the Companies "do not account for ADIT in the Companies' DSIC calculations."²⁴ As the Commission found in its Order in the Columbia case²⁵ and the Commonwealth Court affirmed in *McCloskey*,²⁶ the

²² See Initial Brief, p. 31.

²³ See OCA Main Brief, pp. 9 and 14.

²⁴ OCA Main Brief, p. 10.

²⁵ *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge*, Docket No. P-2012-2338282 (Final Order entered May 22, 2014), pp. 22-23. See Initial Brief, pp. 33-38.

²⁶ 127 A.3d at 869-871.

entire DSIC mechanism constitutes the applicable “rate,” and that rate clearly *does* account for cumulative ADIT through the earnings cap provision of the DSIC. Nothing in Act 40 suggests that it stripped the Commission of the discretion it is granted under the Public Utility Code and the Commonwealth Court’s prior decisions to determine *how* a particular element of revenue requirement may be recognized in ascertaining if a “rate” is just and reasonable.²⁷

III. THE RESERVED ISSUE PERTAINS TO THE TERMS OF AN ADJUSTMENT CLAUSE AND IS NOT PROPERLY WITHIN THE SCOPE OF THIS BASE RATE PROCEEDING

As previously explained, the DSIC in its current form was embodied in the Model Tariff that was approved in the Final Implementation Order, pursuant to the authority conferred by Section 1357(c). Section 1357(c), like Section 1307, authorizes an automatic adjustment clause, which is a rate mechanism that is legally separate from, and operates differently from, base rates.²⁸ Moreover, adjustment clauses, by their nature employ a process for establishing the charges billed to customers that differs markedly from the process used to establish base rates that is governed by Section 1308.²⁹ The OCA does not dispute either of these important points.

Furthermore, the OCA’s Main Brief is silent on the equally significant fact that the Commission’s decisions implementing the DSIC, adopting the Model Tariff, approving DSIC tariff provisions for individual utilities, and considering revisions to the DSIC³⁰ all occurred outside of base rate proceedings. In short, the OCA has not made any *affirmative* argument for considering its proposed revision to the DSIC Rider (which necessarily would entail revisions to the Model Tariff) *in this case*. Instead, the OCA erroneously points to the Companies as the

²⁷ See Initial Brief, pp. 32-38.

²⁸ *Id.* at 22-27.

²⁹ *Id.*

³⁰ See Supplemental Implementation Order, *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611 (Sept. 21, 2016).

alleged reason for insisting the reserved issue should be decided here. In an argument relegated to a footnote,³¹ the OCA claims that unless the reserved issue is considered now, the Companies will rely on the legislative history of Act 40 “to support an argument that this issue should have been determined in this base rate proceeding.”

The OCA has seriously misstated the Companies’ position. The Companies explained that Act 40 was designed and intended to apply *only* to the calculation of base rates, as both Chairman Godshall – the lead sponsor of the bill that became Act 40 – and the Commission’s Chairman both affirmed.³² The Companies did *not* offer the legislative history of Act 40 to try to identify the forum in which *DSIC*-related issues should be considered. Rather, as Mr. D’Angelo’s rebuttal testimony³³ and the Companies’ Initial Brief³⁴ make clear, both the legislative history and the text of Act 40 itself provide irrefutable evidence that Section 1301.1(a) applies only to base rates and does not apply at all to adjustment clauses like the *DSIC*. It is simply wrong for the OCA to assert that the Companies’ position that Act 40 applies *only* to base rates somehow means that the OCA’s proposed revisions to the *DSIC* must be decided in this base rate proceeding.

IV. THE OCA IGNORED TEXTUAL EVIDENCE WITHIN THE FOUR CORNERS OF ACT 40 THAT: (1) EXPRESSES THE LEGISLATIVE INTENT THAT SECTION 1301.1 APPLIES ONLY TO BASE RATES; AND (2) NEGATES THE OCA’S CONTENTION THAT ACT 40 IS SO “CLEAR AND UNAMBIGUOUS” THAT ITS STATED PURPOSE AND LEGISLATIVE HISTORY MAY BE DISREGARDED

In their Initial Brief,³⁵ the Companies explained that Section 1301.1 applies only to base rates and, therefore, the OCA’s attempt to rely on that section to force the Commission to revise

³¹ OCA Main Brief, p. 7 n.2.

³² Initial Brief, pp. 25-26.

³³ Companies’ Statement No. 2-R, pp. 40-43.

³⁴ Initial Brief, pp. 22-27.

the Model Tariff's formula for calculating the quarterly charges under the DSIC should be rejected. In so doing, the Companies provided strong evidence of legislative intent garnered from two sources – the *text* of Act 40 *and* its legislative history.

The OCA contends that no weight should be given to the legislative history of Act 40 – or to any other indices of legislative intent identified in Section 1921(c) of Pennsylvania's statutory construction law – because the terms of Section 1301.1 are allegedly “clear and unambiguous.”³⁶ However, the language that the OCA points to as allegedly “clear and unambiguous” is not relevant to the reserved issue. And, the portion of Section 1301.1 that actually mentions “deferred taxes” in relation to “rate base,” the OCA has chosen to ignore.

The OCA has constructed its entire argument on the following sentence in Section 1301.1(a)³⁷:

If an expense or investment is allowed to be included in a public utility's rates for ratemaking purposes, the related income tax deductions and credits shall also be included in the computation of current or deferred *income tax expense* to reduce rates. (Emphasis added.)

As the quoted language makes clear, it pertains to the calculation of “income tax *expense*” (emphasis added) and not to the use of ADIT as an offset to the original cost of utility plant. The Companies, consistent with the DSIC Model Tariff, their DISC Rider and the “normalization” requirements of the Internal Revenue Code³⁸ have employed “statutory” tax rates and have properly included both “current” and “deferred” taxes in the “income tax expense” reflected in

³⁵ *Id.*

³⁶ In support of its argument, the OCA points to the language of Section 1921(c) stating that the factors enumerated in Section 1921(c)(1)-(8) may be used to ascertain legislative intent “when the words of the statute are not explicit.” As explained above and in the Companies' Initial Brief (pp. 22-28), that condition exists with respect to the language of Act 40.

³⁷ See OCA Main Brief, p. 11.

³⁸ See IRC § 168(f)(2).

the “pretax return”³⁹ they used to calculate quarterly charges under the DSIC. There is no evidence in the record that the Companies’ DSIC calculations do not comply with the sentence from Act 40 quoted above – even if Section 1301.1 were deemed to apply to the DSIC.

Notably, the sentence in Section 1301.1(a) that actually mentions “deferred taxes” in relation to the determination of “rate base,” the OCA does not cite or discuss. That sentence states as follows:

The deferred income taxes used to determine the *rate base* of a public utility for ratemaking purposes shall be based solely on the tax deductions and credits received by the public utility and shall not include any deductions or credits generated by the expenses or investments of a public utility’s parent or any affiliated entity.
(Emphasis added.)

At the outset, the language quoted above is entirely consistent with the express purpose of Act 40 to eliminate the use of CTAs. This language clearly focuses on what the Commission should *not* deduct from a utility’s rate base (i.e., any deduction or credit that is generated by a parent or affiliate).⁴⁰ Consequently, read in the context of Act 40 as a whole, there is no basis for interpreting the language quoted above as a mandate that ADIT must be deducted from the original cost of “eligible property” in calculating the “fixed cost” of that property for purposes of the DSIC.

Just as important, Section 1301.1(a) discusses the recognition of “deferred taxes” in order “to determine the *rate base* of a public utility for ratemaking purposes.” As explained in the Companies’ Initial Brief,⁴¹ “rate base” is a term that is inextricably related to the determination of base rates. This is not a coincidence. The DSIC is designed to reflect only a subset (“fixed costs” of “eligible property”) of all the elements that, in a base rate case, comprise a utility’s

³⁹ See Section 1357(b)(1).

⁴⁰ See Initial Brief, pp. 19-22.

⁴¹ *Id.* at 27.

“rate base.” The concept of “rate base” is, however, highly relevant in base rate proceedings. Consequently, Act 40 clearly – and deliberately – employs a term that is relevant only to a base rate proceeding. In similar fashion, Section 1301.1(c)(2) employs the term “final order,” which is also inextricably related to the establishment of base rates and, in particular, to general base rate proceedings under Section 1308(d).⁴² In fact, the term “final order” does not appear in any DSIC-related Code sections.

Thus, as explained above and in their Initial Brief, the Companies demonstrated that the *text* of Act 40 employs terms that only apply – indeed, only make sense – in the context of base rate proceedings. This is textual evidence *internal* to Act 40, and it fully supports interpreting Act 40 as applicable only to the calculation of base rates in base rate proceedings. The textual evidence is also consistent with Act 40’s express purpose, namely to eliminate CTAs, because CTAs are calculated and imposed in base rate proceedings.

While the textual evidence alone establishes that Act 40 applies only to the calculation of base rates, the same textual evidence completely refutes the OCA’s argument for disregarding both the legislative history of Act 40 and the other evidence of legislative intent. For the reasons summarized above, the use of the terms “rate base” and “final order” totally undercut the OCA’s claim that Section 1301.1(a) is so “clear and unambiguous” that the factors listed in Section 1921(c) of the statutory construction should be disregarded. At a minimum, the textual evidence available within the four corners of Act 40 demonstrates that the “words of the statute” are “not explicit” and, therefore, there is a solid legal justification for analyzing Section 1301.1(a) by reference to all of the factors in Section 1921(c)(1)-(8).

⁴² Initial Brief, pp. 27-28.

As explained in the Companies' Initial Brief, a thorough analysis applying the requisite terms of Section 1921(c) requires the Administrative Law Judge and the Commission to consider the long history of the DSIC during which ADIT has never been deducted in calculating DSIC quarterly charges;⁴³ the express purpose for which Act 40 was enacted, which was to eliminate the use of CTAs and not to tinker with the carefully crafted terms of the DSIC-related Code sections;⁴⁴ and the decisive evidence available from the legislative history of House Bill 1436 (the bill that became Act 40), which, in the words of the bill's chief sponsor, Chairman Godshall, establishes that "this section applies to base rate cases" and "would only go into effect when a utility comes in for a base rate case."⁴⁵ Indeed, in her statement to the House Consumer Affairs Committee, Chairman Brown also illuminated the bill's purpose, stating that the "proposed bill introduces legislation that requires a public utility's federal income tax expense to be calculated on a 'stand-alone' basis . . . *when establishing base rates* for the regulated public utility."⁴⁶ There is no valid basis for the OCA's contention that this highly relevant evidence of legislative intent should be disregarded.

Taken together, the textual evidence available within the four corners of Act 40, due consideration of the factors enumerated in Section 1921(c) of the statutory construction law, and the statements from the Chairman of the House Consumer Affairs Committee and the Commission's Chairman contained in the legislative history of House Bill 1436 fully support the conclusion that Act 40 applies only to the calculation of base rates and is not applicable to the DSIC as the OCA erroneously contends.

⁴³ *Id.* at 11-17.

⁴⁴ *Id.* at 19-22.

⁴⁵ House of Representatives Legislative Journal, Feb. 8, 2016, p. 117. *See* Initial Brief, p. 26 and Appendix B.

⁴⁶ Prepared Testimony of Gladys M. Brown, Chairman, Pennsylvania Public Utility Commission, p. 4. *See* Initial Brief, p. 26 and Appendix D.

V. SECTION 1301.1(C)(2) PRECLUDES THE APPLICATION OF SECTION 1301.1(A) TO THE DSIC RIDERS, EVEN IF ACT 40 WERE DEEMED TO APPLY TO MORE THAN JUST BASE RATES

Section 1301.1(c)(2) provides that Act 40 applies only to “cases where the final order is entered after the effective date of this section.” Even if Act 40 applied to more than just base rates, it would still not apply to the DSIC because the Model Tariff adopted by the Commission, which constitutes the DSIC “rate,” was approved in a Final Implementation Order entered approximately four years before the effective date of Act 40.⁴⁷ The test cases that the OCA appealed to Commonwealth Court to challenge the terms of the Model Tariff (which were also entered prior to Act 40’s effective date), produced the Court’s decision in *McCloskey*, which was issued in November 2015. The Companies’ DSIC Orders, which found and determined that the DSIC Rider conforms to the Model Tariff, were entered on June 9, 2016. Thus, even if the DSIC Orders were deemed necessary to make the Final Implementation Order “final” as to the Companies, that condition has also been satisfied.⁴⁸

The OCA’s Main Brief does not address this additional reason why Act 40 does not apply to the DSIC.

VI. EVEN IF ACT 40 APPLIED TO THE DSIC, IT DOES NOT RETROACTIVELY ELIMINATE OR DIMINISH THE DISCRETION THE COMMISSION HAS TO DETERMINE HOW ADIT SHOULD BE ACCOUNTED FOR IN THE DSIC ADJUSTMENT MECHANISM

The OCA’s argument for revising the DSIC formula is based upon its contention that there is only one way ADIT may be recognized in DSIC tariffs, namely, to deduct incremental ADIT from the original cost of “eligible property” in calculating the “fixed cost” recovered in

⁴⁷ Companies’ Statement No. 2-R, p. 42; *see* Initial Brief, pp. 27-31.

⁴⁸ Initial Brief, p. 31.

quarterly DSIC charges.⁴⁹ Underlying that position is the unstated assumption that unless the OCA's proposed revision to the rate formula is adopted, the Commission will not have accounted for ADIT anywhere in the DSIC adjustment mechanism. That assumption is entirely incorrect.

The DSIC "rate" consists of the *entire* DSIC adjustment mechanism, with all of its terms, conditions, procedures and customer "safeguards," as they are set forth at length in the Model Tariff (and in the DSIC Rider for each of the Companies).⁵⁰ As the Administrative Law Judges in Columbia's DSIC proceedings explained: "Based on the definition of a rate [in Section 102], the entirety of the rate is to be considered when determining whether it is just and reasonable, not just its individual components."⁵¹ The Commission adopted and approved that holding,⁵² and the Commonwealth Court affirmed it.⁵³

The Commission carefully considered the limited scope of an adjustment clause like the DSIC, the limited number of cost components it was designed to reflect, and the admonition of Pennsylvania's appellate courts that adjustment clauses should not attempt to recreate base rate determinations and, in that way, "disassemble the traditional rate-making process."⁵⁴ Based on

⁴⁹ See OCA Main Brief, p. 14 ("the FirstEnergy Companies do not account for ADIT in the Companies' DSIC calculations.").

⁵⁰ See Initial Brief, pp. 29-30.

⁵¹ *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge*, Docket No. P-2012-2338282 (R.D. issued Mar. 6, 2014), p. 45.

⁵² *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge*, *supra*, Final Order at 36-37 and 58.

⁵³ *McCloskey*, *supra*, at 869. See also *McCloskey* at 867 ("Therefore, in assessing whether the DSIC rate was just and reasonable, the Commission argues that the DSIC charge and the limiting provisions of the customer protections under Act 11 must be considered together.").

⁵⁴ See Initial Brief, p. 34.

its analysis, the Commission concluded that it was neither necessary nor appropriate to reflect incremental ADIT in the quarterly calculation of charges under the DSIC formula.⁵⁵

The Commission did not ignore the impact of ADIT. To the contrary, it determined that *cumulative* ADIT – ADIT related to *all* of a utility’s plant in service, including quarterly additions of “eligible property” – is taken into account in calculating the rate of return on equity the utility actually earns each quarter.⁵⁶ The product of that calculation, in turn, must be used to assess whether a utility is exceeding the previously-approved, allowable rate of return on equity employed in the DSIC formula and, if so, the utility must reset its DSIC to *zero*. As the Commission held in PPL Electric Utilities Corporation’s DSIC Order: “[T]he earnings cap *is the accurate approach* as it captures the potential magnitude and complexity of ADIT and other costs without necessarily requiring the DSIC to be treated like a Section 1308(d) base rate proceeding.”⁵⁷ In like fashion, in Columbia’s DSIC Order, the Commission concluded that the earnings cap analysis is a superior mechanism for dealing with the ADIT issue than the incremental approach espoused by the OCA.⁵⁸

The Commission was on solid ground in relying upon the earnings cap and the associated earnings cap analysis to recognize, and account for, the cumulative impact of ADIT – as well as all other factors that determine a utility’s equity return rate. Indeed, the earnings cap process tracks the kind of rate analysis that had previously been approved by the Commonwealth Court

⁵⁵ See *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge*, *supra*, Final Order at 22-23. See Initial Brief, pp. 34-35.

⁵⁶ Moreover, ADIT related to DSIC-eligible utility property is fully reflected as a reduction to rate base when the fixed costs of that property is “rolled in” to base rates in a base rate proceedings and the DSIC is reset at zero. See 66 Pa.C.S. § 1358(b)(1). Thus, in this case, ADIT for all of the Companies’ utility plant in service and utility property projected to be placed in service through December 31, 2017 (the end of the fully projected future test year), including DSIC-eligible property being “rolled in” to base rates, has been full recognized in calculating each Company’s rate base. See, e.g., Met-Ed Exhibit RAD-1, page 1, line 16.

⁵⁷ *Petition of PPL Elec. Util. Corporation for Approval of a Distribution System Improvement Charge*, Docket Nos. P-2012-2325034 et al (Order entered Apr. 9, 2015), p. 36 (emphasis added).

⁵⁸ See Initial Brief, pp. 34-35.

as appropriate in non-general base rate cases.⁵⁹ The Commonwealth Court in *McCloskey* concluded that its prior approval of a similar process in *Equitable* was ample authority for finding that the earnings cap analysis, and the requirement to “zero out” the DSIC if the earnings cap were exceeded, properly recognized ADIT in the DSIC adjustment mechanism and assured that the DSIC is a just and reasonable rate.⁶⁰

There is nothing in Act 40 that eliminates or diminishes the Commission’s authority to determine how ADIT should be recognized in the DSIC adjustment mechanism.⁶¹ And, as the Court held in *McCloskey*, the entire DSIC adjustment mechanism, including both the DSIC formula and the earnings cap, constitutes the “rate” that must be considered. Viewed in that way – as it must be – there is no valid basis to conclude that the Commission abused its discretion in deciding that the quarterly earnings cap analysis properly accounts for cumulative ADIT and, taken together with all the other provisions of the Model Tariff, produces a just and reasonable rate. Accordingly, *McCloskey* remains valid and controlling legal precedent, and the OCA’s proposal to revise the DSIC formula to include incremental ADIT in calculating quarterly charges should be rejected.

VII. CONCLUSION

The reserved issue should not be addressed in this proceeding for the reasons discussed above and in the Companies’ Initial Brief. If, however, the reserved issue is considered in this case, then, for all the reasons also discussed above and in the Companies’ Initial Brief, the Administrative Law Judge should issue a Recommended Decision, and the Commission should enter a final order, finding and determining that Act 40 does not apply to the DSIC and, even if it

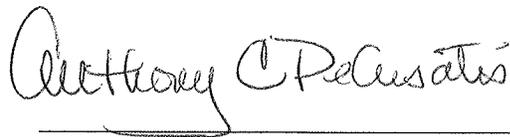
⁵⁹ *Popowsky v. Pa. P.U.C.*, 683 A.2d 958 (Pa. Cmwlth. 1996) (“*Equitable*”). See Initial Brief, pp. 35-36.

⁶⁰ *McCloskey* at 868-869.

⁶¹ See Initial Brief, pp. 21-22 and 32-33.

did, Act 40 neither legislatively overruled *McCloskey* nor revoked or diminished the Commission's discretion to determine that cumulative ADIT is properly taken into account in the earnings cap analysis required by the Model Tariff (and incorporated in the DSIC Rider for each of the Companies). Accordingly, the OCA's proposed revision to the DSIC formula should be rejected.

Respectfully submitted,



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