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December 8, 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 and
West Penn Power Company
Docket Nos. R-2016-2537349, *et al.*

Dear Secretary Chiavetta:

Enclosed for filing on behalf of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company is their Reply to the Exceptions of the Office of Consumer Advocate to the Recommended Decision of Administrative Law Judge Mary D. Long, in the above-referenced proceedings ("Reply Exceptions").

As evidenced by the enclosed Certificate of Service, copies of the Reply Exceptions are being served on the Administrative Law Judge and all parties to this proceeding. Additionally, a courtesy copy of the Reply Exceptions is being sent via e-mail to the Commission's Office of Special Assistants as instructed in your November 21, 2016 transmittal letter.

Very truly yours,

Anthony C. DeCusatis

c: Per Certificate of Service (w/encls.)
Office of Special Assistants at *ra-OSA@pa.gov*

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
vs.	:	**Docket No. R-2016-2537349**
METROPOLITAN EDISON COMPANY	:	

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
vs.	:	**Docket No. R-2016-2537352**
PENNSYLVANIA ELECTRIC COMPANY	:	

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
vs.	:	**Docket No. R-2016-2537355**
PENNSYLVANIA POWER COMPANY	:	

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
vs.	:	**Docket No. R-2016-2537359**
WEST PENN POWER COMPANY	:	

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served copies of the **Reply of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company to the Office of Consumer Advocate's Exceptions to the Recommended Decision of Administrative Law Judge Mary D. Long** on the following persons, in the manner specified below, in accordance with the requirements of 52 Pa. Code § 1.54:

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Dated: December 8, 2016

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

REPLY OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY, PENNSYLVANIA POWER COMPANY AND WEST PENN POWER COMPANY

To The Exceptions Of The Office of Consumer Advocate To The Recommended Decision Of Administrative Law Judge Mary D. Long

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December 8, 2016

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I. INTRODUCTION

A. The Companies' Base Rate Filings And The Joint Petitions For Partial Settlement

This proceeding was initiated on April 28, 2016, when 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") filed with the Pennsylvania Public Utility Commission ("PUC" or the "Commission") tariff supplements proposing increases in their annual distribution revenue. On June 9, 2016, the Commission entered an Order suspending each of the tariff filings and referring them to the Office of Administrative Law Judge for investigation to determine the lawfulness, justness and reasonableness of the Companies' existing and proposed rates, rules and regulations.

Various parties intervened in the ensuing proceeding, including the Office of Consumer Advocate ("OCA"). All of the Companies' cases were assigned to Administrative Law Judge Mary D. Long, who granted the Companies' unopposed request to consolidate their cases for hearing, briefing and decisions. Written direct, supplemental direct, rebuttal and surrebuttal testimony and accompanying exhibits were submitted by various parties, and twelve public input hearings were conducted at locations throughout the Companies' service areas. The parties also undertook extensive discovery.

The parties engaged in negotiations to try to achieve settlements of the issues in the Companies' rate cases. As a result of those efforts, the settling parties were able to agree to settlements of the Companies' base rate cases ("Settlements") that resolved all but one issue, which was reserved for briefing. Accordingly, Joint Petitions for Partial Settlement ("Joint Petitions") were filed on October 14, 2016, which were executed, or not opposed, by all active

parties. A detailed procedural history of the consolidated proceeding is set forth in each of the Joint Petitions.

B. The Issue Reserved For Briefing And Overview Of The Companies' Initial And Reply Briefs

The issue reserved for briefing 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] for the express purpose of eliminating the use of so-called consolidated tax adjustments ("CTAs") in calculating utility base rates.

Each of the Companies established a DSIC that is set forth in virtually identical riders to their respective tariffs ("DSIC Rider"). The Commission approved the DSIC Rider by Orders entered on June 9, 2016,[4] in which it found and determined that the DSIC Rider fully conforms to the Model Tariff adopted in the Final Implementation Order for Act 11 of 2012, pursuant to Section 1353(b).[5] Section 1353(b) requires every utility petitioning to establish a DSIC to file

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[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] *Petition of Metropolitan Edison Company for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2015-2508942 (June 9, 2016) ("Met-Ed DSIC Order"); *Petition of Pennsylvania Electric Company for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2015-2508936 (June 9, 2016) ("Penelec DSIC Order"); *Petition of Pennsylvania Power Company for Approval of a Distribution Sys. 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 Sys. Improvement Charge*, Docket No. P-2015-2508948 (June 9, 2016) ("West Penn DSIC Order") (collectively, the "Companies' DSIC Orders").

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

"an initial tariff that conforms with a model tariff adopted by the commission."[6] 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. For this reason, among others, the reserved issue is not properly within the scope of this consolidated base rate proceeding.

Under the schedule established by Judge Long, the Companies filed their Initial Brief on the reserved issue on September 30, 2016. On October 14, the Companies filed their Reply Brief in response to the OCA's Main Brief. In their Initial (pp. 6 and 10-11) and Reply (pp. 6-7) Briefs, the Companies explained that it would not be appropriate to address a proposed revision to the DSIC formula embedded in the Commission's previously-approved Model Tariff in a distribution base rate case.

Given the procedural posture of the case, the Companies also addressed the substance of the OCA's arguments. As explained in their Initial and Reply Briefs, Section 1301.1(a) does not apply to the DSIC because: (1) Act 40 was expressly designed solely to eliminate the use of CTAs in base rate proceedings and did not alter the elements of the DSIC formula prescribed in Section 1357 as applied in the Final Implementation Order;[7] (2) Section 1301.1(a) applies only to base rates and not to adjustment clauses like the DSIC;[8] and (3) even if Section 1301.1 were deemed to apply to more than just "base rates, the "final order" approving the terms of the DSIC that the OCA now proposes to revise was entered before the effective date of Act 40 and, under

[6] 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 e.g., Petition of PECO Energy Company for Approval of its Electric Distribution Sys. Improvement Charge*, Docket No. P-2015-2471423 (Order entered Oct. 22, 2015), p. 25; *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution Sys. Improvement Charge,* Docket No. P-2012-2338282 (Order entered May 22, 2014), p. 27; *Petition of PPL Elec. Util. Corp. for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2012-2325034 (Order entered May 23, 2013), p. 5.

[7] Initial Brief, pp. 20-22.

[8] *Id.* at 22-27.

Section 1301.1(c)(2), the DSIC is, therefore, excluded from the coverage of Section 1301.1(a).[9] Finally, the Companies explained that, 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.*,[10] which held that cumulative ADIT is already 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 as the OCA proposed then, and is still proposing now.[11]

The OCA is the only party contesting the DSIC Rider, and the arguments set forth in the OCA's Exceptions track those presented in the testimony of its witness, Ralph C. Smith,[12] and in its Main and Reply Briefs, to which the Companies responded, respectively, in the rebuttal testimony of their witness, Richard A. D'Angelo,[13] and in their Initial and Reply Briefs. To a very large extent, the arguments advanced by the OCA were fully addressed in the Companies' Initial and Reply Briefs, and an extensive reanalysis is, therefore, not necessary. Consequently, the Companies' Reply Exceptions will briefly address the principal errors and omissions in the OCA's Exceptions. If the Commission decides to address the reserved issue on the merits in this

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[9] *Id.* 27-31.

[10] 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 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).

[11] 127 A.3d at 870-871.

[12] *See* OCA Statement No. 1, pp. 108-110.

[13] Companies' Statement No. 2-R, pp. 40-43.

case, the Companies urge the Commission to review in detail the expanded discussion of the reserved issue in the Companies' Initial and Reply Briefs.

C. Judge Long's Recommended Decision

Judge Long's Recommended Decision was issued on November 21, 2016. Judge Long found that the "OCA has not articulated a compelling reason why the DSIC issue must be resolved in this base rate proceeding" and was free to file a complaint challenging the formula for calculating charges under the DSIC set forth "in the model tariff included in the Final Implementation Order."[14] Judge Long also suggested that the reserved issue could be added to the issues assigned to Administrative Law Judge Joel Cheskis in the Companies' DSIC Orders.[15] In those Orders, the Commission approved the DSIC Rider as compliant with the Model Tariff, but assigned to the Office of Administrative Law Judge two peripheral issues pertaining to: (1) whether any clauses or riders should be excluded from "distribution revenue"; and (2) whether the Companies had excluded from the DSIC's application their rates and rate schedules that serve customers at transmission-level voltages. A settlement in principle has been reached in that case, which will be memorialized in a Joint Petition for Settlement.[16]

D. The OCA's Exceptions

On December 1, 2016, the OCA filed two exceptions to Judge Long's Recommended Decision. In its Exception No. 1, the OCA takes exception to the Judge's recommendation that its proposed revision to the DSIC formula in the Model Tariff not be addressed in this base rate

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[14] R.D. at 96.

[15] *Id.*

[16] *See* Third Formal Status Report On Settlement Negotiations, which was filed with the Commission and submitted to Judge Cheskis on November 7, 2016 at Docket Nos. P-2015-2508936 *et al.*

proceeding.[17] In addition, the OCA proposes that, if the reserved issue is to be added to the issues assigned to Judge Cheskis, then it should also transfer the record[18] pertaining to the reserved issue, which would become the record for decision on the reserved issue at that docket.

In Exception No. 2, which essentially mirrors its Exception No. 1, the OCA takes exception to the Recommended Decision for not addressing "the substance of the reserved issue regarding ADIT."[19] In so doing, the OCA repeats in summary fashion the arguments it made in its Main and Reply Briefs for amending the DSIC formula in the Model Tariff.

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,[20] 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.

The substance of the OCA's arguments is also wrong, and its proposed revision to the DSIC formula in the Model Tariff should be rejected. Section 1301.1(a) does not compel the formula revision, as the OCA contends. To the contrary, that section does not apply to the DSIC because: (1) Act 40 only eliminated the use of CTAs in base rate proceedings and did not alter the elements of the DSIC formula[21]; (2) Section 1301.1(a) applies only to base rates and not to

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[17] OCA Exceptions, pp. 2-3.

[18] Given that the reserved issue has been fully briefed, the record transferred should include OCA's Main and Reply Briefs and the Companies' Initial and Reply Briefs.

[19] OCA Exceptions, pp. 4-6.

[20] *See* OCA Main Brief, p. 7.

[21] Initial Brief, pp. 20-22.

adjustment clauses like the DSIC[22]; and (3) if Section 1301.1 were deemed to apply to the DSIC, the Final Implementation Order, which established the Model Tariff that the OCA proposes to revise, was entered before the effective date of Act 40 and, therefore, the DSIC is excluded from its coverage.[23] Finally, even if Section 1301.1(a) applied to the DSIC, Act 40 does not retroactively diminish the Commission's discretion to determine *how* ADIT should be reflected in the DSIC. As the Commonwealth Court held in *McCloskey*,[24] the DSIC, viewed in its entirety – i.e., including the earnings cap provision of the Model Tariff – does, in fact, account for cumulative ADIT in a reasonable fashion.

Section 1301.1(a) Was Designed Solely To Eliminate The Use Of CTAs In Base Rate Proceedings And Applies *Only* To Base Rates. The legislative history of Act 40 clearly demonstrates that it was intended for the sole purpose of eliminating CTAs and that it applies *only* to base rates.[25] The OCA cannot marshal any evidence to the contrary from the legislative history of Act 40. Instead, the OCA asserts that the language of Act 40 is "clear and unambiguous" that ADIT must be reflected in calculating charges under adjustment clauses like the DSIC[26] and, therefore, there is no need to consider rules of statutory interpretation set forth in Section 1921(c) of Pennsylvania's statutory construction act.[27]

The OCA's argument is based on a misreading of Section 1301.1. The OCA ignores the sentence in that section that mentions "deferred taxes" in the context of "rate base." The

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[22] *Id.* at 22-27.

[23] *Id.* 27-31. *See* Section 1301.1(c)(2).

[24] 127 A.3d at 870-871.

[25] Initial Brief (pp. 19-20) (quoting the legislative history demonstrating that Act 40's sole purpose was to eliminate CTAs); Initial Brief (pp. 22-31) (quoting the legislative history demonstrating that Act 40 was intended to apply only to base rates).

[26] OCA Exceptions, p. 4.

[27] 1 Pa.C.S. § 1921(c).

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.[28] 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.[29] Both of those textual references provide irrefutable 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. Consequently, there is a sound basis to consider the factors enumerated in Section 1921(c) of the statutory construction law for ascertaining legislative intent. In short, because the OCA has no argument to counter the clear legislative history demonstrating that Act 40 was intended solely to eliminate CTAs and applies only to the calculation of base rates, the OCA's only recourse is to ask the Commission to ignore the legislative history entirely.

The Model Tariff (Which Sets Forth The DSIC "Rate") Was Approved By A Final Order Entered Before The Effective Date Of Act 40. Neither the OCA's Main and Reply Briefs nor its Exceptions addresses the fact 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.[30] 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."[31] Given that

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[28] Initial Brief, pp. 22-27.

[29] *Id.* at 27-28.

[30] See Initial Brief, p. 31.

[31] *See* OCA Main Brief, pp. 9 and 14.

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.

Act 40 Did Not Legislatively Overrule *McCloskey*. The OCA's arguments simply reiterate a position that was rejected previously by the Commission and by the Commonwealth Court in *McCloskey*. Specifically, the OCA persists in asserting that the formulation of the DSIC approved in the Model Tariff does not "account for ADIT in calculating the DSIC."[32] Indeed, the OCA claims – erroneously – that the Commonwealth Court held that it is "unnecessary to account for ADIT" in the DSIC.[33] As the Commission found in its Order in the Columbia case[34] and the Commonwealth Court affirmed in *McCloskey*,[35] the *entire* DSIC mechanism constitutes the applicable "rate," and that rate clearly *does* account for cumulative ADIT in a reasonable fashion through the earnings cap provision of the DSIC. In fact, the earnings cap analysis required under the DSIC is consistent with the revenue requirement analysis the Commission and the Commonwealth Court have previously approved for use in non-general base rate cases.[36] Nothing in Act 40 stripped from the Commission the discretion it is granted under the Public Utility Code and the Commonwealth Court's prior decisions – including *McCloskey* – to

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[32] OCA Exceptions, p. 5. *See* OCA Main Brief, p. 10.

[33] *Id.*

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

[35] 127 A.3d at 869-871.

[36] Initial Brief, pp. 35-38.

determine *how* a particular element of revenue requirement may be recognized in ascertaining if a "rate" is just and reasonable.[37]

III. REPLY TO EXCEPTIONS

A. The Reserved Issue Pertains To The Terms Of An Adjustment Clause And Is Not Properly Within The Scope Of This Base Rate Proceeding (OCA Exception No. 1)

As previously explained, the DSIC in its current form was embodied in the Model Tariff approved in the Final Implementation Order pursuant to 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.[38] Moreover, adjustment clauses, by their nature, employ a process for establishing the charges billed to customers that differs markedly from the process governed by Section 1308 that is used to establish base rates.[39] The OCA does not dispute either of these important points.

Furthermore, the OCA's Exceptions are 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 DSIC[40] 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*. Accordingly, the Commission should adopt Judge Long's recommendation that the reserved issue not be addressed in this case.

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[37] *See* Initial Brief, pp. 32-38.

[38] *Id.* at 22-27.

[39] *Id.*

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

B. The Companies Agree With The OCA's Request That, If The Reserved Issue Is Added To The Issues Assigned To The Office Of Administrative Law Judge By The Companies' DSIC Order, The Relevant Portions Of The Record, Including Briefs, In This Proceeding Should Be Transferred As Well (OCA Exception No. 1).

Although the OCA argues that the reserved issue should be addressed on its merits in this case, it makes the contingent request that, if the Commission decides to adopt Judge Long's suggestion to add the reserved issue to the issues assigned to Judge Cheskis by the Companies' DSIC Orders, then it should transfer the pertinent parts of the record in this case – which should include the OCA's Main and Reply Briefs and the Companies' Initial and Reply Briefs – to that proceeding as well. The Companies agree with the OCA's request and would add that it should encompass any other docket to which the reserved issue may be assigned, including any new docket initiated by the Commission, such as a generic docket like the one in which the Commission entered its recent Supplemental Implementation Order.[41]

C. Contrary To The OCA's Contentions, Clear Textual Evidence Within The Four Corners Of Act 40: (1) Expresses The Legislative Intent That Section 1301.1 Apply Only To Base Rates; And (2) Negates The OCA's Claim That Act 40 Is So "Clear And Unambiguous" That Its Stated Purpose And Legislative History May Be Disregarded (OCA Exception No. 2).

In their Initial Brief,[42] the Companies explained that Act 40 has a single purpose – to eliminate CTAs – and that Section 1301.1 applies only to base rates. Therefore, the OCA's attempt to rely on that section to force the Commission to revise the Model Tariff's formula for calculating quarterly charges under the DSIC should be rejected. In so doing, the Companies

[41] *See* Supplemental Implementation Order, *Implementation of Act 11 of 2012, supra.*

[42] Initial Brief, pp. 19-27. *See also* Companies' Reply Brief, pp. 7-11.

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."[43] However, the language that the OCA points to as allegedly "clear and unambiguous" at page four of its Exceptions 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)[44]:

> 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 Code[45] have employed "statutory" tax rates and have properly included both "current" and "deferred" taxes in the "income tax expense" reflected in the "pretax return"[46] they use to calculate quarterly charges under the DSIC. There is no

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[43] Section 1921(c) states 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."

[44] *See* OCA Exceptions, p. 4 and OCA Main Brief, p. 11.

[45] *See* IRC § 168(f)(2).

[46] *See* Section 1357(b)(1).

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 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).[47] Consequently, when 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,[48] "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 "rate base."[49] The concept of "rate base," is, however, highly relevant in base rate proceedings.

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[47] *See* Initial Brief, pp. 19-22.

[48] *Id.* at 27.

[49] While the DSIC is designed and intended to encompass only the "fixed cost" of "eligible property," the "rate base" determined in a base rate case incorporates a panoply of components, including, for example, in addition to cumulative ADIT, cash working capital, prepaid expenses, materials and supplies, unamortized tax credits,

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).[50] 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 other, equally relevant 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).

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experienced cost of removal and positive salvage, customer advances for construction, contributions in aid of construction, and customer deposits, all of which must be identified, quantified, and added or deducted, as appropriate, to determine a utility's investment on which it may earn a return.

[50] 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 Commission to consider the long history of the DSIC during which ADIT has *never* been deducted in calculating DSIC quarterly charges[51]; 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[52]; 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."[53] 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."[54] 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.

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[51] *Id.* at 11-17.

[52] *Id.* at 19-22.

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

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

D. Section 1301.1(c)(2) Precludes The Application Of Section 1301.1(a) To The DSIC Rider, Even If Act 40 Were Deemed To Apply To More Than Just Base Rates (OCA Exception No. 2)

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.[55] 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. Additionally, 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.[56]

The OCA's Exceptions (like its Main and Reply Briefs) do not refute this additional reason why Act 40 does not apply to the DSIC.

E. Even If Act 40 Applied To The DSIC, It Does Not Retroactively Diminish The Discretion The Commission Is Granted Under The Public Utility Code To Determine *How* ADIT Should Be Accounted For In The DSIC Adjustment Mechanism (OCA Exception No. 2)

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

[55] Companies' Statement No. 2-R, p. 42; *see* Initial Brief, pp. 27-31.

[56] Initial Brief, p. 31.

quarterly DSIC charges.[57] 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).[58] 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."[59] The Commission adopted and approved that holding,[60] and the Commonwealth Court affirmed it.[61]

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."[62] Based on

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[57] *See* OCA Exceptions, p. 5; OCA Main Brief, p. 14 ("the FirstEnergy Companies do not account for ADIT in the Companies' DSIC calculations.").

[58] *See* Initial Brief, pp. 29-30.

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

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

[61] *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.").

[62] *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.[63]

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.[64] 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 reduce 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."[65] 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.[66]

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

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

[64] 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 proceeding 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 fully recognized in calculating each Company's rate base. *See, e.g.*, Met-Ed Exhibit RAD-1, page 1, line 16.

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

[66] *See* Initial Brief, pp. 34-35.

as appropriate in non-general base rate cases.[67] 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.[68]

There is nothing in Act 40 that diminishes – let alone eliminates, as the OCA contends – the Commission's authority and discretion to determine *how* ADIT should be recognized in the DSIC adjustment mechanism.[69] 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.

IV. CONCLUSION

The reserved issue should not be addressed in this proceeding for the reasons discussed above and in the Companies' Initial and Reply Briefs, and the record, including the briefs filed by the Companies and the OCA, should be transferred to the docket to which it is assigned or to any new docket initiated by the Commission. If the reserved issue is to be considered on its merits in this case, then, for all the reasons also discussed above and in the Companies' Initial

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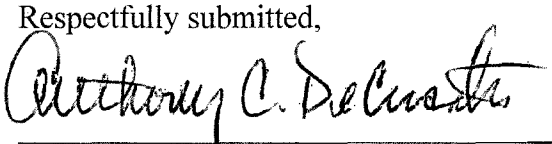
[67] *Popowsky v. Pa. P.U.C.*, 683 A.2d 958 (Pa. Cmwlth. 1996) ("*Equitable*"). *See* Initial Brief, pp. 35-36.

[68] *McCloskey* at 868-869.

[69] *See* Initial Brief, pp. 21-22 and 32-33.

and Reply Briefs, the Commission should find and determine that Act 40 does not apply to the DSIC and, even if it 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 incorporated in the Model Tariff should be rejected.

Respectfully submitted,



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