POST & SCHELL PC
ATTORNEYS AT LAW

Four Penn Center
1600 John F Kennedy Blvd.
Philadelphia, PA 19103
215-587-1000 Main
215-587-1444 Main Fax
www.postschell.com

David B. MacGregor

dmacgregor@postschell.com
215-587-1197 Direct
215-320-4879 Direct Fax
File #: 153362

November 26, 2013

VIA ELECTRONIC FILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Petition of PPL Electric Utilities Corporation For Approval of a Distribution System Improvement Charge - Docket No. P-2012-2325034

Dear Secretary Chiavetta:

Enclosed please find the Initial Brief of PPL Electric Utilities Corporation in the above-referenced proceeding. Copies will be provided as indicated on the Certificate of Service.

Respectfully submitted,

David B. MacGregor

DBM/skr
Enclosures

cc: Honorable Kandace F. Melillo
Certificate of Service

CERTIFICATE OF SERVICE

Docket No. P-2012-2325034

I hereby certify that true and correct copies of the foregoing have been served upon the following persons, in the manner indicated, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

Via E-Mail and First Class Mail

Candis A. Tunilo, Esquire
Erin L. Gannon, Esquire
Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923

Adeolu A. Bakare, Esquire
Pamela C. Polacek, Esquire
McNees Wallace & Nurick LLC
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
PP&L Industrial Customer Alliance

Eric Joseph Epstein
4100 Hillsdale Road
Harrisburg, PA 17112

Steven C. Gray, Esquire
Office of Small Business Advocate
Commerce Building
300 North Second Street, Suite 1102
Harrisburg, PA 17101

Robert D. Knecht
Consultant for OSBA
Industrial Economics Incorporated
2067 Massachusetts Avenue
Cambridge, MA 02140

Date: November 26, 2013

Jessica R. Rogers

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of PPL Electric Utilities	:	
Corporation For Approval of a Distribution	:	Docket Nos. P-2012-2325034
System Improvement Charge	:	
	:	
Office of Consumer Advocate	:	C-2012-2346390
Alan D. Whitehouse	:	C-2013-2345750
Pamela Mosconi	:	C-2013-2346375
John E. Hoag	:	C-2013-2345729
James Weaver	:	C-2013-2351090

INITIAL BRIEF OF PPL ELECTRIC UTILITIES CORPORATION

TO ADMINISTRATIVE LAW JUDGE KANDACE F. MELILLO:

Paul E. Russell (ID # 21643)
Associate General Counsel
PPL Services Corporation
Office of General Counsel
Two North Ninth Street
Allentown, PA 18101
Phone: 610-774-4254
Fax: 610-774-6726
E-mail: perussell@pplweb.com

David B. MacGregor (ID # 28804)
Post & Schell, P.C.
Four Penn Center
1600 John F. Kennedy Boulevard
Philadelphia, PA 19103-2808
Phone: 215-587-1197
Fax: 215-320-4879
E-mail: dmacgregor@postschell.com

Jessica R. Rogers (ID #309842)
Post & Schell, P.C.
17 North Second Street
12th Floor
Harrisburg, PA 17101-1601
Phone: 717-731-1970
E-mail: jrogers@postschell.com

Of Counsel:

Post & Schell, P.C.

Date: November 26, 2013

Attorneys for PPL Electric Utilities Corporation

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I. BACKGROUND

On February 14, 2012, Governor Corbett signed into law Act 11 of 2012 ("Act 11"), which amends Chapters 3, 13 and 33 of the Public Utility Code. As relevant to this proceeding, Act 11 authorizes electric distribution companies ("EDCs"), natural gas distribution companies ("NGDCs"), water utilities, wastewater utilities and city natural gas distribution operations to establish a distribution system improvement charge ("DSIC"). Prior to the adoption of Act 11, water utilities charged a DSIC pursuant to Section 1307(g) of the Public Utility Code, which was repealed by Act 11.

Act 11 provides utilities with the ability to implement a DSIC to recover reasonable and prudent costs incurred to repair, improve or replace certain eligible property that is part of the utility's distribution system. Eligible property for EDCs is defined in Section 1351 of the statute. *See* 66 Pa.C.S. § 1351(1). As a precondition to the initial implementation of a DSIC, each utility must file and obtain approval of a Long-Term Infrastructure Improvement Plan ("LTIIP") that is consistent with the provisions of Section 1352 of the statute. *See* 66 Pa.C.S. § 1352(a).

On April 5, 2012, the Commission held a working group meeting for discussion and feedback from stakeholders regarding implementation of Act 11. The purpose of the meeting was to address certain key implementation issues prior to the issuance of a Tentative Implementation Order. On May 10, 2012, the Commission issued its Tentative Implementation Order addressing and incorporating input from the stakeholder meeting at Docket No. M-2012-2293611. Comments were filed by many interested parties, including PPL Electric Utilities Corporation ("PPL Electric" or "the Company"), the Office of Consumer Advocate ("OCA"), and the PP&L Industrial Customer Alliance ("PPLICA") on May 31, 2012.

On August 2, 2012, the Commission issued its Final Implementation Order establishing procedures and guidelines necessary to implement Act 11. The Final Implementation Order

adopted the requirements established in Act 11, provided additional standards that each utility must meet in developing an LTIIP and DSIC, and gave guidance to utilities for meeting the Commission's standards. The Final Implementation Order also included a model form of DSIC tariff (the "model tariff").

II. PROCEDURAL HISTORY

On September 18, 2012, PPL Electric filed an LTIIP pursuant to Section 1352 of the Public Utility Code, 66 Pa.C.S. § 1352. On October 9, 2012, OCA and PPLICA filed Comments on the LTIIP. PPL Electric's LTIIP was approved by the Commission on January 10, 2013.

On January 15, 2013, pursuant to Section 1353, PPL Electric filed a Petition for Approval of a DSIC. 66 Pa.C.S. § 1353. As part of its Petition, PPL Electric included a form of DSIC tariff consistent with the model tariff, along with supporting direct testimony. On February 4, 2013, the OCA filed an Answer, Notice of Intervention and Formal Complaint and Public Statement. Also on February 4, 2013, PPLICA filed a Petition to Intervene. On February 8, 2013, a Petition to Intervene was filed by Eric Epstein. On March 22, 2013, the Office of Small Business Advocate ("OSBA") filed an Answer, Notice of Intervention, Public Statement, and Notice of Appearance. On March 15, 2013, PPL Electric filed an Answer to the OCA's complaint. Customer complaints were filed by Alan D. Whitehouse, Pamela Mosconi, John E. Hoag, and James Weaver.

By Order entered May 23, 2013, the Commission approved PPL Electric's DSIC, subject to refund, pending final resolution of issues raised in the parties' filings and identified in the Commission's Order ("May 23 Order").[1]

[1] The issues identified by the Commission included the following: Whether customers taking service under Rate Schedule LP-5 should pay the DSIC; if revenues associated with the Company's Act 129 Compliance Rider ("ACR"), Smart Meter Rider, Universal Service Rider, Net Metering Rider, and Competitive Enhancement Rider

On June 6, 2013 PPLICA filed a Motion for Judgment on the Pleadings. PPL Electric filed an Answer to PPLICA's Motion on June 26, 2013. On July 5, 2013, the ALJ issued an order denying PPLICA's Motion.

On June 20, 2013, PPL Electric filed its compliance filing, as directed by the Commission in its May 23 Order. The Company's DSIC rate became effective as of July 1, 2013, subject to refund.

A prehearing conference was held on July 1, 2013, where a procedural schedule was established. Pursuant to the procedural schedule, parties filed direct, rebuttal, surrebuttal, and rejoinder testimony.

A hearing was held on October 29, 2013. Main Briefs for the parties are due on November 26, 2013 and Reply Briefs are due on December 20, 2013.

III. LEGAL STANDARD

As the petitioner, PPL Electric has the burden of proof in this matter. Section 332(a) of the Public Utility Code requires the proponent of a rule or order "to bear the ultimate burden of persuading the Commission, by a preponderance of substantial evidence, that the relief sought is proper and justified under the circumstances." 66 Pa.C.S. § 332(a); *Motheral, Inc. v. Duquesne Light Co.*, C-00003926, 2001 Pa. PUC LEXIS 4, at *9 (Order entered March 23, 2001) (citing *Se-Ling Hosiery v. Margulies*, 70 A.2d 854 (Pa. 1954)). A "preponderance of the evidence" means that one party must present evidence which is more convincing, by even the smallest amount, than the evidence presented by an opposing party. *See Se-Ling Hosiery.* Substantial evidence is "relevant evidence that a reasonable mind may accept as adequate to support a conclusion: more is required than a mere trace of evidence or a suspicion of the existence of a

("CER") are properly included as distribution revenues in calculating the DSIC cap; the impact of accumulated deferred income taxes; and the calculation of state income taxes.

fact sought to be established." *Murphy v. Pa Department of Public Welfare, White Haven Center,* 480 A.2d 382 (Pa. Cmwlth. 1984).

Importantly, however, many of the issues presented in this case relate, in whole or in part, to the proper interpretation and application of a statute, *i.e.*, Act 11. These issues are ultimately questions of law to be decided under the applicable rules of statutory interpretation and construction set forth in 1 Pa.C.S. § 1921, *et. seq.* Resolution of these issues is based on which party's interpretation of the applicable statute is correct and consistent with the intent of the General Assembly.

IV. SUMMARY OF ARGUMENT

Act 11, *inter alia*, authorized the Commission to establish a DSIC mechanism for EDCs and prescribed specific procedural and substantive requirements for DSIC implementation. Importantly, the General Assembly established the DSIC as a reconcilable rate mechanism, and not as a Section 1308 base rate mechanism. The Commission, after receiving extensive public comment, has implemented this legislation through a detailed Implementation Order. As part of this process, both the General Assembly and the Commission have made it clear that the Act 11 DSIC should mirror the DSIC for water utilities, which has been in place since 1997, and should be a simple, straightforward rate mechanism that avoids the complexity and controversy of base rate proceedings.

In preparing its DSIC filing, PPL Electric has carefully and scrupulously followed Act 11 and the Commission's Implementation Order. Only two parties, OCA and PPLICA, have raised any opposition to the Company's filing. For the reasons set forth below, their adjustments should be rejected, and PPL Electric's DSIC should be approved.

A. OCA

The OCA proposes two tax adjustments, both of which relate to the proper treatment of certain book/tax timing differences in the calculation of the DSIC. These adjustments should be rejected for the following seven reasons.

First, the OCA adjustments are inconsistent with Act 11 and its legislative history. Act 11 contains a detailed formula for calculating the DSIC, and neither OCA adjustment is included in this formula. The legislative history clearly demonstrates that this omission was intentional and not inadvertent. The OCA's adjustments, therefore, should be rejected as a matter of law.

Second, the legislative history and the Commission's Final Implementation Order both indicate that the Act 11 DSIC was to mirror the DSIC for water utilities, which was first implemented by the Commission in 1997. No water utility has ever included either of the OCA's adjustments in the calculation of its DSIC. The same result should apply to the Act 11 DSIC.

Third, the OCA proposed its tax adjustments in its comments to the Commission's draft Implementation Order. The Commission specifically rejected the OCA's adjustments, and the Commission should reach the same result in this proceeding.

Fourth, Act 11 established the DSIC as a reconcilable automatic adjustment clause. The OCA candidly admits that both of its tax adjustments are typically made in Section 1308 base rate proceedings. Long-standing Commission and judicial precedent hold that it is not appropriate to examine the panoply of Section 1308 base rate issues in an automatic adjustment clause proceeding, and both the General Assembly and the Commission have properly decided not to do so for the Act 11 DSIC.

Fifth, both the legislative history to Act 11 and the Commission's Final Implementation Order make it clear that the DSIC is intended to be a simple, straightforward mechanism that

avoids the complexity and controversy of Section 1308 base rate proceedings. In order to properly implement the OCA's proposed adjustments, it would be necessary to calculate PPL Electric's total company federal and state income tax expenses on a quarterly basis. Doing so would require estimating PPL Electric's total company revenues, expenses, plant balances, depreciation, and many other items to develop total company taxable income. This would inevitably lead to extended litigation and would be completely and utterly inconsistent with the goal of the General Assembly and the Commission for a simple, straightforward DSIC mechanism that avoids base rate case complexity and controversy.

Sixth, in addition to these legal and policy arguments, the OCA's adjustments are based on a fundamental factual flaw. The OCA repeatedly refers to income tax expense on incremental DSIC plant additions. The Company does not pay income tax expense on particular plant additions or particular revenues generated from plant additions. Rather, the Company, like all taxpayers, pays income taxes based on its overall, total company taxable income. The OCA's adjustments are premised on the hypothetical calculation of incremental tax expense on incremental items of plant. This calculation is conceptually flawed and further demonstrates the OCA's desire to inject total company Section 1308 base rate issues into the DSIC formula.

Finally, the OCA's proposal to calculate incremental tax expense also is fundamentally unfair and will inevitably result in a mismatch of tax deductions and the determination of income tax expense. The Company's current federal and state income tax expenses for ratemaking purposes are based upon the future test year from its last base rate proceeding, *i.e.,* 2012, and reflect deferred income taxes and state income tax expense based on conditions at December 31, 2012. In this DSIC proceeding, the OCA seeks to update PPL Electric's federal and state income tax expense for DSIC eligible property, but completely ignores the many other changes in the

Company's ADIT and state income taxes that have occurred since its last base rate case. This mismatching is clearly inappropriate and should be rejected.

Perhaps recognizing the many shortcomings in its proposals, the OCA makes three additional arguments in support of its position. Each is without merit and should be rejected.

First, the OCA argues that the failure to make its two tax expense adjustments will produce rates that are higher than appropriate, *i.e.,* rates that are not just and reasonable. This argument is completely without merit. The case law is clear that the reasonableness of rates must be judged based on the return produced by the total rates charged by a utility and not based on individual adjustments to those rates. The leading recent case on this point is the United States Supreme Court's decision in *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989). ("*Duquesne*"), where the OCA contended and the United States Supreme Court agreed that the reasonableness of rates must be determined on a total company basis and not based on the allowance or disallowance of individual expense items. The OCA's argument in this DSIC proceeding is completely inconsistent with the position it advocated in *Duquesne* and which the United States Supreme Court accepted. Importantly, the General Assembly included an overall company earnings cap in the DSIC legislation, which ensures that a utility's rates will remain just and reasonable under the controlling legal standard set forth in *Duquesne* and its predecessor decisions.

Second, the OCA contends that the failure to make its two adjustments will violate the "actual taxes paid" doctrine. This is not the case. As explained above, a company pays taxes based on its total net income, not based on individual items of plant or revenue. The incremental tax calculations presented by the OCA do not and logically cannot reflect actual taxes paid or payable to the government. Moreover, the "actual taxes paid" doctrine has only been applied in

base rate proceedings, which further demonstrates OCA's desire to inappropriately inject Section 1308 base rate issues into an automatic adjustment clause proceeding. Finally, the "actual taxes paid" doctrine is a judicial construct and therefore can be modified by the General Assembly. To the extent that this judicial doctrine has any application to the DSIC, such application has been rejected by the General Assembly in Act 11, which provided a detailed formula for calculation of the DSIC and intentionally omitted the OCA's proposed tax adjustments.

Finally, the OCA, apparently recognizing that there is no support in Pennsylvania for its position, cites and relies heavily on other jurisdictions to support its position. As explained below, these decisions are irrelevant to this case, and in any event, the cases cited by OCA are fully distinguishable from the Act 11 DSIC.

For these reasons, the OCA's tax adjustments should be rejected.

B. PPLICA

PPLICA also proposes two adjustments to PPL Electric's DSIC. Both are without merit and should be rejected.

PPLICA first contends that the DSIC should not apply to Rate Schedule LP-5 customers because they take service at "transmission level voltage." This argument should be rejected. First, Act 11, on its face, says that the DSIC shall be applied "equally to all customer classes." While Rate Schedule LP-5 customers take service at "transmission voltage," they are still distribution customers of PPL Electric taking service under a rate schedule contained in PPL Electric's electric distribution tariff. They therefore must pay the DSIC under the plain language of Act 11.

PPLICA presents various arguments in support of its position. These arguments are in error and are fully addressed below. Fundamentally, however, PPLICA does not and cannot reasonably deny that Rate Schedule LP-5 is a distribution service rate schedule contained in PPL

Electric's Commission-approved distribution service tariff, and that PPLICA members who take service under Rate Schedule LP-5 are distribution customers of PPL Electric. The DSIC, therefore, applies to customers taking service under Rate Schedule LP-5. PPLICA's remedy, if any, lies with the General Assembly, not the Commission.

PPLICA next contends that two of PPL Electric's distribution rate riders, the ACR and CER, should not be considered in calculating the 5% DSIC cap. Again, PPLICA simply ignores the plain language of the Act, which clearly excludes from projected distribution revenues only the state tax adjustment surcharge and public fire protection services for water utilities. The ACR and CER are both rates contained in PPL Electric's distribution tariff and are charged to all distribution service customers. In addition, each recovers costs incurred by PPL Electric to meet its statutory obligations as an EDC under the Public Utility Code. Moreover, the costs now recovered by these two distribution rate riders were previously recovered in base distribution rates. Act 11 draws no distinction between base rates and base rate riders. Both clearly collect and recover distribution system costs and are properly included in the calculation of the DSIC cap. Therefore, PPLICA's proposal should be rejected.

For these reasons, and as more fully set forth below, PPL Electric's proposed DSIC filing is fully consistent with Act 11 and should be approved.

V. ARGUMENT

A. PPL ELECTRIC HAS PREPARED ITS DSIC PROPERLY AND IN ACCORDANCE WITH THE REQUIREMENTS OF ACT 11.

PPL Electric's DSIC was prepared in accordance with Act 11 and the model DSIC tariff included with the Commission's Final Implementation Order, which was derived from the long-standing DSIC tariffs for water utilities. The issues identified in this proceeding primarily deal with the appropriate interpretation of Act 11. Under the applicable rules of statutory

interpretation applicable in the Commonwealth of Pennsylvania, the adjustments proposed by the OCA and PPLICA should be rejected. Such a result achieves the intent of the General Assembly and is consistent with the Commission's Final Implementation Order.

B. PPL ELECTRIC'S TAX CALCULATIONS ARE APPROPRIATE, AND THE OCA'S PROPOSED ADJUSTMENTS SHOULD BE REJECTED.

In this proceeding, the OCA has proposed that PPL Electric modify the DSIC calculation: (1) to deduct incremental accumulated deferred income taxes ("ADIT") associated with DSIC-eligible property; and (2) to eliminate from the calculation of pre-tax return any gross-up for state income taxes based on alleged incremental tax deductions on DSIC-eligible property. As a matter of law, such proposals must be rejected as contrary to the intent of the Pennsylvania General Assembly in enacting Act 11.

Before turning to the merits of the OCA's proposed adjustments, a brief description of ADIT and the state income tax gross-up, as relevant to this proceeding, is provided below.

ADIT. ADIT is created as a result of the normalization of certain tax deductions for federal income tax purposes. In general, for both book and tax purposes, expenditures for plant additions are either capitalized and depreciated over a period of years or, in some instances, deducted currently as an expense. PPL Electric St. 4-R, pp. 2-3. In either case, the timing of the depreciation deductions for book purposes often differs from the timing of the depreciation deductions for tax purposes. *Id.* at 3. These timing differences arise primarily from the use of accelerated depreciation (including bonus depreciation) and from the use of shorter depreciable lives for tax purposes than for book purposes. *Id.* As a result of these timing differences, tax depreciation deductions generally exceed book depreciation deductions in the earlier years of an asset's life, and, correspondingly, tax depreciation deductions are generally less than book

depreciation deductions in the later years of an asset's life. *Id.*[2] Ultimately, however, and importantly, the total amount deducted for both book and tax purposes is generally identical over the life of the property, and the amount of income taxes paid over the life of the property will be the same. *Id.* The difference is in the timing of the tax payments. For this reason, tax issues related to this issue are often described as "book/tax" timing differences.

This timing difference between income taxes for tax and book purposes is recorded on the utility's books as a deferred income tax. A positive deferred tax entry reflects the fact that taxes paid to the government in a given year are less than tax expense calculated for book purposes. They are characterized as "deferred" income taxes because, as explained above, the deferred amounts are not permanent tax savings and will ultimately be paid to the government during the later years of the property's life when book depreciation exceeds tax depreciation. In those years, the deferred tax balance for the relevant item of property will be negative, reflecting the fact that tax expense paid to the government is greater than tax expense calculated for book purposes. The total ongoing balance of deferred income taxes, both positive and negative, is recorded on the utility's books as accumulated deferred income taxes, or ADIT.

For ratemaking purposes, these book/tax timing differences are either "normalized" or "flowed through" on a current basis. Under normalization, income tax expense for ratemaking includes both current and deferred incomes taxes, and the deferred income tax amount is deducted from rate base. Under this construct, it is recognized that the deferred tax amount is not a permanent tax savings and will ultimately be paid to the federal government; therefore, it is treated as an interest free loan from the federal government. The deferred taxes are deducted

[2] Certain plant expenditures, such as repair deductions, may be currently deductible as an expense rather than capitalized and depreciated. In this case the entire amount of the capital expenditure is deductible for tax purposes in the year the new plant is placed in service, while for book purposes, the plant is depreciated over its useful life. PPL Electric St. 4-R, p. 3.

from rate base to reflect the fact that a portion of rate base is financed from the interest free loan and not by the utility. Conversely, under the "flow through" method, tax expense for ratemaking purposes reflects only current income tax expense and not deferred income tax expense. As a result, there is no deduction from rate base because the deferred income taxes are not currently reflected in rates; rather, the tax savings are used to reduce current rates, and there is no "loan" from the government.

The OCA contends that DSIC-eligible property will generate incremental deferred income taxes, that it is possible and appropriate to calculate these incremental deferred taxes outside of a Section 1308 base rate case, and that this incremental ADIT balance should be deducted from the DSIC plant balance in calculating the DSIC rate. The Company disagrees.

"Gross Up" For State Income Taxes. In accordance with the plain language of Act 11, the Company included a provision for federal and state income taxes in calculating its DSIC. This so-called "gross-up" adjustment is required because income generated by application of the DSIC is taxable income to the Company. Absent recovery of tax expenses in the DSIC, the Company would be unable to earn its allowed return on DSIC investment.

The OCA contends that due to accelerated tax depreciation and the repairs allowance on DSIC property, PPL Electric will not pay any state income taxes on incremental income from application of the DSIC, and that there should be no "gross-up" for state income taxes. PPL Electric disagrees.

1. OCA's Adjustments are Inconsistent with Act 11 and the Intent of the General Assembly and the Commission

The tax adjustments proposed by the OCA are not identified in the plain language of Act 11 and therefore should be rejected. The primary objective of statutory interpretation is to discern the intent of the General Assembly. The Statutory Construction Act of 1972 ("Statutory

Construction Act") provides that "the object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly." 1 Pa.C.S. § 1921. As the courts have noted, "it is incumbent that the reviewing court endeavor to ascertain the intent of the Legislature." *Commonwealth v. Cox*, 603 Pa. 223, 283, 983 A.2d 666, 703 (2009). In order to ascertain the intent of the General Assembly, the ruling body should first look at the plain language of the statute. *Commonwealth v. Segida*, 604 Pa. 103, 108, 985 A.2d 871, 874 (2009). When the language of the statute is free from ambiguity, the letter of the statute is to be followed. 1 Pa.C.S. § 1921(b). However, if the words are not explicit, then intent may be gleaned from the contemporaneous legislative history. 1 Pa.C.S. § 1921(c)(7). Legislative history may include previous drafts of house bills, as well as statements made by legislators during the time of the statute's enactment. *See Commonwealth v. Wilson*, 529 Pa. 268, 602 A.2d 1290 (1992) (Court relied on statements made by legislature during the enactment process and recorded in the Legislative Journal to determine legislative intent). Applying the language of the statute and the legislative history associated with its enactment, the Commission should conclude as a matter of law that the General Assembly intended that the DSIC mechanism previously adopted for water utilities should continue. Based upon the legislative intent, the Commission should further conclude that OCA's proposed tax modifications to the DSIC formula are contrary to Act 11 and must be rejected.

The plain language of the DSIC provision makes it clear the General Assembly intended to adopt the DSIC formula previously used by water utilities and to reject the tax adjustments proposed by OCA. The statute enacted by the General Assembly embraces all of the concepts originally applicable to the water DSIC. As explained by PPL Electric witness Johnson, and as is evident by a comparison of the DSIC provisions in Act 11 and the prior water utility model

DSIC tariff, Act 11 adopted the water DSIC formula. PPL Electric St. 3-R, p. 2; PPL Electric Ex. BLJ-R2. For example, provisions related to computation of the DSIC contained in Section 1357 and the customer protection provisions contained in Section 1358 are substantially the same as, and in many cases identical to, the model water DSIC tariff.[3] Since its inception, and for the ensuing 16 years, the water utility DSIC formula did not contain either the ADIT deduction or the state income tax adjustments proposed by OCA, and no language was added in the adoption of Act 11 to incorporate either of these changes. The adoption by the General Assembly of the historic water DSIC mechanism, as an exception to the traditional base rate analysis required under Section 1308(d), demonstrates that the OCA's tax adjustments should be rejected. *Popowsky v. Pa P.U.C.*, 869 A.2d 1157, 1160 (Pa. Cmwlth. Ct. 2005)("*Wastewater DSIC*").

The OCA's tax adjustments are omitted from the plain language of Act 11. The Pennsylvania Supreme Court has held that in determining legislative intent it is not appropriate to "supply omissions in the statute, especially where it appears that the item may have been intentionally omitted." *Mt. Village v. Bd. of Supervisors*, 582 Pa. 605, 874 A.2d 1, 22 (Pa. 2005) (citing *Kusza v. Maximonis*, 363 Pa. 479, 70 A.2d 329, 331 (Pa. 1950)). As PPL Electric will explain below, the General Assembly's omission of the tax adjustments was intentional. The

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[3] As just one example, Section 1357(b)(1) provides as follows:

> The pretax return shall be calculated using the Federal and State income tax rates, the utility's actual capital structure and actual cost rates for long-term debt and preferred stock as of the last day of the three-month period ending one month prior to the effective date of the distribution system improvement charge and subsequent updates.

This language is virtually identical to the following provision of the Commission's model water DSIC tariff, which provided:

> Pre-tax return: The pre-tax return will be calculated using the state and federal income tax rates, the Company's actual capital structure and actual cost rates for long-term debt and preferred stock as of the last day of the three-month period ending one month prior to the effective date of the DSIC and subsequent updates.

PPL Electric Ex. BLJ-R2.

fact that neither of OCA's modifications appear in the language of the statute should be taken as a clear demonstration that the General Assembly intended that neither modification be included in the DSIC mechanism adopted in Act 11.[4]

If there were any uncertainty with regard to the intent of the General Assembly in the statutory provisions, and there is not, it would be resolved in PPL Electric's favor based upon a review of the legislative history associated with Act 11. That legislative history makes it clear that the General Assembly specifically considered, and rejected, the OCA's tax-related proposals. PPL Electric witness Bethany Johnson provided legislative history relevant to this issue in her rebuttal testimony, including excerpts from the House Journal, wherein the implementation of the DSIC was discussed. The House Journal documents indicate that an amendment was proposed that would have modified the calculation of the DSIC. The sponsor of the proposed amendment emphasized that the intent of her change was to "offset" the charge by incorporating "tax benefits" in the final DSIC calculation. *See* Exhibit BLJ-R1, Legislative Journal at 1909. This amendment was rejected by the General Assembly. *Id.* at 1911. The omission of OCA's proposed tax modifications from the statute clearly was intentional and should not be added to the statute through a subsequent interpretation that is patently inconsistent with the intent of the General Assembly.

In addition, the legislative history makes it clear that the General Assembly relied on the water DSIC mechanism, as it had been implemented by the Commission, as the foundation for the DSIC mechanism authorized in Act 11. The legislative history indicates that House Bill 1294, which eventually became Act 11, was specifically amended to "memorialize in statute the current PUC procedure and process used to evaluate water utility requests for DSIC." *Id.* at 155.

[4] The language of the statute refers to using the applicable state income tax rate. 66 Pa C.S. § 1357(b)(1). This language is identical to the language used in the water DSIC. The statutory tax rate has always been used in the application of the water utility DSIC. PPL Electric St. 3-R, pp. 3-4.

(emphasis added). The General Assembly's specific reference to the historical water DSIC makes the Commission's treatment of ADIT and state income taxes in water DSICs relevant to determining how to apply Act 11 in this proceeding.

The water DSIC was first implemented by the Commission in 1997. As indicated in Exhibit BLJ-R2, when the Commission implemented the DSIC it provided the water utilities with model tariff language. The model tariff language did not provide for ADIT to be included in calculating the DSIC. PPL Electric St. 3-R, p. 3. Further, witnesses for the Company and OCA agree that no water utility in the state of Pennsylvania has ever included ADIT in calculating its DSIC. *Id.*; OCA St. 1-S, p. 2. In addition, witnesses for the Company and OCA also agree that all water utilities have calculated state income taxes using the full statutory tax rate as part of their calculation of DSIC rates. PPL Electric St. 3-R, p. 4; OCA St. 1-S, p. 2. The prior history of water utility DSICs was directly referenced by the General Assembly when it enacted Act 11. Therefore, in accordance with the provisions of Section 1921(c)(7) of the Statutory Construction Act, the DSIC provisions of Act 11 must be interpreted consistent with the Commission's past practice with the water DSIC.[5]

Moreover, it is important to recognize that the DSIC is an automatic adjustment surcharge mechanism. Such mechanisms are authorized by the General Assembly as exceptions to the traditional base rate filings. *Popowsky v. Pa P.U.C.*, 13 A.3d 583, 591 (Pa. Cmwlth. Ct. 2011) ("*Purchased Water Surcharge*"); *Wastewater DSIC*, 869 A.2d 1157; *Pa. Indus. Energy Coal. v. Pa P.U.C.*, 653 A.2d 1336, 1349 (Pa. Cmwlth. Ct. 1995) ("*PIEC*"). In *PIEC*, for

[5] Section 1921(c)(8) of the Statutory Construction Act further provides that the intention of the General Assembly may be ascertained by considering legislative and administrative interpretations of a statute. The Commission previously interpreted the provisions of the predecessor water DSIC statute to not include OCA's proposed tax offsets, and the legislature reaffirmed this determination in adopting the DSIC.

example, the Pennsylvania Industrial Energy Coalition ("Coalition") argued that a surcharge for recovery of certain demand side management costs would represent impermissible single issue rate making, which would disassemble the traditional ratemaking process. The Court rejected such contention, observing that "the General Assembly specifically allowed...the automatic adjustment of costs within specific procedures." *PIEC* at 1349. The Court further reasoned that the Coalition's objections were rejected because "the surcharge is permitted under the [Public Utility] Code, with procedures to determine the reasonableness of the charges outside of a base rate case." *Id.* at 1350 (emphasis added).

Similarly, in *Purchased Water Surcharge*, the Court rejected an OCA challenge to the institution of a purchased water adjustment surcharge. OCA asserted that the Commission did not have authority to allow a surcharge and that such surcharge would be impermissible retroactive ratemaking. The Commonwealth Court, quoting *PIEC*, again concluded that the charge was legislatively authorized, noting:

> While we recognize that a base rate filing under Section 1308 of the Code is the preferred method for a public utility to recover the cost of providing service we cannot ignore the fact that the General Assembly envisioned the automatic adjustment of rates in enacting Section 1307(a) of the Code.

Id. at 591 (emphasis added).

In *Wastewater DSIC*, the Court rejected a Commission effort to allow a DSIC charge for wastewater companies. In reaching its conclusions, the Court recognized that such charge could be imposed if authorized by the General Assembly:

> To be sure, the General Assembly has authority to exempt utilities from making the used and useful demonstration before recovering its capital expenditures. As noted, by amendment to Section 1307, the legislature has expressly authorized water utilities to recoup these expenses by surcharge.

Id. at 1158.

The OCA has argued in this proceeding that the DSIC should include two adjustments that are "accepted ratemaking practice," *i.e.*, are typically made in a Section 1308(d) base rate proceeding. OCA St. 1-S, p. 2. However, the DSIC surcharge mechanism, as an automatic adjustment charge rate mechanism, is an exception to traditional base rate procedures. The DSIC statute provides the elements for the DSIC mechanism, which is a mechanism distinct from the 1308(d) base rate mechanism, is designed to accomplish a different goal than the 1308(d) mechanism, and therefore has different adjustments associated with it. The OCA's adjustments are not provided for in the statute. Under the doctrine of *expressio unius est exclusis alterius* – the inclusion of a specific matter in a statute implies the exclusion of other matters – OCA's proposed modification must be rejected. The clear language of the statute does not allow for the OCA's adjustments. Further, to resolve any potential ambiguity, the Company provided legislative history that made it clear that OCA's adjustments are not reflected in the statute purposefully. PPL Electric Exhibit BLJ-R1. The Commission should not add what the legislature specifically disavowed. Not only did the General Assembly reject a specific amendment that would have included tax benefits in the calculation of the DSIC, such as ADIT and state income tax adjustments, but they also clearly embraced the Commission's prior practice under the water utility DSIC.

The rules of statutory interpretation in Pennsylvania are clear and require the Commission to interpret the DSIC provisions of Act 11 consistent with the intent of the General Assembly. The evidence presented by PPL Electric demonstrates that the OCA's recommendations with regard to deducting ADIT and disallowing any state income tax gross-up are inconsistent with the legislative intent of the General Assembly when it enacted Act 11. The legislative intent in adopting Act 11 was to adopt the water utility DSIC mechanism and to reject

proposals to incorporate tax modifications. Under the rules of statutory interpretation, OCA's proposals to revise the DSIC mechanism must be rejected.

2. The OCA Tax Adjustments Have Been Previously Rejected by the Commission Because They Would Unduly Complicate the DSIC Formula and are Not Necessary to Ensure that Rates are Just and Reasonable

The Commission directly addressed the OCA's tax adjustments in its Final Implementation Order. In its comments to the Tentative Implementation Order, OCA argued that the federal and state income tax calculations for the DSIC were overstated because they failed to recognize the difference between the utilities' tax depreciation and book depreciation on plant additions reflected in the DSIC. OCA Comments to Tentative Implementation Order, M-2012-2293611, pp. 9-16. In response, the Commission held:

> [T]he DSIC is intended to be a straightforward mechanism which is easy to calculate, easy to audit and which does not require a full rate case analysis. Inclusion of an ADIT adjustment would be inconsistent with that goal and would likely invite litigation over its calculation. Moreover, we note that the water DSIC, used successfully for over 15 years, did not include an ADIT adjustment. And, in any event, consumers remain protected against over earnings by the earnings cap under Section 1358(b)(3) which captures the revenue impact of all other adjustments and insures that the DSIC does not result in unreasonable rates.
>
> Therefore, the Commission declines to adopt the OCA proposal to include, in the DSIC calculation, an adjustment for accumulated deferred income taxes. The adjustment, which was not previously used in the DSIC by the water industry, would add unnecessary complexities to the DSIC and, accordingly, will not be included in the model tariff.

Final Implementation Order, p. 39 (internal citations omitted). It is quite apparent from this language that the Commission did not intend to include an adjustment for ADIT. In its resolution of this issue, the Commission provided three reasons that it did not include an adjustment for ADIT in the DSIC calculation. The first is that the DSIC mechanism was intended to be straightforward and easy to calculate. The second, which has already been

addressed in this brief, is that the water DSIC historically did not include ADIT. The third is that ADIT is already accounted for as part of the earnings cap.

The model tariff language adopted by the Commission is virtually identical to the model tariff language used by the Commission in its 1996 water DSIC Orders. PPL Electric St. 3-R, p. 3. The model tariff from 1996 did not include ADIT in the calculation of the DSIC; therefore, the model tariff for Act 11 does not include ADIT. *Id.* Further, as described in PPL Electric's direct and supplemental direct testimony, the Company's tariff adopted the Commission's model tariff. *Id.* Thus, like the water DSIC that PPL Electric's tariff was based upon, ADIT is not included in the calculation of PPL Electric's DSIC rate. The OCA has acknowledged that no water utility in Pennsylvania has included ADIT in its DSIC. *Id.* at 4. PPL Electric's proposed mechanism, which is consistent with the Commission's historic practice of not including ADIT, is consistent with the long applied water DSIC.

OCA's proposal to include an offset to plant for ADIT in the DSIC also would violate the desire of the General Assembly and the Commission for a straightforward and easy to calculate surcharge mechanism. The purpose of a surcharge mechanism is to establish a simple adjustment mechanism that does not require examination of every component that would be considered in a full base rate case proceeding. *See, e.g., Dorothy Gill v. The Bell Telephone Co. of Pa.*, C-00935402, 1994 Pa. PUC LEXIS 115 (Order entered April 22, 1994) (The State Tax Adjustment Surcharge, a Section 1307 mechanism, was adopted to provide a simple, expeditious mechanism to recover certain utility expenses). In contrast, base rate case calculations have many complexities and reflect all of the changes in revenues, expenses, plant additions and offsetting rate base deductions.

In an analogous context, the Commonwealth Court has recognized that non-base rate cases do not require submission of the full extent of revenues, expenses, rate base and rate of return as is required in a general base rate case. In, *Popowsky v. Pa. P.U.C.*, 683 A.2d 958 (Pa. Cmwlth. Ct. 1996) ("*Equitable*"), the Court considered an appeal from a Commission Order that authorized a non-general rate increase to recover costs associated with a change in accounting for post-retirement benefits other than pensions. OCA argued that the utility was required to present all of the evidence that would be required to support a change in base rates. The Court disagreed and stated:

> In response to such an argument, we would agree with the PUC that the statutory and regulatory scheme do not make the same full-blown standards applicable. If such a high standard applied, there would be no significant difference between non-general rate filings under Section 1308(b) and general rate filings under Section 1308(d). To the contrary, because of the modest nature of non-general rate filings, as required by the statute, we believe the PUC may determine whether the public utility's rates are just and reasonable based on the general information required under 52 Pa. Code § 53.52(b). That the non-general rate filing may be contested does not increase Equitable's evidentiary burden or limit the PUC's discretion.

Id. at 962. Similarly here, it would defeat the purpose of the Act 11 DSIC surcharge provisions to incorporate ADIT adjustments into the rate calculation. This is because the determination of ADIT is not a simple calculation. There are several reasons for the complexity.

First, as acknowledged by OCA witness Catlin and as further explained by PPL Electric witness Torok, whether and to what extent PPL Electric has any ADIT balance not already reflected in base rates depends in part upon its overall tax position. OCA St. 1, p. 7; PPL Electric St. 4-R, p. 6. As explained above, an ADIT liability generally results from tax depreciation deductions that exceed book depreciation deductions. PPL Electric St. 4-R, p. 3. However, PPL Electric has recently generated tax deductions that exceed its income, resulting in tax loss carryforwards. An increase in ADIT liability that results in a net operating loss

carryforward does not provide a current cash tax benefit. *Id.* at 6. The cash benefit is realized when the net operating loss carryforward is utilized. OCA St. 1, p. 7. The result, as conceded by Mr. Catlin, is that no ADIT adjustment can be included at this time due to prior and ongoing tax losses. *Id.* This situation can recur in the future at any time, depending upon available tax deductions under federal law, thereby complicating the determination of ADIT. OCA's own concession in this proceeding, that an ADIT offset was not proper at this time, demonstrates that the adjustment is not easy to calculate and would inevitably invite litigation over the utility's past, present, and future income tax status.

The determination of ADIT for purposes of quarterly DSIC filings is further complicated because PPL Electric's income tax expense is based on the results of operations for its annual accounting period, and not the sum of its calendar quarterly results. *Id.* at 4. Additionally, the quarterly reporting period for purposes of the DSIC calculation does not coincide with PPL Electric's quarterly accounting and reporting periods due to the 30-day lag period. *Id.* In fact, the November through January period overlaps calendar years. *Id.* PPL Electric's actual tax status (*i.e.*, whether it is in a positive tax position or a tax loss position) cannot be known until after the end of the tax year. *Id.* at 5. It is only at that time that the Company will know its taxable income (or loss) before depreciation deductions, as well as the applicable deductions (*i.e.*, repair allowance, bonus depreciation and/or accelerated depreciation) available for the mix of plant additions actually installed. *Id.* at 6. However, the DSIC is calculated on a quarterly basis, and any determination of ADIT would involve estimates that would require subsequent true ups. To inject estimates into the DSIC plant balance used in the calculation would be

contrary to the use of known, historic balances envisioned by the statute.[6] This is clearly inconsistent with the "straightforward" calculation intended for the DSIC.

Finally, the determination of any ADIT deductions is complicated by the fact that, as to plant already reflected in base rates, or plant reflected in a DSIC, the ADIT balance may decline because book depreciation deductions exceed tax depreciation deductions, creating a negative deferred income tax. *Id.* at p. 3. This is particularly the case for plant that is subject to the repair allowance deduction or a bonus depreciation deduction, which can turn around within a few years of the creation of the ADIT. *Id.* Such ADIT balance reductions can offset, in whole or in part, any new ADIT balances created from new DSIC-eligible plant.

It is important to emphasize that the DSIC mechanism established by Act 11 does not ignore ongoing changes in total tax balances. As the Commission recognized in its Final Implementation Order, the impact of tax deductions is already factored into the DSIC through the calculation of the earnings cap. The earnings cap prohibits PPL Electric from charging a DSIC if it exceeds its allowable rate of return. The Company's DSIC will be reset to zero if the data included in the most recent Annual or Quarterly Earnings report filed with the Commission shows that PPL Electric would earn a rate of return that would exceed its allowable rate of return. PPL Electric St. 3-R, p. 4. The Company's calculation of rate base for earnings report purposes includes the current book amount of ADIT and adjustments for state income tax. PPL Electric St. 3-RJ, p. 5. Thus, in order for PPL Electric to get the benefit of a DSIC, it must be in an under-earning position after taking into consideration the impact of the OCA's tax adjustments. PPL Electric St. 3-R, p. 4. Since earnings are reviewed quarterly, the earnings cap

[6] Under Section 1357, the DSIC is to include plant additions actually placed in service.

adequately addresses the concern associated with ADIT for plant additions under the DSIC, without the complication of reviewing these issues in each quarterly DSIC filing.

The OCA has argued that changed circumstances exist which make the inclusion of the tax adjustments, outside of the earnings cap, appropriate at this time. OCA St. 1-S, p. 3. This argument is flawed. While changes have occurred in tax benefits since the initial water DSIC, those changes occurred prior to the enactment of Act 11. Thus, the tax law changes relied upon by the OCA were known to the General Assembly before it adopted Act 11 and there is clear indication in the legislative history that the General Assembly was aware of the very tax benefits which the OCA seeks to address here. PPL Electric Exhibit BLJ-1R. In response to the recognized tax benefits, the General Assembly determined that it was appropriate to continue to use the water DSIC model, and rejected an amendment that would have acknowledged the changed circumstances relied upon by the OCA. Further, this is certainly not the first opportunity the Commission has had to review ADIT and the state income tax gross-up under the DSIC mechanism. The Commission has had many opportunities since the enactment of these tax benefits to address them in the water DSIC and has not done so. PPL Electric St. 3-RJ, pp. 2-3. The OCA cannot support its proposal by relying on changed circumstances.

The OCA has not established that its tax adjustments should be adopted in this proceeding. The adjustment is not provided for by the statute, nor should it be read into the statute based on the application of proper statutory interpretation. The adjustment is inconsistent with the determination of the courts and the Commission that the DSIC, as a surcharge mechanism, should be a simple and straightforward mechanism. The adjustment proposed by OCA should be rejected, and the Commission should uphold the intent of the General Assembly to exclude the OCA's tax adjustments.

3. The OCA's Adjustments Are Based on a Flawed Factual Premise, and if Adopted Would Result in a Fundamental Mismatching of Tax Expense for Ratemaking Purposes

The OCA's tax adjustments both are premised on the assumption that it is possible and appropriate to calculate federal and state income tax expense on an incremental basis and without regard to PPL Electric's overall federal and state income tax expense. As explained below, the OCA's assumption is fundamentally flawed, would result in fundamentally unfair and unreasonable results, and therefore should be rejected.

For tax purposes, there is no distinction between plant included in base rates and plant that will be included in the DSIC. As described by Mr. Torok, specific items of property are not subject to income tax. PPL Electric St. 4-R, p. 5. What is subject to tax is the total net income of PPL Electric computed on an annual, not quarterly, total Company basis. *Id.* A hypothetical calculation of the potential tax effects of placing individual items of plant or property into utility service does not and cannot reflect the actual tax liability of the Company or actual taxes paid to the government. *Id.* The OCA's effort to calculate incremental tax expense on individual units of property is fundamentally inconsistent with basic principles of tax law and simply makes no sense. PPL Electric is the taxpayer, and it is taxed on its total net income, not on income generated by incremental plant additions.

Adoption of OCA's proposal not only is inconsistent with basic tax law concepts, it would inevitably result in a fundamental mismatch of tax expense for ratemaking purposes. The Company's current ADIT and state income tax expense for ratemaking purposes are based upon the future test year from its last base rate proceeding, *i.e.,* 2012. Base rates currently reflect deferred income taxes and state income tax expense based on conditions at December 31, 2012. In this DSIC proceeding, the OCA seeks to update PPL Electric's income tax expense for DSIC eligible property, but completely ignores other changes in the Company's ADIT and state

income taxes that have occurred since its last base rate case. The OCA's tax adjustments reflect the tax effects of incremental DSIC property additions without updating overall tax expense established in PPL Electric's last base rate case reflecting 2012 conditions and will double count deductions.[7] This is fundamentally unfair, and moreover, the only way to correct such unfairness would be to undertake a full tax calculation looking at all plant in service as part of the quarterly DSIC calculation. Only in this way can the changing mix of current tax deductions be taken into account. However, a full tax calculation is directly contrary to the General Assembly's and the Commission's intent that the DSIC be calculated in a simple, straightforward manner. *Id.* at 8. It would also require the Company to undertake tax calculations that are not part of its normal course of business and would introduce true-ups into the DSIC mechanism. *Id.* These are clearly inconsistent with the Commission's determination that the DSIC be simple and easy to calculate.

The OCA's proposal to calculate taxes incrementally would result in improper and inaccurate tax calculations. In order to correctly calculate taxes, a much more complicated and extensive calculation akin to a full base rate tax calculation would be required, which is contrary to the clear intent expressed by the Commission in its Final Implementation Order. Therefore, the OCA's tax proposals should be rejected.

C. THE OCA'S ARGUMENTS IN SUPPORT OF ITS TAX ADJUSTMENTS ARE WITHOUT MERIT AND SHOULD BE REJECTED.

[7] For example, assume a $1 million plant addition in the future test year of the utility's last rate case with a book depreciation life of 10 years which qualifies for the repair allowance. For tax purposes, the entire $1 million investment is taken as a tax deduction in year one, whereas the book depreciation for year one is $100,000. This $1 million tax deduction is used to reduce income tax expense in the base rate case and the tax savings are rolled into base rates. In year two, however, the tax depreciation deduction is zero, and the book depreciation continues to be $100,000. Base rates will continue to reflect tax savings associated with the $1 million year one tax deduction until the utility has another base rate case, even though the deduction is no longer available for tax purposes. The OCA proposes to reflect new ADIT for DSIC plant additions between rate cases, but does not account for other changes since the last base rate case, such as the disappearance of the $1 million tax deduction.

1. Rejection of the OCA's Proposed Tax Adjustments Will Not Result in Unjust and Unreasonable Rates

OCA has argued in its testimony that, without its two tax adjustments, the DSIC will overstate the Company's costs in violation of the standard ratemaking practices. OCA St. 1, p. 5; OCA St. 1-S, p. 2. Essentially, the OCA argues that without its tax adjustments, the DSIC will not produce just and reasonable rates. OCA's contention is contrary to law, and is based upon an unreasonably narrow view of the standard for determining whether rates are just and reasonable.

In Pennsylvania, a rate is defined as more than just the individual components of the mechanism, but rather the entire mechanism and all rules and regulations associated with it. The statutory definition of a rate is:

> Every individual, or joint fare, toll, charge, rental or other compensation whatsoever of any public utility...made, demanded, or received for any service within this part, offered, rendered, or furnished by such public utility...and any rules, regulations, practices, classifications or contracts affecting any such compensation, charge, fare, toll, or rental.

66 Pa.C.S. § 102. It is readily apparent under this definition that any analysis as to whether a rate is just and reasonable must consider the rate as a whole, and not its individual components.

OCA's contention that a rate can be declared unjust or unreasonable by examining in isolation its individual components also is contrary to the well-established legal standard for determining just and reasonable rates, which examines the reasonableness of rates based on whether they produce a fair rate of return for the utility as whole. *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989). In *Duquesne*, the utility contended that the Commission's denial of the recovery of costs associated with the cancellation of a proposed nuclear power plant resulted in unjust and unreasonable rates and confiscated its property in violation of the Fifth Amendment of the United States Constitution. The Court rejected this argument and held that the determination of whether rates approved by a regulatory commission are just and reasonable

must be based on the effect of the rates on overall rate of return earned by the utility and not on the merit or lack of merit of individual expense adjustments. In reaching this result, the Court noted that in determining just and reasonable rates, "the economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result" and that as a result, it is the overall effect of a rate order that is relevant and not its individual components. *Id.* at 314. *See also Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968) ("[N]either law nor economics has yet devised generally accepted standards for the evaluation of rate-making orders."). Thus, the Court acknowledged that there are many ways to achieve rates that are just and reasonable. The Supreme Court held that:

> [W]e reaffirm these teachings of [*FPC v. Hope Natural Gas Co.*, 320 US 591, 602 (1944)]: "[I]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry. . . is at an end. The fact that the method employed to reach that result may contain infirmities is not then important." *Id.* at 602. This language, of course, does not dispense with all of the constitutional difficulties when a utility raises a claim that the rate which it is permitted to charge is so low as to be confiscatory: whether a particular rate is "unjust" or "unreasonable" will depend to some extent on what is a fair rate of return given the risks under a particular rate-setting system, and on the amount of capital upon which the investors are entitled to earn that return.

Duquesne at 314 (emphasis added). The Court went on to find that the disallowance of a single element of expense is not the appropriate standard for determining whether rates are just and reasonable. This is due, in part, to the fact that "errors to the detriment of one party may well be canceled out by countervailing errors or allowances in another part of the rate proceeding." *Id.* Finally, in rejecting that there is a single theory of valuation that produces just and reasonable rates, the Court held:

> [C]ircumstances may favor the use of one ratemaking procedure over another. The designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose

> alternatives which could benefit both consumers and investors. The Constitution within broad limits leaves the States free to decide what ratesetting methodology best meets their needs in balancing the interests of the utility and the public.

Id. at 316. The conclusions to be drawn from *Duquesne* are readily apparent: Any determination regarding whether rates are just and reasonable must look at the total effect of a utility's rates on its ability to have a fair opportunity to earn a fair rate of return on its property devoted to public service.

The OCA has asked the Commission in this case to adopt two specific tax adjustments in calculating the DSIC. For reasons explained above, the General Assembly has not included such adjustments in the calculation of the DSIC charge, and they should be rejected. The Commission's rejection of the OCA's individual rate adjustments, however, cannot and will not, in and of itself, result in unjust and unreasonable rates. The determination of just and reasonable rates must be determined based on total company operations, and not on the acceptance or rejection of individual ratemaking adjustments. The legislature itself has recognized this result by including an earnings cap in Act 11. Under this provision, a utility can only charge a DSIC if, on an overall basis, it is not earning an excessive rate of return, *i.e.*, if its rates are just and reasonable under the *Duquesne* standard. As explained above, the OCA's tax adjustments are both fully reflected in the calculation of the utility's rate of return used to apply the DSIC earnings cap and therefore are fully reflected in the determination of whether the utility is earning a reasonable return and whether its rates are just and reasonable under the correct legal standard.

2. Actual Taxes Paid

The OCA also contends that the failure to adopt its proposed adjustments would violate the "actual taxes paid" doctrine. OCA St. 1, p. 10. Simply described, the actual taxes paid

principle permits a utility to only charge rates which reflect its actual tax expense for any given year. *See Barasch v. Pa P.U.C.*, 491 A.2d 94 (Pa. 1985) ("Barasch"). As explained below, the OCA's reliance on this argument should be rejected for three reasons.

OCA contends that its two tax adjustments are necessary to comply with the actual taxes paid doctrine. This is not the case. First, as explained above in Section B.3, the tax adjustments proposed by the OCA do not and logically cannot reflect actual taxes paid. Taxes paid to the government are calculated for PPL Electric, and indeed for all taxpayers, on a total company basis and not based upon individual items of plant or revenue. The OCA's actual taxes paid argument is premised upon an erroneous factual premise and is inconsistent with fundamental principles of tax law and should be rejected for this reason alone.

Second, the actual taxes paid doctrine has only been applied in base rate proceedings. As discussed previously, the General Assembly did not intend for this proceeding to be a full base rate proceeding under section 1308, but rather a simplified automatic adjustment clause proceeding. The OCA's reliance on actual taxes paid is an ill-conceived proposal to inject Section 1308 base rate issues into an automatic adjustment clause proceeding.

The only way to determine PPL Electric's actual taxes paid for state income tax purposes on the plant additions would be to conduct a full rate case tax analysis. This tax analysis is the antithesis of a simple tax calculation. Conducting such a tax analysis would subject the DSIC to disputes over the proper calculation of federal and state tax liability. As the Commission indicated in its Final Implementation Order, it was seeking to reduce the potential for litigation over the individual elements of the DSIC mechanism by keeping the calculation simple. *Id.* Moreover, conducting the full-blow base rate tax analysis required by the OCA's proposal would

specifically violate the mandate that surcharges be simple mechanisms as set forth by the courts and the Commission.

Finally, even if the "actual taxes paid doctrine" were relevant to this case, and it is not, it is a judicial construct and therefore can be modified by the General Assembly. *Barasch at* 104. To the extent that this judicial doctrine could have had any application to the DSIC, the General Assembly rejected that application in Act 11 where it provided a formula for calculation of the DSIC and intentionally omitted the OCA's proposed adjustments while embracing the Commission's historic water DSIC calculation.

3. Reliance on Other States

OCA witness Catlin asserts that, in determining how to apply Act 11, the Commission should look at DSIC mechanisms developed in other states, either through statute or state utility commission orders. OCA Statement No. 1-S, p. 3. This assertion does not comport with proper statutory interpretation. The Statutory Construction Act does not generally provide for consideration of an issue by another jurisdiction as a basis for determining legislative intent. In *Elder v. Orluck*, 511 Pa. 402, 515 A.2d 517, 522 (1986), the Court noted that it was not appropriate to consider another jurisdiction's statute where there was no indication that the General Assembly based Pennsylvania legislation on legislation adopted in other jurisdictions. The OCA has not argued, and cannot argue, that the General Assembly relied upon any other jurisdiction in developing the DSIC provisions in Act 11. It is clear that the General Assembly based the DSIC provisions of Act 11 upon the Pennsylvania water DSIC, which, as explained above, does not include the modifications proposed by OCA.[8]

[8] Section 1927 of the Statutory Construction Act provides that statutes uniform with those of other states shall be interpreted and construed to effect their general purpose to make laws uniform among jurisdictions. However, as discussed in section V.B. of this brief, there is no uniformity among jurisdictions on DSIC-type provisions.

Even if the practices in other states were relevant, and they are not, the rate mechanisms cited by the OCA are fundamentally different from the Pennsylvania DSIC and offer no meaningful guidance to support the OCA's position. Of the states referenced by the OCA, many do not have mechanisms in place for electric utilities.[9] However, even ignoring that not all of the states identified by OCA have mechanisms for electric utilities, none of the states cited have an earnings cap. *Atlanta Gas*; *Bay State 2010; In re Petition of Pivotal Util. Holdings, Inc. d/b/a Elizabethtown Gas to Extend Its Util. Infrastructure Enhancement Program and Revise Its Util. Infrastructure Enhancement Rate*, 2011 N.J. PUC LEXIS 112 (N.J. B.P.U. 2011); *In re Application of Questar Gas Co. to Increase Distribution Non-Gas Rate and Charges and Make Tariff Modifications*, 2010 Utah PUC LEXIS 133 (Utah P.S.C. 2010); MD. CODE ANN., PUB. UTIL. COS. § 4-210 (2013); KAN. STAT. ANN. §§ 66-2202-2204 (2013); KY. REV. STAT. ANN. § 278.509 (2013); MO. REV. STAT. § 393.1009 (2013); NEB. REV. STAT. §§ 66-1802, 1865-1867 (2012); R.I. GEN. LAWS § 39-1-27.7.1 (2013). Further, these states account for a variety of other adjustments as part of their calculation, including uncollectible accounts, real property, other taxes, operation and maintenance savings, purchased gas costs, and fully projected plant additions, to name only a few, which are not included in the Pennsylvania DSIC.[10] Rather than support the OCA's position in this proceeding, the practices in other states show that there is no absolute formula for calculating a surcharge mechanism, and that many different possible forms may result in just and reasonable rates. The OCA's argument that its tax proposals must be included because some other states include them is undermined by the OCA's

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Therefore, this provision is inapplicable. *See Allegheny County Sportman's League v. Rendell*, 860 A.2d 10 (Pa. 2004).

[9] *See, e.g., In re Atlanta Gas Light Co.'s Pipeline Replacement Program*, 2009 Ga. PUC LEXIS 245 (Ga. P.U.C. 2009) ("*Atlanta Gas*"); *Petition of Bay State Gas Co. for Approval by the Dep't of Pub. Utils. of its Proposed Calendar Year 2009 Targeted Infrastructure Reinvestment Factor for Effect November 1, 2010*, 2012 Mass. PUC LEXIS 160, D.P.U. 10-52 (Mass. Dept. of Telecomms. and Energy Oct. 30, 2012)("*Bay State 2010*").

[10] *See, e.g., Bay State 2010*; MD. CODE ANN., PUB. UTIL. COS. § 4-210 (2013).

failure to similarly advocate to include other major rate components, which are included in other states but not included in Pennsylvania.

The OCA's argument that the Commission should look to other states rather than adhere to the clear directives from the General Assembly is inconsistent with the rules of statutory interpretation and should be rejected.

D. PPLICA'S PROPOSALS ARE NOT CONSISTENT WITH ACT 11 AND SHOULD BE REJECTED

PPLICA has argued in this proceeding that PPL Electric should make two adjustments to its DSIC mechanism. The first of these is to exclude the LP-5 customer class from application of the DSIC. The second proposal is that certain riders charged to distribution customers, namely the Act 129 Compliance Rider ("ACR") and the Competitive Enhancement Rider ("CER"), should not be included in PPL Electric's calculation of its distribution revenue. Neither of these proposals conforms with the plain language of Act 11 or the Commission's Final Implementation Order. Therefore, these proposals should be rejected.

1. The Act 11 DSIC Should Apply to Rate Schedule LP-5.

PPLICA contends that the DSIC should not apply to Rate Schedule LP-5 customers because they take service at "transmission level voltage." This argument should be rejected. The clear and unambiguous language of Act 11 provides that the DSIC is to be applied "equally to all customer classes." 66 Pa. C.S. §1358 (d)(1). In its Final Implementation Order, the Commission specifically carved out natural gas customers who have competitive options, because those customers can completely opt out of taking service from a natural gas distribution company. However, in the very same discussion, the Commission provided for different treatment with regard to EDCs. The Commission provided that for EDCs, "DSIC surcharges are to be applied to any customers served from higher voltage facilities which are included within

the EDC's distribution plant for ratemaking purposes." *Id.* at 46. Thus, the relevant inquiry here is whether Rate Schedule LP-5 customers are distribution customers for ratemaking purposes.

PPL Electric's Rate Schedule LP-5 customers are distribution customers for ratemaking purposes. Rate Schedule LP-5 customers take service under PPL Electric's Commission-approved distribution tariff and are allocated distribution costs in the Company's cost of service study. PPL Electric St. 3-R, p. 8. PPLICA's own witness acknowledged that operating, maintenance and other related customer costs have been allocated to Rate Schedule LP-5 customers in PPL Electric's cost of service study in its last base rate proceeding. *Id.* The fact that these customers take service at transmission level voltage does not mean that they are not distribution customers. PPL Electric St. 3-RJ, p. 6. The rate schedule under which they take service is in PPL Electric's retail distribution tariff and is included in PPL Electric's distribution cost of service study. Rate Schedule LP-5 is within a distribution customer class of PPL Electric, so the DSIC is applicable to Large Commercial and Industrial customers taking service under this rate schedule. *Id.*

PPLICA has argued in its testimony that Rate Schedule LP-5 customers are not allocated any distribution plant costs under PPL Electric's class cost of service study. This is incorrect for two reasons. The first is that Rate Schedule LP-5 customers are allocated some costs associated with distribution plant in the cost of service study. *Id.* at 7. The second is that, based on the clear language of Act 11, the DSIC should apply to all distribution customers without any consideration as to cost allocation. If Mr. Baudino is correct that no DSIC-eligible plant serves Rate Schedule LP-5 customers, then in PPL Electric's next base rate case, none of this plant will be allocated to Rate Schedule LP-5, and it will not be included in the base rates paid by those customers. *Id.* However, Act 11 does not require a cost of service study for customers to be

charged the DSIC; in fact, the statute requires the DSIC charge to be an equal charge to all customer classes, without regard to cost of service principles. Thus, PPLICA's argument as to the relative amount of DSIC-eligible plant that would be allocated to Rate Schedule LP-5 customers in a base rate proceeding is not relevant to the Commission's determination in this proceeding. *Id.* While Rate Schedule LP-5 customers take service at "transmission voltage," they are still distribution customers of PPL Electric taking service under a rate schedule contained in PPL Electric's electric distribution tariff. Therefore, they must pay the DSIC under the plain language of Act 11.

Fundamentally, PPLICA does not and cannot deny that Rate Schedule LP-5 customers are distribution service customers of PPL Electric which are allocated distribution plant and other distribution costs in the ratemaking process. Act 11 requires that the DSIC apply to all distribution service customers equally. Thus, PPLICA's remedy lies with the General Assembly, not with the Commission.

2. PPL Electric's Distribution Riders Should be Included in the Calculation of the DSIC Cap.

In order to properly determine the 5% revenue cap associated with the DSIC, which a utility cannot exceed when charging its customers, utilities are required by Act 11 to calculate their projected quarterly revenues. Act 11 is clear that for all utilities other than water utilities, this should exclude only the state tax adjustment surcharge. As a result, PPL Electric defined projected quarterly revenues in its DSIC formula to include all applicable clauses and riders. This definition is consistent with Act 11 and the Commission's model tariff. PPL Electric has included only those clauses and riders that apply to distribution service customers, including the Smart Meter Rider, Act 129 Rider ("ACR"), Universal Service Rider, and Competitive Enhancement Rider ("CER"). These charges are applied, on a non-bypassable basis, for

electricity supplied to customers who receive distribution service from the Company under its tariff, and PPL Electric has appropriately included these applicable riders in its determination of projected quarterly revenues.

In its May 23 Order implementing PPL Electric's DSIC, the Commission identified five riders that are the subject of PPLICA's proposal, which included the four riders identified in the previous paragraph and a Net Metering Rider.[11] PPLICA, while initially raising questions about several of these riders, has narrowed the scope of its proposal to two riders. PPLICA has proposed in this proceeding that PPL Electric's ACR and CER riders be excluded from the calculation of the revenue cap. This proposal creates an artificial and irrelevant distinction between distribution revenues and non-bypassable revenues. The proposal should be rejected.

First, Act 11 provides only that "projected revenues shall not include revenues from public fire protection service earned by water utilities and the State tax adjustment surcharge." 66 Pa. C.S. §1357 (d)(2). No other riders or elements of distribution rates are excluded. Based on this clear language, the calculation of the projected revenues should include all other riders that were not specifically excluded by the General Assembly.

Further, the model tariff included with the Commission's Final Implementation Order for the DSIC identifies specifically that riders should be included in the calculation of the charge. The model tariff provides that:

> Projected quarterly revenues for distribution service (including all applicable clauses and riders) from existing customers plus revenue from any customers which will be acquired by the beginning of the applicable service period.

[11] While the Net Metering Rider was identified by the Commission, as described by witness Johnson in her Affidavit, the Commission appears to be addressing the Net Metering for Renewable Customer-Generators, which does not have a Section 1307(e) report and adjustment associated with it. As a result, the Company does not separate those revenues out in the same manner as it does with the other Section 1307(e) riders, and those revenues are calculated as part of the base rate revenues in the DSIC.

Consistent with this language, PPL Electric calculated its quarterly revenues to include all applicable riders. ACR and CER are part of the Company's distribution service tariff, and they recover costs booked to the distribution business pursuant to FERC's Uniform Systems of Accounts for distribution service. PPL Electric St. 3-R, pp. 8-9. The ACR and CER were therefore included.

For the purposes of calculating its revenues, PPL Electric's revenues are generated by either distribution, transmission or generation service. The fact that certain Company costs are recoverable through a Section 1307 automatic adjustment clause instead of a Section 1308 base rate does not preclude them from being considered as distribution costs. *Id.* at 9. Specifically, the costs recovered in the CER and ACR are mandated by the PUC and are the responsibility of the Electric Distribution Company. If these costs were not recovered in Section 1307 adjustment clauses, they would be included and recovered in the Company's Section 1308 distribution rates, and the revenues would not be accounted for any differently than other base distribution revenues. *Id.* For billing purposes, both the CER and ACR are combined with general residential distribution service rates and included as a single line item on the residential customer's bill for "distribution service." *Id.* at 11.

The CER recovers costs related to competitive retail electricity enhancement initiatives undertaken by electric distribution companies and related consumer education programs. *Id.* at 9. The CER applies to all distribution service customers whether the customer obtains generation service through an EGS or default supply. In the Company's most recent base rate case, in which the CER mechanism was approved, PPL Electric proposed that absent approval of the CER mechanism and the proposed costs, the Company would seek recovery of the costs through base rates. *Id.* These programs are targeted at distribution customers, the costs are

clearly related to distribution service, and but for the existence of the rider mechanism, these costs would be recovered through base rates. *Id.*

The ACR recovers costs associated with Act 129, which was signed into law in 2008. Act 129 requires large EDCs to file energy conservation plans with the Commission designed to achieve specified demand and energy reduction targets. Cost recovery for Act 129 is capped at 2% of the EDC's revenues, and EDCs are guaranteed cost recovery through a Section 1307 automatic adjustment clause. *Id.* at 10. Revenues related to recovering the cost of this program are obviously distribution related. The costs at issue under Act 129 energy conservation plans are similar to energy conservation and education programs in place prior to Act 129. *Id.* These costs have always been included in distribution rates. *Id.* The costs of Act 129 energy conservation plans are also recovered in distribution rates, but through a Section 1307 automatic adjustment clause instead of Section 1308 base rates. *Id.* The fact that the legislature authorized Section 1307 rate recovery for energy conservation costs does not and cannot somehow transform these costs into something other than distribution service costs. Further, were it not for PPL Electric being the provider of distribution services, it would not be incurring these costs. *Id.* The obligation to achieve energy savings is imposed by statute on the EDC, the onus for these programs is placed upon the EDC, and recovery of the costs is therefore distribution revenue which should be included in the DSIC.

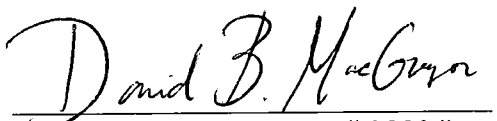
The ACR and CER are both rates contained in PPL Electric's distribution tariff and are charged to all distribution service customers. In addition, each recovers costs incurred by PPL Electric to meet its statutory obligations as an electric distribution company under the Public Utility Code. The costs now recovered by these two distribution rate riders were previously recovered in base distribution rates. Act 11 draws no distinction between base rates and base

rate riders. Both of these riders clearly collect and recover distribution system costs and are properly included in the calculation of the DSIC cap. PPLICA's proposal should be rejected.

VI. CONCLUSION

For the foregoing reasons, PPL Electric respectfully requests that its calculation mechanism for the Distribution System Improvement Charge be approved as filed, and that the modifications proposed by the OCA and PPLICA be denied.

Respectfully submitted,



David B. MacGregor (ID # 28804)
Post & Schell, P.C.
Four Penn Center
1600 John F. Kennedy Boulevard
Philadelphia, PA 19103-2808
Phone: 215-587-1197
Fax: 215-320-4879
E-mail: dmacgregor@postschell.com

Jessica R. Rogers (ID #309842)
Post & Schell, P.C.
17 North Second Street
12th Floor
Harrisburg, PA 17101-1601
Phone: 717-731-1970
E-mail: jrogers@postschell.com

Attorneys for PPL Electric Utilities Corporation

Paul E. Russell (ID # 21643)
Associate General Counsel
PPL Services Corporation
Office of General Counsel
Two North Ninth Street
Allentown, PA 18101
Phone: 610-774-4254
Fax: 610-774-6726
E-mail: perussell@pplweb.com

Of Counsel:

Post & Schell, P.C.

Date: November 26, 2013

Appendix A

APPENDIX "A"

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of PPL Electric Utilities Corporation	:	
For Approval of a Distribution System	:	Docket Nos. P-2012-2325034
Improvement Charge	:	
	:	
Office of Consumer Advocate	:	C-2012-2346390
Alan D. Whitehouse	:	C-2013-2345750
Pamela Mosconi	:	C-2013-2346375
John E. Hoag	:	C-2013-2345729
James Weaver	:	C-2013-2351090

PROPOSED FINDINGS OF FACT

1. On February 14, 2012, Governor Corbett signed into law Act 11 of 2012 ("Act 11"), which amends Chapters 3, 13 and 33 of the Public Utility Code.

2. Act 11 authorizes electric distribution companies ("EDCs"), natural gas distribution companies ("NGDCs"), water utilities, wastewater utilities and city natural gas distribution operations to establish a distribution system improvement charge ("DSIC").

3. On May 10, 2012, the Commission issued its Tentative Implementation Order addressing and incorporating input from the stakeholder meeting at Docket No. M-2012-2293611.

4. Comments to the Tentative Implementation Order were filed by PPL Electric Utilities Corporation ("PPL Electric" or "the Company"), the Office of Consumer Advocate ("OCA"), and the PP&L Industrial Customer Alliance ("PPLICA") on May 31, 2012.

5. On August 2, 2012, the Commission issued its Final Implementation Order establishing procedures and guidelines necessary to implement Act 11.

6. The Final Implementation Order also included a model form of DSIC tariff (the "model tariff").

7. On September 18, 2012, PPL Electric filed an LTIIP pursuant to Section 1352 of the Public Utility Code, 66 Pa.C.S. § 1352.

8. On January 15, 2013, pursuant to Section 1353, PPL Electric filed a Petition for Approval of a DSIC. 66 Pa.C.S. § 1353. As part of the Petition, PPL Electric included a form of DSIC tariff consistent with the model tariff, along with supporting direct testimony.

9. On May 23, 2013, the Commission entered an order approving the Company's DSIC, subject to refund.

10. On June 20, 2013, PPL Electric filed its compliance filing, as directed by the Commission in its May 23 Order.

11. In general, for both book and tax purposes, expenditures for plant additions are either capitalized and depreciated over a period of years, or in some instances, deducted currently as an expense. PPL Electric St. 4-R, pp. 2-3.

12. In either case, the timing of the depreciation deductions for book purposes often differs from the timing of the depreciation deductions for tax purposes. PPL Electric St. 4-R, p. 3.

13. These timing differences arise primarily from the use of accelerated depreciation (including bonus depreciation) and from the use of shorter depreciable lives for tax purposes than for book purposes. PPL Electric St. 4-R, p. 3

14. As a result of these timing differences, tax depreciation deductions generally exceed book depreciation deductions in the earlier years of an asset's life, and correspondingly, tax depreciation deductions are generally less than book depreciation deductions in the later years of an asset's life and produce accumulated deferred income taxes ("ADIT"). PPL Electric St. 4-R, p. 3

15. Ultimately, however, and importantly, the total amount deducted for both book and tax purposes is generally identical over the life of the property, and the amount of income taxes paid over the life of the property will be the same. PPL Electric St. 4-R, p. 3

16. The Statutory Construction Act of 1972 ("Statutory Construction Act") provides that "the object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly." 1 Pa.C.S. § 1921.

17. As the courts have noted, "it is incumbent that the reviewing court endeavor to ascertain the intent of the Legislature." *Commonwealth v. Cox*, 603 Pa. 223, 283, 983 A.2d 666, 703 (2009).

18. In order to ascertain the intent of the General Assembly, the ruling body should first look at the plain language of the statute. *Commonwealth v. Segida*, 604 Pa. 103, 108, 985 A.2d 871, 874 (2009).

19. When the language of the statute is free from ambiguity, the letter of the statute is to be followed. 1 Pa.C.S. § 1921(b).

20. If the words of a statute are not explicit, then intent may be gleaned from the contemporaneous legislative history. 1 Pa.C.S. § 1921(c)(7).

21. Legislative history may include previous drafts of house bills, as well as statements made by legislators during the time of the statute's enactment. *See Commonwealth v. Wilson*, 529 Pa. 268, 602 A.2d 1290 (1992).

22. A comparison of the DSIC provisions in Act 11 and the prior water utility model DSIC tariff shows that Act 11 adopted the water DSIC formula. PPL Electric St. 3-R, p. 2; PPL Electric Ex. BLJ-R2.

23. It is not appropriate to "supply omissions in the statute, especially where it appears that the item may have been intentionally omitted." *Mt. Village v. Bd. of Supervisors*, 582 Pa. 605, 874 A.2d 1, 22 (Pa. 2005).

24. The General Assembly specifically considered an amendment to House Bill 1294 which would have incorporated tax benefits into the DSIC calculation, and the amendment was rejected. Exhibit BLJ-R1, Legislative Journal p. 1909-1911.

25. The legislative history indicates House Bill 1294, which eventually became Act 11, was specifically amended, to "memorialize in statute the current PUC procedure and process used to evaluate water utility requests for DSIC." Exhibit BLJ-R1 at 155.

26. While changes have occurred in tax benefits since the initial water DSIC, those changes occurred prior to the enactment of Act 11, the tax law changes relied upon by the OCA were known to the General Assembly before it adopted Act 11 and there is clear indication in the legislative history that the General Assembly was aware of the very tax benefits which the OCA seeks to address here. PPL Electric Exhibit BLJ-R1.

27. The Commission has had opportunities since the enactment of these tax benefits to address them in the water DSIC and has not done so. PPL Electric St. 3-RJ, pp. 2-3.

28. The Commission directly addressed the OCA's tax adjustments in its Final Implementation Order and rejected its tax adjustments. Final Implementation Order, p. 39.

29. The Commission specifically excluded ADIT from the DSIC in its Final Implementation Order. Final Implementation Order at p. 39.

30. The model tariff language adopted by the Commission is virtually identical to the model tariff language used by the Commission in its 1996 water DSIC Orders. PPL Electric St. 3-R, p. 3.

31. PPL Electric's tariff adopted the Commission's model tariff. PPL Electric St. 3-R, p. 3.

32. The model tariff for the historic water DSIC did not provide for ADIT to be included in calculating the DSIC. PPL Electric St. 3-R, p. 3.

33. No water utility in the state of Pennsylvania has ever included ADIT in calculating its DSIC. PPL Electric St. 3-R, p. 3; OCA St. 1-S, p. 2.

34. All water utilities have calculated state income taxes using the full statutory tax rate as part of their calculation of DSIC rates. PPL Electric St. 3-R, p. 4; OCA St. 1-S, p. 2.

35. For tax purposes, there is no distinction between plant included in base rates and plant that will be included in the DSIC, because specific items of property are not subject to income tax. PPL Electric St. 4-R, p. 5.

36. The total net income of PPL Electric computed on an annual, not quarterly, total Company basis is subject to tax. PPL Electric St. 4-R, p. 5.

37. Whether and to what extent PPL Electric has any ADIT balance not already reflected in base rates depends in part upon its overall tax position. OCA St. 1, p. 7; PPL Electric St. 4-R, p. 6.

38. PPL Electric has recently generated tax deductions that exceed its income, resulting in tax loss carryforwards. OCA St. 1, p. 7.

39. An increase in ADIT liability that results in a net operating loss carryforward does not provide a current cash tax benefit. PPL Electric St. 4-R, p. 6.

40. A hypothetical calculation of the potential tax effects of placing individual items of plant or property into utility service does not and cannot reflect the actual tax liability of the Company or actual taxes paid to the government. PPL Electric St. 4-R, p. 5.

41. PPL Electric's income tax expense is based on the results of operations for its annual accounting period, and not the sum of its calendar quarterly results, and any calculation to adjust this issue would involve estimates and additional calculations not normally performed by the Company. PPL Electric St. 4-R, pp. 4-6.

42. A full tax calculation, which is directly contrary to the General Assembly's and the Commission's intent that the DSIC be calculated in a simple, straight forward manner, would be the only way to correct for the errors in OCA's calculation. PPL Electric St. 4-R, p. 8.

43. A full tax calculation for each DSIC would also require the Company to undertake tax calculations that are not part of its normal course of business and would introduce true-ups into the DSIC mechanism. PPL Electric St. 4-R, p. 8.

44. The earnings cap prohibits PPL Electric from charging a DSIC if it exceeds its allowable rate of return, because the Company's DSIC will be reset to zero if the data included in the most recent Annual or Quarterly Earnings report filed with the Commission shows that PPL Electric would earn a rate of return that would exceed its allowable rate of return. PPL Electric St. 3-R, p. 4.

45. The Company's calculation of rate base for earnings report purposes includes the current book amount of ADIT and adjustments for state income tax. PPL Electric St. 3-RJ, p. 5.

46. In order for PPL Electric to get the benefit of a DSIC, it must be in an under-earning position after taking into consideration the impact of the OCA's tax adjustments. PPL Electric St. 3-R, p. 4.

47. The Commission provided that for EDCs, "DSIC surcharges are to be applied to any customers served from higher voltage facilities which are included within the EDC's distribution plant for ratemaking purposes." *Final Implementation Order* at 46.

48. Rate Schedule LP-5 customers take service under PPL Electric's Commission-approved distribution tariff and are allocated distribution costs in the Company's cost of service study. PPL Electric St. 3-R, p. 8.

49. PPLICA's own witness acknowledged that operating, maintenance, and other related customer costs have been allocated to Rate Schedule LP-5 customers in PPL Electric's cost of service study in its last base rate proceeding. PPL Electric St. 3-R, p. 8.

50. The fact that these customers take service at transmission level voltage does not mean that they are not distribution customers. PPL Electric St. 3-RJ, p. 6.

51. Rate Schedule LP-5 is within a distribution customer class of PPL Electric, so the DISC is applicable to Large Commercial and Industrial customers taking service under this rate schedule. PPL Electric St. 3-RJ, p. 6.

52. Rate Schedule LP-5 customers are allocated some costs associated with distribution plant in the cost of service study. PPL Electric St. 3-RJ, p. 7.

53. Act 11 does not require a cost of service study for customers to be charged the DSIC; in fact, the statute requires the DSIC charge to be an equal charge to all customer classes, without regard to cost of service principles and therefore the relative amount of DSIC-eligible plant that would be allocated to Rate Schedule LP-5 customers in a base rate proceeding is not relevant to the Commission's determination in this proceeding. PPL Electric St. 3-RJ, p. 7.

54. The model tariff included with the Commission's Final Implementation Order for the DSIC identifies specifically that riders should be included in the calculation of the charge, providing that:

> Projected quarterly revenues for distribution service (including all applicable clauses and riders) from existing customers plus revenue from any customers which will be acquired by the beginning of the applicable service period.

Final Implementation Order, p. 52.

55. ACR and CER are part of the Company's distribution service tariff, and they recover costs booked to the distribution business pursuant to FERC's Uniform Systems of Accounts for distribution service. PPL Electric St. 3-R, pp. 8-9.

56. The fact that certain Company costs are recoverable through a Section 1307 automatic adjustment clause instead of a Section 1308 base rate does not preclude them from being considered as distribution costs. PPL Electric St. 3-R, p. 9.

57. If the ACR and CER costs were not recovered in Section 1307 adjustment clauses, they would be included and recovered in the Company's Section 1308 distribution rates, and the revenues would not be accounted for any differently than other base distribution revenues. PPL Electric St. 3-R, p. 9.

58. For billing purposes, both the CER and ACR are combined with general residential distribution service rates and included as a single line item on the residential customer's bill for "distribution service." PPL Electric St. 3-R, p. 11.

59. The CER recovers costs related to competitive retail electricity enhancement initiatives undertaken by electric distribution companies and related consumer education programs. PPL Electric St. 3-R, p. 9.

60. In the Company's most recent base rate case, in which the CER mechanism was approved, PPL Electric proposed that absent approval of the CER mechanism and the proposed costs, the Company would seek recovery of the costs through base rates. PPL Electric St. 3-R, p. 9.

61. These programs are targeted at distribution customers, the costs are clearly related to distribution service, and but for the existence of the rider mechanism, these costs would be recovered through base rates. PPL Electric St. 3-R, p. 9.

62. Cost recovery for Act 129 is capped at 2% of the EDC's revenues, and EDCs are guaranteed cost recovery through a Section 1307 automatic adjustment clause. PPL Electric St. 3-R, p. 10.

63. The costs at issue under Act 129 energy conservation plans are similar to energy conservation and education programs in place prior to Act 129. PPL Electric St. 3-R, p. 10.

64. The costs of Act 129 energy conservation plans are also recovered in distribution rates, but through a Section 1307 automatic adjustment clause instead of Section 1308 base rates. PPL Electric St. 3-R, p. 10.

65. Were PPL Electric not the provider of distribution services, it would not be incurring these costs. PPL Electric St. 3-R, p. 10.

66. These costs have always been included in distribution rates. PPL Electric St. 3-R, p. 10.

PROPOSED CONCLUSIONS OF LAW

1. Act 11 does not provide for an adjustment to DSIC-eligible plant for Accumulated Deferred Income Taxes.

2. Act 11 does not provide for an adjustment to the calculation of the state income tax gross up for incremental tax depreciation deductions.

3. The General Assembly clearly intended to adopt the water utility DSIC procedure in enacting Act 11.

4. The General Assembly clearly rejected a proposal to amend the water DSIC procedure that would have included tax benefits in the DSIC calculations.

5. The Statutory Construction Act does not provide for consideration of an issue by another jurisdiction as a basis for determining legislative intent. *Elder v. Orluck,* 511 Pa. 402, 515 A.2d 517, 522 (1986).

6. A surcharge mechanism is authorized by the General Assembly, and is an exception to the traditional base rate filings. *Popowsky v. Pa P.U.C.*, 13 A.3d 583, 591 (Pa. Cmwlth. Ct. 2011); *Pennsylvania Industrial Energy Coalition v. Pa P.U.C.*, 653 A.2d 1336, 1349 (Pa. Cmwlth. Ct. 1995).

7. The purpose of a surcharge mechanism is to establish a simple adjustment mechanism that does not require examination of every component that would be considered in a full base rate case proceeding. *See, e.g., Dorothy Gill v. The Bell Telephone Company of Pennsylvania*, C-00935402, 1994 Pa. PUC LEXIS 115 (Order entered April 22, 1994).

8. A rate is defined as:

> Every individual, or joint fare, toll, charge, rental or other compensation whatsoever of any public utility...made, demanded,

> or received for any service within this part, offered, rendered, or furnished by such public utility...and any rules, regulations, practices, classifications or contracts affecting any such compensation, charge, fare, toll, or rental.

66 Pa.C.S. § 102.

9. Any determination regarding whether rates are just and reasonable must look at the total effect of a utility's rates on its ability to have a fair opportunity to earn a fair rate of return on its property devoted to public service. *Duquesne Light Co. v. Barasch*, 488 US 299, 314 (1989).

10. The "actual taxes paid doctrine" is a judicial construct and therefore can be modified by the General Assembly. *Barasch v. Pa P.U.C.*, 491 A.2d 94, 104 (Pa. 1985).

11. The clear and unambiguous language of Act 11 provides that the DSIC is to be applied "equally to all customer classes." 66 Pa. C.S. §1358 (d)(1).

12. Act 11 provides only that "projected revenues shall not include revenues from public fire protection service earned by water utilities and the State tax adjustment surcharge." 66 PA. C.S. §1357 (d)(2).

PROPOSED ORDERING PARAGRAPHS

It is hereby ordered that:

1. OCA's proposal to adjust the DSIC mechanism for ADIT is denied.

2. OCA's proposal to disallow the state income tax gross-up is denied.

3. PPLICA's proposal to exclude Rate Schedule LP-5 customers from paying the DSIC is denied.

4. PPLICA's proposal to exclude the Smart Meter Rider, Act 129 Rider, Universal Service Rider, and Competitive Enhancement Rider from the determination of projected quarterly revenues is denied.

5. In all other respects, PPL Electric's DSIC tariff is approved as filed.