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December 20, 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 Reply 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/jl
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).

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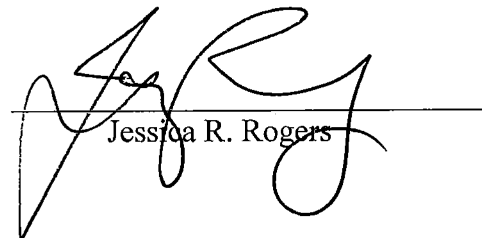

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of PPL Electric Utilities Corporation For Approval of a Distribution System Improvement Charge	:	Docket Nos. P-2012-2325034
	:	
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John E. Hoag	:	C-2013-2345729
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REPLY BRIEF OF PPL ELECTRIC UTILITIES CORPORATION

TO ADMINISTRATIVE LAW JUDGE KANDACE F. MELILLO:

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I. INTRODUCTION

Pursuant to the procedural schedule adopted in this proceeding, PPL Electric Utilities Corporation ("PPL Electric" or the "Company"), the Office of Consumer Advocate ("OCA") and the PP&L Industrial Customer Alliance ("PPLICA") filed Main Briefs in this proceeding on November 26, 2013. The Main Briefs address the calculation of the Company's Distribution System Improvement Charge ("DSIC"). PPL Electric's DSIC was approved by the Pennsylvania Public Utility Commission ("Commission") on May 23, 2013 ("May 23 Order"), subject to the outcome of this proceeding. In its May 23 Order, the Commission excluded accumulated deferred income tax ("ADIT") from the calculation of the DSIC charge, and included a state income tax gross-up. The Commission's action on both of these items was consistent with the plain language of Act 11 and its legislative history, the historic calculation of water DSICs in Pennsylvania, and the Commission's Final Implementation Order on Act 11 issued on August 2, 2012 at Docket No. M-2012-2293611.

OCA has disputed in this proceeding the appropriateness of these two long-standing Commission practices. PPLICA has disputed the Company's application of the DSIC to Rate Schedule LP-5 customers, despite the statute's clear language that the DSIC should apply "equally to all customer classes." In addition, PPLICA has disputed the inclusion of three riders in the calculation of total revenues. The three riders identified by PPLICA are the Act 129 Compliance Rider ("ACR"), the Competitive Enhancement Rider ("CER"), and, raised for the first time in PPLICA's Main Brief, the "Net Metering Rider."

PPL Electric hereby files its Reply Brief in response to the Main Briefs filed by OCA and PPLICA. PPL Electric will endeavor to avoid repeating arguments set forth in the Company's Main Brief. In this brief, PPL Electric will show that OCA deviates from the plain language of Act 11 and well-established rules of statutory interpretation, and mischaracterizes fundamental

principles of utility ratemaking. PPLICA simply ignores the plain language of the statute entirely, and attempts to justify its position with evidence that is neither relevant nor logically consistent. Therefore, the proposals from OCA and PPLICA should be rejected, and the Company's DSIC should be calculated pursuant to the Commission's May 23 Order.

II. ARGUMENT

A. OCA AND PPLICA MISSTATE THE LEGAL STANDARD.

In its Main Brief, the OCA incorrectly describes the legal standard to be applied in this case. The OCA asserts that PPL Electric bears the burden of proof in this proceeding, and characterizes that burden as "formidable." (OCA M. B., p. 7). The OCA's description of the utility's burden as "formidable" is simply wrong. The courts have described the burden of proof as requiring that one party present evidence which is more convincing, by even the smallest amount, than the evidence presented by an opposing party. *See Se-Ling Hosiery v. Margulies*, 70 A.2d 854 (Pa. 1954). This cannot be fairly described as a "formidable" burden. In addition, the issues in this case are largely legal and there is no burden of proof for legal issues. Rather, the showing that must be made in this proceeding is whether the DSIC proposed by the Company is consistent with the intent of the General Assembly, the Commission's historic DSIC practice and procedure, the Commission's Final Implementation Order, and the development of just and reasonable rates. As described in the Company's Main Brief and this Reply Brief, PPL Electric has made that showing.

PPLICA does not lay out a legal standard at the outset of its brief. However, beginning on page 21 of its Main Brief, PPLICA attempts to argue that PPL Electric failed to meet its affirmative burden regarding what it incorrectly identifies as the "Net Metering Rider," which was included in the Commission's Implementation Order. As the Commonwealth Court has explained: "While it is axiomatic that a utility has the burden of proving the justness and

reasonableness of its proposed rates, it cannot be called upon to account for every action absent prior notice that such action is to be challenged." *Allegheny Center Associates v. Pa. P.U.C.*, 570 A.2d 149, 153 (Pa. Cmwlth. 1990). Therefore, while the ultimate burden of proof does not shift from the utility, a party proposing an adjustment to a ratemaking claim bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment.

PPLICA plainly admits in its brief that "PPLICA did not submit testimony addressing PPL's Net Metering Rider," but claims that "parties were not afforded an opportunity to address PPL's Net Metering Rider as directed by the May 23, 2012 Order." (PPLICA M.B. pp. 21-22). While PPL Electric will address PPLICA's inaccurate factual allegations regarding what PPLICA refers to as the "Net Metering Rider" in Section D.3 of this Reply Brief, PPLICA clearly misstates the legal standard applicable in this proceeding. PPLICA had the burden of providing evidence to show that its adjustment was reasonable. PPLICA's failure to raise this issue during the evidentiary phase of this proceeding, when it plainly had notice based upon the Commission's Order, and its attempt to raise the issue for the first time in its Main Brief, is procedurally improper. *See, e.g., Pa. P.U.C. v. Mechanicsburg Water Co.*, 1993 Pa. PUC LEXIS 112 (July 22, 1993). Thus, not only is PPLICA factually wrong, it also provides an incorrect legal standard, which should be rejected.

B. OCA'S STATUTORY INTERPRETATION IS FLAWED.

OCA's statutory interpretation of Act 11 can be briefly summarized as follows. Act 11 amends the Public Utility Code. The Public Utility Code requires rates to be just and reasonable. Rate calculations in general rate proceedings under Section 1308(d) include adjustments for ADIT and reflect accelerated tax depreciation in calculating state tax expenses. Without these two adjustments, the DSIC charge is not just and reasonable.

As PPL Electric will explain, this analysis suffers from several fundamental flaws. First, the General Assembly has defined how the DSIC is to be calculated. That definition determines whether the rate is "just and reasonable." That definition does not include the adjustments proposed by OCA, and it is improper under the rules of statutory interpretation to add such adjustments. A surcharge mechanism is to be distinguished from a base rate calculation. By its very nature, a surcharge mechanism does not include every component of a base rate case. OCA seeks to selectively modify the long-established DSIC mechanism to include certain base rate components while ignoring other traditional ratemaking components. Such modifications are not part of the legislatively defined surcharge formula, and should not be adopted. Second, OCA improperly and unduly restricts its analysis of whether the DSIC rate is "just and reasonable" to the calculation of the charge. However, the DSIC rate is more than just the charge; it includes the earnings cap provisions as well. The earnings cap examines the total return earned by the utility and suspends operation of the DSIC if the utility earns more than a specified return. This ensures that the utility's rates are just and reasonable as a whole, including the DSIC.

1. OCA Improperly Proposes to Add Components to the General Assembly's Definition of the DSIC Rate.

OCA relies upon traditional base-rate calculations under Section 1308(d) of the Public Utility Code to argue for its proposed ADIT offset and its proposed elimination of the state income tax gross-up. (OCA M.B., pp. 13-14). However, the DSIC is not a traditional base rate charge under Section 1308(d). The DSIC is a surcharge mechanism established by the General Assembly in Act 11, and set forth in Section 1357. OCA errs in proposing to amend the General Assembly's specific provisions for the DSIC.

As described in the Company's Main Brief, the Courts of Pennsylvania have held that surcharge mechanisms are authorized by the General Assembly as exceptions to the traditional

base-rate mechanism. *Popowsky v. Pa P.U.C.*, 13 A.3d 583, 591 (Pa. Cmwlth. Ct. 2011) ("*Purchased Water Surcharge*"); *Popowsky v. Pa P.U.C.*, 869 A.2d 1157, 1160 (Pa. Cmwlth. Ct. 2005) ("*Wastewater DSIC*"); *Pennsylvania Industrial Energy Coalition v. Pa P.U.C.*, 653 A.2d 1336, 1349 (Pa. Cmwlth. Ct. 1995) ("*PIEC*"). The Courts have made it clear that the General Assembly has the authority to exempt utilities from the traditional base rate analysis through the implementation of a surcharge mechanism. *Wastewater DSIC* at 1158. A surcharge mechanism is permitted to deviate from the 1308(d) base rate requirements, particularly where the General Assembly has included procedures to ensure the reasonableness of the charges outside a base rate case. *PIEC* at 1350.

The DSIC surcharge mechanism is an exception to traditional base rate procedures, and correct statutory interpretation requires that the adjudicating body look at what has expressly been provided in the statute. 1 Pa.C.S. § 1921(b). In this instance, the DSIC statute provides the elements for the DSIC mechanism, which is a mechanism distinct from the 1308(d) base rate mechanism. As described in PPL Electric's Main Brief, the doctrine of *expressio unius est exclusis alterius* leads to the conclusion that OCA's proposal should be rejected, because 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 accelerated tax depreciation adjustments, but they also clearly embraced the Commission's prior practice under the water DSIC.

Since the OCA cannot ignore that the historical practice of the water DSIC did not include its two tax proposals at issue in this proceeding, the OCA has instead argued that the General Assembly gave the Commission authority to adjust its methodology. (OCA M.B., pp. 24-25). This is misleading, as the statute and the legislative history indicate that the General Assembly fully embraced the Commission's historic practice, and emphasized in the language of the statute that the current practice would not be altered or interrupted by the enactment of Act 11.

OCA has offered no basis under the rules of statutory interpretation to alter the General Assembly's authorized exception to base rate procedures as set forth in Act 11. OCA's proposals are improper and must be rejected.

2. The DSIC Provides for Just and Reasonable Rates.

OCA contends that, without its two traditional base-rate adjustments, the DSIC produces an unjust or unreasonable rate. (OCA M.B., p. 12). OCA's contention is contrary to law and is based upon an unreasonably narrow view of the "just and reasonable" standard.

OCA focuses on the formula for calculating the DSIC charge, and contends that the earnings cap provisions are not relevant to determining whether the rate is "just and reasonable." (OCA M.B., pp. 22-23). 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. 66 Pa.C.S. § 102. Under the definition of a rate, the entirety of the rate is to be considered, and not individual components.

As stated in PPL Electric's Main Brief, the United States Supreme Court has instructed that it is improper to look at the inclusion or exclusion of individual components in determining whether a rate is just and reasonable. *Duquesne Light Co. v. Barasch*, 488 US 299, 314 (1989)

("*Barasch*"). In *Barasch*, the Court acknowledged that there are many ways to achieve rates that are just and reasonable. The Supreme Court held:

> [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.

Id. at 314. The Court went on to find that the disallowance of a single element is not the appropriate standard for determining whether rates are just and reasonable. The Court also rejected the idea that there is a single theory of valuation that produces just and reasonable rates. *Id.* at 316. The conclusions to be drawn from *Barasch* are readily apparent. There is no single way to arrive at just and reasonable rates; however, any determination regarding whether rates are just and reasonable must look at the total effect of rates.

The courts of Pennsylvania have reached similar determinations regarding what constitutes a just and reasonable rate. In *Popowsky v. Pa. P.U.C.*, 683 A.2d 958 (Pa. Cmwlth. Ct. 1996) ("*Equitable*"), the Commonwealth Court considered an appeal from a Commission Order that authorized a non-general rate increase in a 1308(b) proceeding. The Company did not undertake the full calculation associated with a base rate proceeding under 1308(d). The Court held that the Commission could determine whether a non-general rate increase was just and reasonable based upon findings concerning the utility's rate of return and offsetting savings.

The OCA's argument in this proceeding is strikingly similar to the argument rejected by the Supreme Court in *Barasch*. The OCA has argued in its Main Brief that the determination of

just and reasonable rates should be limited to the inclusion or exclusion of two individual factors, ADIT and state income taxes, rather than the entirety of the rate. As determined by the Supreme Court, a single disallowance does not result in unreasonable rates. The Court looked to the entirety of the utility's return to conclude whether the rate was unreasonable. Here, the OCA has asked the Commission in this case to choose selective additional base rate adjustments to add to the DSIC, based on its argument that without these particular adjustments the rate will be unjust or unreasonable. The OCA also ignores that the DSIC also excludes other adjustments, such as an adjustment for uncollectibles, which would benefit PPL Electric. The Supreme Court specifically acknowledged that this balancing of allowances and disallowances is the very reason adjudicative bodies must not look at individual components of the rate in determining whether rates are just and reasonable. *Barasch* at 314. The appropriate inquiry is whether the total effect of the surcharge results in unjust and unreasonable rates. The Commission and the General Assembly have addressed that very issue with the use of the earnings cap.

In assessing whether the DSIC rate is just and reasonable, the charge and the limiting provisions of customer protections must be considered together. *See* 66 Pa.C.S. § 102. In particular, the Commission and the General Assembly have identified that the earnings cap plays a critical role in ensuring that the total effect of DSIC rates is just and reasonable. The earnings cap compares the utility's current quarter's earnings, as reflected in its Quarterly Earnings Report, to the Commission's allowed rate of return. In so doing, the earnings cap takes into consideration the many moving parts identified in a 1308(d) proceeding, including the very same components (ADIT and accelerated tax depreciation deductions used to calculate state income taxes) that the OCA challenges. (PPL Electric St. No. 3-R, pp. 4-5). The earnings cap examines whether the utility's rates are just and reasonable, as measured by the utility's return on equity.

The DSIC may not be charged if the utility is overearning the authorized return. Such determination is consistent with *Barasch* and *Equitable* in assessing whether rates are just and reasonable.

The DSIC rate, as applied in its entirety, contains provisions to ensure that the rate is just and reasonable. OCA's proposal to include selective adjustments to the calculation of the surcharge is not necessary in order to establish just and reasonable rates.

3. OCA's Proposed Adjustments Are Contrary to the Purpose of a Surcharge.

OCA's assertion that its adjustments must be adopted because they are reflected in a traditional base rate calculation ignores the distinctions between automatic adjustment mechanisms and base rate mechanisms. *See PIEC; Purchased Water Adjustment.* Such assertion also ignores the plain language of the statute and rules of statutory interpretation. (PPL Electric M.B., pp. 12-19). If adopted, OCA's assertion would render any distinction between non-1308(d) adjustments and 1308(d) proceedings substantially moot, as any surcharge could be challenged as not including all of the changing components of base rates. That cannot be the correct interpretation of Section 1357 as it would make the provision superfluous.

At the heart of its argument, the OCA expresses dissatisfaction with the formula specified by the General Assembly to calculate the DSIC, and proposes that the formula be revised to include other base rate components. OCA asserts these proposed "revisions" are needed to reflect new circumstances that have arisen since the water DSIC was established. (OCA M.B., p. 28). However, these "new" circumstances substantially predated the adoption of Act 11. Bonus depreciation, in particular, has existed since 2001. (PPL Electric St. No. 3-RJ, pp. 2-3). The legislative history indicates that the General Assembly was aware of these tax benefits, and

chose to exclude them. (PPL Electric Ex. BLJ-1R). Therefore, these are not new changes relevant to the interpretation of Act 11.

The General Assembly dictated the formula for the surcharge and concluded that it would create a surcharge that was not a full ratemaking mechanism and was limited in scope. In the same surcharge rate, the General Assembly decided to include an earnings cap, to capture the effect of other adjustments. Had the General Assembly decided to include the OCA's additional components, it might have included other adjustments, or eliminated the earnings cap. The Commission should not disregard the General Assembly's determination as to the design of the rate. The OCA's adjustments should be rejected.

C. OCA'S TAX PROPOSALS SHOULD NOT BE INCLUDED IN THE DSIC CHARGE CALCULATION.

In this proceeding, the OCA has argued that its adjustments must be included in the DSIC calculation in order to arrive at just and reasonable rates. (OCA M.B., p. 12). As explained in PPL Electric's Main Brief and in the previous section of this Reply Brief, the OCA's argument is incorrect as a matter of law and under applicable rules of statutory interpretation. Further, the OCA's arguments about the calculation and impact of its adjustments are misleading, inaccurate, and contrary to the General Assembly and Commission's intent in applying the DSIC. The OCA's arguments should be rejected.

1. The DSIC Rate is Not Calculated Incorrectly.

The OCA argues in its Main Brief that the Company is proposing a rate that is calculated incorrectly. (OCA M.B., p. 18). This is factually unsupported. The Company has proposed the same DSIC mechanism used by the water utilities, which has been found to produce just and reasonable rates for more than 15 years. OCA has not disputed that the Company's mechanism is identical to the water DSIC mechanism with regard to its treatment of the tax adjustments.

(PPL Electric St. 3-R, p. 3). Therefore, OCA's argument must be premised on the concept that the Commission has been supporting the incorrect calculation of rates for the entirety of the water DSIC, and that the General Assembly in relying upon the water DSIC as its model has codified an incorrect calculation of rates. Such contention disregards the General Assembly's authority to establish the terms of a surcharge mechanism that is an exception to the full base rate process. *Wastewater DSIC* at 1160. OCA's argument that PPL Electric's support of the water DSIC mechanism means that the Company supports an improper calculation should be given no weight or consideration.

As the Company has shown, the use of a calculation that varies from the 1308(d) base rate calculation does not mean that the Company is calculating rates incorrectly. The OCA's dissertation on the treatment of ADIT for base rate purposes is not informative on the issue of the calculation of the DSIC charge. OCA ignores the distinction between base rate proceedings and non-base rate proceedings, such as automatic adjustment mechanisms, which do not require all of the adjustments of a base rate proceeding. *See Equitable; PIEC.* The scope of a surcharge mechanism is established by the General Assembly, and the components included by the Commission must be consistent with the criteria identified by the General Assembly. *See Equitable; PIEC.* In the case of Act 11, the method selected by the General Assembly does not include an adjustment for ADIT in the charge calculation, but does include ADIT in the determination of whether the overall rate is just and reasonable, through the earnings cap component of the rate. The fact that the OCA does not prefer or agree with the way the General Assembly has determined to calculate the DSIC, or agree with the General Assembly's determination of the procedures to be used to measure whether the rate is just and reasonable, does not make that calculation incorrect. *PIEC* at 1349. The Commission should not ignore the

intent of the General Assembly. OCA's claim that the DSIC rate is calculated incorrectly is wrong, and should be rejected.

2. The Earnings Cap is a Critical Portion of the DSIC Rate That Captures the Complexities of Proper Tax Calculations.

OCA asserts that the calculation of the DSIC charge should reflect incremental taxes created by new DSIC plant. (OCA M.B., p. 22-23). OCA's assertion fails to recognize that the earnings cap does capture ADIT in the DSIC rate, while avoiding the complications of including ADIT in the calculation of the charge.

The OCA argues in its Main Brief that incremental ADIT can be a significant adjustment to the DSIC. (OCA M.B., pp. 16-17). However, the OCA concedes that, in this case, the incremental ADIT at issue is $0, due to the Company's current tax loss position. (OCA M.B., p. 17). Importantly, the OCA argument ignores the issue of changing and decreasing tax balances in base rates. As explained by PPL Electric's witness, the total tax balance that is reflected in a base rate proceeding changes yearly, and tax deductions on new plant can be offset by declining tax offsets on plant already reflected in base rates. (PPL Electric St 4-R, p. 3). These changes cannot be accurately captured in the simple formula to compute the DSIC charge. However, they can be, and are, captured through the earnings cap portion of the DSIC rate. OCA's failure to acknowledge the importance of the earnings cap allows it to overemphasize the impact that exclusion of tax adjustments from the DSIC mechanism would have. While the OCA insists that these tax adjustments are not recognized in the DSIC at all, that is inaccurate. Tax adjustments for these changes are part of the earnings cap calculation, and are therefore included in the determination of the total effect of the DSIC rate. If increases in tax deductions are substantial, the impact can be that the utility will overearn its authorized return, which will be reflected in the DSIC earnings cap and will result in the DSIC being suspended. Thus, OCA's argument about

the significance of incremental tax deductions is both misleading in this specific proceeding and in the larger analysis of the proper function of the DSIC mechanism.

OCA repeatedly asserts that following the intent of the General Assembly and the Commission's historic water DSIC practice, by not including tax adjustments, would result in the Company recovering costs that it has not "incurred." (OCA M.B., pp. 24). This is inaccurate. When PPL Electric invests in DSIC eligible property, it uses shareholder capital to make the necessary investments. Whether it will subsequently receive incremental deferred tax benefits is not known until after a tax return is filed. (PPL Electric St. No. 4-R, p. 4). In addition, OCA errs in asserting that any resulting incremental tax deductions must be traced to DSIC-eligible plant in calculating the quarterly charge. Incremental tax deductions can be used by the Company in a variety of ways.[1] The DSIC rate, specifically the earnings cap portion of the rate, accounts for such uses by deducting the total tax adjustments in computing rate base, and calculating the Company's earned return on the total rate base. The OCA's insistence that DSIC plant is funded by zero-cost or non-investor supplied capital, and thus that the Company will recover costs it has not incurred, fails to recognize that any net benefit received from tax adjustments is reflected in the earnings cap.

The OCA argues that the earnings report takes into consideration other factors that are unrelated to the DSIC and is therefore not adequate. (OCA M.B., p. 23). However, it is this feature of looking at rates from an overall rate of return basis that provides an appropriate test of whether the utility's rates are just and reasonable. *See Equitable; Barasch.* The critical point is

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[1] ADIT is a separate ratemaking adjustment to rate base, not unlike customer deposits, or cash working capital; it is not plant or a part of plant balances. *See Pa P.U.C. v. Columbia Gas of Pennsylvania, Inc.*, 1990 Pa PUC LEXIS 164, *17 (1990)(Recommended Decision). The General Assembly chose to define what components would be reflected in the surcharge calculation, specifically referencing property placed in service and depreciation, and chose not to include ADIT. However, the General Assembly did include an earnings cap, which takes into consideration the ADIT associated with all plant in service.

that the utility cannot apply a DSIC if it is over earning its authorized rate of return. As required by *Barasch*, just and reasonable rates cannot be determined by looking at individual allowances or disallowances, but rather must consider the total effect of the rates. The Commission and General Assembly have done that by applying the earnings cap. The earnings cap adequately addresses OCA's concerns, and therefore the OCA's proposed adjustments are not necessary.

3. OCA's Reference to Comments Concerning Accrued Depreciation Is Irrelevant to the Treatment of ADIT.

OCA attempts to undermine the clear omission by the General Assembly of any reference to ADIT by pointing to comments in the legislative history regarding accrued depreciation. (OCA M.B., p. 26).[2] Accrued depreciation is plainly a different issue from ADIT and is not a relevant fact. What is relevant, and what OCA attempts to downplay through its discussion of accrued depreciation, is that portion of the legislative history wherein an amendment was offered to revise the calculation of the charge to include "tax benefits." (PPL Electric Exhibit BLJ-1R, p. 1909). The General Assembly rejected the amendment. (*Id.* at 1911).

OCA also fails to consider the specific terms of Act 11, which lack any reference to tax adjustments, and the context in which Act 11 was adopted. As explained in PPL Electric's Main Brief, Act 11 clearly intended to adopt the water utility DSIC, and that DSIC did not include OCA's proposed tax adjustments. (PPL Electric M.B., p. 18). OCA's reference to comments in the legislative history regarding accrued depreciation do not support its claim that its other tax adjustments must be included in the calculation of the DSIC charge.

[2] PPL Electric notes that Act 11 clearly addresses depreciation and does not address ADIT at all. Accrued depreciation on plant reflected in the DSIC formula is part of the calculation of the DSIC charge. Final Implementation Order, p. 52.

4. The Commission Should Not Ignore Past DSIC Procedure in Interpreting Act 11.

The OCA uses convenient phrasing in its Main Brief to assert that this is the first opportunity to review the issue of tax adjustments for EDCs. (OCA M.B., p. 27). While technically true, this is certainly not the first opportunity the Commission has had to review tax adjustments under the DSIC mechanism. The Act 11 DSIC is identical to the historic water DSIC. (PPL Electric St. No. 3-R, p. 3). The OCA would have the Commission ignore the entirety of its history with the water DSIC. This history was significant to the General Assembly, which indicated that it modeled the Act 11 DSIC after the Commission's water DSIC. (PPL Electric St. No. 3-R, p. 3; Exhibit No. BLJ-1R).[3] Proper statutory interpretation requires that the prior practice be recognized in interpreting Act 11. (PPL Electric M.B., p. 16).

OCA contends that the Commission's past practice with the water DSIC may be ignored because there is language in the statute indicating that the Commission has the authority to amend its prior practice and procedure associated with the water DSIC. (OCA M.B., p. 24). OCA supports this argument with fragments of quotes from the statute, including a partial quote of 1358(c). OCA's Main Brief states that 1358(c) provides "nothing under this subchapter shall be construed as limiting the existing ratemaking authority of the Commission." (OCA M.B., p. 24). The full language actually provides that, "Except as otherwise expressly provided under this subchapter, nothing under this subchapter shall be construed as limiting the existing ratemaking authority of the Commission." 66 Pa. C.S. § 1358(c) (emphasis added). Section 1358(c) recognizes that where the General Assembly has expressly provided for a certain result, the

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[3] The OCA has asserted that new circumstances exist since the Commission's adoption of the water DSIC, but, as explained in PPL Electric's Main Brief and in this Reply Brief, the new circumstances relied upon by the OCA have existed during the pendency of the water utility DSIC, and no adjustments were made to the formula. (PPL Electric M.B., p. 24).

Commission lacks the authority to make a determination that is contradictory to the command of the General Assembly.

A clear example of the flaw in OCA's argument can be found in the reconciliation requirements. Historically, the Commission required an annual reconciliation of the DSIC. Prior to the passage of Act 11, the Commission had the authority to adjust the frequency and timing of the reconciliation. The Commission could have changed its practice and procedure to require water utilities to reconcile their DSIC on a semiannual or biannual basis, and to commence and end the reconciliation period at any point in the calendar year. However, Act 11 has now codified the annual reconciliation requirement, and has specified that the calendar year reconciliation will end on December 31 of each year. 66 Pa. C.S. § 1358(e). The Commission no longer has the authority to adjust these items. The OCA's analysis fails by not recognizing that those parts of the water DSIC practice and procedure that have been codified in statute by the General Assembly can no longer be modified by the Commission. As the Company has shown in its Main Brief and this Reply Brief, the General Assembly has provided the specific calculation for the DSIC, and that calculation adopted the Commission's historic treatment of tax benefits for water DSICs and purposefully excluded the adjustments now proposed by the OCA. The OCA's argument that the statute provides the Commission the authority to ignore its historic water DSIC procedure should be rejected.

5. The DSIC-like Mechanisms Adopted by Other States Are Irrelevant to a Proper Interpretation of Pennsylvania's Act 11.

OCA places substantial reliance upon the use of ADIT adjustments in DSIC-like mechanisms of other jurisdictions. (OCA M.B., pp. 18; 28-29). This is irrelevant for two reasons. First, interpretation of a Pennsylvania statute based on treatment by other jurisdictions is prohibited by the rules of statutory interpretation. (PPL Electric M.B., p. 11). On this ground

alone, the OCA's inclusion of analysis of other states' mechanism should be rejected. Second, and as described in PPL Electric's Main Brief in more detail, the mechanisms in the states referenced by the OCA are fundamentally different from the Pennsylvania DSIC and therefore offer no meaningful guidance to support the OCA's position. (PPL Electric M.B., pp. 31-33). The OCA's argument that ADIT, in particular, must be included because other states include it is undermined by the OCA's failure to similarly advocate to include other major rate components, which are included in other states but not included in Pennsylvania.

6. OCA's Proposed Adjustments are Unfair and Do Not Reflect "Actual Taxes Paid" Principles.

The OCA proposes that state income taxes for DSIC purposes be calculated based solely on incremental tax depreciation deductions associated with plant additions captured in the DSIC. (OCA M.B., pp. 30-36). Based upon this incremental approach, OCA asserts that no state income tax gross-up is appropriate because incremental deductions exceed taxable income before deductions. However, OCA's adjustment ignores offsetting reductions in state tax depreciation deductions for plant that is reflected in base rates. Not only is this distinction arbitrary, it is completely inconsistent with the OCA's claims that the DSIC should reflect actual taxes paid principles. The effect of OCA's proposed adjustment is to provide customers with tax deductions in excess of those received.

OCA argues in its Main Brief that there is a distinction between state tax depreciation deductions associated with plant in the DSIC versus plant in base rates. (OCA M.B., pp. 32-33). The assertion that state tax deductions reflected in calculating base rates can be ignored is inconsistent with actual taxes paid principles. As described in the Company's Main Brief, PPL Electric's base rates include a deduction for state taxes associated with one-time deductions, such as the repair allowance and bonus depreciation. Further, tax depreciation deductions decline

over the tax life of the plant. PPL Electric's tax obligations are not calculated on a stand-alone or incremental basis. (PPL Electric St. No. 4-R, p. 5). Test year state income tax deductions are incorporated into base rates on a representative basis for the future. An incremental calculation that focuses exclusively on new plant, while ignoring the amount of deductions already calculated into rates, results in a double-counting, because the Company would provide customers with two deductions for the single tax benefit actually received by the Company in any given year. In this case, the customer would get the benefit of both the deduction reflected in the DSIC and the deduction already reflected in base rates, which the Company no longer receives after the test year tax filing. The OCA is advocating for a double-counting of state income tax deductions, which is clearly inconsistent with base rate principles and "actual taxes paid."

7. It Would Be Contrary to the Simple Structure of A Surcharge Mechanism to Adopt the OCA's Proposals.

The Court has held that surcharge mechanisms should be easy to calculate exceptions to the base rate calculation. *Wastewater DSIC* at 1156. In addition, in the Commission's Final Implementation Order, the Commission specifically determined that the "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." Final Implementation Order at p. 39. As discussed in the previous section, the OCA's incremental approach is fundamentally flawed and would not result in "actual taxes paid." Rather, the OCA's proposal would double-count the Company's available tax deductions, because the OCA's proposal would fail to take into consideration the expiration of certain tax benefits associated with plant in rate base. Thus, the OCA's incremental approach must fail.

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 DSIC calculation. Conducting such a tax analysis would subject the DSIC to disputes over the proper calculation of 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.*

Further, the OCA acknowledges in its Main Brief that adoption of its tax proposals will require additional calculations that the Company does not currently undertake. (OCA M.B., p. 19). As admitted by the OCA, these additional calculations would rely on numerous estimates and projections. (OCA M.B., pp. 19-20). As a result, adoption of OCA's proposal would not only complicate the calculation of the DSIC mechanism, but would complicate the reconciliation process. Adoption of OCA's proposal would undermine the establishment of a mechanism that is simple and easy to reconcile, which is contrary to the goal of the General Assembly and Commission.

8. Conclusion

The OCA's proposal to adjust for only two components (ADIT and state income taxes) of the traditional ratemaking process as opposed to the many other components excluded from the DSIC mechanism is unfairly selective. There are other base rate adjustments that would increase the Company's recovery. The OCA does not advocate for the inclusion of adjustments that would increase the DSIC charge, even though its argument that traditional ratemaking principles should apply to the DSIC charge would seemingly require them. The OCA's proposal is an example of regulatory selectivity that would unfairly disadvantage the Company by adding requirements to the statute which were not included by the General Assembly. Further, OCA's proposal is unnecessary, because the General Assembly has included an earnings cap provision

that captures these adjustments and applies the proper earnings standard in determining whether rates are just and reasonable. OCA's tax adjustments should be rejected.

The DSIC surcharge mechanism was established by the General Assembly to apply the Commission's historic water DSIC practice and procedure. OCA's attempts to undermine the General Assembly's clear re-authorization of that mechanism, would rewrite the DSIC mechanism. That result is not a permissible interpretation of the statute. Further, OCA's proposal would lead to patently unfair results that would double-count the tax benefits available to the Company. This fundamental miscalculation, which OCA failed to explain in its Main Brief, should not be incorporated into the DSIC mechanism. The ALJ and the Commission should follow the practice and procedure established in the water DSIC and reject the OCA's proposal.

D. PPLICA'S ARGUMENTS IGNORE THE PLAIN LANGUAGE OF THE STATUTE.

1. Rate Schedule LP-5 Customers Should Be Charged the DSIC

PPLICA's argument in its Main Brief that Rate Schedule LP-5 customers should be excluded from the DSIC consistently overlooks appropriate statutory interpretation. While PPLICA attempts to mince the words of the Commission's Final Implementation Order to fit its legal argument in this proceeding, at no point does it discuss the plain language of Act 11. Act 11, on its face, says that the DSIC shall be applied "equally to all customer classes." Rate Schedule LP-5 is a distribution customer class of PPL Electric. Based on the plain language of the statute, the DSIC must apply to Rate Schedule LP-5.

PPLICA does not dispute that Rate Schedule LP-5 customers are distribution customers. Nor does PPLICA dispute that Rate Schedule LP-5 customers are included in PPL Electric's cost of service study and have distribution plant included for ratemaking purposes. Instead, PPLICA

attempts to argue that the plant included for ratemaking purposes is not the "right" kind of plant. (PPLICA M.B., p. 11). Based on the plain language of Act 11, the DSIC should apply equally to all customer classes. In determining whether to apply the DSIC to a particular electric customer, the Commission correctly determined that if that customer is not served from facilities which are included within distribution plant for ratemaking purposes, then the customer should not pay the DSIC. Thus, the relevant inquiry in this proceeding is whether there is any plant included for ratemaking purposes for the Rate Schedule LP-5 customers, and not whether there is a certain qualifying type of plant included for ratemaking purposes. PPLICA attempts to read into the Commission's Final Implementation Order language which is simply not present. PPLICA's proposal to exclude Rate Schedule LP-5 customers is inconsistent with the plain language of Act 11, and with the language in the Commission's Final Implementation Order, and should be rejected.

2. The ACR and CER Should be Included in the Revenue Calculation

PPLICA has argued in this proceeding that the ACR and CER, which are distribution riders, should be excluded from revenues for the purpose of calculating the DSIC cap. In making its arguments, PPLICA ignores both the statutory language included in Act 11 and the nature of the riders.

PPLICA argues in its Main Brief that Act 11 provides flexibility in determining what is included in the calculation of revenues. (PPLICA M.B., p. 13). That is simply incorrect. As described in PPL Electric's Main Brief, 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. It is clear from this language that the General Assembly provided the formula for calculating revenues, and that the calculation does not exclude other riders.

Further, PPLICA asserts that the revenues associated with the ACR and CER are not received for distribution services. (PPLICA M.B., pp. 15-17). According to PPLICA's definition, a rider could only be included in the determination of revenues if it was directly related to distribution plant. That, however, is not the appropriate analysis for determination of whether revenues are distribution revenues. In its Main Brief, PPL Electric provided the statutory definition of a rate, which includes, "Every individual, or joint fare, toll, charge, rental or other compensation whatsoever of any public utility…" 66 Pa.C.S. § 102. It is readily apparent from this broad definition that PPLICA's narrow definition of a distribution rate as only those rates that are charged for distribution services that directly relate to distribution plant is not appropriate. The statutory language of Act 11 clearly states that the relevant inquiry is the projected revenues for the quarterly period during which the charge will be collected. PPLICA's additional requirement, that the revenues be directly associated with distribution plant, is not supported by the statute. As required by Act 11, and by the very definition of a rate, PPLICA's argument should be rejected. Distribution rates, and therefore the revenues associated with those rates, apply broadly to the joint charges collected by the utility for the provision of service.

PPLICA argues that a distinction should be drawn between the revenues generated by the ACR and CER and "distribution revenues." (PPLICA M.B., pp. 16-17). PPLICA's distinction is illogical. As stated in PPL Electric's testimony and its Main Brief, if PPL Electric were not recovering these costs through the ACR and the CER, they would be incorporated into base rates, and therefore would be considered part of the Company's revenue for the purposes of calculating the projected quarterly revenues for the DSIC. (PPL Electric M.B., pp. 37-38; PPL Electric St. No. 3-R, pp. 9-10). It would be illogical to conclude that these costs should be treated differently, depending on whether or not they were recovered through a rider. Yet that is

exactly what PPLICA has proposed in this proceeding. Further, the ACR and CER are included in the line item for "distribution service" on the customer's bill, along with the other riders which PPLICA has agreed are appropriately included in the DSIC. (PPL Electric St. No. 3-R, p. 11).

PPLICA also attempts to support its exclusion of the ACR and CER revenues by claiming that their inclusion is contrary to Act 11 and the Public Utility Code. (PPLICA M.B., pp. 17-21). Ignoring, once again, that the statutory language clearly provides for their inclusion, PPLICA supports its conclusion by combining its two previously presented issues. PPLICA once again argues that distribution rates somehow exclude mandatory costs that are statutorily required in order to provide distribution service. In making this argument PPLICA ignores the language of Act 11, the statutory definition of a rate, and logic itself, none of which support PPLICA's conclusion.

Finally, PPLICA argues that inclusion of the revenues associated with the ACR and CER would be discriminatory, because the impact "creates unreasonable rate discrimination between customer classes." (PPLICA M.B., p. 19). In support of this argument, PPLICA presents a lengthy analysis, not included in the record, which purports to show that the inclusion of the ACR and CER in calculation of the 5% DISC cap will have a disproportionate percentage impact on Large C&I customers. PPLICA's argument should be rejected. First, the issue presented is whether the ACR and CER collect distribution revenues, and as explained above, they clearly do, and they are included in the line item for "distribution service" on the customer's bill. They are therefore distribution revenues that should be included in the calculation of the cap. The fact that this may have a disproportionate impact on Large C&I customers is completely irrelevant to the issue presented. Second, PPLICA's argument seems to be premised on the notion that there is a separate DSIC charge for each customer class. There is not. There is one DSIC rate that applies

equally to all customer classes. The fact that the ACR or CER, or any distribution rate rider, recovers more or less revenue from different customer classes is completely irrelevant to the issue of whether the ACR and CER are distribution rate riders. The statutory language clearly requires the DSIC to be applied equally to all customer classes. The fact that an increase in the DSIC cap calculation, due to the appropriate inclusion of a rider that captures distribution revenues, may result in a greater percent increase for a particular customer class does not show discriminatory rates where the General Assembly has required such a result.

The plain language of the statute provides the formula for calculating the projected quarterly revenues, and does not accommodate PPLICA's overly narrow definition of "distribution rates." PPLICA's analysis would result in an illogical and artificial distinction between base rate revenues and revenues recovered through riders. The General Assembly has set forth the appropriate formula for determining projected quarterly revenues. PPLICA's disagreement with that formula must be addressed by the General Assembly, and not by the Commission. PPLICA's proposal to exclude the ACR and CER should be rejected.

3. PPLICA's Argument Regarding the "Net Metering Rider" is Factually Incorrect and Should be Rejected.

As described previously in this Reply Brief, PPLICA has misstated the legal standard applicable to an analysis of what it refers to as the "Net Metering Rider," and, therefore, its arguments should be rejected on this issue. However, PPL Electric will address the arguments made in PPLICA's brief, which have no merit.

PPL Electric does not have a "Net Metering Rider." PPL Electric does have a tariff provision entitled "Net Metering for Renewable Customer-Generators." (Affidavit of Bethany L. Johnson). As described in the affidavit, distribution revenues associated with these customers are included in the base distribution dollars which have been identified in this proceeding. This

is because net metering is a service provided to customers who take normal distribution service under their applicable customer class, unless they are producing enough generation to supply their use entirely. Aside from any deduction on the customer's bill that it receives due to its monthly generation, the customer will pay the Company for standard distribution service. Therefore, any revenue generated by these customers is treated as base distribution dollars, because the dollars are generated through the exact same process as customers who are not eligible for net metering.

As noted in Ms. Johnson's affidavit, the Company did not distinguish dollars associated with these customers because the tariff provision is not a Section 1307 reconcilable rider. This is because, as described previously, no revenues are generated from the application of the tariff provision itself. Any revenues generated by customers who are eligible for the tariff provision are normal distribution revenues, which would be generated whether or not the customer is eligible for net metering. Exclusion of the tariff provision would have minimal impact on the calculation of the DSIC cap. However, that impact would actually increase PPL Electric's distribution revenues, because the tariff provision provides a reduction in the distribution bills of customer-generators.

In addition, there is no logical basis for the exclusion proposed by PPLICA, and it is completely contrary to PPLICA's other arguments to exclude this tariff provision. Net metering customers utilize distribution plant and contribute to basic distribution revenues. PPL Electric's Net Metering for Renewable Customer-Generators tariff provision specifically notes that "the customer-generator is responsible for the customer charge, demand charge and other applicable charges under the applicable Rate Schedule." The customer charge, demand charge, and other applicable charges are distribution charges for use of the distribution system, and are charged to

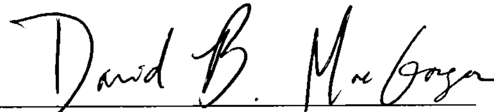
all distribution customers. The DSIC will apply to net-metering customers because they are treated like other customers in their applicable Rate Schedule. Therefore, the tariff provision for Net Metering for Renewable Customer-Generators should be included in the calculation of distribution revenues.

PPLICA failed to provide any testimony during this proceeding about the tariff provision relating to Net Metering for Renewable Customer-Generators. Even its argument and requested relief are unclear, and may have the impact of increasing the Company's revenues, which seems contrary to PPLICA's purpose. PPLICA's proposal to exclude the "Net Metering Rider" should be rejected.

III. 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,



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