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March 2, 2017

VIA e-FILING

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

**Re: Petitions of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company for Approval of a Distribution System Improvement Charge, Docket Nos. P-2015-2508942, et al.
Office of Consumer Advocate v. Metropolitan Edison Company, et al.,
Docket Nos. C-2016-2531040, et al.**

Dear Secretary Chiavetta:

Enclosed for filing is the **Further Prehearing Conference Memorandum of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company** in the above-captioned matters. A copy has been served on Administrative Law Judge Joel H. Cheskis and the parties / intervenors of record in accordance with the attached Certificate of Service.

Very truly yours,



Anthony C. DeCusatis

Enclosures

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

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

| | | |
|---|---|---|
| PETITIONS OF METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY, PENNSYLVANIA POWER COMPANY AND WEST PENN POWER COMPANY FOR APPROVAL OF A DISTRIBUTION SYSTEM IMPROVEMENT CHARGE | : | Docket Nos. P-2015-2508942, et al. |
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| OFFICE OF CONSUMER ADVOCATE | : | Docket Nos. C-2016-2531040, et al. |
| | : | |
| v. | : | |
| | : | |
| | : | |
| METROPOLITAN EDISON COMPANY, ET AL. | : | |

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served a copy of the **Further Prehearing Conference Memorandum of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company** on the following persons in the matter specified in accordance with the requirements of 52 Pa. Code § 1.54:

VIA ELECTRONIC AND/OR FIRST CLASS MAIL

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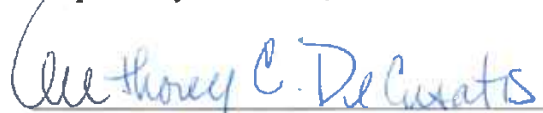
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Dated: March 2, 2017

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Petition of Metropolitan Edison Company for
Approval of a Distribution System Improvement
Charge** : : **Docket No. P-2015-2508942**

Office of Consumer Advocate :
v. : **Docket No. C-2016-2531040**
Metropolitan Edison Company :

**Petition of Pennsylvania Electric Company for
Approval of a Distribution System Improvement
Charge** : : **Docket No. P-2015-2508936**

Office of Consumer Advocate :
v. : **Docket No. C-2016-2531060**
Pennsylvania Electric Company :

**Petition of Pennsylvania Power Company for
Approval of a Distribution System Improvement
Charge** : : **Docket No. P-2015-2508931**

Office of Consumer Advocate :
v. : **Docket No. C-2016-2531054**
Pennsylvania Power Company :

**Petition of West Penn Power Company for
Approval of a Distribution System Improvement
Charge** : : **Docket No. P-2015-2508948**

Office of Consumer Advocate :
v. : **Docket No. C-2016-2531019**
West Penn Power Company :

**FURTHER PREHEARING CONFERENCE MEMORANDUM OF
METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC
COMPANY, PENNSYLVANIA POWER COMPANY AND WEST PENN
POWER COMPANY**

March 2, 2017

FURTHER PREHEARING CONFERENCE MEMORANDUM

I. INTRODUCTION

This Prehearing Conference Memorandum is being submitted on behalf of Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company (“Penelec”), Pennsylvania Power Company (“Penn Power”) and West Penn Power Company (“West Penn”) (individually, a “Company” and collectively, the “Companies”) pursuant to the Further Prehearing Conference Order issued by Administrative Law Judge Joel H. Cheskis on February 22, 2017.

II. HISTORY OF THE PROCEEDING

The Companies’ Base Rate Cases. On January 19, 2017, the Pennsylvania Public Utility Commission (“Commission”) entered its Opinion and Order (“January 19, 2017 Order”) in the Companies’ base rate cases at Docket Nos. R-2016-2537349, *et al.* The January 19, 2017 Order granted Joint Petitions for Partial Settlements (“Joint Petitions”) filed on October 14, 2016, and approved the terms and conditions of the base rate increase settlements set forth therein. The Joint Petitions reserved for briefing and decision one issue (the “reserved issue”), which pertains to the formula for calculating the distribution system improvement charge (“DSIC”) set forth in the Companies’ DSIC Riders.

This Proceeding’s Prior Procedural History. The Companies’ DSIC Riders were approved by the Commission’s Orders entered June 9, 2016 at the above-referenced docket numbers (the “DSIC Orders”). In the DSIC Orders, the Commission referred to the Office of Administrative Law Judge (“OALJ”) three DSIC implementation issues that had been raised in pleadings filed by intervenors in this case. Subsequently, those issues were assigned to

Administrative Law Judge Cheskis. A Joint Petition for Settlement of Pending Issues, which encompasses only those issues referred to the OALJ by the Commission's DSIC Orders, was filed on February 2, 2017, together with Statements in Support by the Joint Petitioners. On February 16, 2017, the Joint Petitioners filed and served their joint proposed Findings of Fact, Conclusions of Law and Ordering Paragraphs.

Relationship Of This Proceeding To The Companies' Base Rate Cases. In its January 19, 2017 Order, the Commission concluded that it would not decide on its merits as part of the Companies' base rate cases the issue reserved from the settlement of those cases and, instead, referred the reserved issue to this proceeding. Additionally, in Ordering Paragraph No. 4 of the January 19, 2017 Order, the Commission transferred to this proceeding "the relevant part of the record" in the Companies' base rate cases including the OCA's Exceptions, the Companies' Replies, the OCA's Main and Reply Briefs, the Companies' Initial and Reply Briefs, OCA Statement No. 1 and the Companies' Statement No. 2-R.¹ The Companies and the OCA each submitted their Proposed Findings of Fact, Conclusions of Law and Proposed Ordering Paragraphs as appendices to their Initial and Main Briefs, respectively.

III. NATURE AND SCOPE OF THIS PROCEEDING AND THE OFFICE OF CONSUMER ADVOCATE'S ("OCA") REQUEST TO SUBMIT SUPPLEMENTAL TESTIMONY ON A CONTINGENT ISSUE

The referral to this case of the reserved issue together with the relevant parts of the record and the briefs, exceptions and reply exceptions in the Companies' base rate case provide the

¹ On February 3, 2017, the OCA filed a Petition for Reconsideration or Clarification ("Petition") for the limited purpose of requesting the Commission to revise Ordering Paragraph No. 4 to specifically include OCA Statement No. 1-SR because the OCA believes that pages 33-36 of that statement are relevant to the reserved issue. On February 10, 2017, the Companies responded to the Petition with a letter stating that they believe the general terms of the referral (the "relevant parts of the record") are not limited by the itemized list following "including" in Ordering Paragraph No. 4 and, therefore, OCA Statement No. 1-SR is reasonably comprehended by the record transfer. Accordingly, the Companies indicated that they have no objection to the Commission granting the OCA's request to clarify its January 19, 2017 Order to specifically direct the inclusion of OCA Statement No. 1-SR in the parts of the record transferred to this proceeding.

complete and sufficient basis for the Administrative Law Judge to address and decide, in a Recommended Decision, the reserved issue referred to this proceeding. In brief, that issue is whether the enactment of Act 40 of 2016, which added Section 1301.1 to the Public Utility Code, requires the Commission to revise the formula for calculating quarterly DSIC charges set forth in the Model Tariff for the DSIC that the Commission approved for use by utilities in its Final Implementation Order.² The Companies' DSIC Riders conform to the terms of the Model Tariff, as the Commission found and determined in the June 9, 2017 Orders approving the DSIC Riders.³

With respect to the reserved issue that was assigned to this case, no further process (i.e., discovery, testimony, hearings or briefing) is required, nor should it be permitted. Indeed, the Office of Consumer Advocate ("OCA") has stated in briefs to the Commission that the reserved issue itself is a "legal" issue and is "ripe" for decision based on the record and briefs in the base rate case.⁴

The OCA has, however, pointed out in letters to the Administrative Law Judge and the parties that: (1) the reserved issue was discussed on the record and in briefs submitted in the base rate case principally in terms of how federal accumulated deferred income taxes ("ADIT") would be reflected in the calculation of quarterly DSIC charges if the OCA's position were adopted by the Commission; (2) the OCA contends that, in addition to revisions to the DSIC formula to reflect federal ADIT, further revisions would also be needed to reflect state income tax

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

³ *See, e.g.*, Met-Ed's June 9, 2016 Order at Docket No. P-2015-2508942 (p. 7) ("Met-Ed's proposed DSIC Rider is consistent with the Model Tariff . . .").

⁴ The OCA stated with regard to the issue reserved for decision that "there is no dispute regarding the facts relevant to this issue" (OCA Main Brief, p. 6); that the contested issue "is a legal issue and therefore, not necessarily tied to the evidence or amount thereof in the record" (OCA Main Brief, p. 10); "the Parties do not disagree on the facts relevant to this issue" (OCA Main Brief, p. 10) and "the record in this matter fully developed the issue, and it would be a waste of resources to create another record" (OCA Exceptions, p. 3).

deductions and credits, if the OCA's position on the reserved issue were adopted; and (3) revisions related to state income tax implications were not set forth on the record in the base rate case. Accordingly, the OCA has proposed the submission of supplemental testimony to set forth and discuss the parties' positions on how state income tax deductions and credits should be reflected in the DSIC formula if the OCA's position were to prevail.

The Companies would not object to the submission of supplemental testimony and accompanying exhibits, if any, if such testimony and exhibits are limited to the contingent issue delineated above, namely, how, if at all, the DSIC formula for calculating quarterly DSIC charges should be revised to reflect state tax deductions and credits in the event the OCA's position on the reserved issue is adopted by the Commission. To that end, the Companies propose the submission of supplemental testimony and accompanying exhibits in accordance with the schedule set forth below.

IV. PROPOSAL TO ACCOMMODATE THE OCA'S REQUEST

Because the contingent issue to be addressed by the additional round of testimony involves how the DSIC would change if the OCA's position on the reserved issue were adopted (i.e., no changes would be needed if the Companies' position is affirmed), the Companies propose that OCA be permitted to submit Supplemental Direct Testimony, the Companies be permitted to submit Supplemental Rebuttal Testimony responding to the OCA Supplemental Direct, the OCA be permitted to submit Supplemental Surrebuttal Testimony responding to the Companies' Supplemental Rebuttal; and the Companies be permitted to submit Supplemental Rejoinder Testimony responding to the OCA's Supplemental Surrebuttal.⁵ All of the testimony

⁵ The Companies had the opportunity to submit Rejoinder testimony in their base rate cases, but settlement obviated the need to submit Rejoinder.

and accompanying exhibits thus submitted would be deemed supplemental to the testimony presented in the record that has been transferred to this case by the January 19, 2017 Order. The Companies propose the following schedule for testimony submission and an evidentiary hearing, which is the product of discussions and an agreement with the OCA:⁶

| | |
|-----------------------------------|----------------|
| OCA Supplemental Direct | March 21, 2017 |
| Companies' Supplemental Rebuttal | April 13, 2017 |
| OCA's Supplemental Surrebuttal | May 1, 2017 |
| Companies' Supplemental Rejoinder | May 5, 2017 |
| Evidentiary Hearing | May 12, 2017 |

Supplemental briefs, which the Companies envision being relatively short, would also be limited to the contingent state income tax issue identified above.

V. MATTERS IDENTIFIED IN THE FURTHER PREHEARING CONFERENCE ORDER TO BE ADDRESSED IN THE FURTHER PREHEARING MEMORANDA

The Further Prehearing Conference Order (pp. 4-5) identifies five matters that the parties are asked to address in their Further Prehearing Conference Memoranda. The Companies' responses are set forth below.

A. A Statement Regarding Possible Settlement Of The Case

The reserved issue was held out for litigation and decision in the base rates cases (and subsequently assigned to this case) because the parties could not reach a settlement on the issue. Because the reserved issue involves a fundamental difference between the Companies and the OCA on interpretation and application of a provision of the Public Utility Code that is an issue of

⁶ The Companies understand that the OCA will be proposing the same schedule.

first impression, the Companies do not believe that a settlement of the reserved issue is likely to occur. After the OCA's Supplemental Direct Testimony is submitted, the Companies will explore the possibility of a stipulation that may resolve the contingent issue to be addressed in the supplemental testimony.

B. A Proposed Plan And Schedule Of Discovery

The Companies do not believe that formal discovery is necessary given the limited scope of the supplemental testimony. However, the Companies will work cooperatively with the OCA to provide opportunities for informal discovery as needed and to develop a schedule for expedited formal discovery, if formal discovery should become necessary.

C. A Proposed Schedule For Litigation

The Companies' proposed schedule has been provided in Section IV, above.

D. Names, Business Addresses, And Telephone Numbers Of Witnesses Each Party Expects To Call And The Subject Matter Of Each Witness' Testimony

The Companies intend to present the testimony of Charles V. Fullem, who is employed by FirstEnergy Service Company as Director – Rates and Regulatory Affairs – Pennsylvania. Mr. Fullem submitted direct testimony in the Companies' base rate cases. Mr. Fullem's business address is 2800 Pottsville Pike, Reading, Pennsylvania 19605, and his business telephone number is 610-921-6525. It is anticipated that Mr. Fullem would submit Supplemental Rebuttal Testimony to respond to the Supplemental Direct Testimony of the OCA and, if necessary, Supplemental Rejoinder Testimony to respond to the Supplemental Surrebuttal of the OCA with

respect to the contingent issue. The Companies reserve the right to supplement their witness list after they have had the opportunity to review the OCA's Supplemental Direct Testimony.

E. Issues And Sub-Issues To Be Addressed

The reserved issue that has been assigned to this case by the Commission has been identified and is discussed in the January 19, 2017 Order. The Companies' position on the reserved issue is summarized in the January 19, 2017 Order and is discussed in more detail in the Companies' Initial and Reply Briefs and their Reply to the OCA's Exceptions. More specifically, the reserved issue is articulated in the first full paragraph at page 5 of the Companies' Initial Brief and in Section II.B., at pages 6-8 thereof. A summary and overview of the Companies' position on the reserved issue is provided at pages 8-10 of their Initial Brief,⁷ pages 1-6 of their Reply Brief and pages 6-10 of their Reply to Exceptions. A copy of the referenced pages from the Companies' Initial and Reply Briefs and Reply to Exceptions is provided as Appendix A to this Memorandum.

As previously explained, the record and briefing on the fundamental issue reserved for decision in the Companies' base rate cases and assigned to this proceeding is complete, and the reserved issue is now ready for decision. As also explained, the OCA would like the opportunity to submit testimony limited to the contingent issue of how state tax deductions and credits should be reflected in the calculation of DSIC quarterly charges if the OCA's position on the reserved issue were adopted. As discussed in Section IV, *supra*, the Companies would acquiesce in the OCA's request subject to the terms and conditions in Section IV. The Companies' intend to review the OCA's Supplemental Direct Testimony and determine whether, or to what extent,

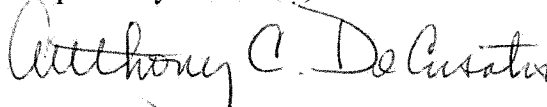
⁷ Please note that errata on page 10 of the Companies' Initial Brief were corrected by a revised page 10 filed by the Companies on October 10, 2016.

they may agree or disagree with the OCA's position. Consequently, they are not in a position to articulate a specific position on the contingent issue at this time.

VI. CONCLUSION

WHEREFORE, the Companies submit this Further Prehearing Conference Memorandum in compliance with the Further Prehearing Conference Order in this case and respectfully request that Administrative Law Judge Cheskis accept the proposal set forth in Section IV, above, for the further conduct of this proceeding.

Respectfully submitted,



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Dated: March 2, 2017

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APPENDIX A

**RELEVANT PORTIONS OF THE COMPANIES'
INITIAL AND REPLY BRIEFS AND
REPLY TO EXCEPTIONS
CITED IN THEIR FURTHER PREHEARING
CONFERENCE MEMORANDUM**

COMPANIES' INITIAL BRIEF

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

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September 30, 2016

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Charge (“DSIC”) that conforms to the terms of the “Model Tariff” the Commission adopted, pursuant to Section 1353 of the Public Utility Code,⁷ in its Final Implementation Order for Act 11 of 2012.⁸

The reserved issue pertains to the formula in Riders N, O and R (hereafter referred to collectively as the “DSIC Rider”) for calculating the “fixed cost” of “eligible property”⁹ recovered through the DSIC. Specifically, the OCA, through its witness, Ralph C. Smith,¹⁰ citing Section 1301.1, which was added to the Public Utility Code earlier this year,¹¹ contends that the formula in the DSIC Rider – and by extension, the formula in the Commission’s Model Tariff – should be modified by inserting a term that deducts from the original cost of “eligible property” accumulated deferred income taxes (“ADIT”) that may accrue with respect to that property. The Companies submitted the testimony of Richard A. D’Angelo, FirstEnergy’s Manager – Rates and Regulatory Affairs – Pennsylvania, rebutting Mr. Smith’s arguments.¹²

The OCA also contends that the issue reserved for briefing should properly be addressed in this proceeding because the DSIC Rider constitutes an existing “rate” of the Companies. The OCA submits that, as an existing “rate,” the terms of the DSIC Rider are within the scope of its Complaints against the Companies’ existing and proposed rates, which were consolidated with the Commission’s investigation at this docket.

⁷ See 66 Pa.C.S. § 1353(b)(1) (“A petition for commission approval of a distribution system improvement charge shall include . . . [a]n initial tariff that complies with a model tariff adopted by the commission.”).

⁸ *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611 (Aug. 2, 2012) (“Final Implementation Order”), pp. 30-31 and Appendix A.

⁹ See 66 Pa.C.S. §§ 1351 (defining “eligible property”) and 1357(a)(3) (defining “fixed cost”).

¹⁰ OCA Statement No. 1, pp. 108-110.

¹¹ 66 Pa.C.S. § 1301.1.

¹² Companies’ Statement No. 2-R, pp. 40-43. Mr. D’Angelo explained that Section 1301.1 does not apply to the DSIC and, even if it did, it does not eliminate or diminish the Commission’s discretion to determine how ADIT should be recognized in the DSIC adjustment mechanism.

II. OVERVIEW AND SUMMARY OF ARGUMENT

A. The Reserved Issue Should Not Be Addressed In this Case

Given the procedural posture of the reserved issue, the Companies, in Section IV, *infra*, address that issue on its merits. However, as explained in Section III, *infra*, the reserved issue should not be addressed in this case. The reserved issue pertains to the terms of an adjustment clause established under Section 1357(c), which, as explained in Section IV.C.2, *infra*, is not a "base rate" and differs markedly from base rates established under the authority of Section 1308(d). This consolidated proceeding encompasses the Companies' base rates. Accordingly, the reserved issue is not properly within the scope of this proceeding.

B. The Companies' Argument On The Merits

In *McCloskey v. Pa. P.U.C.*,¹³ the Commonwealth Court held that the Commission did not abuse the discretion afforded it under the Public Utility Code to set just and reasonable rates when it determined that incremental ADIT associated with quarterly additions of "eligible property" need not be included in the quarterly calculations of the DSIC.¹⁴ The Court rejected the OCA's contention that the Commission-approved DSIC adjustment clause ignores the impact of ADIT. To the contrary, the DSIC, viewed in its entirety, takes ADIT into account because cumulative ADIT (i.e., ADIT related to *all* of a utility's property, including the ADIT associated with incremental additions of "eligible property") is fully reflected in the calculation of a utility's achieved rate of return on equity that is performed, and filed, each quarter. The utility's

¹³ 127 A.3d 860 (Pa. Cmwlth. 2015) ("*McCloskey*"). This case was an appeal from a Commission Order approving a DSIC for Columbia Gas of Pennsylvania, Inc. ("Columbia"). Similar issues were also decided against the OCA in an unreported opinion issued the same day in the OCA's appeal from a Commission Order approving a DSIC for Little Washington Wastewater Company ("Little Washington"). *McCloskey v. Pa. P.U.C.*, No. 1358 C.D. 2014 (Nov. 3, 2015) ("*McCloskey-Little Washington*").

¹⁴ 127 A.3d at 870-871.

achieved rate of return on equity, in turn, is compared, each quarter, to its allowable rate of return on equity to determine if it has breached the “earnings cap”¹⁵ and, therefore, must reduce its DSIC to *zero*. The Court determined that the Commission’s approach, which recognizes cumulative ADIT, is reasonable and, therefore, the Commission had properly exercised its permissible discretion to set just and reasonable rates in rejecting the OCA’s alternative, incremental approach. In so doing, the Court followed Pennsylvania appellate court precedent holding that there is no “single way” to determine just and reasonable rates; that the Commission is “vested with discretion to decide what factors it will consider”¹⁶ in establishing a rate,¹⁶ and that the *entire* adjustment clause constitutes a “rate.”¹⁷

Notwithstanding the foregoing, Mr. Smith and the OCA contend that the subsequent enactment of Section 1301.1(a) of the Public Utility Code¹⁸ requires the Commission to adopt the very same proposed revision to the DSIC formula rejected by the Commonwealth Court in *McCloskey*.¹⁹ Section 1301.1(a) was added to the Public Utility Code by Act 40 of 2016 (“Act 40”)²⁰ to eliminate the use of so-called consolidated tax adjustments (“CTA”) in calculating

¹⁵ See 66 Pa.C.S. § 1358(b)(3).

¹⁶ 127 A.3d at 868, quoting *Popowsky v. Pa. P.U.C.*, 669 A.2d 1029, 1040 (Pa. Cmwlth. 1995). See also *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 313 (1989) (Rejecting the argument advanced by appellants in that case that “subsidiary elements” of a ratemaking methodology may be “examined piecemeal.”)

¹⁷ 127 A.3d at 867 (Accepting the Commission’s position that “the DSIC charge and the limiting provisions of the customer protections under Act 11 must be considered together.” The “earnings cap” is one of the “customer protections” embedded in the DSIC Model Tariff.) See *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge*, Docket No. P-2012-2338282 (Final Order entered May 22, 2014), p. 22 (“However, the ALJs stated that, ‘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.’”) quoting R.D. issued Mar. 6, 2014), p. 45. See also 66 Pa.C.S. § 102 (defining a “rate” as including “any rules, regulations, practices, classifications or contracts affecting any . . . charge.”).

¹⁸ 66 Pa.C.S. § 1301.1(a).

¹⁹ OCA Statement No. 1, pp. 108-110.

²⁰ Act 40 was enacted on June 12, 2016 to become effective in sixty days (i.e., by August 11, 2016) for “all cases where the final order is entered after the effective date of this section.”

utility base rates.²¹ Nonetheless, the OCA submits that Section 1301.1(a): (1) applies to the formula for calculating the DSIC incorporated in the Model Tariff; and (2) retroactively removes from the Commission the discretion to determine how ADIT should be recognized in establishing a just and reasonable DSIC adjustment clause. Both contentions are erroneous.

Act 40 does not apply to the DSIC for three reasons. First, Act 40 does not mention the DSIC or otherwise indicate that the amendments it was making to the Public Utility Code altered the method of calculating the DSIC that had been approved by the Commission and affirmed by the Commonwealth Court. To the contrary, Act 40 was explicitly designed to eliminate the use of CTAs.²² Nothing within the four corners of that act or in its legislative history suggests it would alter the elements of the DSIC formula prescribed in Section 1357 or deprive the Commission of its discretion to determine *how* ADIT should be accounted for in designing DSIC tariffs.²³

Second, the legislative history of Act 40 is clear that Section 1301.1 was intended to apply only to base rates established under Section 1308.²⁴ The lead sponsor of H.B. 1436, which became Act 40, stated that “this section applies to base rate cases” and “would only go into effect when a utility comes in for a base rate case.”²⁵ Additional evidence from the text of Act 40 and

²¹ See Public Hearing In Re: House Bill 1436, Pennsylvania House of Representatives, Consumer Affairs Committee, Sept. 29, 2015 (“H.B. 1436 Public Hearing”), Tr. at 4-5 (Opening Statement of Chairman Robert Godshall): “House Bill 1436 would eliminate the consolidated tax approach and adopt a standalone approach used by a majority of the states and the Federal Energy Regulatory Commission.” See also *House of Representatives Legislative Journal*, February 8, 2016, p. 117 (Remarks of Robert Godshall, Chairman, Consumer Affairs Committee (“... this section applies to base rate cases . . .”). Copies of the Public Hearing transcript and the House Legislative Journal are attached as Appendices A and B, respectively.

²² See Companies' Statement No. 2-R, pp. 40-41.

²³ See 1 Pa.C.S. § 1921(c) (Legislative intent may be ascertained from the “occasion and necessity for the statute,” the “circumstances under which it was enacted,” the “object to be attained,” the “contemporaneous legislative history,” and “legislative and administrative interpretations” bearing on the relevant statute.)

²⁴ 66 Pa.C.S. § 1308.

²⁵ House of Representatives Legislative Journal, Feb. 8, 2016, p. 117 (Remarks of Robert Godshall, Chairman, House Consumer Affairs Committee). See also Companies' Statement No. 2-R, pp. 41-42.

its legislative history also supports this conclusion. The DSIC is a “sliding scale of rates or other method for the automatic adjustment of rates”²⁶ that is based on the same authority granted under Section 1307.²⁷ As such, the DSIC is not a “base rate” and, therefore, Section 1301.1 does not apply to it.

Third, Act 40 expressly provides: “This section shall apply to all cases where the final order is entered after the effective date of this section.”²⁸ The DSIC formula the OCA proposes to revise was approved in the Final Implementation Order as part of the Model Tariff that Section 1353(b) required the Commission to adopt. The Final Implementation Order was entered on August 2, 2012, and the DSIC formula it approved was affirmed by the Commonwealth Court in *McCloskey* in November 2015.²⁹ The Final Implementation Order was the “final order” that established the DSIC “rate” now challenged by the OCA. As such, Section 1301.1 does not apply to that “rate.”³⁰ Moreover, even the Commission Orders approving the Companies’ DSIC Rider, which found that it conforms to the Model Tariff, were also entered prior to the effective date of Act 40.³¹

Furthermore, even if Act 40 applied to the Model Tariff, it does not retroactively revoke or diminish the discretion afforded the Commission, and affirmed in *McCloskey*, to determine how ADIT should be reflected in the DSIC.³² As previously explained, cumulative ADIT related to all of a utility’s plant in service is fully reflected in the quarterly calculation of a utility’s

²⁶ 66 Pa.C.S. § 1357(c).

²⁷ 66 Pa.C.S. § 1358(e)(2). This section requires the reconciliation of revenues and costs “in accordance with section 1307(e).”

²⁸ As previously noted, the effective date is August 11, 2016.

²⁹ As previously noted, the OCA appealed from two Commission Orders that approved DSIC tariffs conforming to the Model Tariff. These two appeals were the “test cases” for challenging the terms of the Model Tariff.

³⁰ See Companies’ Statement No. 2-R, p. 42.

³¹ 66 Pa.C.S. § 1301.1(c)(2).

³² See Companies’ Statement No. 2-R, pp. 40-41.

achieved rate of return on equity used to determine whether it may charge a DSIC or, alternatively, must reduce the charge to zero if its “earnings cap” is exceeded. The DSIC formula does not ignore the impact on the DSIC of ADIT and, therefore, does not violate Section 1301.1(a) as the OCA contends. To the contrary, the Commission’s Model Tariff accounts for ADIT – just not in the manner the OCA prefers. Simply stated, Act 40 did not strip the Commission of its discretion to choose the method for reflecting ADIT in the DSIC adjustment mechanism – a method that the Commonwealth Court has determined is just and reasonable.

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

The DSIC in its current form was embodied in the Model Tariff that was approved in the Final Implementation Order, pursuant to the authority conferred by Section 1357(c).³³ Section 1357(c), like Section 1307, authorizes an automatic adjustment clause, which is a rate mechanism that is legally separate from, and operates differently from, base rates, as explained in detail in Section IV.C.2, *infra*. Moreover, adjustment clauses, by their nature employ a process for establishing the charges billed to customers that differs markedly from the process used to establish base rates, which is delineated in Section 1308.

The Companies initiated this proceeding by filing proposed increases in base rates under Section 1308(d), and they did not propose any revisions to the terms of their DSIC Riders which were then pending approval by the Commission. Moreover, the Commission's Order initiating its investigation does not mention the DSIC. Notably, the Commission approved the DSIC Riders and initiated its investigation of the Companies' base rate filings at the same public meeting.

³³ 66 Pa.C.S. § 1357(c).

COMPANIES' REPLY BRIEF

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**PENNSYLVANIA PUBLIC UTILITY
COMMISSION**

v.

**METROPOLITAN EDISON COMPANY,
PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY AND
WEST PENN POWER COMPANY**

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Docket Nos. R-2016-2537349, et al.

REPLY BRIEF

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October 14, 2016

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I. INTRODUCTION

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

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

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

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

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

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

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

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

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

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

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

⁸ *Id.* at 27-32.

⁹ *Id.* at 10-11.

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

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

II. SUMMARY OF ARGUMENT

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

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

¹² OCA Main Brief, p. 7.

¹³ Initial Brief, pp. 20-22.

¹⁴ *Id.* at 22-27.

¹⁵ *Id.* 27-31.

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

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

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

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

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

¹⁷ 127 A.3d at 870-871.

¹⁸ OCA Main Brief, p. 14.

¹⁹ 1 Pa.C.S. § 1921(c).

²⁰ Initial Brief, pp. 22-27.

²¹ *Id.* at 27-28.

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

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

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

²² See Initial Brief, p. 31.

²³ See OCA Main Brief, pp. 9 and 14.

²⁴ OCA Main Brief, p. 10.

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

²⁶ 127 A.3d at 869-871.

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

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

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

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

²⁷ See Initial Brief, pp. 32-38.

²⁸ *Id.* at 22-27.

²⁹ *Id.*

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

COMPANIES' REPLY TO EXCEPTIONS

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**PENNSYLVANIA PUBLIC UTILITY
COMMISSION**

v.

**METROPOLITAN EDISON COMPANY,
PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY AND
WEST PENN POWER COMPANY**

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Docket Nos. R-2016-2537349, et al.

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

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

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December 8, 2016

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I. INTRODUCTION

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

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

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

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

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

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

The issue reserved for briefing pertains to the OCA's proposal to amend the formula for calculating quarterly charges under the Distribution System Improvement Charge ("DSIC") to deduct accumulated deferred income taxes ("ADIT") from the original cost of "eligible property."¹ The OCA contends its proposed revision is required by Section 1301.1(a),² which was added to the Public Utility Code by Act 40 of 2016 ("Act 40")³ for the express purpose of eliminating the use of so-called consolidated tax adjustments ("CTAs") in calculating utility base rates.

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

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

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

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

⁴ *Petition of Metropolitan Edison Company for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2015-2508942 (June 9, 2016) ("Met-Ed DSIC Order"); *Petition of Pennsylvania Electric Company for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2015-2508936 (June 9, 2016) ("Penelec DSIC Order"); *Petition of Pennsylvania Power Company for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2015-2508931 (June 9, 2016) ("Penn Power DSIC Order"); *Petition of West Penn Power Company for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2015-2508948 (June 9, 2016) ("West Penn DSIC Order") (collectively, the "Companies' DSIC Orders").

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

“an initial tariff that conforms with a model tariff adopted by the commission.”⁶ Thus, while the object of the OCA’s proposed revision in this case is the DSIC Rider, the OCA is, in fact, contesting the terms of the Model Tariff adopted by the Final Implementation Order. For this reason, among others, the reserved issue is not properly within the scope of this consolidated base rate proceeding.

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

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

⁶ As a consequence, in every case where a utility has petitioned to establish a DSIC, the Commission has held that it is required to find, as a condition precedent to approving a DSIC, that the utility’s initial tariff complies with its Model Tariff. See e.g., *Petition of PECO Energy Company for Approval of its Electric Distribution Sys. Improvement Charge*, Docket No. P-2015-2471423 (Order entered Oct. 22, 2015), p. 25; *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2012-2338282 (Order entered May 22, 2014), p. 27; *Petition of PPL Elec. Util. Corp. for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2012-2325034 (Order entered May 23, 2013), p. 5.

⁷ Initial Brief, pp. 20-22.

⁸ *Id.* at 22-27.

Section 1301.1(c)(2), the DSIC is, therefore, excluded from the coverage of Section 1301.1(a).⁹ Finally, the Companies explained that, even if the DSIC were within the scope of Section 1301.1(a), nothing in Act 40 retroactively eliminated or diminished the Commission's discretion to determine *how* ADIT should be reflected in the DSIC. Consequently, Act 40 did not legislatively overrule *McCloskey v. Pa. P.U.C.*,¹⁰ which held that cumulative ADIT is already properly recognized in the DSIC through the earnings cap provision of the Model Tariff and, therefore, the Commission did not abuse its discretion to set just and reasonable rates when it determined that incremental ADIT associated with quarterly additions of "eligible property" need not be included in the calculation of quarterly charges under the DSIC as the OCA proposed then, and is still proposing now.¹¹

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

⁹ *Id.* 27-31.

¹⁰ 127 A.3d 860 (Pa. Cmwlth. 2015) ("*McCloskey*"). This case was an appeal from a Commission Order approving a DSIC for Columbia Gas of Pennsylvania, Inc. ("Columbia"). Similar issues were also decided against the OCA in an unreported opinion issued the same day in the OCA's appeal from a Commission Order approving a DSIC for Little Washington Wastewater Company. *McCloskey v. Pa. P.U.C.*, No. 1358 C.D. 2014 (Nov. 3, 2015).

¹¹ 127 A.3d at 870-871.

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

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

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

C. Judge Long's Recommended Decision

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

D. The OCA's Exceptions

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

¹⁴ R.D. at 96.

¹⁵ *Id.*

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

proceeding.¹⁷ In addition, the OCA proposes that, if the reserved issue is to be added to the issues assigned to Judge Cheskis, then it should also transfer the record¹⁸ pertaining to the reserved issue, which would become the record for decision on the reserved issue at that docket.

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

II. SUMMARY OF ARGUMENT

For all the reasons set forth in the Companies’ Initial Brief (pp. 10-11), the reserved issue is not within the scope of this base rate proceeding. Although the OCA contends that the DSIC Rider constitutes an existing rate and, as such, could conceivably be covered by the OCA’s Complaints in this case,²⁰ the OCA has not provided any valid reason why the terms of the DSIC Rider – and more broadly, the terms of the Model Tariff, which is the real target of the OCA’s arguments – should be considered here.

The substance of the OCA’s arguments is also wrong, and its proposed revision to the DSIC formula in the Model Tariff should be rejected. Section 1301.1(a) does not compel the formula revision, as the OCA contends. To the contrary, that section does not apply to the DSIC because: (1) Act 40 only eliminated the use of CTAs in base rate proceedings and did not alter the elements of the DSIC formula²¹; (2) Section 1301.1(a) applies only to base rates and not to

¹⁷ OCA Exceptions, pp. 2-3.

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

¹⁹ OCA Exceptions, pp. 4-6.

²⁰ See OCA Main Brief, p. 7.

²¹ Initial Brief, pp. 20-22.

adjustment clauses like the DSIC²²; and (3) if Section 1301.1 were deemed to apply to the DSIC, the Final Implementation Order, which established the Model Tariff that the OCA proposes to revise, was entered before the effective date of Act 40 and, therefore, the DSIC is excluded from its coverage.²³ Finally, even if Section 1301.1(a) applied to the DSIC, Act 40 does not retroactively diminish the Commission’s discretion to determine *how* ADIT should be reflected in the DSIC. As the Commonwealth Court held in *McCloskey*,²⁴ the DSIC, viewed in its entirety – i.e., including the earnings cap provision of the Model Tariff – does, in fact, account for cumulative ADIT in a reasonable fashion.

Section 1301.1(a) Was Designed Solely To Eliminate The Use Of CTAs In Base Rate Proceedings And Applies *Only* To Base Rates. The legislative history of Act 40 clearly demonstrates that it was intended for the sole purpose of eliminating CTAs and that it applies *only* to base rates.²⁵ The OCA cannot marshal any evidence to the contrary from the legislative history of Act 40. Instead, the OCA asserts that the language of Act 40 is “clear and unambiguous” that ADIT must be reflected in calculating charges under adjustment clauses like the DSIC²⁶ and, therefore, there is no need to consider rules of statutory interpretation set forth in Section 1921(c) of Pennsylvania’s statutory construction act.²⁷

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

²² *Id.* at 22-27.

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

²⁴ 127 A.3d at 870-871.

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

²⁶ OCA Exceptions, p. 4.

²⁷ 1 Pa.C.S. § 1921(c).

reference to “rate base” is a clear indication that Section 1301.1(a) applies only to base rates, for the reasons explained in detail in the Companies’ Initial Brief.²⁸ Additionally, the OCA did not even consider the term “final order” in Section 1301.1(c)(2), which is a formulation that is relevant only in the context of a base rate proceeding, as also explained in the Companies’ Initial Brief.²⁹ Both of those textual references provide irrefutable evidence *from within the four corners of Act 40* that it is intended, and designed, to apply *only* to base rates. In any event, those statutory terms, at a minimum, negate the OCA’s claim that Section 1301.1 is “clear and unambiguous” in its application to the DSIC. Consequently, there is a sound basis to consider the factors enumerated in Section 1921(c) of the statutory construction law for ascertaining legislative intent. In short, because the OCA has no argument to counter the clear legislative history demonstrating that Act 40 was intended solely to eliminate CTAs and applies only to the calculation of base rates, the OCA’s only recourse is to ask the Commission to ignore the legislative history entirely.

The Model Tariff (Which Sets Forth The DSIC “Rate”) Was Approved By A Final Order Entered Before The Effective Date Of Act 40. Neither the OCA’s Main and Reply Briefs nor its Exceptions addresses the fact that the “final order” approving the DSIC – i.e., the Final Implementation Order that adopted the Model Tariff – was entered before the effective date of Act 40. Indeed, even the Companies’ DSIC Orders were entered before Act 40’s effective date.³⁰ While the OCA did not address this additional reason why Act 40 is not applicable to the DSIC, the OCA agrees with the Companies that the DSIC Rider itself is a “rate.”³¹ Given that

²⁸ Initial Brief, pp. 22-27.

²⁹ *Id.* at 27-28.

³⁰ See Initial Brief, p. 31.

³¹ See OCA Main Brief, pp. 9 and 14.

acknowledgment and concession, the OCA has no grounds for disputing that the applicable “rate” – i.e., the DSIC mechanism that the Companies incorporated in the DSIC Rider – was established when the Commission adopted the Model Tariff. Consequently, Section 1301.1(c)(2) precludes the application of Act 40 to the DSIC even if Act 40 were deemed to apply to more than just base rates.

Act 40 Did Not Legislatively Overrule *McCloskey*. The OCA’s arguments simply reiterate a position that was rejected previously by the Commission and by the Commonwealth Court in *McCloskey*. Specifically, the OCA persists in asserting that the formulation of the DSIC approved in the Model Tariff does not “account for ADIT in calculating the DSIC.”³² Indeed, the OCA claims – erroneously – that the Commonwealth Court held that it is “unnecessary to account for ADIT” in the DSIC.³³ As the Commission found in its Order in the Columbia case³⁴ and the Commonwealth Court affirmed in *McCloskey*,³⁵ the *entire* DSIC mechanism constitutes the applicable “rate,” and that rate clearly *does* account for cumulative ADIT in a reasonable fashion through the earnings cap provision of the DSIC. In fact, the earnings cap analysis required under the DSIC is consistent with the revenue requirement analysis the Commission and the Commonwealth Court have previously approved for use in non-general base rate cases.³⁶ Nothing in Act 40 stripped from the Commission the discretion it is granted under the Public Utility Code and the Commonwealth Court’s prior decisions – including *McCloskey* – to

³² OCA Exceptions, p. 5. See OCA Main Brief, p. 10.

³³ *Id.*

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

³⁵ 127 A.3d at 869-871.

³⁶ Initial Brief, pp. 35-38.

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

III. REPLY TO EXCEPTIONS

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

As previously explained, the DSIC in its current form was embodied in the Model Tariff approved in the Final Implementation Order pursuant to authority conferred by Section 1357(c). Section 1357(c), like Section 1307, authorizes an automatic adjustment clause, which is a rate mechanism that is legally separate from, and operates differently from, base rates.³⁸ Moreover, adjustment clauses, by their nature, employ a process for establishing the charges billed to customers that differs markedly from the process governed by Section 1308 that is used to establish base rates.³⁹ The OCA does not dispute either of these important points.

Furthermore, the OCA’s Exceptions are silent on the equally significant fact that the Commission’s decisions implementing the DSIC, adopting the Model Tariff, approving DSIC tariff provisions for individual utilities, and considering revisions to the DSIC⁴⁰ all occurred outside of base rate proceedings. In short, the OCA has not made any *affirmative* argument for considering its proposed revision to the DSIC Rider (which necessarily would entail revisions to the Model Tariff) *in this case*. Accordingly, the Commission should adopt Judge Long’s recommendation that the reserved issue not be addressed in this case.

³⁷ See Initial Brief, pp. 32-38.

³⁸ *Id.* at 22-27.

³⁹ *Id.*

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