

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

555 Walnut Street, 5th Floor, Forum Place
Harrisburg, Pennsylvania 17101-1923
(717) 783-5048
800-684-6560

FAX (717) 783-7152
consumer@paoca.org

June 5, 2017

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

RE: Petition of Metropolitan Edison Co.
for Approval of a DSIC
Docket Nos. P-2015-2508942,
C-2016-2531040

Petition of Pennsylvania Power Co.
for Approval of a DSIC
Docket Nos. P-2015-2508931,
C-2016-2531054

Petition of Pennsylvania Electric Co.
for Approval of a DSIC
Docket Nos. P-2015-2508936,
C-2016-2531060

Petition of West Penn Power Co.
for Approval of a DSIC
Docket Nos. P-2015-2508948,
C-2016-2531019

Dear Counsel:

Attached for electronic filing is the Office of Consumer Advocate's Main Brief in the above-referenced proceeding.

Copies have been served in accordance with the attached Certificate of Service.

Respectfully,

/s/ Erin L. Gannon
Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney I.D. # 83487
E-Mail: EGannon@paoca.org

Enclosures

cc: Honorable Joel H. Cheskis, ALJ
Certificate of Service

234317

CERTIFICATE OF SERVICE

Petition of Metropolitan Edison Co. for Approval : Docket Nos. P-2015-2508942,
of a Distribution System Improvement Charge : C-2016-2531040

Petition of Pennsylvania Electric Co. for Approval : Docket Nos. P-2015-2508936,
of a Distribution System Improvement Charge : C-2016-2531060

Petition of Pennsylvania Power Co. for Approval : Docket Nos. P-2015-2508931,
of a Distribution System Improvement Charge : C-2016-2531054

Petition of West Penn Power Co. for Approval : Docket Nos. P-2015-2508948,
of a Distribution System Improvement Charge : C-2016-2531019

I hereby certify that I have this day served a true copy of following document, the Office of Consumer Advocate's Main Brief, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 5th day of June 2017

SERVICE BY E-MAIL AND FIRST CLASS MAIL, POSTAGE PREPAID

Daniel G. Asmus
Small Business Advocate
Office of Small Business Advocate
300 North Second Street
Harrisburg, PA 17101

Anthony C. DeCusatis
Morgan, Lewis & Bockius LLP
1701 Market Street
Philadelphia, PA 19103-2921
*Counsel for Metropolitan Edison Company,
Pennsylvania Electric Company,
Pennsylvania Power Company,
West Penn Power Company*

John L. Munsch
FirstEnergy Service Company
800 Cabin Hill Drive
Greensburg, PA 15601
*Counsel for Metropolitan Edison Company,
Pennsylvania Electric Company,
Pennsylvania Power Company,
West Penn Power Company*

David F. Boehm
Boehm Kurtz & Lowry
36 E. Seventh Street
Suite 1510
Cincinnati, Oh 45202
Counsel for AK Steel Corporation

Susan E. Bruce
Charis Mincavage
Alessandra Hylander
McNees, Wallace & Nurick
100 Pine Street
P.O. Box 1166
Harrisburg, PA 17108-1166
*Counsel for Met-Ed Industrial Users Group,
Penelec Industrial Coalition,
Penn Power Users Group,
West Penn Power Industrial Intervenors*

Thomas J. Sniscak
William E. Lehman
Hawke McKeon and Sniscak LLP
100 N. Tenth Street
Harrisburg, PA 17101
*Counsel for The Pennsylvania State
University*

/s/ Erin L. Gannon
Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney I.D. # 83487
E-Mail: EGannon@paoca.org

Harrison W. Breitman
Assistant Consumer Advocate
Attorney ID # 320580
E-Mail: HBreitman@paoca.org

Darryl Lawrence
Senior Assistant Consumer Advocate
PA Attorney I.D. # 93682
E-Mail: DLawrence@paoca.org

Counsel for Office of Consumer Advocate
555 Walnut Street, 5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048

234319

**BEFORE THE PENNSYLVANIA
PUBLIC UTILITY COMMISSION**

Petition of Metropolitan Edison Co. for Approval of a Distribution System Improvement Charge	:	:	Docket Nos. P-2015-2508942, C-2016-2531040
Petition of Pennsylvania Electric Co. for Approval of a Distribution System Improvement Charge	:	:	Docket Nos. P-2015-2508936, C-2016-2531060
Petition of Pennsylvania Power Co. for Approval of a Distribution System Improvement Charge	:	:	Docket Nos. P-2015-2508931, C-2016-2531054
Petition of West Penn Power Co. for Approval of a Distribution System Improvement Charge	:	:	Docket Nos. P-2015-2508948, C-2016-2531019

**OCA MAIN BRIEF ADDRESSING
STATE INCOME TAX ISSUES**

Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney I.D. # 83487
E-Mail: EGannon@paoca.org

Counsel for:
Tanya J. McCloskey
Acting Consumer Advocate

Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152

Dated: June 5, 2017

TABLE OF CONTENTS

I. INTRODUCTION 1

II. STATEMENT OF QUESTIONS PRESENTED..... 1

III. PROCEDURAL HISTORY..... 1

IV. BURDEN OF PROOF 5

V. SUMMARY OF ARGUMENT 6

VI. ARGUMENT 7

 A. Act 40 Requires that State Income Taxes Be Accounted For in DSIC Calculations. .. 8

 B. Methods for Including State Income Tax Deductions Related to DSIC-Eligible
 Investment in the DSIC Formula. 12

VII. CONCLUSION..... 16

APPENDICES

- Appendix A: OCA Proposed Findings of Fact
- Appendix B: OCA Proposed Conclusions of Law
- Appendix C: OCA Proposed Ordering Paragraphs

TABLE OF AUTHORITIES

	Page(s)
Cases	
<u>Berner v. Pa. PUC</u> , 382 Pa. 622, 116 A.2d 738 (1955).....	6
<u>Brockway Glass v. Pa. PUC</u> , 63 Pa. Commw. 238, 437 A.2d 1067 (1981)	5
<u>Burleson v. Pa. PUC</u> , 461 A.2d 1234 (Pa. 1983).....	5
<u>Commw. Office of the Governor v. Donahue</u> , 59 A.3d 1165 (Pa. Commw. Ct. 2013)	11
<u>Commw. v. Ramos</u> , 623 Pa. 420, 83 A.3d 86 (2013).....	11
<u>Lower Frederick Twp. v. Pa. PUC</u> , 48 Pa. Commw. 222, 409 A.2d 505 (1980)	5
<u>McCloskey v. Pa. PUC</u> , 127 A.3d 860 (Pa. Commw. Ct. 2015)	8-9
<u>Pa. Associated Builders & Contrs., Inc. v. Commw. Dept. of General Servs.</u> , 593 Pa. 580, 932 A.2d 1271 (2007).....	11
<u>Pa. PUC v. Seder</u> , 139 A.3d 165 (Pa. 2016).....	11
<u>University of Pa. v. Pa. PUC</u> , 86 Pa. Commw. 410, 485 A.2d 1217 (1984)	6
Administrative Decisions	
<u>Implementation of Act 11 of 2012</u> , Docket No. M-2012-2293611, Supplemental Implementation Order (Sept. 21, 2016).....	10
<u>Pa. PUC v. Met-Ed et al.</u> , Docket Nos. R-2016-2537349 et al., Order (Jan. 19, 2017)	3-4
<u>Pa. PUC v. Equitable Gas Co.</u> , 57 PaPUC 423 (1983).....	6
<u>Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a DSIC</u> , Docket No. P-2012-2338282, Opinion and Order (May 22, 2014)	8, 10, 12

Statutes

1 Pa. C.S. § 1903(a)..... 11

1 Pa. C.S. § 1921(b) 11

1 Pa. C.S. § 1936 14

66 Pa. C.S. § 102 10

66 Pa. C.S. § 315(a)..... 5

66 Pa. C.S. § 331(d) 3-4

66 Pa. C.S. § 1301.1 3, 6, 10

66 Pa. C.S. § 1301.1(a)..... 9, 11

66 Pa. C.S. § 1301.1(c)(2)..... 7

66 Pa. C.S. § 1351 10

66 Pa. C.S. § 1353(a)..... 8

66 Pa. C.S. § 1357(b)(1)..... 14

I. INTRODUCTION

In this Main Brief the Office of Consumer Advocate (OCA) addresses one issue, whether Act 40 of 2016 requires the FirstEnergy companies to include state income tax deductions and credits in the calculation of the Distribution System Improvement Charge (DSIC). The OCA has previously submitted Main and Reply Briefs arguing that Act 40 requires an Accumulated Deferred Income Tax (ADIT) offset to be included in any DSIC rate charged to customers to reflect federal income tax deductions.¹ There is no distinction in Act 40 between federal and state income taxes. Therefore, the OCA argues that, for the same reasons, Act 40 requires that state income tax deductions be included in the DSIC.

II. STATEMENT OF QUESTIONS PRESENTED

The three matters before the Presiding Officer and Commission for decision are:

- (1) whether Act 40 requires the FirstEnergy Companies to modify their DSIC calculation to include federal income tax deductions generated by DSIC investment (the subject of briefs dated September 30, 2016 and October 14, 2016);
- (2) whether Act 40 requires the Companies to modify their DSIC calculation to include state income tax deductions generated by DSIC investment (the subject of this brief); and
- (3) whether the proposed Joint Petition for Settlement of Pending Issues filed on February 2, 2017 is in the public interest and should be approved.

The OCA respectfully submits that all questions should be answered in the affirmative.

III. PROCEDURAL HISTORY

On February 16, 2016, Metropolitan Edison Company (Met-Ed), West Penn Power Company (West Penn), Pennsylvania Electric Company (Penelec) and Pennsylvania Power Company (Penn Power) (collectively referred to as the Companies or FirstEnergy) filed

¹ As discussed below, the parties' briefs addressing ADIT were moved into this record by Commission Order entered January 19, 2017 in Docket Nos. R-2016-2537349 et al.

individual Petitions requesting approval to establish and implement a DSIC to become effective as of July 1, 2016.

On February 26, 2016, the OCA filed Answers and Formal Complaints in response to the Companies' Petitions. On March 7, 2016, Citizens for Pennsylvania's Future (PennFuture) and the Environmental Defense Fund (EDF) jointly filed Petitions to Intervene. On the same date, the Met-Ed Industrial Energy Users Group (MEIUG), the Penelec Industrial Customer Alliance (PICA), the Penn Power Users Group (PPUG) and the West Penn Power Industrial Intervenors (WPPII) filed a Petition to Intervene and Answer with respect to the Petition of the Company that serves their respective members. On March 9, 2016, the OSBA filed a Notice of Appearance and Intervention in each of the Companies' cases as well as Answers to each of the Petitions. On the same date, The Pennsylvania State University (PSU) filed a Petition to Intervene in West Penn's case. On April 1, 2016, AK Steel Corporation filed a Petition to Intervene in West Penn's case. Two customers filed Formal Complaints on April 4, 2016 and April 18, 2016, respectively.

On June 9, 2016, the Commission entered four Opinions and Orders in which it approved a DSIC for each Company subject to recoupment and/or refund pending final resolution of matters referred to the Office of Administrative Law Judge for hearings. The substantive issues identified for hearings were the following:

- a. Whether certain customers taking service at transmission voltage rates should be included under the DSIC;
- b. Whether other customers should also be exempt from the DSIC; and
- c. If revenues associated with the riders in [the Company's] tariff are properly included as distribution revenues.

On July 25, 2016, EDF/PennFuture filed a joint Notice of Withdrawal from each of the Companies' proceedings.

This matter was assigned to Administrative Law Judge Joel H. Cheskis (ALJ). On August 11, 2016, the ALJ issued a Consolidation Order to consolidate the DSIC Petition and Complaint cases. Consistent with the Scheduling Order issued on August 12, 2016, the parties participated in discovery and settlement discussions and provided periodic status reports on those discussions to the ALJ. Met-Ed, Penelec, Penn Power, West Penn, OCA, OSBA, MEIUG, PICA, PPUG and WPPH reached a settlement agreement addressing the issues referred for hearings by the Commission's June 9, 2016 DSIC Orders (Joint Petition for Settlement of Pending Issues). The Joint Petition was filed on February 2, 2017.

In the proposed Settlement, the parties recognized that DSIC-related issues were being considered in the Companies' consolidated base rate cases at Docket Nos. R-2016-2537349 (Met-Ed), R-2016-2537342 (Penelec), R-2016-2537355 (Penn Power) and R-2016-2537359 (West Penn). The proposed settlement, therefore, did not extend to or resolve any additional issues that the Commission might subsequently assign to this proceeding.

On January 19, 2017, the Commission issued an Order in the consolidated base rate proceedings, which referred to this proceeding the contested issue regarding the impact of recently enacted Act 40, codified at 66 Pa. C.S. § 1301.1, on the calculation of the DSIC, specifically, with regard to ADIT. The Commission transferred to this proceeding parts of the base rate case record pertaining to this issue.² Pa. PUC v. Met-Ed et al., Docket Nos. R-2016-2537349 et al., Order at 38-40, 42 (Jan. 19, 2017). The Order stated, further, that "ALJ Cheskis has the authority and discretion under Section 331(d) of the Code to permit further development

² Pursuant to the OCA's Petition for Clarification, the Commission entered an Order on May 18, 2017 clarifying the parts of the record that it intended to transfer. Pa. PUC v. Met-Ed et al., Docket Nos. R-2016-2537349 et al., Order at 12-14 (May 18, 2017).

of the record if it is determined to be necessary to make a decision on the DSIC calculation in light of Act 40.” Id. at 39.

By letters filed on February 14 and 15, 2017, the OCA notified the Presiding Officer and parties that it intended to present supplemental testimony addressing the impact of Act 40 on the calculation of state income taxes in the DSIC. A further prehearing conference was held on March 6, 2017 where a schedule was established for the parties to supplement the evidentiary record. The OCA and Company submitted supplemental testimony pursuant to that schedule. A hearing was held on May 12, 2017 for the purpose of entering those supplemental materials into the record.

The record before the Presiding Officer and Commission includes, from the base rate proceeding at Docket No. R-2016-2537349:

- OCA St. 1
- OCA St. 1-SR
- Companies’ St. 2-R
- OCA’s and Companies’ Main and Reply Briefs and Exceptions and Replies to Exceptions addressing Act 40 and federal income tax deductions (ADIT)

in addition to the following, from the DSIC proceeding at Docket No. P-2015-2508942:

- OCA St. 1-Supp. and Exh. LA-ME-1
- OCA St. 1SR-Supp.
- FirstEnergy Companies St. 1R-Supp.
- FirstEnergy Companies St. 1RJ-Supp.
- FirstEnergy Companies Exh. 1-Supp.
- The proposed Joint Petition for Settlement of Pending Issues filed on February 2, 2017, which addresses whether the DSIC should apply to certain customers and whether the Companies properly included revenues associated with riders in the DSIC calculation.
- FirstEnergy Companies St. 1 and Exhs. 1-6 (supporting the proposed Settlement)

After submission of the parties’ Main and Reply Briefs addressing state income tax deductions, the Act 40 federal and state income tax issue and the proposed Joint Petition for Settlement will be ready for decision.

IV. BURDEN OF PROOF

The FirstEnergy Companies bear the burden of proof to establish the justness and reasonableness of every element of the proposed Distribution System Improvement Charge. As set forth in Section 315(a) of the Public Utility Code:

Reasonableness of rates – In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceedings upon the complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa. C.S. § 315(a). The Commonwealth Court interprets this principle as follows:

Section 315(a) of the Public Utility Code, 66 Pa. C.S. § 315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the utility. It is well-established that the evidence adduced by a utility to meet this burden must be substantial.

Lower Frederick Twp. v. Pa. PUC, 48 Pa. Commw. 222, 226-27, 409 A.2d 505, 507 (1980). (Citations omitted). See also Brockway Glass v. Pa. PUC, 63 Pa. Commw. 238, 437 A.2d 1067 (1981).

The Pennsylvania Supreme Court has stated that the party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position. Even where a party has established a prima facie case, the party with the burden must establish that “the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary.” Burleson v. Pa. PUC, 461 A.2d 1234, 1236 (Pa. 1983) (Burleson). Thus, a utility has an affirmative burden to establish the justness and reasonableness of every component of its rate request.

The OCA points out that Pennsylvania law is clear that there is no similar burden for a party proposing an adjustment to a utility rate filing. See e.g. Berner v. Pa. PUC, 382 Pa. 622, 116 A.2d 738 (1955) (Berner). In Berner, the Pennsylvania Supreme Court stated:

[T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to demonstrate the reasonable necessity and cost of the installations and that is the burden which the utility patently failed to carry.

Id., 382 Pa. at 631, 116 A.2d at 744. The Commission recognizes this standard in its rate determinations. See Pa. PUC v. Equitable Gas Co., 57 PaPUC 423, 471 (1983). See also University of Pa. v. Pa. PUC, 86 Pa. Commw. 410, 485 A.2d 1217 (1984). Thus, it is unnecessary for the OCA (or any challenger) to prove that the DSICs proposed by the FirstEnergy Companies are unjust, unreasonable or not in the public interest. To prevail in its challenge, Pennsylvania law requires only that the OCA show how the Companies failed to meet their burden of proof.

In conclusion, the FirstEnergy Companies must affirmatively demonstrate the reasonableness of every element of the proposed DSIC calculation and demonstrate that the proposed rate is just, reasonable and in the public interest. The OCA will show that the Companies have failed to satisfy their statutory burden in the manner set forth below.

V. SUMMARY OF ARGUMENT

Act 40 took effect on August 11, 2016 and applies to all cases where the final order is entered into after its effective date. 66 Pa. C.S. § 1301.1. Act 40 states that related income tax deductions and credits “shall” be included in the computation of current or deferred income tax expense to reduce rates. The DSIC is a “rate” and recovers current and deferred income tax deductions; therefore, the DSIC calculation should be modified to recover federal and state income tax deductions generated by DSIC investment. Act 40 reversed existing appellate

precedent, under which the Commission could approve DSIC tariffs that did not reflect federal and state income tax deductions.

The OCA identified two methods to implement that change for state income tax purposes, by either adjusting the revenue conversion factor or by breaking out and reflecting a calculation of the allowance for state income tax expense that reflects the related income tax deductions and credits. Either method can be used to capture state income tax deductions related to placing DSIC-eligible plant in service that are not reflected in the Companies' existing formula.

The OCA also submits that the proposed Joint Petition for Settlement is a reasonable resolution of the remaining issues in this proceeding and its approval is in the public interest.

VI. ARGUMENT

Act 40 was signed into law on June 12, 2016 and took effect on August 11, 2016. It applies to all cases where the final order is entered into after its effective date. 66 Pa. C.S. § 1301.1(c)(2). In the Companies' consolidated base rate proceedings, the OCA took the position that Act 40 requires income tax deductions and credits to be included in the computation of the DSIC. The OCA specifically addressed the inclusion of ADIT, which pertains to federal income tax deductions and credits. State income tax deductions and credits were not addressed in the context of the base rate case.

Accordingly, in this DSIC proceeding, the record was further developed to address state income tax deductions and credits. Specifically, the OCA provided testimony regarding the basis for including state income tax deductions and credits related to DSIC investment in the calculation of the DSIC and how that calculation could be made. The OCA submitted

supplemental direct and surrebuttal testimony on these matters, sponsored by Ralph C. Smith.³
OCA St. 1-Supp.; OCA St. 1SR-Supp.

The other issues that were raised in the DSIC proceeding – whether the DSIC should apply to certain customers and whether the Companies properly included revenues associated with riders in the DSIC calculation – are addressed in the Joint Petition for Settlement of Pending Issues filed on February 2, 2017. The OCA submits that proposed Settlement should be approved for the reasons set forth in the OCA’s Statement in Support. See Joint Settlement, App. B.

A. Act 40 Requires that State Income Taxes Be Accounted For in DSIC Calculations.

Prior to the passage of Act 40, which amended Chapter 13 of the Public Utility Code, Act 11 of 2012 was signed into law. Act 11, *inter alia*, permitted certain utilities, including electric utilities, to petition the Commission for approval to implement a DSIC. See 66 Pa. C.S. § 1353(a). In one of the first cases before the Commission seeking approval of a DSIC under Act 11, the OCA asserted that the utility should be required to recognize federal and state income tax benefits recovered through the DSIC and generated by the investment in replaced infrastructure. The Commission rejected the OCA’s assertions. See Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge, Docket No. P-2012-2338282, Opinion and Order (May 22, 2014) (Columbia Gas). The OCA appealed the Commission’s determination, and on appeal the Commission asserted that “in enacting Act 11, the General Assembly envisioned a simple and straightforward process of establishing rates for the DSIC surcharge that would be easy to calculate and audit” McCloskey v. Pa. PUC, 127

³ Mr. Smith’s testimony addressing federal income tax deductions (ADIT) was transferred from the base rate proceeding to the DSIC proceeding and is labeled as OCA Statement Nos. 1 and 1SR. Specifically, see pages 108 to 110 of his direct and pages 35 to 36 of his surrebuttal testimony.

A.3d 860, 867 (Pa. Commw. Ct. 2015) (McCloskey). In upholding the Commission's decision and discretion to determine the components required for calculation of the DSIC rate, the Commonwealth Court stated:

Had the General Assembly wanted to ... curtail the Commission's discretion to allow utilities to continue to utilize this practice, the General Assembly could have explicitly incorporated such a prohibition or placed a limit on the Commission's discretion at the time it enacted Act 11. However, the General Assembly declined to take such action when the statute was drafted or enacted.

McCloskey, 127 A.3d 860, 870-71.

Shortly after the Commonwealth Court's determination in McCloskey, the General Assembly passed Act 40 of 2016, and the Governor signed Act 40 into law. Specifically regarding the computation of utility rates, Act 40 states, in relevant part:

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

66 Pa. C.S. § 1301.1(a). The OCA submits that Act 40 now requires the inclusion of federal and state income tax deductions in the DSIC rate charged to customers because the related investment is being included in the DSIC rate.

As OCA witness Ralph C. Smith,⁴ a Certified Public Accountant and attorney, explained in his Direct Testimony in the base rate proceeding:

A utility DSIC is a form of utility rates. That form of utility rates is commonly referred to as a surcharge. A utility DSIC would typically include costs related to investment in infrastructure. Act 40 provides that if an investment is allowed to be included in a utility's rates, the related income tax deductions and credits shall

⁴ Mr. Smith is a Senior Regulatory Consultant at Larkin & Associates, PLLC in Livonia, Michigan. He provides consulting and expert witness services regarding rate cases and regulatory filings on behalf of industry, state attorneys general, consumer groups, municipalities, and public service commission staff. Mr. Smith is also a licensed C.P.A. and attorney in Michigan. A complete description of Mr. Smith's qualifications is provided in OCA Statement No. 1, Attachment RCS-1.

also be included in the computation of current and deferred income tax expense to reduce rates.

OCA St. 1 at 110; OCA St. 1S at 1-2. As such, Act 40 requires a different treatment of state income taxes than that previously approved by the Commission in Columbia Gas.

As Mr. Smith testified, the DSIC is a rate. The Public Utility Code specifically defines “Rate” as follows:

Every individual, or joint fare, toll, charge, rental, or other compensation whatsoever of any public utility ... made, demanded, or received for any service within this part, offered, rendered, or furnished by such public utility

66 Pa. C.S. § 102. (Emphasis added). The Public Utility Code defines “Distribution system improvement charge” as follows:

A charge imposed by a utility to recover the reasonable and prudent costs incurred to repair, improve or replace eligible property that is part of the utility’s distribution system.

66 Pa. C.S. § 1351. (Emphasis added).

This Commission has recognized that Act 11, which permits certain utilities to implement a DSIC with Commission approval, was enacted to provide “ratemaking flexibility for utilities.” See Implementation of Act 11 of 2012, Docket No. M-2012-2293611, Supplemental Implementation Order at 2 (Sept. 21, 2016). Further, the Commission detailed the requirements of utilities regarding their DSICs during general base rate cases, including resetting the DSIC rate to zero, the filing of earnings reports during the pendency of a general base rate case and references to the DSIC in the compliance tariff filed after the conclusion of the general base rate case. Id. As such, there can be no doubt that the DSIC is a “rate” pursuant to the Public Utility Code.

FirstEnergy witnesses D’Angelo testified that the express purpose of Section 1301.1 is to eliminate the use of consolidated tax adjustments and does not apply to riders and adjustment

clauses. FE St. 2R at 41-42. Mr. D'Angelo cited to Representative Godshall's comment that Act 40 "applies to base rate cases" to support his argument. Id. The OCA submits that the Companies' position that Act 40 does not apply to the DSIC and reliance on the Act's legislative history should be rejected. Act 40 applies generally to a utility's "rates for ratemaking purposes" and provides no exceptions to the requirement that "related income tax deductions and credits shall also be included in the computation of current or deferred income tax expense to reduce rates" whenever an expense or investment is permitted to be included in a utility's rates. See 66 Pa. C.S. § 1301.1(a); OCA St. 1SR-Supp. at 2. The language of Act 40 is clear and unambiguous in this regard, and as such, "the letter of it is not to be disregarded under the pretext of pursuing its spirit." 1 Pa. C.S. § 1921(b). It is only when the words of a statute are not explicit that factors extraneous to the statutory language may be consulted to ascertain the General Assembly's intent in enacting the statute. See Pa. Associated Builders & Contrs., Inc. v. Commw. Dept. of General Servs., 593 Pa. 580, 592, 932 A.2d 1271, 1278 (2007). See also Commw. Office of the Governor v. Donahue, 59 A.3d 1165, 1168 (Pa. Commw. Ct. 2013).

As discussed above, the DSIC is a "rate," as such term is specifically defined in the Public Utility Code, and therefore, must be addressed as part of general ratemaking. When technical words are defined in a statute, they "shall be construed according to such peculiar and appropriate meaning or definition." 1 Pa. C.S. § 1903(a). See, e.g., Pa. PUC v. Seder, 139 A.3d 165, *172 (Pa. 2016) (Commonwealth Court held that it was bound by the definition of "Commission" in the Public Utility Code in construing 66 Pa. C.S. § 335(d)).

Even if the General Assembly's intent in enacting Act 40 was relevant, it is well-established that when enacting legislation, it is presumed that the General Assembly is familiar with existing law. See e.g. Commw. v. Ramos, 623 Pa. 420, 428, 83 A.3d 86, 91 (2013). It,

therefore, must be presumed that in passing Act 40, the General Assembly was aware of the recent Commonwealth Court order finding it unnecessary to account for state income tax deductions in calculating the DSIC. Act 40 requires that utilities include all “related income tax deductions and credits” in their computation of their DSIC charges, which therefore, requires the inclusion of state income tax deductions in their computations. The General Assembly did not limit the application of Act 40 to the consolidated tax adjustment or to “base rates,” and therefore, it must be presumed that Act 40 applies to all “rates” as defined in the Public Utility Code, of which the DSIC is one. OCA St. 1SR-Supp. at 2. As such, the FirstEnergy Companies should be directed to include state income tax deductions related to placing DSIC-eligible plant in service in their DSIC computations, as required by Act 40.

B. Methods for Including State Income Tax Deductions Related to DSIC-Eligible Investment in the DSIC Formula.

In contrast to federal income tax deductions, state income tax deductions are flowed through in utility rates on a current basis.⁵ OCA St. 1-Supp. at 2. OCA witness Smith identified two ways to recognize the impact of the deductions related to the state income taxes recovered through the DSIC. Id. at 2-3; OCA St. 1SR-Supp. at 3-4, 6-7, 8-9. Both methods accomplish the same thing; they reduce the DSIC by the amount the utility’s state income tax decreases as a result of state income tax deductions related to the DSIC includable property. OCA St. 1SR-Supp. at 3-4. As Mr. Smith explained:

One method is to use an “effective” tax rate. This converts the impact of the state income tax deductions related to DSIC investment, which is the dollar amount by which taxable income is reduced, to a percentage that can be used in the Company’s existing DSIC calculation.

...

⁵ Stated otherwise, the state income tax rate used to calculate the DSIC revenue requirement should reflect the state income tax expense actually paid. Columbia Gas at 37-38, 40. This contrasts with federal income tax deductions which are deferred and not flowed through on a current basis. Id. at 18-19; OCA St. 1 at 108-09.

Another method to recognize the impact of the deductions is to have a separate calculation of the amount of state income tax expense that is reflected in the DSIC revenue requirement. Here, the amount is not converted to a percentage and the unadjusted statutory state income tax rate is used in the calculation. Either method will produce the same DSIC rate.

While either method will serve to include related income tax deductions and credits in the computation of current or deferred income tax expense to reduce DSIC rates, I recommended using the effective tax rate method because it does not alter the Companies' existing DSIC formula.

Id. at 3.

The first method would not change the existing DSIC formula contained in the FirstEnergy Companies' tariffs.⁶ It would adjust the revenue conversion factor (or tax multiplier) used to calculate the pre-tax rate of return (PTRR) in the DSIC formula used by the Companies to flow-through the state income tax deductions related to DSIC investment:

$$\text{DSIC} = \frac{(\text{DSI} * \text{PTRR}) + \text{Dep} + e}{\text{PQR}}$$

OCA St. 1SR-Supp. at 8-9. Specifically, the tax multiplier would reflect the actual amount of state income taxes that the utility will pay on DSIC income. Id. at 3, 6-7; OCA St. 1-Supp. at 2.

The second method would change the existing DSIC formula contained in the Companies' DSIC tariffs. Specifically, a separate component would be added to the formula to provide for the allowance for income taxes. OCA St. 1SR-Supp. at 8-9. The income tax calculation would reflect the impact of state income tax deductions on DSIC eligible property.

$$\text{DSIC} = \frac{(\text{DSI} * \text{ROR}) + \text{Dep} + e + \text{IT}}{\text{PQR}}$$

where "IT" is the allowance for income taxes, and "ROR" is the weighted cost of capital (aka rate of return), exclusive of income taxes.

Id. at 9.

⁶ The mechanics of the PTRR calculation are not included in the FirstEnergy Companies' DSIC tariff riders. They are provided in the calculations supporting each Company's quarterly DSIC updates. See OCA Exh. LA-ME-1 (PTRR calculation from MetEd June 20, 2016 DSIC compliance filing).

FirstEnergy argues that using an effective tax rate (the first method discussed above) is inconsistent with the requirement of Section 1357(b)(1) that the pre-tax return be calculated using the state income tax rate. FE St. 1R (Supp) at 7-8; FE St. 1RJ (Supp) at 1-2. The cited provision of Act 11 states that “the pre-tax return shall be calculated using the Federal and State income tax rates.” 66 Pa. C.S. § 1357(b)(1). First, if there is a conflict between the statutes, Act 40 prevails. The Rules of Statutory Construction provide that where the provisions of two statutes cannot be reconciled, the statute latest in date of final enactment shall prevail. 1 Pa. C.S. § 1936.

Second, contrary to the testimony of FirstEnergy’s witness, using an effective tax rate in the DSIC calculation does not change the applicable statutory state income tax rate. Just as calculating an average tax rate or a marginal tax rate does not change the applicable statutory tax rate. OCA St. 1-Supp. at 3-4. OCA witness Smith provided an example showing how state income tax deductions impact state income tax expense without changing the statutory state income tax rate:

Example A			
	Taxable Income	State Tax Rate	State Income Tax Expense
Taxable Income <i>before</i> reflecting state tax deductions	\$100,000	9.99%	\$9,990
Taxable Income <i>after</i> reflecting state tax deductions	\$50,000	9.99%	\$4,995

Id. at 4. The effective tax rate derived from this example is 4.995 percent.⁷ The calculation is still based on the statutory state income tax rate of 9.99 percent.

FirstEnergy witness Fullem also argues that calculating an effective tax rate would require additional analysis and data than currently used to calculate the DSIC, *i.e.* data that is included in quarterly earnings reports to the Commission or annual Form 1 filings to the Federal Energy Regulatory Commission. FE St. 1R (Supp) at 10. Mr. Fullem stated:

However, it would appear that this is the kind of comprehensive revenue requirement determination that the Commission has previously held is not necessary for calculating the quarterly DSIC rate.

Id.; see also FE St. 1RJ (Supp) at 5. Again, the Companies' position ignores that the law has changed. Act 40 now requires the inclusion of federal and state income tax deductions in the DSIC rate.

To this end, the OCA identified two methods to recognize the impact of the deductions related to the state income taxes recovered through the DSIC. OCA St. 1-Supp. at 2-3; OCA St. 1SR-Supp. at 3, 6-10. Mr. Smith stated:

As I stated above and in my prior testimony, Act 40 changed the law. I am recommending a way to implement that change, for state income tax purposes, by either adjusting the revenue conversion factor, or by breaking out and reflecting a calculation of the allowance for state income tax expense that reflects the related income tax deductions and credits.

OCA St. 1SR-Supp. at 8. The Companies' witness suggests that these methods will double-count the state income tax deductions. Mr. Fullem contends that the existing formula already gives customers credit for the state income tax deductions in an amount equal to the book depreciation recognized as an allowable expense in the DSIC calculation. FE St. 1RJ (Supp) at 3-4. In response to discovery, however, the Companies recognized that there are additional tax


⁷ \$4,995 actual state income tax (after fully reflecting all related state income tax deductions) divided by the \$100,000 pre-tax income (e.g., equity return prior to fully reflecting the state tax depreciation deductions) equals an "effective" tax rate of 4.995 percent. OCA St. 1S-Supp. at 5.

deductions that are not reflected in the existing DSIC formula. FE Exh. 1 (Supp) at 1-2. The OCA's recommended adjustments to the formula are intended to capture the impact of these additional state income tax deductions. The point is to calculate the state income tax deductions once, but to make sure that all DSIC-related state income tax deductions are in fact counted in the determination of the DSIC rate. See OCA St. 1SR-Supp. at 5-7.

VII. CONCLUSION

Act 40 requires that if an expense or investment is allowed to be included in DSIC rates for ratemaking purposes, the related income tax deductions and credits shall also be included in the computation of current or deferred income tax expense to reduce DSIC rates. Based on the foregoing discussion and the OCA's Main and Reply Briefs addressing ADIT, the FirstEnergy Companies should be directed to fully reflect all DSIC-related federal and state income tax deductions and credits in their DSIC computations.

Respectfully submitted,


Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney I.D. # 83487
E-mail: EGannon@paoca.org

Office of Consumer Advocate
5th Floor, Forum Place
555 Walnut Street
Harrisburg, PA 17101-1923
Telephone: 717-783-5048
Facsimile: 717-783-7152

Counsel for:
Tanya J. McCloskey
Acting Consumer Advocate

June 5, 2017

OCA Proposed Findings of Fact

1. Act 40 was signed into law on June 12, 2016 and took effect on August 11, 2016. It applies to all cases where the final order is entered into after its effective date. 66 Pa. C.S. § 1301.1(c)(2).
2. Shortly after the Commonwealth Court’s determination in McCloskey v. Pa. PUC, 127 A.3d 860, 867 (Pa. Commw. Ct. 2015), the General Assembly passed Act 40 of 2016, and the Governor signed Act 40 into law.
3. OCA witness Ralph C. Smith is a Certified Public Accountant and attorney. OCA St. 1, Attachment RCS-1.
4. In contrast to federal income tax deductions, state income tax deductions are flowed through in rates on a current basis. OCA St. 1-Supp. at 2.
5. The FirstEnergy Companies’ proposed DSIC calculation does not fully reflect state income tax deductions generated by capital investment that is recovered through the DSIC. FE Exh. 1 (Supp) at 1-2; OCA St. 1SR-Supp. at 5, 8; FE St. 1R (Supp) at 9-11.
6. One method for recognizing the impact of deductions related to state income taxes recovered through the DSIC is to use an “effective” tax rate. This converts the impact of the state income tax deductions related to DSIC investment, which is the dollar amount by which taxable income is reduced, to a percentage that can be used in the Company’s existing DSIC calculation. OCA St. 1-Supp. at 2-3; OCA St. 1SR-Supp. at 3-4, 6-7, 8-9.
7. A second method is to have a separate calculation of the amount of state income tax expense that is reflected in the DSIC revenue requirement.

$$\text{DSIC} = \frac{(\text{DSI} * \text{ROR}) + \text{Dep} + e + \text{IT}}{\text{PQR}}$$

where “IT” is the allowance for income taxes, and “ROR” is the weighted cost of capital (aka rate of return), exclusive of income taxes. OCA St. 1SR-Supp. at 8-9. Here, the amount is not converted to a percentage and the unadjusted statutory state income tax rate is used in the calculation. Id.

8. Either method will serve to include related income tax deductions and credits in the computation of current or deferred income tax expense to reduce DSIC rates. OCA St. 1SR-Supp. at 3.
9. Using an effective tax rate in the DSIC calculation does not change the applicable statutory state income tax rate. Just as calculating an average tax rate or a marginal tax rate does not change the applicable statutory tax rate. OCA St. 1-Supp. at 3-4.

OCA Proposed Conclusions of Law

1. The Companies' DSIC rates must be just and reasonable. 66 Pa. C.S. § 1301.
2. The burden of proving that every element of the proposed DSIC calculation and the resulting DSIC rate is just, reasonable and in the public interest is on the FirstEnergy Companies. 66 Pa. C.S. § 315(a); 66 Pa. C.S. § 1301.
3. The burden of proof does not shift to parties challenging a requested rate increase. Berner v. Pa. PUC, 382 Pa. 622, 631, 116 A.2d 738, 744 (1955); Pa. PUC v. Equitable Gas Co., 57 PaPUC 423, 471 (1983); University of Pennsylvania v. Pa. PUC, 86 Pa. Commw. 410, 485 A.2d 1217 (1984).
4. The FirstEnergy Companies have failed to demonstrate that the proposed DSIC calculation, which does not reflect all state income tax deductions related to investment recovered through the DSIC, will produce a just and reasonable rate. 66 Pa. C.S. § 315(a); 66 Pa. C.S. § 1301; 66 Pa. C.S. § 1301.1.
5. The DSIC is a "rate" pursuant to the Public Utility Code. 66 Pa. C.S. § 102; 66 Pa. C.S. § 1353(a).
6. Act 40 requires the inclusion of federal and state income tax deductions in the DSIC rate charged to customers because the related investment is being included in the DSIC rate. 66 Pa. C.S. § 1301.1(a).
7. The proposed Joint Petition for Settlement of Pending Issues filed on February 2, 2017 is in the public interest.

OCA Proposed Ordering Paragraphs

IT IS HEREBY ORDERED THAT:

1. That, within ten (10) days, the FirstEnergy Companies are directed to make compliance filings, including supporting workpapers, for their DSIC tariffs that fully reflect all federal and state income tax deductions and credits related to placing DSIC-eligible plant in service in the DSIC rate.
2. The Joint Petition for Approval of Settlement dated February 2, 2017 is hereby approved in its entirety without modification.
3. The Complaints of the Office of Consumer Advocate at Docket Nos. C-2016-2531040, C-2016-2531060, C-2016-2531054 and C-2016-2531019 are granted in part and denied in part, to the extent consistent with this Commission's Opinion and Order.

BY THE COMMISSION

(SEAL)

ORDER ADOPTED:

ORDER ENTERED:

Date: _____