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June 21, 2017

VIA eFILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105

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, on behalf of **Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company**, please find their **Supplemental Reply Brief** (the "Reply Brief") in the above-referenced proceedings.

A copy of this Reply Brief will be served on Administrative Law Judge Joel Cheskis and those parties identified on the attached Certificate of Service.

Very truly yours,

Anthony C. DeCusatis

ACD/tp
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.***
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 **Supplemental Reply Brief** on the following persons in the matter specified in accordance with the requirements of 52 Pa. Code § 1.54:

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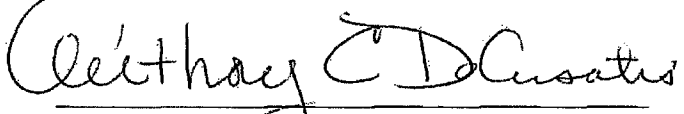

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Dated: June 21, 2017

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** **P-2015-2508936** **P-2015-2508931** **P-2015-2508948**
OFFICE OF CONSUMER ADVOCATE	:		
v.	:	**Docket Nos.**	**C-2016-2531040** **C-2016-2531060**
METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY PENNSYLVANIA POWER COMPANY WEST PENN POWER COMPANY	:		**C-2016-2531054** **C-2016-2531019**

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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 Supplemental Reply Brief in response to the Supplemental Main Brief filed by the Office of Consumer Advocate ("OCA"). As explained in the Companies' Supplemental Initial Brief filed on June 5, 2017, the supplemental testimony and supplemental briefs in this proceeding pertain to a contingent sub-issue that would have to be resolved only if the Administrative Law Judge ("ALJ") and the Pennsylvania Public Utility Commission ("PUC" or the "Commission") adopt the OCA's position on the issue reserved for decision pursuant to the terms of the Joint Petitions for Partial Settlement in the Companies' consolidated base rate proceedings.[1] In approving the Joint Petitions, the Commission transferred the reserved issue to this proceeding together with relevant portions of the record in the consolidated base rate cases, the Companies' and OCA's briefs on the reserved issue, the OCA's Exceptions and the Companies' Reply to those Exceptions.

In summary, the reserved issue is whether the enactment of Act 40 of 2016 ("Act 40"), which added Section 1301.1 to the Pennsylvania Public Utility Code,[2] requires the Commission to amend its Model Tariff to revise the terms for calculating quarterly updates under the Distribution System Improvement Charge ("DSIC").[3] The Model Tariff was adopted and

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1 *Pa. P.U.C. v. Metropolitan Edison Co.*, Docket Nos. R-2016-2537349, *et al.*; *Pa. P.U.C. v. Pennsylvania Electric Co.*, Docket Nos. R-2016-2537352, *et al.*; *Pa. P.U.C. v. Pennsylvania Power Co.*, Docket Nos. R-2016-2537355, *et al.*; *Pa. P.U.C. v. West Penn Power Co.*, Docket Nos. R-2016-2537359, *et al.* (collectively, the "DSIC Orders").

2 Hereafter, all references to a "Section" are to sections of the Pennsylvania Public Utility Code, 66 Pa.C.S. §§ 101 *et seq.*, unless otherwise indicated.

3 It is not disputed that the Companies' DSIC Riders (which are currently in effect) conform to the terms of the Model Tariff, as the Commission expressly found and determined in the June 9, 2017 Orders approving those Riders. *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 . . .").

approved in the Commission's Final Implementation Order for Act 11 of 2012 to fulfil the requirements of Section 1353(b)(1).[4] The reserved issue was addressed at length in the Companies' Initial and Reply Briefs filed in their consolidated base rate proceedings on September 20 and October 14, 2016, respectively, and in their Reply to the OCA's Exceptions in that case, which was filed on December 8, 2016. The Companies' Supplemental Initial Brief (pp. 4-11 and 18-19) also contains a summary of the principal reasons why the OCA's interpretation of Section 1301.1 is not correct and should be rejected.

The contingent sub-issue, which was introduced by the OCA after the reserved issue had been transferred to this proceeding, involves how, if at all, the DSIC methodology for calculating quarterly changes in DSIC charges should be revised to reflect state income tax deductions and credits if the OCA's proposed interpretation of Section 1301.1 were to prevail.[5]

II. SUMMARY OF ARGUMENT

The Entire DSIC Adjustment Mechanism, As Set Forth In The Model Tariff And In The Companies' DISC Riders, Is A "Rate" (Section III.A., *infra*). The OCA's Supplemental Main Brief tries to characterize the "rate" relevant to the reserved issue as merely a monetary charge. In so doing, the OCA discards an important element of the definition of "rate" in Section 102, which states that a "rate" includes "rules, regulations, practices, classifications or contracts . . . affecting any charge." Relying on this statutory definition, the Commission and the Commonwealth Court found and determined that the entire DSIC mechanism as set forth in the Model Tariff and in a utility's DSIC Rider constitutes the "rate" that must be analyzed for purposes of justness, reasonableness and conformity to applicable law. Applying this well-

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

[5] *See* Companies' Supp. Initial Brief, pp. 2-3.

established principle, it is clear that the relevant DSIC "rate" was approved by a final order entered before Act 40's effective date (Section III.A.1., *infra*); that the DSIC properly accounts for the tax effects that are the subject of the OCA's challenge (Section III.A.2., *infra*); and that the OCA's burden of proof contentions are simply wrong (Section III.A.3., *infra*).

The Reserved Issue – Statutory Interpretation And Legislative History (Section III.B., *infra*). In its Supplemental Main Brief (pp. 8-12) the OCA once again argues that Act 40 overrides – and substantively amends – the explicit and specific instructions for calculating DSIC charges delineated in Section 1357[6] even though: (1) Act 40 does not mention the DSIC or Section 1357; (2) controlling rules of statutory construction provide that specific statutory provisions control over the general;[7] and (3) both the text of Act 40 and its legislative history show that its provisions were intended to apply only to base rates. Moreover, the "final order(s)" relevant to the DSIC were entered prior to the effective date of Act 40.[8]

The OCA has no argument to counter the clear legislative history demonstrating that Act 40 has a narrow purpose – to eliminate the use of consolidated federal income tax adjustments ("CTAs") in base rate cases – and that it applies only to the calculation of base rates.[9] Therefore, the OCA's only recourse is to ask the ALJ and the Commission to ignore Act 40's legislative history in its entirety because Act 40 allegedly is "clear and unambiguous." In so doing, the

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6 The terms of Section 1357 and the manner in which the OCA's interpretation would conflict with those statutory provisions are discussed in the Companies' Supplemental Initial Brief (pp. 9-11 and 19) and in Section III.C., *infra*.

7 1 Pa.C.S. § 1933. *See also* Section III.C., *infra*.

8 *See* Companies' Initial Brief, pp. 27-31 and Companies' Reply Brief, p. 12. The OCA has not addressed this important point either in its briefs filed in the consolidated base rate cases or in its Supplemental Main Brief.

9 *See* Companies' Reply Brief, pp. 7-11, and the statement of the chief sponsor of the bill that became Act 40 that "this section applies to base rate cases" and "would only go into effect when a utility comes in for a base rate case." House of Representatives Legislative Journal, Feb. 8, 2016, p. 117. *See also* Companies' Initial Brief, p. 26 and Appendix B thereto. The legislative history also contains the statement of the Commission's Chairman that the purpose of the bill which became Act 40 was to specify how a utility's federal income taxes should be calculated "when establishing base rates." Prepared Testimony of Gladys M. Brown, Chairman, Pennsylvania Public Utility Commission, p. 4. *See* Companies' Initial Brief, p. 26 and Appendix D.

OCA refuses to acknowledge important textual references within the four corners of Act 40 signaling that Section 1301.1 was intended and designed to apply only to base rates.[10] For that reason, the OCA's proposed interpretation, which conflicts with the relevant textual evidence, undercuts the OCA's claim that Act 40 is so "clear and unambiguous" that the factors set forth in Section 1921(c) of Pennsylvania's statutory construction law,[11] including Act 40's definitive legislative history, should be disregarded.

The Contingent Sub-Issue (Section III.C., *infra*). The OCA has proposed two methods for changing the DSIC formula to reflect, in calculating quarterly charges, state income tax deductions and credits.[12] Both methods incorporate, in one form or another, the concept of an "effective tax rate." One method would do so explicitly by adjusting the pre-tax return component of the calculation to employ an "effective" tax rate rather than the statutory tax rates required by the Final Implementation Order, which in turn conforms to the terms of Section 1357.[13] The other method gets to the same place by inserting a new variable into the DSIC formula for a free-standing calculation of income taxes. As explained in the Company's Supplemental Initial Brief,[14] the OCA's recommendations do not fit the terms of Sections 1357, conflict with the Final Implementation Order, and are inconsistent with the PUC's directive that the calculation of the DSIC should be "a straight-forward mechanism which is easy to calculate, easy to audit and which does not require a full rate case analysis."[15] In short, the OCA's recommendation underscores the sound reasons why the OCA's interpretation of Act 40 should

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[10] Companies' Reply Brief, pp. 7-11; Companies' Reply to Exceptions, pp. 7-8 and 11-15. *See also* Companies' Initial Brief, pp. 19-22 and 25-27.

[11] 1 Pa.C.S. §§ 1921(c)(1)-(8). *See* Companies' Initial Brief, pp. 19-22.

[12] OCA Supp. Main Brief, pp. 12-13.

[13] *See* Companies' Supp. Initial Brief, pp. 10-13.

[14] Companies' Supp. Initial Brief, pp. 13-15 and 18.

[15] Final Implementation Order, pp. 38-39.

be rejected.[16] Additionally, the changes to the DSIC formula proposed by the OCA's witness, Ralph C. Smith, would double-count the tax deduction for book depreciation.[17]

If the ALJ and the Commission reject – as they should – the OCA's interpretation of Section 1301.1, then it should not be necessary to address the contingent sub-issue. If, notwithstanding the rejection of the OCA's interpretation of Act 40, a decision on the contingent sub-issue were necessary, then the calculation of the revenue conversion factor used to "gross-up" the equity return component of the Pre-Tax Rate of Return would have to follow (with respect to the state income tax portion of that calculation) the detailed three-step process described in Paragraph No. 30 of the Companies' Proposed Findings of Fact.[18]

III. ARGUMENT

A. The Commission, With The Commonwealth Court's Approval, Has Previously Determined That The *Entire* DSIC Mechanism Set Forth In A Utility's DSIC Rider Is The Relevant "Rate" For Purposes Of Determining Whether The DSIC Is Just And Reasonable

A fundamental concept is central to understanding why the OCA's interpretation of Act 40 and its "burden of proof" contentions are erroneous and should be rejected. Specifically, the "rate" that is the subject of the reserved issue is the *entire* DSIC adjustment mechanism as set forth in the Companies' DSIC Riders. As the complete definition of "rate" in Section 102 makes clear, a "rate" is not just a specific dollar amount. Rather, a "rate" includes "any rules, regulations, practices, classifications or contracts . . . affecting any . . .charge." In the Columbia Gas of Pennsylvania, Inc. ("Columbia") DSIC proceeding that was the precursor of the OCA's

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[16] *See* Companies' Supp. Initial Brief, pp. 18-19 and Companies' St. 1-RJ, p. 3.

[17] Companies' Supp. Initial Brief, p. 17 and Companies' St. 1-RJ, p. 3.

[18] *See* Companies' Proposed Findings of Fact ¶¶ 30 and 43.

appeal to Commonwealth Court in *McCloskey v. Pa. P.U.C.*,[19] the presiding Administrative Law Judges found and determined – and the Commission affirmed – 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."[20] Indeed, in *McCloskey*, the Commonwealth Court relied on this bedrock principle[21] in determining that the entire DSIC adjustment mechanism, including the DSIC formula, the "earnings cap" and other customer protections, constitute the "rate" that must be assessed for justness and reasonableness.[22] Applying that principle here leads to the conclusion that Act 40 does not apply to the DSIC. It also establishes that the OCA's attempt to shift the burden of proof to the Companies is unavailing.

1. The "Rate" Challenged By The OCA Is The DSIC Adjustment Mechanism Set Forth In The Model Tariff And DSIC Riders, And That "Rate" Was Approved By A "Final Order" Entered Prior To The Effective Date Of Act 40.

Section 1301.1(c)(2) provides that Act 40 applies only to "cases where the final order is entered after the effective date of this section." Even if Act 40 applied to more than just base rates – and it does not – it would still not apply to the DSIC because the Model Tariff adopted by the Commission, which constitutes the DSIC "rate," was approved in the Final Implementation

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19 127 A.3d 860 (Pa. Cmwlth. 2015) ("*McCloskey*").

20 *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution Sys. Improvement Charge*, Docket No. P-2012-2338282 (R.D. issued Mar. 6, 2014), p. 45. *See* Final Order entered May 22, 2014, p. 58 ("[T]he Recommended Decision of Administrative Law Judges Mark A. Hoyer and Jeffrey A. Watson, issued on March 6, 2014, is adopted, consistent with this Opinion and Order.").

21 As explained in the Companies' Initial Brief (pp. 29-20), precedents from other states, the Federal Energy Regulatory Commission and the United States Court of Appeals for the District of Columbia Circuit confirm the well-established principle that the entire adjustment mechanism is a "rate."

22 *McCloskey, supra*, at 867 and 869. *See* Companies' Initial Brief, pp. 38-39.

Order entered approximately four years before the effective date of Act 40.[23] The test cases that the OCA appealed to Commonwealth Court to challenge the terms of the Model Tariff (which were also entered prior to Act 40's effective date), produced the Court's decision in *McCloskey* and its companion case, *McCloskey – Little Washington*[24], which were issued in November 2015. Moreover, the Companies' DSIC Orders, which found and determined that their DSIC Riders fully conform to the Model Tariff, were entered on June 9, 2016. Thus, even if the DSIC Orders were deemed necessary to make the Final Implementation Order "final" as to the Companies, that condition has also been satisfied.[25] The finality of both the Final Implementation Order and the Companies' DSIC Orders is clear from existing appellate court precedent that is discussed in the Companies' Initial Brief (p. 30, n. 84 and n. 85). Notably, the OCA has not addressed, let alone attempted to refute, this point in any of its testimony, briefs or exceptions.

2. Contrary To The OCA's Contentions, The DSIC Adjustment Mechanism Set Forth In The Model Tariff And DSIC Riders Does Not Fail To Recognize Either ADIT Or State Income Tax Deductions And Credits

The OCA's arguments to amend the DSIC formula proceed on the basis of three fundamental premises: (1) that Act 40 applies to the DSIC; (2) that Act 40 requires the Commission to recognize ADIT and state income tax deductions and credits in the DISC "rate;" and (3) that the DSIC "rate" approved by the Commission does not recognize ADIT or applicable state income tax benefits.[26] For the reasons explained previously and in Section III.B., *infra*, the OCA's first and second premises are incorrect. In addition, because the OCA still does not acknowledge what the Commission and the Commonwealth Court have previously

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

[24] *McCloskey v. Pa. P.U.C.*, No. 1358 CD 2014 (Nov. 3, 2015).

[25] *See* Companies' Initial Brief, p. 31.

[26] *See* OCA Supp. Main Brief, pp. 8-9.

determined, namely, that the "rate" is the entire DSIC adjustment mechanism, the OCA's third premise is also wrong.

The OCA contends there is only one way ADIT and property-related state income tax deductions and credits[27] may be recognized in DSIC tariffs, namely, to deduct incremental ADIT from the original cost of "eligible property" and to include incremental property-related state income tax deductions and credits on "eligible property" in calculating the pre-tax return component of quarterly DSIC charges.[28] Underlying the OCA's position is the unstated assumption that unless the OCA's proposed revision to the DSIC formula is adopted, the Commission will not have accounted for those federal and state income tax effects anywhere in the DSIC adjustment mechanism. That assumption is incorrect.

As previously explained, the DSIC "rate" consists of the *entire* DSIC adjustment mechanism, with all of its terms, conditions, procedures and customer "safeguards," as they are set forth at length in the Model Tariff (and in the DSIC Rider for each of the Companies).[29] The Commission carefully considered the limited scope of an adjustment clause like the DSIC, the limited number of cost components it was designed to reflect, and the admonition of Pennsylvania's appellate courts that adjustment clauses should not attempt to recreate base rate determinations and, in that way, "disassemble the traditional rate-making process."[30] Based on its analysis, the Commission concluded that it was neither necessary nor appropriate to reflect

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[27] As explained in the Companies' Supplemental Initial Brief (p. 9 n. 14), the state income tax deductions and credits at issue pertain to tax-timing differences attributable to accelerated depreciation that may be claimed for tax purposes. In the early years of a property addition, accelerated depreciation claimed for tax purposes exceeds book depreciation. The "timing" difference is eliminated over time as the accelerated depreciation diminishes in later years and book depreciation eventually exceeds tax depreciation. This effect is "normalized" for federal income tax purposes, which gives rise to ADIT, and is flowed-through in calculating state income tax expense in base rate cases.

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

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

[30] *See* Companies' Initial Brief, p. 34.

incremental ADIT or *incremental* state income tax deductions and credits in the quarterly calculation of charges under the DSIC formula.[31]

The Commission did not, however, ignore the impact of ADIT. To the contrary, it determined that *cumulative* ADIT (ADIT related to *all* of a utility's plant in service, including quarterly additions of "eligible property") and *cumulative* property-related state income tax deductions and credits generated by *all* of a utility's property are properly taken into account in calculating the rate of return on equity the utility actually earns each quarter. The product of that calculation, in turn, is used to do a quarterly assessment of whether a utility is exceeding the previously-approved, allowable rate of return on equity employed in the DSIC formula and, if so, the utility *must reduce its DSIC to zero*.[32] In PPL Electric Utilities Corporation's DSIC Order, the Commission held: "[T]he earnings cap *is the accurate approach* as it captures the potential magnitude and complexity of ADIT and other costs without necessarily requiring the DSIC to be treated like a Section 1308(d) base rate proceeding."[33] In like fashion, in Columbia's DSIC Order, the Commission concluded that the earnings cap analysis is a superior mechanism for dealing with the ADIT issue than the incremental approach espoused by the OCA.[34]

The Commission was on solid ground in relying upon the earnings cap and the associated earnings cap analysis to recognize, and account for, the cumulative impact of ADIT and property-related state income tax deductions and credits, as well as *all other factors* that determine a utility's equity return rate. Indeed, the earnings cap process tracks the kind of rate

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

32 Section 1358(b)(3) and Model Tariff , Section 4.F. (Earnings Reports). This provision is incorporated in the Companies' DSIC Riders.

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

34 *See* Companies' Initial Brief, pp. 34-35.

analysis that the Commonwealth Court previously approved as appropriate in non-general base rate cases.[35] In *McCloskey* the Court concluded that its prior approval of a similar process in *Equitable* was ample authority for finding that the earnings cap analysis, and the requirement to "zero out" the DSIC if the earnings cap were exceeded, properly recognized ADIT and state income tax deductions and credits in the DSIC adjustment mechanism.[36]

Nothing in Act 40 diminishes – let alone eliminates, as the OCA contends – the Commission's authority and discretion to determine *how* ADIT and state income tax deductions and credits should be recognized in the DSIC adjustment mechanism.[37] And, as *McCloskey holds*, the *entire* DSIC adjustment mechanism, including the DSIC formula, the earnings cap and all other customer protections, constitute the "rate" that must be considered. Viewed in that way – as it must be – there is no valid basis to conclude that the Commission abused its discretion in deciding that the quarterly earnings cap analysis properly accounts for cumulative ADIT and property-related state income tax deductions and credits and, taken together with all the other provisions of the Model Tariff, produces a just and reasonable rate.

3. Contrary To The OCA's Contention, The Companies Do Not Have The Burden Of Proof As To Either The Reserved Issue Or The Contingent Sub-Issue

The OCA contends that the Companies bear the "burden of proof." At the outset, it should be noted that burden of proof is fundamentally an evidentiary standard and, as such, is not relevant to a question of law, such as statutory interpretation. In any event, the OCA's contention depends on its assumption that the DSIC is a "proposed rate."[38] Once again, the OCA

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

36 *McCloskey* at 868-869.

37 *See* Companies' Initial Brief, pp. 21-22 and 32-33.

38 *See e.g.*, OCA Supp. Main Brief, p. 5 ("Thus, a utility has an affirmative burden to establish the justness and reasonableness of every component of its *rate request*" (emphasis added).)

conflates a monetary charge with the entire DSIC adjustment mechanism and implicitly assumes that the former is at issue but the latter is not. Of course, that position contravenes the OCA's own position in this case, which seeks a change in the fundamental terms of the DSIC Riders and, by necessary extension, in the Commission-approved Model Tariff as well.

As previously explained, the "rate" for each Company is its entire DSIC Rider, and those Riders are no longer "proposed." The Riders are currently in effect pursuant to Commission Orders finding and determining that they conform to the Model Tariff.[39] Indeed, for that reason, the real object of the OCA's proposal in this case is not the Companies' DSIC Riders, but the Model Tariff and the Final Implementation Order approving it. The Commission's findings and conclusions in all of those Orders are "prima facie evidence of the facts found and shall remain conclusive upon all parties affected thereby."[40] The OCA is the party seeking to overturn the relevant portions of the Final Implementation Order, the Model Tariff, and the Orders determining that the Companies' DSIC Riders conform to the Model Tariff. Accordingly, as to all issues of fact where evidentiary standards may apply, the OCA is the party with the "burden of proof."

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[39] Although the DSIC Orders assigned certain issues to the Office of Administrative Law Judge, none of those issues pertained to the fundamental terms of the Model Tariff or the fundamental terms of the DSIC approved in the Final Implementation Order. In fact, the scope of the assignment was strictly limited to the specific issues delineated in Ordering Paragraph No. 4 of each of the DSIC Orders. The specifically assigned issues are the subject of the Joint Petition for Settlement of Pending Issues that was filed on February 2, 2017.

[40] Section 316.

B. The ALJ And The Commission Should Reject The OCA's Efforts To Divert Attention From The Explicit Purpose Of Act 40 And Its Definitive Legislative History, Which Establish That Act 40 Does Not Apply To The DISC

The OCA contends[41] that no weight should be given to the legislative history of Act 40 – or to any other indices of legislative intent identified in Section 1921(c) of Pennsylvania's statutory construction law[42] – because the terms of Section 1301.1 are allegedly "clear and unambiguous." Giving any credence to the OCA's argument requires acceptance of the paradox that statutory language the OCA contends is "clear and unambiguous" directly contradicts the singular purpose and limited scope of Act 40 explicitly articulated by its chief sponsor (the Chairman of the House Consumer Affairs Committee) and by the Commission's Chairman in her testimony to that Committee on this matter. In fact, the OCA's argument ignores the Acting Consumer Advocate's own testimony to the House Consumer Affairs Committee that the purpose of the bill which became Act 40 was to "eliminate the longstanding consolidated tax adjustment."[43] Nonetheless, even under the strictest application of the "not explicit" condition in

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41 *See* OCA Supp. Main Brief, p. 11.

42 1 Pa.C.S. § 1921 provides as follows:

§ 1921. Legislative intent controls.

(a) The object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly. Every statute shall be construed, if possible, to give effect to all its provisions.

(b) When the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit.

(c) When the words of a statute are not explicit, the intention of the General Assembly may be ascertained by considering, among other matters:

(1) The occasion and necessity for the statute.
(2) The circumstances under which it was enacted.
(3) The mischief to be remedied.
(4) The object to be attained.
(5) The former law, if any, including other statutes upon the same or similar subjects.
(6) The consequences of a particular interpretation.
(7) The contemporaneous legislative history.
(8) Legislative and administrative interpretations of such statute.

43 H.B. 1436 Public Hearing, Tr. 31. *See* Companies' Initial Brief, p. 19. If the Acting Consumer Advocate believed that Act 40 would have the far-reaching effects – including effectively reshaping fundamental aspects

Section 1921(c), it is clear that recourse to the indices of legislative intent in Section 1921(c)(1)-(8) is proper and authorized here.[44] As explained below and in the Companies' Reply Brief and Reply Exceptions,[45] there is unmistakable textual evidence within the four corners of Act 40 signaling legislative intent that Section 1301.1 should apply only to base rates. That language cannot be reconciled with the OCA's claim that Act 40 is "clear and unambiguous" in its application to the full range of adjustment clauses that have been approved by the Commission for use by utilities.[46]

The OCA's contention that the DSIC formula must be revised to include a separate term, for ADIT is based on a reference in Section 1301.1(a) to recognizing "deferred taxes" in order "to determine the *rate base* of a public utility for ratemaking purposes" (emphasis added). As explained in the Companies' Initial Brief,[47] "rate base" is a term that is inextricably related to the determination of base rates. This is not a coincidence. The DSIC is not designed to recover a return on a utility's "rate base." Rather, it was designed to recover costs relating to only a subset ("fixed costs" of "eligible property") of all the elements that, in a base rate case, comprise a utility's "rate base." The concept of "rate base" is, however, highly relevant in base rate proceedings, where all elements of "rate base"[48] are included in calculating a utility's allowed return. Consequently, Act 40 clearly employs a term that is relevant *only* to a base rate

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of Section 1357 – as the OCA now asserts, it raises the question why those views were not brought to the Committee's attention at the time of her testimony.

44 In their Initial Brief (pp. 21-22), the Companies analyzed Act 40 based on the eight factors in Section 1921(c). That analysis shows there is no valid basis for the OCA's proposed interpretation of Act 40.

45 *See* Companies' Reply Brief, pp. 7-12 and Reply to Exceptions, pp. 11-15.

46 While the OCA only discusses its interpretation of Act 40 in connection with the DSIC, its argument would, necessarily, apply Act 40 to all Section 1307 adjustment clauses. The OCA has not even tried to confront this far-reaching – but unmentioned – consequence of adopting its position.

47 Companies' Initial Brief, p. 27.

48 "Rate base" in base rate cases includes, for example, cash working capital, prepaid expenses, material and supplies, as well as ADIT and a host of other factors. *Id.*

proceeding. In similar fashion, Section 1301.1(c)(2) employs the term "final order," which is also inextricably related to the establishment of base rates and, in particular, to general base rate proceedings under Section 1308(d).[49] In fact, the term "final order" does not appear in any DSIC-related Code sections.[50]

Thus, the Companies have demonstrated that the *text* of Act 40 employs terms that only apply – indeed, only make sense – in the context of base rate proceedings. This is textual evidence *internal* to Act 40, and it fully supports interpreting Act 40 as applicable only to the calculation of base rates in base rate proceedings. Indeed, the textual evidence is also consistent with Act 40's sole, express purpose, namely, to eliminate CTAs, because prior to Act 40's effective date, CTAs were calculated and imposed only in base rate proceedings.

While the textual evidence itself limits Act 40 application to base rates, the same textual evidence completely refutes the OCA's argument for disregarding both the legislative history of Act 40 and other evidence of legislative intent. For the reasons summarized above, the use of the terms "rate base" and "final order" totally undercut the OCA's claim that Section 1301.1(a) is so "clear and unambiguous" that the factors listed in Section 1921(c) of the statutory construction law should be disregarded. At a minimum, the textual evidence available within the four corners of Act 40 demonstrates that the "words of the statute" are "not explicit" and, therefore, there is a solid legal justification for analyzing Section 1301.1(a) by reference to all of the factors in Section 1921(c)(1)-(8).

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49 Companies' Initial Brief, pp. 27-28.

50 Even the term "order" appears only once in the DISC-related Code sections. Notably, "order" is used in Section 1358(c) to direct the Commission to approve "specific procedures" for establishing a DSIC by "regulation or order." Pursuant to Section 1363(b)(1), that requirement should be fulfilled by the PUC's adopting a "model tariff." Consequently, the only final "order" that could be relevant to applying Act 40 is the Final Implementation Order and, as previously explained, that Order was entered well prior to the effective date of Act 40.

As explained in the Companies' Initial Brief, a thorough analysis applying the requisite terms of Section 1921(c) requires the ALJ and the Commission to consider the long history of the DSIC during which neither ADIT nor state income tax deductions and credits were included in calculating quarterly DSIC charges;[51] the express purpose for which Act 40 was enacted, which was to eliminate the use of CTAs and not to tinker with the carefully crafted terms of the DSIC-related Code sections;[52] and the decisive evidence available from the legislative history of House Bill 1436 (precursor of Act 40), which, in the words of the bill's chief sponsor, establishes that "this section applies to base rate cases" and "would only go into effect when a utility comes in for a base rate case."[53] There is no valid basis for the OCA's contention that this highly relevant evidence of legislative intent should be disregarded.

C. The OCA's Proposals To Address The Contingent Sub-Issue Would Introduce Precisely The Kind Of Computational Complexity The Commission – With The Approval Of The Commonwealth Court – Has Determined Is Inconsistent With The Fundamental Purpose Of Adjustment Clauses Authorized By The Public Utility Code

The contingent sub-issue concerns how, if at all, the DSIC adjustment mechanism would have to be revised to reflect incremental property-related state income tax deductions and credits in the quarterly recalculation of the DSIC charge. This issue has been addressed fully in the Companies' Initial Brief[54] and, therefore, the Companies will not repeat that discussion here. There are, however, three points that the OCA has touched upon that require a response.

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[51] *Id.* at 11-17. In *McCloskey*, the Court considered the long history of the water industry's use of a DSIC prior to Act 11's extension of the DSIC to other forms of utility service as strong evidence of legislative intent that the DSIC-related Code provisions should conform to the water industry's historic practice and not include ADIT or state income tax deductions and credits in the calculation of quarterly DSIC charges. *McCloskey*, 127 A.3d at 871, n. 21.

[52] Companies' Initial Brief, pp. 19-22.

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

[54] Companies' Initial Brief, pp. 8-20.

The OCA's Proposed Alternative Calculation Methods. The OCA explains that its witness, Mr. Smith, proposed two methods for changing the DSIC calculation to reflect state income tax deductions and credits. One method, which Mr. Smith prefers, would require calculating the "effective" state income tax rate and using that calculated value in lieu of the "statutory" rate (9.9%) required by the Final Implementation Order. The OCA contends that this method "would not change the existing DSIC formula."[55] However, the DSIC formula as it now exists clearly requires the use of "statutory" tax rates, as mandated in the Final Implementation Order. If the OCA's position were adopted, some amendment or addition to the DSIC formula would be needed to signal that change. Furthermore, it should be noted that the OCA's proposal to reflect ADIT in the DSIC calculation unquestionably would require the addition of a new term to the DSIC formula – which, again, would contravene the terms of the Final Implementation Order and Model Tariff.

The other method the OCA proposes to recognize state income tax deductions and credits would, by the OCA's admission, require the introduction of an entirely new term to the DSIC formula. This alternative would, in effect, provide for a free-standing calculation of the state income taxes a utility would be permitted to recover with respect to the return component of the DSIC calculation. In addition to moving the DSIC calculation one step closer to the equivalent of a base-rate revenue requirement analysis – a result the Commission has previously held should not occur – this alternative would be inconsistent with the "pretax return" component of the DSIC that is specifically delineated in Section 1357(b)(1). Moreover, as the OCA conceded, this alternative produces the same result as the "effective tax rate" alternative previously described.

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[55] OCA Supp. Main Brief, p. 13.

That being the case, it is clear that even the "effective tax rate" alternative cannot fit within the prescribed terms of Section 1357(b). The inconsistency with existing law underscores the error.

Statutory Interpretation And Legislative Intent. The OCA has virtually conceded that its proposed methodology for recognizing state income tax deductions and credits (and, by necessary implication, its proposal regarding ADIT as well conflicts with the specific instructions for calculating the DSIC detailed in Section 1357(b).[56] This conflict is telling because it underscores the Companies' position that Act 40 was never intended to make wholesale amendments to the detailed and specific statutory provisions authorizing the DSIC and prescribing its terms.

The OCA, faced with this conundrum, has chosen to invoke the rules of statutory interpretation – rules that it previously argued should be ignored because Act 40 is allegedly "clear and unambiguous." Obviously, the OCA has undercut its own position. If Act 40 as interpreted by the OCA cannot be reconciled with Section 1357(b) – and, it cannot – then certainly the condition precedent in Section 1921(c) ("not explicit") for examining the legislative history of Act 40 to discern legislative intent has been satisfied.

Furthermore, even the OCA's recourse to Section 1936 of the statutory construction law[57] is unavailing. That provision states: "Whenever the provisions of two or more statutes enacted finally by different General Assemblies are irreconcilable, the statute latest in date of final enactment shall prevail." Act 40 can, in fact, be reconciled with Section 1357(b) if, as its legislative history and all other indices of legislative intent demonstrate, Act 40 was intended to

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[56] OCA Supp. Main Brief, p. 14 .

[57] 1 Pa.C.S. § 1936.

apply only to base rates. Additionally, Section 1933 of the statutory construction law[58] – not Section 1936 – is far more relevant to interpreting Act 40. Section 1933 provides:

> Whenever a general provision in a statute shall be in conflict with a special provision in the same or another statute, the two shall be construed, if possible, so that effect may be given to both. If the conflict between the two provisions is irreconcilable, the special provisions shall prevail and shall be construed as an exception to the general provision, unless the general provision shall be enacted later and it shall be the manifest intention of the General Assembly that such general provision shall prevail.

The first sentence of Section 1933 should control; Act 40 can be reconciled with Section 1357 by interpreting Act 40 to conform to the clear indication of legislative intent evident from its legislative history. For much the same reason, the second sentence of Section 1933 requires the same result. Section 1357(b) contains very specific instructions for calculating each component of the DSIC formula. The language in Act 40 on which the OCA relies is general and decidedly non-specific – indeed, so non-specific it does not even identify the detailed provisions of Section 1357 as something it might affect, let alone substantively amend in the manner the OCA envisions. The specific (Section 1357) controls over the general (Act 40), unless the general provision was enacted later in time "*and* it shall be the manifest intention of the General Assembly that such general provision shall prevail." At a minimum, this provision provides a sound basis for examining the legislative history and other indices of legislative intent in Section 1921(c) – and, therefore, is a further refutation of the OCA's argument that legislative history should be disregarded. Giving due consideration to legislative history and other evidence of legislative intent, the "manifest intention" of the General Assembly that Act 40 should apply only to base rates is unmistakable. Hence, Section 1933 of the statutory construction act also requires the OCA's interpretation of Act 40 to be rejected.

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[58] 1 Pa.C.S. § 1933.

The Fundamental Nature Of Adjustment Clauses. The OCA tries to minimize the Commission's determination that the DSIC should be a "straight-forward mechanism" that is easy to calculate and audit.[59] However, that proposition was validated by the Commonwealth Court in *McCloskey*.[60] Furthermore, the Commission's determination that the DSIC should be a "straight-forward mechanism . . . which does not require a full rate case analysis"[61] is consistent with Pennsylvania appellate court precedent holding that adjustment clauses like the DSIC should recover specified elements of a utility's revenue requirement "without the necessity of the broad, costly and time-consuming inquiry required in general base rate cases."[62] As explained in the Companies' Supplemental Initial Brief (pp. 18-19), the OCA's proposed methodology for including state income tax deductions and credits in the DSIC quarterly calculation cannot pass this test, which is a further reason why the OCA's interpretation of Act 40 should be rejected.

IV. CONCLUSION

For all the reasons discussed above, in the Companies' Supplemental Initial Brief, in the Companies' Initial and Reply Briefs and in their Reply to the OCA's Exceptions, the Administrative Law Judge should issue a Recommended Decision, and the Commission should enter a final order, finding and determining that Act 40 does not apply to the DSIC and, even if it did, Act 40 neither overruled *McCloskey* and *McCloskey-Little Washington* nor revoked the Commission's discretion to determine that cumulative ADIT and all applicable state income tax deductions and credits are properly taken into account in the earnings cap analysis required by

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59 *See* OCA Supp. Main Brief, p. 15.

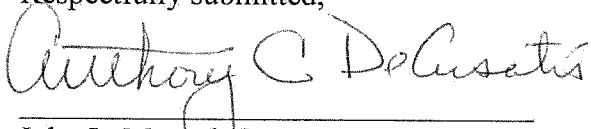
60 *See* 127 A.3d at 870-871 (Noting that the Commission intended to create a "simplified framework" for calculating the DSIC while imposing an important customer protection – the "earnings cap" – to assure that all aspects of a utility's revenue requirement are properly considered in determining whether it is earning at or below its allowed rate of return and resetting the DSIC to zero if an exceedance occurs.)

61 Final Implementation Order, pp. 38-39.

62 *Pa. Indus. Energy Coal. v. Pa. P.U.C.*, 653 A.2d 1336, 1148 (Pa. Cmwlth. 1995).

the Model Tariff (and incorporated in the DSIC Rider for each of the Companies). Accordingly, the OCA's proposed revision to the DSIC formula and methodology should be rejected, and it should not be necessary to address the contingent sub-issue pertaining to the recognition of state income tax deductions and credits discussed in the Supplemental Testimony of the OCA. As also explained above and in the Companies' Supplemental Initial Brief, there is no practical means to implement the DSIC formula revisions to recognize state income tax deductions and credits proposed by the OCA, which is further strong evidence that the OCA's fundamental position regarding the application of Act 40 to the DSIC is erroneous.

Respectfully submitted,



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