BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge	: : :	P-2015-2508942
Office of Consumer Advocate v. Metropolitan Edison Company	: : : : :	C-2016-2531040
Petition of West Penn Power Company for Approval of a Distribution System Improvement Charge	: : :	P-2015-2508948
Office of Consumer Advocate v. West Penn Power Company	: : : : :	C-2016-2531019
Petition of Pennsylvania Electric Company for Approval of a Distribution System Improvement Charge	: : :	P-2015-2508936
Office of Consumer Advocate v. Pennsylvania Electric Company	: : : : :	C-2016-2531060
Petition of Pennsylvania Power Company for Approval of a Distribution System Improvement Charge	: : :	P-2015-2508931

Office of Consumer Advocate	:	
	:	
v.	:	C-2016-2531054
	:	
Pennsylvania Power Company	:	

RECOMMENDED DECISION

Before
Joel H. Cheskis
Administrative Law Judge

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I. INTRODUCTION

This Decision recommends disposal of issues emanating from two proceedings involving four electric distribution companies. The first proceeding involves the companies' requests to increase their base rates and the second proceeding involves the companies' individual requests for the implementation of a distribution system improvement charge. With regard to the issues emanating from the companies' base rate proceedings, this Decision recommends that the Commission direct the companies to account for related federal and state income tax deductions and credits in the computation of current or deferred income tax expense to reduce rates when an expense or investment is allowed to be included in the companies' rates for ratemaking purposes. With regard to the issues emanating from the companies' request for implementation of a distribution system improvement charge, this Decision recommends approval of a Joint Petition for Settlement of Pending Issues because the settlement is in the public interest and supported by substantial evidence.

II. HISTORY OF THE PROCEEDING

On February 14, 2012, Governor Corbett signed into law Act 11 of 2012, (Act 11), which amends Chapters 3, 13 and 33 of the Public Utility Code. Act 11, *inter alia*, provides jurisdictional water and wastewater utilities, electric distribution companies (EDCs) and natural gas distribution companies (NGDCs) or a city natural gas distribution operation with the ability to implement a distribution system improvement charge (DSIC) to recover reasonable and prudent costs incurred to repair, improve or replace certain eligible distribution property that is part of the utility's distribution system. The eligible property for the utilities is defined in Section 1351 of the Public Utility Code. Act 11 states that as a precondition to the implementation of a DSIC, a utility must file a Long-Term Infrastructure Improvement Plan (LTIIP) with the Public Utility Commission (Commission) that is consistent with Section 1352 of the Public Utility Code. On August 2, 2012, the Commission issued Implementation of Act 11 of 2012, Docket Number M-2012-2293611 (Final Implementation Order entered Aug. 2, 2012) (Final Implementation Order), establishing procedures and guidelines necessary to implement Act 11.

In accordance with the Final Implementation Order, Pennsylvania Electric Company (Penelec) filed a petition on September 18, 2015 with the Commission seeking approval of its LTIIP, Docket Number P-2015-2508936. Similarly, on October 19, 2015 Metropolitan Edison Company (Met-Ed) filed a petition with the Commission seeking approval of its LTIIP, Docket Number P-2015-2508942, West Penn Power Company (West Penn) filed a petition with the Commission seeking approval of its LTIIP, Docket Number P-2015-2508948, and Pennsylvania Power Company (Penn Power) filed a petition with the Commission seeking approval of its LTIIP, Docket Number P-2015-2508931. The Commission approved the petitions for LTIIP filed by Penelec, Met-Ed, West Penn and Penn Power (collectively referred to as "the companies") by separate orders dated February 11, 2016. As a result, on February 16, 2016, each of the four companies filed a proposed tariff supplement or petition to implement a DSIC rider into the respective tariffs with an effective date of July 1, 2016. These filings form the initial basis of this proceeding.

On February 26, 2016, the Office of Consumer Advocate (OCA) filed formal complaints, public statements and answers in response to each of the petitions. On March 7, 2016, petitions to intervene were filed in response to each petition jointly by Citizens for Pennsylvania's Future (CPF) and the Environmental Defense Fund (EDF), as well as by Met-Ed Industrial Users Group (MEIUG), West Penn Power Industrial Intervenors (WPPII), Penelec Industrial Customer Alliance (PICA) and the Penn Power User's Group (PPUG) (collectively referred to as "the large users groups"), the respective large users groups for each company, in the proceedings relevant to them. On March 9, 2016, the Office of Small Business Advocate (OSBA) filed a notice of appearance, notice of intervention, answer and public statement in response to each proceeding and the Pennsylvania State University (PSU) filed a petition to intervene in the petition involving West Penn. On April 1, 2016, AK Steel Corporation (AK Steel) also filed a petition to intervene in the case involving West Penn. Complaints were filed by individual customers Eve McCauley and Michelle Perry on April 4, 2016 and April 18, 2016, respectively.

In response to these filings, the companies filed answers to the complaints and answers to the petitions for intervention and the parties began exchanging discovery.

On June 9, 2016, the Commission entered separate Opinion and Orders approving the four individual petitions filed by the companies. *See e.g.*, Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge, Docket Numbers P-2015-2508942 (Opinion and Orders entered June 9, 2016) (June 9th Orders). In the June 9th Orders, the Commission determined that the petitions comply with the requirements of Act 11 and the Final Implementation Order. The Commission found the petitions to be consistent with applicable law and Commission policy and allowed the tariffs to go into effect on July 1, 2016. The Commission, however, also referred some matters to the Office of Administrative Law Judge (OALJ) for hearing and preparation of recommended decisions regarding various issues raised in response to the petitions. In particular, the Commission referred the following issues to OALJ:

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;

c. If revenues associated with the riders in Pennsylvania Power Company's tariff are properly included as distribution revenues;

d. The Petition for Intervention of Penn Power Users Group;

e. The Joint Petition for Intervention of the Citizen's for Pennsylvania's Future and the Environmental Defense Fund; and

f. The Joint Motion to Compel of the Citizen's for Pennsylvania's Future and the Environmental Defense Fund and the Commission waives the fifteen (15) day timeframe restriction set forth in 52 Pa. Code § 5.342.

On June 20, 2016, each of the companies filed a tariff supplement adding its DSIC rider to its tariff. On July 13, 2016, the Commission's Secretary issued a single letter informing all parties that their respective DSIC riders complied with the terms of the DSIC orders.

On July 25, 2016, CPF and EDF filed a joint notice of withdrawal in each proceeding.

On July 28, 2016, the Commission issued Hearing Notices establishing Initial Prehearing Conferences consecutively for the cases involving those issues referred to the OALJ for Wednesday, August 10, 2016 beginning at 10:00 a.m. and assigning me as the Presiding Officer. Prehearing Conference Orders were issued on July 28, 2016. Pursuant to those Prehearing Conference Orders, prehearing memoranda were submitted by the companies, the OCA, the OSBA, the large user groups separately for the respective proceedings and Penn State University with regard to the proceeding involving West Penn.

The prehearing conferences convened as scheduled. The following counsel were present: Anthony C. DeCuastis, Esquire, and John Munsch, Esquire, on behalf of the companies; Daniel Asmus, Esquire, on behalf of OSBA; Darryl Lawrence, Esquire and Harrison Breitman, Esquire, on behalf of the OCA; Alessandra Hylander, Esquire, on behalf of the large users groups; and Christopher Arfaa, Esquire, on behalf of Penn State University. David Boehm, Esquire, previously indicated on behalf of AK Steel that he would be unable to attend the prehearing conferences but would like to remain on the Commission's service list for the proceeding. As per the directive in the Prehearing Conference Orders regarding participation in this proceeding, the service list for this proceeding was limited to these parties.

In each of their prehearing memoranda, the companies proposed that consolidation of the four proceedings would promote administrative efficiency and avoid delays and duplicative efforts that would cause the unnecessary expenditure of time and resources by the Commission, the presiding officer and the parties. As a result, prior to the commencement of the prehearing conferences, a discussion was held off the record regarding whether the four separate proceedings should be consolidated. No party objected to consolidation. Therefore, one prehearing conference was held for all four proceedings and a Consolidation Order was issued dated August 11, 2016 formally consolidating the cases.

In addition, various procedural issues were discussed during the prehearing conference. The petitions to intervene of the respective large user groups were granted. With respect to the establishment of a procedural schedule, the companies proposed that, in lieu of establishing a procedural schedule, the parties would schedule two or more settlement and/or

technical conferences to be held between August 15 and September 15, 2016 and report back to the Presiding Officer on the status of the negotiations by September 19, 2016. The companies further proposed that, if the matter is not, by that time, the subject of a settlement, a second prehearing conference would be held between September 28 and October 20, 2016 to determine whether the submission of testimony and scheduling of an evidentiary hearing may be required. No party objected to the companies' proposal and, therefore, it was ordered as part of this proceeding. A scheduling order was issued dated August 12, 2016 addressing other procedural issues and reminding the parties that Commission policy encourages settlement.

On September 19, 2016, October 20, 2016 and November 7, 2016, the parties submitted status reports on the settlement discussions. In particular, in the third formal status report filed on November 7, 2016, the parties indicated that a comprehensive settlement in principle had been reached and that the parties would be submitting a joint petition for settlement and supporting statements memorializing the agreement.

On February 2, 2017, the companies, the OCA, the OSBA and the large users groups filed a Joint Petition for Settlement of Pending Issues (settlement) requesting that the settlement be approved in its entirety without modification. Attached to the settlement were Exhibits 1 thru 4, comprising revised tariff supplements for each company, in both clean and redlined versions, as well as Statements A thru D, comprising statements in support of the settlements from the companies, the OCA, the OSBA and the large users groups, respectively. AK Steel and PSU included letters indicating they do not oppose the settlement. On February 8, 2017, a motion for admission of testimony and exhibits was submitted by the companies in support of the settlement. On February 16, 2017, the parties jointly proposed findings of fact, conclusions of law and ordering paragraphs in support of the settlement.

Concurrent with this procedural history, on April 28, 2016, a separate proceeding was held regarding the companies' requests for increases in their base rates.[1] These requests were consolidated and litigated together. In that proceeding, the parties agreed to a settlement of

[1] The lead Docket Numbers for each company filing were: R-2016-2537349 (Met-Ed), R-2016-2537352 (Penelec), R-2016-2537355 (Penn Power) and R-2016-2537359 (West Penn).

all but one issue. The lone issue which the parties did not agree was the treatment of Adjusted Deferred Income Tax (ADIT) in the companies' DSIC rider.

With regard to this lone issue, on June 12, 2016, Act 40 of 2016 was signed into law, effective August 11, 2016. Act 40 added Section 1301.1 to the Public Utility Code regarding computation of income tax expense for ratemaking purposes. The parties submitted briefs in the base rate case on the impact, if any, of the enactment of Act 40 on the companies' base rates.

On January 19, 2017, the Commission acted in response to these consolidated base rate proceedings. *See*, Pa.P.U.C., *et al.* v. Metropolitan Edison Co., *et al*, Docket Numbers R-2016-2537349, *et al.* (Opinion and Order entered Jan. 19, 2017) (Jan. 19th Order). In the Jan. 19th Order, the Commission approved the partial settlement submitted by the parties but determined that issues regarding the application of Section 1301.1 pertaining to the inclusion of ADIT in the calculation of the DSIC riders should be addressed in this proceeding involving the companies' DSICs. Id. at 38. The Commission stated: "Because the contested issue involves the DSIC calculation, it should be considered in the context of all of the issues directly related to the DSIC. As of the date of this Opinion and Order, ALJ Cheskis has not yet issued a Recommended Decision in the DSIC proceeding and no evidentiary hearings have been conducted." Id. at 38-39. The Commission added: "Given the status of the DSIC proceeding, there is adequate time to resolve the contested issue within the DSIC proceeding." Id. at 39. The Commission also transferred the relevant parts of the record concerning the OCA's claim with regarding to the calculation of ADIT in the companies' DSICs to this proceeding. Id.; *see also*, Pa.P.U.C., *et al.* v. Metropolitan Edison Co., *et al*, Docket Numbers R-2016-2537349, *et al.* (Opinion and Order entered May 18, 2017). This included briefs and written testimony submitted by the parties on this issue.

As a result, on February 21, 2017, a hearing notice was issued setting a further prehearing conference for Monday, March 6, 2017 in Hearing Room 4 of the Commonwealth Keystone Building in Harrisburg for the purpose of addressing the issues referred to this proceeding by the Commission in the Jan. 19th Order. A further prehearing conference order was

issued on February 22, 2017. Pursuant to the further prehearing conference order, the parties submitted prehearing memoranda on March 2, 2017.

On March 6, 2017, the further prehearing conference convened as scheduled. The following counsel entered their appearance: Anthony DeCusatis, Esquire and John Munsch, Esquire, appeared on behalf of the companies; Erin Gannon, Esquire, on behalf of the OCA; Daniel Asmus, Esquire, on behalf of the OSBA; and Alessandra Hylander, Esquire on behalf of the industrial users groups. During the further prehearing conference, various procedural issues were discussed. In particular, the following schedule was established for litigation of the lone outstanding issue:

OCA Supplemental Direct Testimony	March 21, 2017
All parties' Supplemental Rebuttal Testimony	April 13, 2017
All parties' Supplemental Surrebuttal Testimony	May 1, 2017
Companies' Supplemental Rejoinder Testimony	May 5, 2017
Hearings in Harrisburg	May 12, 2017

Scheduling Order #2 was issued on March 6, 2017 memorializing the procedural issues agreed to in the further prehearing conference and a hearing notice was issued on March 7, 2017 regarding the initial hearing for this matter for May 12, 2017 in Harrisburg.

Pursuant to Scheduling Order #2, the OCA and the companies pre-served written testimony. On May 12, 2017, a hearing convened in Harrisburg for the purpose of admitting into the record via stipulation the written testimony pre-served by the OCA and the companies. The following pre-served written testimony was admitted into the record:

OCA

Statement No. 1-Supp (Supplemental Direct Testimony of Ralph C. Smith)
Statement No. 1-SR-Supp (Supplemental Surrebuttal Testimony of Ralph C. Smith)
Exhibit LA-ME-1 (accompanying exhibits)

The Companies

Statement No. 1-R (Supplemental Rebuttal Testimony of Charles V. Fullem)
Statement No. 1-RJ (Supplemental Rejoinder Testimony of Charles V. Fullem)
Exhibit Number 1 (Supplemental) (responses to OCA interrogatories Set 1, no. 2)

In addition, during the evidentiary hearing, the outstanding motion for admission of testimony and exhibits submitted on February 8, 2017 in support of the settlement was granted formally admitting into the record of this proceeding Statement No. 1 with accompanying exhibits 1-6, the direct testimony of Kevin M. Siedt, for each company.

During the hearing, the parties agreed to submit Main Briefs on June 5, 2017 and Reply Briefs on June 21, 2017 setting forth their respective positions on the outstanding issue. On May 15, 2017, a briefing order was issued memorializing the briefing due dates and setting forth additional requirements regarding the briefs. Pursuant to the briefing order, both the OCA and the companies submitted both main and reply briefs.

The record in this proceeding closed on June 21, 2017 when the reply briefs for the contested issue were submitted. For the reasons discussed below, it is recommended that the settlement of the issues emanating from the companies' DSIC proceeding be approved in its entirety because it is in the public interest and supported by substantial evidence. With regard to the contested issue emanating from the companies' base rate proceeding, it is recommended that the companies be directed to account for related income tax deductions and credits in the computation of current or deferred income tax expense to reduce rates when an expense or investment is allowed to be included in a public utility's rates for ratemaking purposes as proposed by the OCA.

III. FINDINGS OF FACT

A. General

1. Penn Power, Penelec, West Penn and Met-Ed are electric distribution companies that transmit and distribute electricity to retail customers within the Commonwealth

and are, therefore, "public utilities" within the meaning of Section 102 of the Public Utility Code, 66 Pa.C.S. § 102, subject to the jurisdiction of the Commission.

2. Penn Power, Penelec, West Penn and Met-Ed are subsidiaries of First Energy Corporation.

3. Penn Power provides electric distribution and provider of last resort services to approximately 163,000 customers in a certified service territory that encompasses all or portions of six counties in western Pennsylvania.

4. Penelec provides electric distribution services to approximately 584,000 customers in a certified service territory in all or portions of 31 counties in Pennsylvania.

5. West Penn provides electric distribution, transmission and provider of last resort services to approximately 721,000 customers in a certified service territory encompassing all or portions of 23 counties in western and central Pennsylvania.

6. Met-Ed provides electric distribution service to approximately 558,000 customers in all or portions of 13 counties in eastern Pennsylvania.

B. Contested Issue

7. A utility DSIC is a form of utility rates commonly referred to as a surcharge. OCA S.M.B. at 9-10.

8. The FirstEnergy companies do not account for ADIT in their respective DSIC calculations. OCA M.B. at 10.[2]

[2] The cite to "M.B." and "R.B." refers to the Main Briefs and Reply Briefs submitted by the parties in the proceeding emanating from the companies' base rate case. The cite to "S.M.B." and "S.R.B." refers to the Supplemental Main Briefs and Supplemental Reply Briefs submitted by the parties in the proceeding emanating from the companies' DSIC proceedings.

9. Federal income tax effects of certain tax timing differences, such as accelerated forms of depreciation, are "normalized" for ratemaking purposes, which results in deferred taxes being recorded and, under normalization accounting, ADIT are deducted from rate base because they are assumed to represent a source of non-investor supplied capital. First Energy (FE) S.M.B. at 9, n.34.

10. In contrast to federal income tax deductions, state income tax deductions are flowed through in utility rates on a current basis. OCA S.M.B. at 12.

11. The state income tax rate used to calculate the DSIC revenue requirement should reflect the state income tax expense actually paid. OCA S.M.B. at 12, n. 5.

12. Both ways identified by OCA witness Ralph Smith to recognize the impact of the deductions to the state income taxes recovered through the DSIC, 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 S.M.B. at 12, *citing*, OCA St. 1SR-Supp. at 3-4.

13. The OCA's first method to recognize the impact of deductions would not change the existing DSIC formula contained in the FirstEnergy Companies' tariffs but 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 as follows:

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

OCA S.R.B. at 13, *citing*, OCA St. 1SR-Supp. at 8-9.

14. In the OCA's first method, the tax multiplier would reflect the actual amount of state income taxes that the utility will pay on DSIC income. OCA S.R.B. at 13, *citing*, OCA St. 1SR-Supp at 3, 6-7; OCA St. 1-Supp. at 2.

15. The mechanics of the pre-tax rate of return are not included in the companies' tariff riders but are provided in the calculations supporting each companies' quarterly DSIC updates. *See*, OCA Exh. LA-ME-1.

16. Using an effective tax rate in the DSIC calculation does not change the applicable statutory income tax rate. OCA S.M.B. at 14, *citing*, OCA St. 1-Supp at 3-4.

17. The OCA's second method to recognize the impact of deductions would change the existing DSIC formula contained in the Companies' DSIC tariffs because a separate component would be added to the formula to provide for the allowance for income taxes. OCA S.R.B. at 13, *citing*, OCA St. 1SR-Supp. at 8-9.

18. In the OCA's second method, the income tax calculation would reflect the impact of state income tax deductions on DSIC eligible property as follows:

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

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 S.R.B. at 13, *citing*, OCA St. 1SR-Supp at 9.

19. The OCA's second method would adjust the revenue factor used to calculate the pre-tax rate of return in the DSIC formula to flow-through the state income tax deductions related to DSIC investment. *See*, OCA S.M.B. at 13, *citing*, OCA St. 1SR-Supp at 8-9.

C. Settled Issues

20. Met-Ed Exhibit Number 1 is the Long-Term Infrastructure Improvement Plan for Met-Ed. Met-Ed Exh. No. 1.

21. Met-Ed Exhibit Number 2 is the Met-Ed DSIC Rider R for Met-Ed. Met-Ed Exh. No. 2.

22. Met-Ed Exhibit Number 3 is various schedules and revenue forecasts for Met-Ed's DISC. Met-Ed Exh. No. 3.

23. Met-Ed Exhibit Number 4 is the Base Rate Case Certification signed by Charles Fullem dated February 16, 2017 at Docket Number P-2015-2508942. Met-Ed Exh. No. 4.

24. Met-Ed Exhibit Number 5 is Met-Ed's Notice of Proposed Electric Distribution System Improvement Charge. Met-Ed Exh. No. 5.

25. Met-Ed Exhibit Number 6 is Met-Ed's answers to OSBA interrogatories Sets I and II. Met-Ed Exh. No. 6.

26. Penelec Exhibit Number 1 is the Long-Term Infrastructure Improvement Plan for Penelec. Penelec Exh. No. 1.

27. Penelec Exhibit Number 2 is the DSIC Rider R for Penelec. Penelec Exh. No. 2.

28. Penelec Exhibit Number 3 is various schedules and revenue forecasts for Penelec's DISC. Penelec Exh. No. 3.

29. Penelec Exhibit Number 4 is the Base Rate Case Certification signed by Charles Fullem dated February 16, 2017 at Docket Number P-2015-2508936. Penelec Exh. No. 4.

30. Penelec Exhibit Number 5 is Penelec's Notice of Proposed Electric Distribution System Improvement Charge. Penelec Exh. No. 5.

31. Penelec Exhibit Number 6 is Penelec's answers to OSBA interrogatories Sets I and II. Penelec Exh. No. 6.

32. Penn Power Exhibit Number 1 is the Long-Term Infrastructure Improvement Plan for Penn Power. Penn Power Exh. No. 1.

33. Penn Power Exhibit Number 2 is the DSIC Rider O for Penn Power. Penn Power. No. 2.

34. Penn Power Exhibit Number 3 is various schedules and revenue forecasts for Penn Power's DISC. Penn Power Exh. No. 3.

35. Penn Power Exhibit Number 4 the Base Rate Case Certification signed by Charles Fullem dated February 16, 2017 at Docket Number P-2015-2508931. Penn Power Exh. No. 4.

36. Penn Power Exhibit Number 5 is Penn Power's Notice of Proposed Electric Distribution System Improvement Charge. Penn Power Exh. No. 5.

37. Penn Power Exhibit Number 6 is Penn Power's answers to OSBA interrogatories Sets I and II. Penn Power Exh. No. 6.

38. West Penn Exhibit Number 1 is the Long-Term Infrastructure Improvement Plan for West Penn. West Penn Exh. No. 1.

39. West Penn Exhibit Number 2 is the DSIC Rider N for West Penn. West Penn Exh. No. 2.

40. West Penn Exhibit Number 3 is various schedules and revenue forecasts for West Penn's DISC. West Penn Exh. No. 3.

41. West Penn Exhibit Number 4 is the Base Rate Case Certification signed by Charles Fullem dated February 16, 2017 at Docket Number P-2015-2508948. West Penn Exh. No. 4.

42. West Penn Exhibit Number 5 is West Penn's Notice of Proposed Electric Distribution System Improvement Charge. West Penn Exh. No. 5.

43. West Penn Exhibit Number 6 is West Penn's answers to OSBA interrogatories Sets I and II. West Penn Exh. No. 6.

IV. DISCUSSION

1. Contested Issue

A. Burden of Proof

In this proceeding, the OCA argued that the companies bear the burden of proof to establish the justness and reasonableness of every element of the DSIC. OCA S.M.B. at 5; OCA M.B. at 8. In support of its position, the OCA cites to Section 315 of the Public Utility Code which provides that "in any proceeding upon 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); *see also*, Lower Frederick Twp. Pa.P.U.C., 409 A.2d 505, 507 (Pa. Cmwlth 1980). The OCA added that the companies must affirmatively demonstrate the reasonableness of every element of the DSIC calculation and demonstrate that the rate is just, reasonable and in the public interest. OCA S.M.B. at 5-6.

In response, the companies argued that the companies' DSIC are no longer "proposed rates" but that the riders are currently in effect. FE S.R.B. at 11. The companies further argued that since those rates are currently in effect, and "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," the OCA is the party with the burden of proof. Id.

Both parties, however, also argued that the issues of burden of proof and whether a party has satisfied the burden of proof is not dispositive because the issue is a legal issue and, therefore, not necessarily tied to the evidence or amount thereof in the record. *See*, OCA M.B. at 10 and FE S.R.B. at 10 ("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."). The OCA added that "the parties do not disagree on the facts relevant to the issue – that the FirstEnergy companies do not account for ADIT in the companies' DSIC calculation. As such, determining which party bears the burden of proof and whether that party has met its burden is likely irrelevant to the ultimate decision on the Act 40/ADIT issue." OCA M.B. at 10.

This proceeding arises from the companies' submission of petitions for approval of a DSIC. As discussed above, the companies filed petitions seeking approval of their respective long-term infrastructure improvement plans and those petitions were approved on February 11, 2016. On February 16, 2016, each of the companies then filed a proposed tariff supplement or petition to implement a DSIC rider into their respective tariffs with an effective date of July 1, 2016. Issues arising from these filings form the initial basis of this proceeding. *See*, June 9th Orders, *supra*. The companies' DSIC proceedings were approved by the Commission subject to the resolution of certain outstanding issues. Subsequently, in disposing of the companies' base rate proceedings, the Commission referred the OCA's claim regarding the calculation of ADIT in the companies' DSIC riders to this proceeding. Jan. 19th Order at 39. As such, the underlying DSIC proceeding, in which the companies, as the petitioners, have the burden is not final and issues pertaining to the companies' DSIC arise from the underlying rate proceeding in which the companies also have the burden of proof.

Furthermore, however, it is noted that a party that offers a proposal not included in the original filing bears the burden of proof for such proposal. Pa. Pub. Util. Comm'n v.

Metropolitan Edison Co., Docket No. R-00061366 (Opinion and Order entered January 11, 2007) (Met-Ed); *see also*, Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Approval of their Default Service Programs, Docket Nos. P-2009-2093053 and P-2009-2093054 (Opinion and Order entered Nov. 6, 2009) (where competing proposals are introduced, the sponsoring party must show that the alternative proposal will better service customers). As a result, the OCA has the burden to demonstrate that its specific proposals to account for related state income tax deductions and credits in the computation of current or deferred income tax expense to reduce rates when an expense or investment is allowed to be included in rates are appropriate and should be adopted.

Therefore, the companies continue to have the burden to demonstrate that their DSICs are just and reasonable and should be approved pursuant to Section 315 of the Public Utility Code. This includes accounting for related income tax deductions and credits in the computation of current or deferred income tax expense to reduce rates when an expense or investment is allowed to be included in a public utility's rates for ratemaking purposes. But, the OCA has the burden to prove that one of its proposed methods should be adopted to incorporate that impact into the calculation of the companies' DSIC. Whether and how Section 1301.1 affects DSIC is not purely a legal issue, as the parties have argued. To the extent that this proceeding involved purely legal issues, there would be no need for the referral to the OALJ for the development of an evidentiary record. Yet, expert testimony was necessary to develop this issue and the burden of proof is relevant to resolve the contested issue.

Finally, it is also noted that all decisions of the Commission must be supported by substantial evidence. 2 Pa.C.S. § 704. "Substantial evidence" is such relevant evidence that a reasonable mind might accept as adequate to support a conclusion. More is required than a mere trace of evidence or a suspicion of the existence of a fact sought to be established. Norfolk & Western Ry. Co. v. Pa. Pub. Util. Comm'n, 489 Pa. 109, 413 A.2d 1037 (1980); Erie Resistor Corp. v. Unemployment Comp. Bd. of Review, 194 Pa. Superior 278, 166 A.2d 96 (1961); and Murphy v. Comm., Dept. of Public Welfare, White Haven Center, 85 Pa.Cmwlth 23, 480 A.2d 382 (1984).

B. Position of the parties

The issues emanating from the companies' base rate case and the issued raised in the supplemental testimony in this proceeding are substantially similar. In its supplemental main brief, the OCA articulated the issues as:

> 1. Whether Act 40 requires the First Energy Companies to modify their DSIC calculation to include federal income tax deductions generated by DSIC investment; and
>
> 2. Whether Act 40 requires the Companies to modify their DSIC calculation to include state income tax deductions generated by DSIC investment.

OCA S.M.B. at 1; *see also*, Tr. 22. In other words, the issue raised in supplemental testimony in this proceeding involves ***state*** taxes whereas the outstanding issue emanating from the companies' base rate case involves ***federal*** taxes. As discussed below, the parties have made the same arguments in the briefs filed in both proceedings with the exception of the additional issue regarding the specific methods proposed by the OCA regarding the impact of state income taxes on the companies' DSICs. As such, issues involving both state and federal taxes will be addressed together in this Decision.

For example, in its supplemental main brief, the OCA argued that Act 40, which took effect on August 11, 2016, applies to the companies' DSICs and requires that related income tax deductions and credits "shall" be included in the computation of current or deferred income tax expense to reduce rates. Id. at 6; OCA M.B. at 10-15. The OCA argued that the DSIC is a "rate" and recovers current and deferred income tax deductions and, therefore, the DSIC calculation should be modified to recover federal and state income tax deductions generated by DSIC investment. Id.; OCA M.B. at 13-14. The OCA added that Act 40 reversed existing appellate precedent, under which the Commission could approve DSIC tariffs that did not reflect federal and state income tax deductions. Id. at 6-7.

More specifically, the OCA argues that Act 40 was specifically enacted by the General Assembly in response to the Commonwealth Court's interpretation of Act 11 of 2012 in Tanya J. McCloskey v. Pa. P.U.C., 127 A.3d 860 (Pa. Cmwlth 2015) (McCloskey). Act 11 permitted certain utilities, including electric distribution companies, to petition the Commission for the implementation of a DSIC. 66 Pa.C.S. § 1353(a). The OCA noted that, in one of the first cases before the Commission seeking approval of a DSIC under Act 11, the OCA advocated that the utility should be required to recognize federal and state income tax benefits in the DSIC and generated by investment in replaced infrastructure. OCA S.M.B. at 8, *citing,* Petition of Columbia Gas of Pennsylvania, Inc. for approval of a Distribution System Improvement Charge, Docket No. P-2012-2338282 (Opinion and Order entered May 22, 2014) (Columbia Gas); OCA M.B. at 11. The Commission rejected the OCA's argument and the OCA appealed to the Commonwealth Court. In McCloskey, the Commonwealth Court upheld the Commission's decision noting, among other things, that the Commission has discretion to determine the components required for calculation of the DSIC rate. Id. at 8-9, *citing*, McCloskey at 870-871.

In its briefs, however, the OCA further argued that, shortly after the Commonwealth Court's decision in McCloskey, the General Assembly passed Act 40 of 2016. Id. at 9; OCA M.B. at 11-12. Act 40 added Section 1301.1 to the Public Utility Code. The OCA noted that Section 1301.1 provides, in relevant part, that "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. The OCA presented expert witness testimony in support of its position that "Act 40 now requires 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." OCA S.M.B. at 9; *see also,* OCA St. 1 at 110; OCA St. 1S at 1-2. The OCA argued that "Act 40 requires a different treatment of state income taxes than that previously approved by the Commission in Columbia Gas." Id. at 10.

The OCA then proposed two methods to implement the changes it advocates for with regard to state income tax purposes. The OCA noted that "in contrast to federal income tax deductions, state income tax deductions are flowed through in utility rates on a current basis."

OCA S.M.B. at 12. The state income tax rate used to calculate the DSIC revenue requirement should reflect the state income tax expense actually paid. Id. at 12, n. 5. OCA witness Ralph Smith identified two ways to recognize the impact of the deductions to the state income taxes recovered through the DSIC, both of which "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." Id., *citing*, OCA St. 1SR-Supp. at 3-4. The OCA provided specific details and formulas for each position, noting that the first method would not change the existing DSIC formula contained in the companies' tariffs but the second method would. Id. at 13-16. OCA witness Smith concluded:

> 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.

Id. at 15, *citing*, OCA St. 1SR-Supp at 8.

In contrast, the companies presented a witness and briefs in support of its position that Act 40 is not in response to the Commonwealth Court's ruling in McCloskey or the Commission's ruling in Columbia Gas and does not allow for the revisions that the OCA advocates be made to the companies' DSIC. The companies argued that Act 40 does not apply to the DSIC generally for three reasons. FE S.M.B. at 6-8; FE M.B. at 8-9, 18-19.

First, the companies argued that Act 40 was added to the Public Utility Code for "the express purpose of eliminating the use of [consolidated tax adjustments] in calculating utility base rates." Id. at 5; FE M.B. at 19. The companies added: "nothing within the four corners of Act 40, or in the 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 and state income tax deductions and credits should be accounted for in designing DSIC tariffs." Id. at 6 (emphasis in original); FE M.B. at 8, 25-26. Second, the companies argued that "the legislative history of Act 40 is clear that Section 1301.1 was intended to apply ***only*** to ***base***

rates established under Section 1308 and not to adjustment clauses such as the DSIC." Id. (emphasis in original); FE M.B. 25. The companies quoted from the Legislative Journal in concluding that "the DSIC is not a 'base rate' and, therefore Section 1301.1 does not apply to it." Id. at 6-7 (citations omitted); FE M.B. at 8-9, 22-23. Third, the companies argued that, by its own terms, Act 40 applies "to all cases where the final order is entered after the effective date of this section." Id. at 7; FE M.B. at 9, 27-28. The companies argued that the Final Implementation Order adopting the DSIC formula the OCA proposes to revise was adopted on August 2, 2012 and, therefore, Section 1301.1 does not apply because Act 40 was not effective at that time. Id.

Finally, the companies also argued that, even if Act 40 did apply to the DSIC, it could not retroactively revoke the discretion afforded to the Commission to determine how ADIT and state income tax deductions and credits should be accounted for in the DSIC. *See e.g.*, FE S.M.B. at 6, 8; FE M.B. at 32-39. The companies argued that the DSIC formula does not ignore the impact of the DSIC on ADIT and state income tax deductions and credits and, therefore, violate Section 1301.1 – it just does not account for those deductions and credits in a manner that the OCA prefers. Id. at 8.

The companies then addressed the specific proposals offered by the OCA to reflect state income tax deductions and credits if its interpretation of Act 40 were adopted. The companies began by examining the statutory language of Section 1357 which describes the components of the DSIC formula. Id. at 9-11. The companies concluded that "neither Section 1357 nor the Commission's Model Tariff provides any direction as to how, if at all, ADIT could be factored into the calculation of the original cost of eligible property or how state income tax deductions and/or credits could be factored into the calculation of the 'pretax return' as that term is defined and described by Section 1357." Id. at 11; FE M.B. at 13-14.

With regard to the specific proposals made by the OCA, the companies then argued that, while the Commission has stated that the DSIC is intended to be a straightforward mechanism that is easy to calculate, easy to audit and does not require a full case analysis, the OCA's proposal has none of these characteristics. Id. at 13. The companies also argued that there is no practical way to implement the OCA's proposal consistent with the Commission's

established guidelines for DSIC. Id. at 13-14, *citing*, FE St 1-R (supp) at 7. The companies identified three steps that would be required under the OCA's proposal and argued "that process was a far cry from the 'straightforward mechanism' the Commission has also envisioned the DSIC to be." Id. at 15. After raising additional specific concerns about the OCA's recommendations, the companies then concluded by arguing that "the OCA's recommendation cannot be implemented and should not be adopted, which is a further reason to reject the OCA's interpretation of Act 40." Id. at 18-19.

In addition, in their Supplemental Reply Brief, the companies reiterated in response to the OCA's supplemental brief what they believe are several flaws in the OCA's arguments. For example, the companies reiterated their position that the Commission previously determined in Columbia Gas, and affirmed in McCloskey, 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. FE S.R.B. at 5-6. The companies also reiterated their position that Act 40 does not apply to the DSIC because the Model Tariff adopted by the Commission was approved in the Final Implementation Order approximately four years before the effective date of Act 40. Id. at 6-7; FE R.B. at 12. The companies also reiterated their positions that the DSIC already recognizes ADIT and state income tax deductions and credits, as well as that the OCA's specific proposed formulas are not straightforward and easy to calculate and audit and are therefore inconsistent with the fundamental nature of an adjustment clause. Id. at 7-10, 15-19; FE R.B. at 14. Finally, the companies argued that the purpose of Act 40 was to eliminate the longstanding consolidated tax adjustment, as demonstrated by a review of the legislative history, and not to revise the DSIC formula as the OCA has proposed in this proceeding. Id. at 12-15; FE R.B. at 10.

Likewise, in its Supplemental Reply Brief, the OCA responded to many of the arguments raised by the companies. In particular, the OCA argued that Columbia Gas and McCloskey are no longer relevant because Act 40 has been enacted. OCA S.R.B. at 3; OCA R.B. at 2. The OCA argued that, therefore, "Act 40 eliminates any Commission discretion regarding the treatment of federal and state income tax deductions in DSIC – it requires them to be included." Id. The OCA then discussed other instances where the General Assembly has

amended a statute to legislatively overrule a decision of the judiciary. Id. at 3-4 (citations omitted). The OCA added that the language of Act 40 requiring inclusion of state income tax deductions in DSIC is clear and unambiguous. Id. at 4-5; OCA M.B. at 14; OCA R.B. at 2-3. The OCA also responded to the companies' specific concerns regarding the formulas the OCA proposed in support of its position in the proceeding. The OCA argued that the companies raised "false hurdles to give credence to [their] arguments regarding statutory construction." Id. at 6. The OCA added that the companies' arguments regarding double-counting are misleading and that "the companies do not argue that they are not able to calculate the required offset, only that it would require three additional steps." Id. at 6-9. The OCA noted that the companies informed estimates can be reconciled under Act 11. Id. at 9.

C. Disposition

1. Section 1301.1

I find that Section 1301.1 requires the companies' to account for related federal and state income tax deductions and credits in the computation of current or deferred income tax expense to reduce rates when an expense or investment is allowed to be included in their rates for ratemaking purposes.

When reviewing the evidentiary record developed in this proceeding, it is clear that the companies' DSICs must include federal and state income tax deductions and credits generated by DSIC investment. The OCA has demonstrated that doing so will ensure that the companies' DSICs are consistent with the Public Utility Code and are just, reasonable and in the public interest.

To begin, Section 1301.1, added to the Public Utility Code by the General Assembly in Act 40, provides:

> **§ 1301.1. Computation of income tax expense for ratemaking purposes.**

(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. If an expense or investment is not allowed to be included in a public utility's rates, the related income tax deductions and credits, including tax losses of the public utility's parent or affiliated companies, shall not be included in the computation of income tax expense to reduce rates. The deferred income taxes used to determine the rate base of a public utility for ratemaking purposes shall be based solely on the tax deductions and credits received by the public utility and shall not include any deductions or credits generated by the expenses or investments of a public utility's parent or any affiliated entity. The income tax expense shall be computed using the applicable statutory income tax rates.

(b) Revenue use.—

If a differential accrues to a public utility resulting from applying the ratemaking methods employed by the commission prior to the effective date of subsection (a) for ratemaking purposes, the differential shall be used as follows:

(1) fifty percent to support reliability or infrastructure related to the rate-base eligible capital investment as determined by the commission; and

(2) fifty percent for general corporate purposes.

(c) Application.—

The following shall apply:

(1) Subsection (b) shall no longer apply after December 31, 2025.

(2) This section shall apply to all cases where the final order is entered after the effective date of this section.

66 Pa.C.S. § 1301.1. The relevant portion of Section 1301.1 that is at the heart of this proceeding is subsection (a), and specifically the first sentence of subsection (a).

In addition, in McCloskey, which both parties discuss at length in their briefs, the Commonwealth Court affirmed a decision of the Commission approving the petition for a DSIC of Columbia Gas, a natural gas distribution company. In the proceeding before the Commission, the Commission concluded that Columbia was not required to include an ADIT adjustment in its DSIC calculation and that Columbia was permitted to include the state income tax "gross-up" in its DSIC calculation. McCloskey at 865. The OCA appealed contending that the Commission erred as a matter of law when it approved a DSIC calculation that did not recognize ADIT tax benefits recovered through the surcharge and generated by the investment in the replaced parts of its infrastructure. Id. at 866. The OCA argued, among other things, that Pennsylvania law and well established ratemaking policy requires that Columbia's tax benefits be reflected in the rates paid by its ratepayers. Id. The Commission countered that the General Assembly envisioned a simple and straightforward process of establishing rates for the DSIC surcharge that would be easy to calculate and audit. Id. at 867.

In affirming the Commission's decision, the Commonwealth Court determined, among other things, that the United States Supreme Court has acknowledged that there are many ways to achieve rates that are just and reasonable and a determination as to whether rates were just and reasonable must involve a look at the total effect of the rates. Id. at 868 (citations omitted). The Commonwealth Court also determined that the Commission is vested with the discretion to decide what factors it will consider in setting or evaluating a utility's rates. Id. (citations omitted). The Commonwealth Court noted that there are earnings caps and "resets" as consumer protections and concluded that, "in the current conflict, this Court will not substitute its judgment for that of the Commission." Id. at 870-871.

Most significantly, however, is the timing of McCloskey and the enactment of Section 1301.1. Section 1301.1 was enacted by the General Assembly after McCloskey was issued. McCloskey was issued by the Commonwealth Court on November 3, 2015 and Act 40 became effective August 11, 2016. The parties have argued in their brief whether or not Section 1301.1 was enacted in response to McCloskey. However, whether the General Assembly enacted Section 1301.1 ***specifically in response to*** the Commonwealth Court's decision in

McCloskey, as the OCA argued, is irrelevant. It is sufficient that Section 1301.1 was enacted ***after*** McCloskey was issued. As a result, Section 1301.1 governs the facts of this case.

More specifically, the relevant first sentence in subsection (a) of Section 1301.1 is clear and unambiguous:

> 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) (emphasis added). The plain language of Section 1301.1 requires that the impact of any tax deductions and credits related to an expense or investment that is allowed to be included in a public utility's rates for ratemaking purposes ***shall*** be included in the computation of current or deferred income tax expense to reduce rates. It is well accepted that "shall" as used in statutes is generally imperative or mandatory and must be given a compulsory meaning as denoting obligation. *See*, Black's Law Dictionary, 6th Ed., West Publishing Co. at 1375.

The OCA, therefore, is correct that the companies must modify their DSIC calculation to include federal and state income tax deductions generated by DSIC investment. Doing so is what the General Assembly directed when enacting Act 40, regardless of McCloskey. No further analysis is required. The discretion previously afforded to the Commission in McCloskey is no longer present in light of the enactment of Act 40. The companies' arguments to the contrary are without merit and should be rejected.

First, the companies argued that Act 40 was enacted for the express purpose of eliminating the use of consolidated tax adjustments in calculating utility base rate and that nothing within the four corners of Act 40, or in the legislative history, suggests it would alter the elements of the DSIC formula or deprive the Commission of its discretion in designing the DSIC tariff. FE S.M.B. at 6-8; FE M.B. 8-9, 18-19. Yet, there is nothing in the plain language of Section 1301.1 that suggests as such. Rather, Subsection (a) of Section 1301.1 says if an expense or investment is allowed to be included in a utility's rates for ratemaking purposes so

too should the related income tax deductions and credits be included. 66 Pa.C.S. § 1301.1. Subsection (a) then articulates the inverse: if the expense or investment is not allowed to be included in a utility's rates for ratemaking purposes, any related income tax deductions and credits cannot be included. Id. The third and fourth sentences in subsection (a) then articulate how those deductions and credits should be calculated. Id. This language is clear and unambiguous.

The rules of statutory construction require that "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." 1 Pa.C.S. § 1921(b). In this case, the language of Section 1301.1 is clear and free from all ambiguity and therefore the letter of the statute cannot be disregarded.

The companies' reliance on legislative history as a reason to adopt its position in this proceeding is misplaced. Where the plain language of the statute is discernible, as is the case here, there is no need to look to the legislative history. As the rules of statutory construction further require, "when the words of the statute are not explicit, the intention of the General Assembly may be ascertained by considering, among other matters: …. (7) the contemporaneous legislative history." 1 Pa.C.S. § 1921(c)(7); *see also,* Yellow Cab Co. of Pittsburgh v. Pa. P.U.C., 501 A.2d 323 (Pa. Cmwlth 1985). In this case, however, the words of Section 1301.1 are explicit and, therefore, there is no need to look to the contemporaneous legislative history to ascertain the intention of the General Assembly, as the companies argue. Certainly, the argument of the sponsoring representative during the legislative debates, or the testimony of witnesses during a committee hearing, do not outweigh the clear and explicit terms of the language approved by the majority of the members of the General Assembly and signed by the Governor.

With regard to the companies' argument that adopting the OCA's position would "deprive the Commission of its discretion to determine ***how*** ADIT and state income tax deductions and credits should be accounted for in designing DSIC tariffs," FE S.M.B. at 6, this argument will also be rejected. As the OCA noted, Section 1301.1 states that "… the related income tax deductions and credits ***shall*** also be included….". 66 Pa.C.S. § 1301.1(a)(emphasis

added). The companies attempt to characterize Section 1301.1 by arguing that the Commission's discretion cannot be "retroactively revoked" is without merit. The Commission has only the authority granted to it by the General Assembly and the Commission must act within, and cannot exceed, its statutory authority. City of Pittsburgh v. Pa. Pub. Util. Comm'n, 43 A.2d 348 (Pa.Super. Ct. 1945). Again, the General Assembly has removed the Commission's discretion in this area. The Commission ***must*** include in the computation of current or deferred income tax expense the related income tax deductions and credits to reduce rates if an expense or investment is allowed to be included in a public utility's rates for ratemaking purposes.

In their second argument, the companies reiterate that the legislative history supports their position in this proceeding. This argument will again be rejected. The legislative history is not relevant here because the words of Section 1301.1 are clear and free from ambiguity. Again, the words of Section 1301.1 are explicit and, therefore, there is no need to look to the contemporaneous legislative history to ascertain the intention of the General Assembly, as the companies argue. The companies' argument that Section 1301.1 was only intended to apply to base rates and not to adjustment clauses such as the DSIC will be rejected because the companies' argument arises from its reliance on legislative history. In this case, there is no need to rely on legislative history. The plain reading of Section 1301.1 is sufficient. Therefore, the companies' argument, among other things, that the lead sponsor of the bill that became Act 40 stated that this section applies only to base rate cases will be rejected. If Section 1301.1 were only to apply to base rates, the explicit language of Section 1301.1 would say so. It does not.

Third, the companies' argument that "Section 1301.1 applies to all cases where the final order is entered after the effective date of this section," is also without merit and will be rejected. The companies argued that the Commission's Final Implementation Order, *supra*, that was entered August 2, 2012, is the "final order" for determining whether Section 1301.1 applies. FE S.M.B. at 7. Section 1301.1(c), which became effective on August 11, 2016, provides that the statute applies "to all cases where the final order is entered after the effective date of this section." 66 Pa.C.S. § 1301.1(c). These consolidated cases arise from the DSIC filings made by the companies on February 16, 2016. Although the Commission entered orders in response to

each of the companies' respective filings on June 9, 2016, the Commission specifically referred several issues to the OALJ for hearing and preparation of recommended decisions. The specific issue with regard to the impact of ADIT and state income taxes on the companies' DSIC was then referred to this proceeding in the Commission's order in response to the companies' respective base rate filings entered on January 19, 2017.

As a result, there has been no "final order" for purposes of this particular issue in this case entered prior to the effective date of Act 40 that would bar the application of Section 1301.1, as the companies argue. Rather, the final order in this proceeding will be entered following the issuance of this decision and the Commission's consideration of any exceptions and reply exceptions. The final order will be entered after August 11, 2016, the effective date of Section 1301.1 and, therefore, Section 1301.1 is applicable to this proceeding. The companies' argument to the contrary will be denied.

The companies' argument that the Final Implementation Order is the "final order" for purposes of determining whether Section 1301.1 applies, and therefore Section 1301.1 does not apply because it was issued before the effective date, is further without merit because the OCA is not advocating in this proceeding that ***every*** electric distribution company's DSIC rider be changed – only that the companies' DSIC rider be changed. The OCA is not addressing the Final Implementation Order but the companies' specific DSIC riders. It would violate other electric distribution companies' due process rights to change their DSIC riders in this proceeding without providing them notice and an opportunity to be heard. As a result, the Final Implementation Order is not the correct order to use when determining whether Section 1301.1 is applicable. The companies' argument to the contrary will be rejected.

Finally, the companies argued that the DSIC is not a "base rate" and, therefore, Section 1301.1 does not apply to it. This argument will also be rejected. The Public Utility Code specifically defines "rate" to include, in pertinent part, "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. This is a broad definition and includes the DSIC. As OCA witness Smith

testified, "a utility DSIC is a form of utility rates. That form of utility rates is commonly referred to as a surcharge." OCA S.M.B. at 9-10 (citation omitted). I agree. The companies' argument to the contrary must be rejected.

2. Method

I find that the companies should implement the OCA's first proposed method to consider the impact of state income taxes on their respective DSICs. Having found that the OCA is correct with regard to the impact of the application of Section 1301.1 on the companies' DSIC calculations, it is next necessary to determine how that impact should be measured. As both parties noted, in contrast to federal income tax deductions, state income tax deductions are flowed through in utility rates on a current basis. OCA S.M.B. at 12; FE S.M.B. at 9, n.34. As the companies stated in their brief, federal income tax effects of certain tax timing differences, such as accelerated forms of depreciation, are "normalized" for ratemaking purposes, which results in deferred taxes being recorded. FE S.M.B. at 9, n.34. Under normalization accounting, ADIT are deducted from rate base because they are assumed to represent a source of non-investor supplied capital. Id. The state tax effects of tax timing differences, such as accelerated depreciation, are not "normalized," but instead are flowed-through directly to customers in calculating state income tax expense. Id.

As a result, the OCA's witness identified two ways to recognize the impact of the deductions related to the state income taxes recovered through the DSIC, noting that both methods accomplish the same thing: they reduce the DSIC by the amount the utility's income tax decreases as a result of state income tax deductions related to the DSIC includable property. Id., *citing*, OCA St. 1SR-Supp at 3-4. As the OCA articulated in its Supplemental Main Brief:

> The first method would not change the existing DSIC formula contained in the FirstEnergy Companies' tariffs. 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:

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

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.

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

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.

Id. at 13 (internal footnote omitted).

In response to the specific methods to incorporate Section 1301.1 in the companies' DSICs, the companies argued that the OCA's proposals, which the companies refer to as the "contingent sub-issue," would introduce precisely the kind of computational complexity the Commission has determined is inconsistent with the fundamental purpose of adjustment clauses authorized by the Public Utility Code. FE S.R.B. at 15-19. More specifically, the companies argued that one method contravenes the DSIC formula as it now exists which clearly requires the use of statutory tax rates, as mandated by the Final Implementation Order, and that the other method requires the introduction of an entirely new term to the DSIC formula. Id. at 16. The companies further reiterated their position that adoption of either of the OCA's proposed methods would be contrary to statutory interpretation and legislative intent. Id. at 17-18. Finally, the companies also argued that Pennsylvania appellate court precedent holds that adjustment clauses like 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." Id. at 19 (citation omitted).

As noted above, a party that offers a proposal not included in the original filing bears the burden of proof for such proposal. Pa. Pub. Util. Comm'n v. Metropolitan Edison Co., Docket No. R-00061366 (Opinion and Order entered January 11, 2007); *see also*, Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Approval of their Default Service Programs, Docket Nos. P-2009-2093053 and P-2009-2093054 (Opinion and Order entered Nov. 6, 2009) (where competing proposals are introduced, the sponsoring party must show that the alternative proposal will better service customers). In this case, whereas the companies have the burden to demonstrate that their DSIC's comply with all applicable laws and regulations pursuant to Section 315, the OCA has the burden to demonstrate that its proposals that allow that to happen should be adopted. Substantial record evidence demonstrates that the first proposal offered by the OCA to incorporate the impact of Section 1301.1 on the companies' DSICs should be adopted.

As the OCA witness noted, the first method would not change the existing DSIC formula contained in the companies' tariffs but would adjust the revenue conversion factor used to calculate the pre-tax rate of return in the DSIC formula. OCA S.M.B. at 13, *citing*, OCA St. 1SR-Supp at 8-9. The tax multiplier would reflect the actual amount of state income taxes that the company will pay on DSIC income. Id. Furthermore, the mechanics of the pre-tax rate of return are not included in the companies' tariff riders but are provided in the calculations supporting each companies' quarterly DSIC updates. *See*, OCA Exh. LA-ME-1. The OCA also refuted the companies' arguments that using an effective tax rate is inconsistent with the requirement in Section 1357(b)(1) that the state income tax rate be used by showing that using an effective tax rate in the DSIC calculation does not change the applicable statutory income tax rate. OCA S.M.B. at 14, *citing*, OCA St. 1-Supp at 3-4.

Furthermore, many of the arguments posed by the companies in response to the OCA's specific methods to recognize the impact of Section 1301.1 on DSIC are without merit. The companies' arguments fail to consider that Section 1301.1 was enacted after the Commission's Final Implementation Order and after McCloskey. The companies' arguments would be relevant if Section 1301.1 was never enacted. Any modifications to the companies' DSICs are necessary, however, given that Section 1301.1 was enacted. As the OCA noted, "the

companies' position ignores that the law has changed. Act 40 no longer requires the inclusion of federal and state tax deductions in the DSIC rate." OCA S.M.B. at 15. I agree. To the extent that the companies are required to modify their existing DSIC to comply with Section 1301.1, that is what the General Assembly required.

With regard to the companies' argument that the OCA's specific proposals to recognize the impact of Section 1301.1 on the companies' DSIC are contrary to the legislative history, this argument will again be rejected. As noted above, where the plain language of the statute is discernible, as is the case here, there is no need to look at legislative history. 66 Pa.C.S. § 1921(b). A review of legislative history is only a factor in interpreting a statute when the words of the statute are not explicit. 66 Pa.C.S. § 1921(c). Such is not the case with regard to Section 1301.1 and, therefore, the companies' arguments with regard to the legislative history demonstrating that the OCA's specific proposals to implement the impact of Section 1301.1 on the DSIC are without merit and will be rejected.

With regard to the companies' argument that the OCA's specific proposals should be rejected because the DSIC should be a straightforward mechanism that is easy to calculate and audit, this argument will also be rejected. Neither of the proposals presented by the OCA appear to be so complex that the DSIC would no longer be straightforward and easy to calculate and audit. While adopting either of the OCA's proposals would require some additional efforts on behalf of the companies, and may also require additional efforts to audit, doing so is necessary to comply with Section 1301.1. Although there may be the need for additional development and refinement of what the OCA specifically proposed in this proceeding, such efforts can be conducted in the compliance filing phase of this proceeding and are not sufficient to warrant denying adoption of either of the OCA's proposals. Even with a possible three additional steps, as the companies argue, the OCA's proposals are not unduly burdensome and should be adopted. Adopting the OCA's proposed method is not the "broad, costly time-consuming inquiry required in general base rate cases," but necessary to comply with Section

1301.1. In addition, if the specific rates developed are contested, the rates could go into effect subject to further review and recoupment. *See*, OCA S.M.B. at 9.[3]

Having rejected the companies' arguments with regard to the OCA's specific proposals, it is recommended that the OCA's first method be adopted. As noted by the OCA, this method would not change the existing DSIC formula contained in the companies' tariffs and would adjust the revenue factor used to calculate the pre-tax rate of return in the DSIC formula to flow-through the state income tax deductions related to DSIC investment. *See*, OCA S.M.B. at 13, *citing*, OCA St. 1SR-Supp at 8-9. The tax multiplier would reflect the actual amount of state income taxes that the companies will pay on DSIC income. Id. Substantial record evidence in this proceeding supports modifying the companies' DSIC to incorporate the impact of the implementation of Section 1301.1 as required in the first method proposed by the OCA. The OCA has satisfied its burden to demonstrate that method one should be adopted. *See*, Met-Ed, *supra*.

D Conclusion

The OCA has correctly established that Section 1301.1 supersedes the Commonwealth Court decision in McCloskey and the Commission's decision in Columbia Gas when determining the appropriate rates for the companies' DSICs. Whether or not the General Assembly enacted Section 1301.1 specifically in response to McCloskey is irrelevant. The Commonwealth Court approved the decision of the Commission in Columbia Gas to not account for state and federal deductions and credits from DSIC expenses to reduce rates – in part saying it was in the Commission's discretion not to do so – but the General Assembly has subsequently declared that such deductions and credits must be included in the computation. The Commission's discretion in this area has been removed. It is within the prerogative of the

[3] It is further noted that, in arguing that the OCA's recommendation cannot be implemented and should not be adopted as a further reason to reject the OCA's interpretation of Act 40, the companies criticize the OCA's proposals as being "simplistic." FE S.M.B. at 18. The companies cannot have it both ways. Either the OCA's proposals are too complex to be a straightforward mechanism, or they are too simplistic. They cannot be both.

General Assembly to make this change to the Public Utility Code and the Commission must now follow that change. Doing so is consistent with appellate precedent regarding utility ratemaking.

The companies' reading of Section 1301.1 is too narrow and must be rejected. The companies' reliance on legislative history, among other things, to support its argument that the OCA's position in this proceeding should be rejected is misplaced. There is no need to consult legislative history because the statute is explicit. The words of Section 1301.1 are clear and free from all ambiguity and, therefore, "the letter of [Section 1301.1] must not be disregarded under the pretext of pursuing its spirit." The companies' arguments to the contrary must be rejected. So too must the companies' arguments that fail to recognize that the requirements of Section 1301.1 are mandatory be rejected. Much of the companies' arguments are relevant under McCloskey but are no longer relevant now that Section 1301.1 has been added to the Public Utility Code.

Finally, it is recommended that the first method proposed by the OCA to incorporate the impact of the enactment of Section 1301.1 on the companies' DSIC should be adopted. This method incorporates the related state income tax deductions and credits in the computation of current or deferred income tax expenses to reduce rates when an expense or investment is allowed to be included in the companies' rates, as Section 1301.1 requires. The companies' reasons for rejecting the OCA's proposed method one are without merit.

II. Settlement

A. Legal Standard

With regard to the issues emanating from the companies' proceeding involving their February 16, 2016 petitions for a DSIC, as noted above, in the June 9th Orders, the Commission determined that the petitions comply with the requirements of Act 11 and the Final Implementation Order. The Commission, however, also referred matters arising from those petitions to the OALJ for hearing and preparation of recommended decisions regarding those issues. On February 2, 2017, the companies, the OCA, the OSBA and the large users group filed

a settlement of those issues referred to the OALJ. Attached to the settlement were statements in support of the settlement from each party and tariff supplements. In addition, on May 12, 2017, a joint motion for admission of testimony and exhibits in support of the settlement was granted.

Commission policy promotes settlements. 52 Pa.Code § 5.231. Settlements lessen the time and expense the parties must expend litigating a case and at the same time conserve administrative resources. The Commission has indicated that settlement results are often preferable to those achieved at the conclusion of a fully litigated proceeding. 52 Pa.Code § 69.401. The focus of inquiry for determining whether a proposed settlement should be recommended for approval is not a "burden of proof" standard, as is utilized for contested matters. Pa. Pub. Util. Comm'n., *et al*. v. City of Lancaster – Bureau of Water, Docket Nos. R-2010-2179103, *et al*., Opinion and Order (entered July 14, 2011) (Lancaster). Instead, the benchmark for determining the acceptability of a settlement or partial settlement is whether the proposed terms and conditions are in the public interest. Id.; *citing*, Warner v. GTE North, Inc., Docket No. C-00902815, Opinion and Order (entered April 1, 1996) (Warner); Pa. Pub. Util. Comm'n. v. CS Water and Sewer Associates, 74 Pa. PUC 767 (1991).

It is against this backdrop that the settlement submitted by the parties on February 2, 2017 will be judged.

B. Terms of the Settlement

In the settlement, the companies, OCA, OSBA and the large users groups have agreed to resolve the issues emanating from the companies' DSIC proceedings as follows (with original paragraph numbering maintained):

> 20. Projected Quarterly Revenues for Distribution Service will exclude the following Riders in calculating the DSIC percentage:
>
> a. Default Service Support Rider (for all Companies);
> b. NUG [Non-Utility Generation] Rider (for Met-Ed and Penelec, which are the only Companies with NUG Riders); and
> c. Solar Photovoltaic Rider (for Met-Ed, Penelec, and Penn Power, which are the only Companies with Solar Photovoltaic Riders).

21. With respect to Penelec Rate Schedules GP and LP, the Company clarifies, confirms and agrees that, consistent with current practice, only those customers served at voltages over 46 kV are excluded from the application of the DSIC.

22. Any customers taking service under the second paragraph of the Availability/Applicability section of Penelec's Partial Service Rider (which applies to customers taking service at a voltage level that is less than 115 kV but are served directly from a source with voltage of 115 kV or greater through a single transformation) are excluded from the DSIC because such customers pay an investment charge for the facilities connecting the 115 kV or higher source and their location and are deemed to be Transmission-level customers.

23. With respect to Penn Power Rate Schedules GT and GSDS, the Company clarifies, confirms and agrees that, consistent with current practice, only those customers served at voltages over 69 kV are excluded from the application of the DSIC.

24. With respect to West Penn Power, if DSIC revenues billed to one or more Rate 40 customers receiving service by a single transformation from a transmission line operating at 100 kV or greater through a substation located on the customer's premises or within 2500 feet of the customer's premises exceed $750 per month, WPPII may file a Notice to reopen the issue of the application of the DSIC to Rate 40 customers that meet the previously-described criteria and, upon filing of such a Notice, (1) discussions among the parties to resolve this issue shall be reconvened promptly; and (2) if an impasse is reached and the issue cannot be resolved by negotiations among the parties, WPPII may reinstate the portion of its challenge to the Petition relating to this issue. Any refunds, recoupment and/or reallocation of customer payment responsibility for the DSIC that result from a Commission decision entered at the conclusion of the process described above shall be effective only for charges under the DSIC billed from and after the date of the first quarterly update of the DSIC after such Order is entered unless the parties expressly agree otherwise.

25. The DSIC Rider for Met-Ed will be revised to provide that the DSIC will not apply to customers on Rate TP served at Transmission Voltage. If DSIC revenues billed to one or more Rate TP customers receiving service voltages other than Transmission Voltage exceed $750 per month, MEIUG may file a Notice to reopen the issue of the application of the DSIC to such customers and, upon filing of such a Notice, (1) discussions among the parties to resolve this issue shall be reconvened promptly; and (2) if an

> impasse is reached and the issue cannot be resolved by negotiations among the parties, MEIUG may reinstate the portion of its challenge to the Petition relating to this issue. Any refunds, recoupment and/or reallocation of customer payment responsibility for the DSIC that result from a Commission decision entered at the conclusion of the process described above shall be effective only for charges under the DSIC billed from and after the date of the first quarterly update of the DSIC after such Order is entered unless the parties expressly agree otherwise.
>
> 26. Modifications to the existing DSIC charge will begin to apply when the Companies become eligible to begin to charge the DSIC after the DSIC is reduced to zero at the conclusion of their pending 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).[4]
>
> 27. Within 90 days of the Commission's entering an Order approving this Settlement, the Companies will meet with representatives of MEIUG, PICA, PPUG and WPPII to develop a process to provide, for each year of the remaining term of their current Long-Term Infrastructure Improvement Plans ("LTIIPs"), annual, and annually updated, estimates of the impact of the DSIC on the members of those groups.

See, Settlement at 8-11.

The settlement is conditioned upon the standard terms and conditions found in most settlements submitted to the Commission. This includes that approval of the settlement shall not be construed as approval of any party's position on an issue except to effectuate the terms of the settlement and that the settlement may not be cited as precedent in any future proceeding except to implement the settlement. Id. at 12-13. The settlement is presented without prejudice to any position which any of the parties may have advanced and without prejudice to the position any of the parties may advance in the future on the merits of the issues in future proceeding. Id. at 13. The settlement is conditioned on the Commission's approval of

[4] [original footnote 9] Joint Petitions for Partial Settlements of the Companies base rate cases were filed on October 14, 2016. On November 21, 2016, the presiding Administrative Law Judge issued a Recommended Decision recommending adoption and approval of the settlements. If approved by the Commission, the settlement rates reflected in the Joint Petitions would become effective on January 27, 2017. The Companies' base rate cases were developed on the basis of a fully projected future test year ending December 31, 2017.

the terms and conditions contained therein without modification and parties may withdraw from the settlement if the Commission disapproves or modifies any terms or conditions. Id. The parties have also agreed to waive the filing of exceptions if the Recommended Decision recommends that the settlement be approved without modification. Id. at 13-14.

It is also specifically noted that the settlement encompasses and resolves only those issues that were assigned to the OALJ by the June 9th Orders and that the settlement does not extend to, or resolve, additional issues the Commission may assign to the OALJ at the DSIC docket numbers. Id. at 12. Nor does the settlement restrict, compromise or otherwise affect any parties' rights to litigate any such issues if additional issues are assigned to the DSIC docket numbers. Id.

AK Steel and PSU indicated they do not oppose the settlement.

C. Public Interest

As noted above, it is the policy of the Commission to promote settlements. 52 Pa.Code § 5.231(a). The benchmark for determining the acceptability of a settlement or partial settlement is whether the proposed terms and conditions are in the public interest. Lancaster, Warner, *supra.* In the settlement, the parties indicated that the settlement is in the public interest and should be approved without modification because the settlement resolves a number of important and contentious issues that would require substantial administrative burdens and costs to litigate. Id. at 11. The parties further indicated that the settlement is in the public interest because it was achieved after conducting discovery and engaging in in-depth discussions resulting in a "carefully crafted package representing reasonable negotiated compromises on the issues." Id. Finally, the parties noted that the settlement is consistent with the Commission's rules and practices encouraging settlement and is supported by substantial evidence. Id. at 11-12.

In addition, each of the parties provided a Statement in Support of the Settlement wherein they discussed why they believe that the settlement is in the public interest and should be approved in its entirety without modification.

1. The companies

In their statement in support, the companies cited to various reasons why the settlement is in the public interest and should be approved without modification. In particular, the companies noted that the settling parties have agreed that the distribution revenues used in calculating the DSIC after the effective date of the new base rates and to determine the 5% cap will not include: 1) as to all companies, revenues billed under the Default Service Support Charge, 2) as to Met-Ed, Penelec and Penn Power, revenues billed under the Solar Photovoltaic Requirements Charge, and 3) as to Met-Ed and Penelec, revenues billed under the Non-Utility Generator (NUG) Charge.

The companies identified specific rate schedules to which the DSIC will apply, noting that this is not an area where "bright lines" can be drawn, and that the companies considered the totality of the circumstances in deciding which rate schedules and customers should be excluded from their DSICs. In support of their position that the settlement is in the public interest, the companies noted that, for Penelec, the settlement clarified and confirmed Penelec's DSIC and current practice that only customers served on Rate Schedules GP and LP at voltages over 46 kV are excluded from the application of Penelec's DSIC. For Penn Power, the settlement clarified and confirmed that Penn Power's DSIC and current practice that only customers served on Rate Schedules GT and GDS at voltages over 69 kV are excluded from application of Penn Power's DSIC. For West Penn, the settlement provides that the DSIC does not apply to Rate Schedules 44 and 46 and WPPII cannot challenge the application of the DSIC to the category of customers it proposed to exclude from DSIC unless and until DSIC exceeds $750 per month for a customer that is part of WPPII. Finally, for Met-Ed, the parties noted that the settlement provides that the DSIC will not apply to customers served on Met-Ed Rate TP that receive service at Transmission Voltage.

More generally, the companies noted that the settlement is in the public interest because it provides that modifications to the existing DSIC will not begin to apply until the companies become eligible to charge the DSIC again after it is reduced to zero at the conclusion of their base rate cases. The companies also noted their agreement to meet with the large users groups to develop a process to provide, for each year of the remaining term of the current LTIIPs, annual estimates of the impact of the DSIC on the large user groups' members. Finally, the companies also argued that the settlement is in the public interest because substantial litigation and associated costs would be avoided and the settlement is consistent with Commission policy that promotes settlement.

2. The OCA

In its statement in support, the OCA argued that the settlement is in the public interest and should be approved without modification because paragraph 20 of the settlement, regarding inclusion of rider revenues in the DSIC calculation, specifies that only revenues derived from distribution service will be included in the DSIC calculation. The OCA noted that the companies' original filings did not specify which riders were proposed to be included and excluded for purposes of calculating the DSIC.

The OCA further stated that the settlement is in the public interest because paragraphs 21-26, regarding application of DSIC to all customers, address the OCA's concern that Met-Ed's Rate Schedule TP was in the public interest and consistent with Act 11 and prior Commission orders by revising the DSIC rider to limit exclusion from the DSIC to customers on rate TP served at Transmission Voltage. Similarly, the OCA noted that these paragraphs provide clarification and confirmation of Penelec Rate Schedule GP and LP and Penn Power Rate Schedules GT and GSDS that only those customers served at transmission-level voltages or deemed to be transmission-level customers will be excluded from application of the DSIC. For West Penn, the OCA provided that these paragraphs clarify that West Penn will apply the DSIC to all Rate Schedule 40 customers receiving transmission-level service at 100kV or greater. The OCA further stated that these clarifications and revisions to the companies' tariffs will help ensure that all customers served by eligible categories of distribution facilities contribute to the

improvement of those facilities by paying the DSIC. The OCA also added that the settlement is in the public interest because it requires the companies to implement modifications to the existing DSIC charge at the same time they become eligible to begin charging a DSIC rate at the conclusion of the base rate proceedings.

Finally, the OCA recognizes that the settlement is in the public interest because it allows the effect of the new statute on the companies' calculation of the DSIC rate to be addressed in the then-pending rate proceedings or be consolidated with these DSIC dockets.

3. The OSBA

In its statement in support, the OSBA argued that the settlement is in the public interest and should be approved without modification because paragraph 20 of the settlement excludes revenues when calculating the DSIC percentage associated with the Default Service Support Rider (for all companies), the Non-Utility Generation (NUG) Rider (for Met-Ed and Penelec, the only companies with NUG riders) and the Solar Photovoltaic Rider (for Met-Ed, Penelec and Penn Power, the only companies with Solar Photovoltaic Riders). The OSBA took no position with respect to the other issues identified in the June 9th Orders.

4. The large user groups

In their statement in support, the large users stated that the settlement is in the public interest and should be approved without modification for all the large users because the expenses incurred for completing the proceeding will be less than they would have been if the proceeding had been fully litigated and uncertainties regarding possible appeals are also eliminated. The large users groups also stated that the settlement is in the public interest and should be approved without modification because of the individual benefits to each group of large users.

For example, for WPPII, West Penn's large user group, the settlement is in the public interest because the settlement proposes that, if the DSIC revenues billed to one or more

Rate 40 customers receiving service by a single transformation from a transmission line operating at 100kV or greater through a substation located on the customer's premises or within 2500 feet of the customer's premises exceed $750 per month, WPPII can reopen the issue of application of the DSIC to Rate 40 customers and resume settlement discussions on that issue. Similarly, for MEIUG, Met-Ed's large user group, the settlement is in the public interest because it proposes that the DSIC Rider will be revised to provide that the DSIC will not apply to customers on Rate TP served at Transmission Voltage and, if the DSIC revenues billed to one or more customers on Rate TP receiving voltages other than Transmission Voltage exceed $750 per month, then MEIUG may reopen the issue of the application of the DSIC to such customers and resume settlement discussions on that issue.

For both WPPII and MEIUG, those large users groups reserved the right to reinstate their challenge to this issue at the Commission if those settlement discussions fail. In addition, both WPPII and MEIUG noted that the settlement is in the public interest because any refunds, recoupment or reallocation of customer payment responsibility for the DSIC that result from a Commission decision entered at the conclusion of this process shall be effectively only for charges under the DSIC billed from and after the date of the first quarterly update of the DSIC after such order is entered unless the parties agree otherwise.

For PICA, Penelec's large user group, the large users group stated that the settlement is in the public interest because only those customers served at voltages over 46 kV are excluded from the application of the DSIC and customers taking service under the second paragraph of the Availability/Applicability section of Penelec's partial service rider are excluded from the DSIC because such customers pay an investment charge for the facilities connecting the 115 kV or higher source and their location and are deemed to be Transmission-level customers. For PPUG, Penn Power's large user group, the large users group stated that the settlement is in the public interest because, with regard to Rate Schedules GT and GSDS, Penn Power clarified, confirmed and agreed that only those customers served at voltages over 69 kV are excluded from the application of the DSIC.

Finally, the large users group stated that, for all the companies' large users, the settlement is in the public interest because the companies agreed to meet annually with the large users groups within 90 days of Commission approval of the settlement to develop a process to provide estimates of the impact of the DSIC on the members of those groups for each year of the remaining term of their current LTIIP.

D. Disposition

Substantial record evidence demonstrates that the settlement submitted by the companies, OCA, OSBA and the large users group is in the public interest and should be adopted in its entirety without modification.

To begin, as noted in the Commission's June 9th Orders, the purpose of this proceeding is to determine 1) whether certain customers taking service at transmission voltage rates should be included under the DSIC, 2) whether other customers should be exempt from the DSIC and 3) if revenues associated with the riders in Penn Power's tariff are properly included as distribution revenues. June 9th Orders at 21. As a general matter, the settlement is in the public interest and should be approved without modification because it addresses each of the issues the Commission directed be addressed in this proceeding. In addressing these issues, the parties determined specifically which rate schedules and customers will be included under the respective DSICs. The settlement is clear and provides sufficient detail so that the concerns raised in the issues the Commission referred to this proceeding have been addressed. In addition, the settlement is also in the public interest and should be approved without modification because it provides parties the opportunity to reopen certain issues regarding the application of the DSIC to certain customers, including providing an opportunity for the parties to resolve any subsequent issues informally and without further Commission involvement, unless the parties cannot resolve the matter informally. This process protects the parties' rights in the future and also increases the chances that subsequent issues will be resolved without the time and expense associated with a formal commission proceeding.

The settlement is also in the public interest and should be approved without modification because it also requires parties to meet within 90 days of a Commission order approving the settlement to develop a process to provide the large user groups with an estimate of the impact of the DSIC on its members for each year of the remaining term of their current LTIIP. This informal exchange of information will reduce the opportunity for further litigation. The parties are commended for encouraging an open and free exchange of information amongst themselves.

Finally, although this portion of the settlement has since become moot, the settlement is also in the public interest because it reserved the rights of the parties to address any issues pertaining to the DSIC that arose from the companies' base rate cases. Those issues were subsequently referred to this proceeding by the Commission's Jan. 19th Order and disposed of above.

As with most settlements, approving the settlement without modification is also in the public interest because doing so will avoid the substantial time and expense involved in further litigation. Settlements lessen the time and expense the parties must expend litigating a case and at the same time conserve administrative hearing resources. Pa. P.U.C., *et al*. v. PECO Energy Co., *et al.*, Docket No. R-2010-2161575 (Recommended Decision issued November 2, 2010) (Opinion and Order entered Dec. 21, 2010). The Commission has indicated that settlement results are often preferable to those achieved at the conclusion of a fully litigated proceeding. 52 Pa.Code § 69.401. Rate cases, for example, are expensive to litigate and the cost of such litigation at a reasonable level is an operating expense recovered in the rates approved by the Commission. This means that a settlement, which allows the parties to avoid the substantial costs of preparing and serving testimony and the cross-examination of witnesses in lengthy hearings, the preparation and service of briefs, reply briefs, exceptions and reply exceptions, together with the briefs and reply briefs necessitated by any appeal of the Commission's decision, yields significant expense savings for the companies' customers.

The parties were able to resolve the issues emanating from the companies' DSIC proceedings without the need for prolonged litigation, including preparing pre-served testimony,

hearings to examine or cross-examine witnesses, preparing main and reply briefs, preparing exceptions and reply exceptions, preparing a Commission Order and any possibility of appeal. Avoiding these expenses serves the interests of all parties involved and the Commission and is, therefore, in the public interest.

Finally, the settlement is also in the public interest and should be approved without modification because it is supported by substantial evidence. As noted above, shortly after submission of the settlement, the parties filed a motion for the admission of testimony and exhibits in support of the settlement. Those testimony and exhibits included, for each of the companies, Direct Testimony of Kevin M. Siedt and Exhibit Nos. 1-5 accompanying that Direct Testimony. In addition, the parties also moved for the admission of answers by the companies to various interrogatories served in this proceeding by the OSBA. The motion was granted on May 12, 2017 formally admitting those documents into the record in support of the settlement. The discovery exchanged in this proceeding, and admitted into the record via stipulation, demonstrates in part that the issues referred to this proceeding by the Commission have been vetted by the parties. All the parties should be commended for such an investigation which resulted in the settlement and which further supports adopting the settlement as being in the public interest.

In conclusion, each of the benefits described above are reasonable and support approving the settlement, which is supported by substantial evidence, without modification as being in the public interest. Each of the issues referred to this proceeding by the Commission have been addressed by the settlement.

V. CONCLUSION

In conclusion, the companies' DSIC must comply with Act 40. Act 40 added Section 1301.1 of the Public Utility Code and requires that the companies' respective DSICs must account for related income tax deductions and credits in the computation of current or deferred income tax expense to reduce rates when an expense or investment is allowed to be included in a public utility's rates for ratemaking purposes. Section 1301.1 became effective in

August, 2016, after the Commission's determination that DSICs did not need to account for such impact on rates, and the Commonwealth Court's affirmation of that decision. The General Assembly, however, subsequently determined that such deductions and credits must be accounted for. Now, the companies must comply with the General Assembly's directive. The Commission's discretion in this area has been removed. The companies' arguments to the contrary are without merit and must be rejected.

This Decision recommends that Commission require the companies to adopt the first method proposed by the OCA in this proceeding that incorporates the impact of the enactment of 1301.1 on the companies' DSIC. This method incorporates the related state income tax deductions and credits in the computation of current or deferred income tax expenses to reduce rates when an expense or investment is allowed to be included in the companies' rates. Again, the companies' arguments for rejecting the OCA's proposed method are without merit.

Finally, this Decision recommends that the settlement of the issues arising from the companies' DSIC proceedings regarding which customers and rate classes will be included in the DSIC should be adopted in its entirety and without modification because it is in the public interest and supported by substantial evidence. The settlement addresses all of the issues referred to this proceeding by the Commission and provides, among other things, for an informal method for the parties to resolve any subsequent disputes that might arise in the future without expending significant additional time and expense.

VI. CONCLUSIONS OF LAW

A. General

1. The Commission has jurisdiction over the parties and subject matter of this proceeding. 66 Pa.C.S. §§ 2801, *et seq.*

2. All decisions of the Commission must be supported by substantial evidence. 2 Pa.C.S. § 704.

3. "Substantial evidence" is such relevant evidence that a reasonable mind might accept as adequate to support a conclusion. More is required than a mere trace of evidence or a suspicion of the existence of a fact sought to be established. Norfolk & Western Ry. Co. v. Pa. Pub. Util. Comm'n, 489 Pa. 109, 413 A.2d 1037 (1980); Erie Resistor Corp. v. Unemployment Comp. Bd. of Review, 194 Pa. Superior 278, 166 A.2d 96 (1961); and Murphy v. Comm., Dept. of Public Welfare, White Haven Center, 85 Pa.Cmwlth 23, 480 A.2d 382 (1984).

B. Contested Issue

4. In any proceeding upon 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); *see also*, Lower Frederick Twp. Pa.P.U.C., 409 A.2d 505, 507 (Pa. Cmwlth 1980).

5. The companies have the burden to demonstrate that their DSICs are just, reasonable and in the public interest. 66 Pa.C.S. §315(a).

6. Act 11 of 2012 permitted certain utilities, including electric distribution companies, to petition the Commission for the implementation of a DSIC. 66 Pa.C.S. § 1353(a).

7. 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).

8. If an expense or investment is not allowed to be included in a public utility's rates, the related income tax deductions and credits, including tax losses of the public utility's parent or affiliated companies, shall not be included in the computation of income tax expense to reduce rates. 66 Pa.C.S. § 1301.1(a).

9. The deferred income taxes used to determine the rate base of a public utility for ratemaking purposes shall be based solely on the tax deductions and credits received by the public utility and shall not include any deductions or credits generated by the expenses or investments of a public utility's parent or any affiliated entity. The income tax expense shall be computed using the applicable statutory income tax rates. 66 Pa.C.S. § 1301.1(a).

10. It is well accepted that "shall" as used in statutes is generally imperative or mandatory and must be given a compulsory meaning as denoting obligation. *See*, Black's Law Dictionary, 6th Ed., West Publishing Co. at 1375.

11. 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. 1 Pa.C.S. § 1921(b).

12. When the words of the statute are not explicit, the intention of the General Assembly may be ascertained by considering, among other matters, including the contemporaneous legislative history. 1 Pa.C.S. § 1921(c)(7); *see also*, Yellow Cab Co. of Pittsburgh v. Pa. P.U.C., 501 A.2d 323 (Pa. Cmwlth 1985).

13. The language of Act 40 requiring inclusion of state income tax deductions in DSIC is clear and unambiguous. OCA S.R.B. at 4-5.

14. The Commission has only the authority granted to it by the General Assembly and the Commission must act within, and cannot exceed, its statutory authority. City of Pittsburgh v. Pa. Pub. Util. Comm'n, 43 A.2d 348 (Pa.Super. Ct. 1945).

15. Section 1301.1(c), which became effective on August 11, 2016, provides that the statute applies "to all cases where the final order is entered after the effective date of this section." 66 Pa.C.S. § 1301.1(c).

16. 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.

17. A party that offers a proposal not included in the original filing bears the burden of proof for such proposal. Pa. Pub. Util. Comm'n v. Metropolitan Edison Co., Docket No. R-00061366 (Opinion and Order entered January 11, 2007); *see also*, Joint Petition of Metropolitan Edison Company and Pennsylvania Electric Company for Approval of their Default Service Programs, Docket Nos. P-2009-2093053 and P-2009-2093054 (Opinion and Order entered Nov. 6, 2009) (where competing proposals are introduced, the sponsoring party must show that the alternative proposal will better service customers).

C. Settled Issues

18. Commission policy promotes settlements. 52 Pa.Code § 5.231.

19. The Commission has indicated that settlement results are often preferable to those achieved at the conclusion of a fully litigated proceeding. 52 Pa.Code § 69.401.

20. The focus of inquiry for determining whether a proposed settlement should be recommended for approval is not a "burden of proof" standard, as is utilized for contested matters; rather, the benchmark for determining the acceptability of a settlement or partial settlement is whether the proposed terms and conditions are in the public interest. Pa. Pub. Util. Comm'n, *et al*. v. City of Lancaster – Bureau of Water, Docket Nos. R-2010-2179103, *et al*., Opinion and Order (entered July 14, 2011); Warner v. GTE North, Inc., Docket No. C-00902815, Opinion and Order (entered April 1, 1996); Pa. Pub. Util. Comm'n. v. CS Water and Sewer Associates, 74 Pa. PUC 767 (1991).

21. The Joint Petition for Settlement of Pending Issues filed in this case on February 2, 2017 is in the public interest and should be adopted in its entirety without modification.

22. The formal Complaints filed by the Office of Consumer Advocate should be dismissed.

VII. ORDER

THEREFORE,

IT IS RECOMMENDED:

1. That the Joint Petition for Settlement of Pending Issues submitted by Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company, West Penn Power Company, the Office of Consumer Advocate, the Office of Small Business Advocate, the Met-Ed Industrial Energy Users Group, the Penelec Industrial Customer Alliance, the Penn Power Users Group and the West Penn Power Industrial Intervenors on February 2, 2017 at Docket Numbers P-2015-2508942, *et al*. is granted and the settlement is approved in its entirety without modification because it is in the public interest and supported by substantial evidence.

2. That the modifications to the Distribution System Improvement Charge for Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company, West Penn Power Company, as set forth in the Joint Petition for Settlement of Pending Issues, will begin to apply when the companies next become eligible to charge the DSIC, recognizing that their DSIC charges were reduced to zero as of January 27, 2017, the effective date of the base rates approved by the Commission in its Final Order in the Companies' 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).

3. That Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company, West Penn Power Company are authorized to file the tariff

supplements attached to the Joint Petition as Exhibits 1-4 to be effective in accordance with the terms of the Settlement and Ordering Paragraph No. 2, above.

4. That within ten (10) days, Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company, West Penn Power Company are directed to make compliance filings, including supporting work papers, 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, consistent with the above discussion.

5. That the complaints filed by 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.

Date: July 26, 2017

/s/
Joel H. Cheskis
Administrative Law Judge