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March 12, 2018

VIA ELECTRONIC FILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

**Re: Tax Cuts and Job Acts – PUBLIC VERSION
Docket No. M-2018-2641242**

Dear Secretary Chiavetta:

Pursuant to the Pennsylvania Public Utility Commission's ("Commission") Secretarial Letter dated March 2, 2018 in the above-referenced proceeding, enclosed herewith for filing is the public version of the Comments of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company. The Non-Public version is being submitted under separate cover via United Parcel Service. The comments were filed improperly on March 9, 2017 and at Commission request are being re-submitted as a corrective filing.

Please contact me if you have any questions regarding this matter.

Very truly yours,



Tori L. Giesler

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Enclosures

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

RE: TAX CUTS AND JOBS ACT OF 2017 : DOCKET NO. M-2018-2641242

**RESPONSES TO DATA REQUESTS AND COMMENTS OF
METROPOLITAN EDISON COMPANY,
PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY
AND WEST PENN POWER COMPANY**

**Submitted Pursuant To
The Pennsylvania Public Utility Commission's
Secretarial Letter Issued February 12, 2018**

I. INTRODUCTION AND RESPONSES TO DATA REQUESTS

On February 12, 2018, the Pennsylvania Public Utility Commission (“PUC” or the “Commission”) issued a Secretarial Letter at the above-referenced docket to “commence a proceeding by which the Commission shall seek to determine the effects of the TCJA [Tax Cuts and Jobs Act of 2017] on the tax liabilities of Commission-regulated public utilities for 2018 and future years and the feasibility of reflecting such impacts in the rates charged to Pennsylvania utility ratepayers.”

In furtherance of its announced goals, the Commission requested that the utilities identified in Attachment A to the Secretarial Letter: (1) provide verified responses to nine data requests set forth in Attachment B to the Secretarial Letter “in order to calculate, among other things, the net effect on income tax expense and rate base” of changes in the federal tax law made by the TCJA; and (2) complete the “template” spreadsheet captioned “Calculation of State and Federal Income

Taxes” provided as Attachment C to the Secretarial Letter.¹ The Secretarial Letter further requested that responses to its data requests and the completed template be submitted within 25 days of its issuance, or by March 9, 2018.²

As requested by the Secretarial Letter, Metropolitan Edison Company (“Met-Ed”), Pennsylvania Electric Company (“Penelec”), Pennsylvania Power Company (“Penn Power”) and West Penn Power Company (“West Penn”) (individually, a “Company” and, collectively, the “Companies”) are submitting their consolidated responses to the Commission’s data requests, which are attached hereto as Appendix A, and their completed spreadsheet templates, which are attached hereto as Confidential Appendices B through E.

II. THE COMPANIES’ COMMENTS ON THE ISSUES IDENTIFIED IN THE COMMISSION’S SECRETARIAL LETTER

A. Overview

The Secretarial Letter also requested interested parties to submit comments addressing the following three issues:

(1) whether the Commission should adjust current customer rates to reflect the reduced annual state and federal income tax expenses of public utilities due to the tax rate changes in the TCJA; (2) if so, the appropriate negative surcharge or other methodologies that would permit immediate modifications to consumer rates; and (3) whether the surcharge or other methodology should provide that any refunds to customer due to the reduced taxes be effective as of January 1, 2018.³

¹ Secretarial Letter, p. 2.

² *Id.*

³ *Id.*

The Companies appreciate the opportunity the Commission is providing to address the issues identified above and hereby submit their comments on those issues, as set forth below.

The issues presented in the Secretarial Letter directly implicate two important ratemaking doctrines, namely the prohibitions against “single-issue” and “retroactive” ratemaking. Issues (1) and (2) ask, in effect, whether the Commission should change the Companies’ base rates, outside of a base rate case, to reflect a change in a single element (federal income tax) of their overall revenue requirement and if so, what methodology would allow for immediate modifications to rates. In a similar vein, issue (3) asks whether the Commission should require the Companies to “refund” a portion of the revenues they collected since January 1, 2018 pursuant to Commission-made rates previously judged to be “just and reasonable” based on a retroactive recalculation of a single element of revenue requirement (federal income taxes) recovered in those rates. The answer in each instance is a definitive “no,” as mandated by prohibitions against single-issue and retroactive ratemaking that are deeply engrained in Pennsylvania law. If the Companies’ base rates are to be adjusted, any rate change can only be effective *prospectively*.⁴ Moreover, such a prospective rate change could lawfully be implemented only pursuant to a Commission determination, made “after reasonable notice and hearing,”⁵ that the new rates are “just and reasonable” considering *all* the elements comprising the Companies’ revenue requirement – not just an “isolated item of revenue or expense,” such as tax expense.⁶ If these fundamental principles

⁴ *Cheltenham & Abington Sewerage Co. v. Pa. P.U.C.*, 25 A.2d 334, 337 (Pa. 1942) (“[A] commission-made rate furnishes the applicable law for the utility and its customers until a change is made by the commission.”); *West Penn Power Co. v. Pa. P.U.C.*, 100 A.2d 110, 114 (Pa. Super. 1953) (The Commission “could not give retroactive effect” to a rate determination and “direct refunds to consumers” for charges billed pursuant to “previously approved” rates.).

⁵ 66 Pa.C.S. § 1309(a). *See also* 1 Pa.C.S. § 504.

⁶ *See Phila. Elec. Co. v. Pa. P.U.C.*, 502 A.2d 722, 727-728 (Pa. Cmwlth. 1985) (The “general rule” under Pennsylvania law is that “there may be no line by line examination” of “particular items of expense

are observed, then a properly adjudicated rate change should, under the current circumstances, be implemented by a rider establishing a rate credit expressed as a percentage reduction to the Companies' existing base rates. In connection with the approval and establishment of a rider that conforms to the legal requirements discussed in these Comments, the Companies are willing to make certain additional commitments as set forth in more detail in Section II.D., *infra*.

B. Any Change In The Companies' Rates Can Only Be Effective Prospectively – The Commission Is Barred From Ordering “Refunds” of Amounts Billed Under Commission-Made Rates

The Companies' current base rates were established in a consolidated base rate proceeding that concluded with a final order of the Commission entered January 19, 2017⁷ approving those rates for service rendered on and after January 27, 2017. Accordingly, those rates are “Commission-made” rates.⁸

In the seminal case of *Cheltenham & Abington Sewerage Co. v. Pa. P.U.C.*, *supra*, the Pennsylvania Supreme Court held that “a commission-made rate furnishes the applicable law for the utility and its customers until a change is made by the commission.”⁹ In that case, the Court reversed the decisions of the Superior Court and the Commission that would have required the utility to refund amounts collected pursuant to a final order establishing Commission-made rates

or revenue,” and variations in “an isolated item of revenue or expense” may not “without more” support “a Commission order of refund or recovery.”).

⁷ *Pa. P.U.C. v. Metropolitan Edison Co.*, Docket No. R-2016-2537349 *et al*; *Pa. P.U.C. v. Pennsylvania Elec. Co.*, Docket No. R-2016-2537352 *et al*; *Pa. P.U.C. v. Pennsylvania Power Co.*, Docket No. R-2016-2537355 *et al*; *Pa. P.U.C. v. West Penn Power Co.*, Docket No. R-2016-2537359 *et al*.

⁸ The Commission's final order approved and adopted a settlement of all issues pertaining to the Companies' base rates. As this Commission has previously held, pursuant to well-established appellate precedent, rates established by Commission approval of a rate case settlement are Commission-made rates. *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611 (Final Implementation Order entered Aug. 2, 2012), p. 37 (“The rates that are approved in a Commission order relative to the settlement are rates with the same force and effect as if every element of the proceeding had been contested through the briefing and exceptions stage and are, therefore, just and reasonable.”).

⁹ 25 A.2d at 337.

based on a subsequent order purporting to find, retroactively, that those rates were unjust and unreasonable. The Pennsylvania Supreme Court provided the following prescription, which has been consistently reaffirmed:

Rates having in other respects the attributes of commission-made rates do not lose their effect as such by an indefinite expression of opinion that some of the factors on which they are based are variable and may not stand a pragmatic test, a situation which is always implied. To sustain the position of the Superior Court would be to give a retroactive effect to the order of August 30, 1935, without notice to the utility. The mere institution of an inquiry did not constitute notice that a departure would be made from the tariff established by the commission in its quasi-legislative capacity.¹⁰

The principle established in *Cheltenham & Abington Sewerage Co.* was subsequently applied in *West Penn Power Co. v. Pa. P.U.C.*, *supra*, where the Pennsylvania Superior Court articulated further the dimensions of the prohibition against giving retroactive effect to Commission orders determining just and reasonable rates:

Finally, the Commission, having approved the rates under tariff No. 30, could not summarily reverse its order of approval and apply such reversal retroactively by ordering refunds for the period between October 29, 1951 [the effective date of the October 26, 1951 order finding West Penn's rates just and reasonable], and April 14, 1953 [the date of an order denying rehearing of a February 16, 1953 order directing refunds of amounts billed under the approved rates back to October 29, 1951]. The order of October 26, 1951, amounted in law to formal Commission approval of the new rates filed by the Company under tariff No. 30, and rendered the rates in effect Commission-made rates. Consequently, *after it had previously approved the rates, the Commission could not give retroactive effect to its order of February 16, 1953, and direct refunds to customers for charges made beginning October 29, 1951.*¹¹

¹⁰ 25 A.2d at 338-339.

¹¹ 100 A.2d at 114 (emphasis added).

The Superior Court stated further that “the Commission had no authority without notice and a hearing to reverse such action [its determination of just and reasonable rates in its October 26, 1951 order] and enter the order of February 16, 1953.”¹² The Court then noted that the Commission “is of course free to take prospective action on the reasonableness of the Company’s rates now being charged and collected under tariff No. 30.”¹³ In short, a utility is legally entitled to charge Commission-made rates free from the possibility of subsequent refunds of amounts recovered under those rates until the Commission, after reasonable notice and hearing, determines that such rates are no longer just and reasonable and establishes new rates, which can only be effective prospectively.

The full weight of Pennsylvania law embodied in the well-established prohibition against retroactive ratemaking bars the Commission from ordering utilities “by surcharge or other methodology” to provide “refunds to customers due to these [TCJA] reduced taxes . . . effective as of January 1, 2018.” Any adjustment to the Companies’ rates can only be made prospectively and, even then, only after providing “reasonable notice and hearing.”¹⁴ Furthermore, the Commission’s Secretarial Letter does not satisfy any of the criteria for effecting a lawful prospective change in the Companies’ rates. Not only was the Secretarial Letter issued without providing an opportunity for a hearing, it is the same kind of “indefinite expression of opinion”

¹² *Id.*

¹³ *Id.*

¹⁴ The requirement for “reasonable notice and hearing” is also set forth in Section 1309 of the Public Utility Code, as discussed in Section II.C., *infra*.

that the Pennsylvania Supreme Court held, in *Cheltenham & Abington Sewerage Co.*, could not lawfully demarcate the point after which a utility's rates would be subject to refund.¹⁵

C. A Prospective Change In The Companies' Base Rates Can Only Be Made After Notice And A Hearing In Which All Of The Elements Comprising The Companies' Revenue Requirement Are Properly Considered

Because the Companies' current base rates are "Commission-made" rates, the Commission cannot reduce those rates without: (1) providing the Companies reasonable notice and a hearing (an opportunity to make an evidentiary record to provide "substantial evidence" to support Commission findings); and (2) properly considering all of the elements that collectively represent the Companies' revenue requirement in order to determine rates that are "just and reasonable" to customers and the utility.¹⁶ Neither of those requirements has been satisfied at this time, and the Commission cannot lawfully reduce the Companies rates without doing so. The legal basis for each requirement is discussed below.

As the Superior Court found and determined in *West Penn Power Co.*, refunds of amounts recovered under Commission-made rates are legally barred, and prospective reductions in Commission-made rates cannot lawfully be made without providing the affected utility notice and an opportunity for a hearing:

[U]nder rudimentary principles of due process and fair play the Commission cannot subsequently reverse a previous order *without*

¹⁵ 25 A.2d at 338 (Commission-made rates "do not lose their effect as such by an indefinite expression of opinion that some of the factors on which they are based are variable and may not stand a pragmatic test.").

¹⁶ 66 Pa.C.S. § 1301. See *Pennsylvania Gas and Water Co. v. Pennsylvania Pub. Util. Comm'n*, 341 A.2d 239 (Pa. Cmwlth. 1975) (A public utility is entitled to an opportunity to earn a fair rate of return on the value of the property dedicated to public service determined pursuant to criteria set forth in the landmark cases of *Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923) and *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).).

giving notice to a utility and an opportunity to be heard. While the Commission has power to rescind or amend any order made by it [citations omitted], the exercise of such function cannot violate fundamental principles of fairness or constitutional guarantees [citations omitted].

* * *

It is our conclusion that the action of the Commission on October 26, 1951 [determining the utility's rates to be just and reasonable], constituted a conclusive affirmative order stated in terms of administrative finality, and that the Commission had no authority *without notice and a hearing* to reverse such action and enter the order of February 16, 1953, from which the Company appealed.¹⁷

The legal necessity of providing an affected utility a reasonable opportunity for a hearing before its rates are reduced prospectively is derived from fundamental principles of due process set out in *West Penn Power Co.* In addition, those principles are now firmly embedded in the Public Utility Code, where Section 1309¹⁸ provides as follows:

Whenever the commission, *after reasonable notice and hearing*, upon its own motion or upon complaint, finds that the existing rates of any public utility for any service are unjust, unreasonable, or in anywise in violation of any provision of law, the commission shall determine the just and reasonable rates . . . to be thereafter observed and in force, and shall fix the same by order to be served upon the public utility, and such rates shall constitute the legal rates of the public utility until changed as provided in this part.

To reiterate, the Companies' existing base rates are Commission-made rates and, as such, cannot be reduced unless the Companies are provided the opportunity for a hearing as required by Section 1309 and binding Pennsylvania appellate court precedent. Indeed, the Commission, as an

¹⁷ 100 A.2d at 114 (emphasis added).

¹⁸ 66 Pa.C.S. § 1309 (emphasis added). Section 1309 reflects the legislative mandate imposed on all Pennsylvania agencies by 1 Pa.C.S. § 504 ("No adjudication of a Commonwealth agency shall be valid as to any party unless he shall have been afforded reasonable notice of a hearing and an opportunity to be heard.").

administrative agency, cannot lawfully make the findings necessary to determine “just and reasonable” rates except on the basis of a record that contains substantial evidence to support those findings.¹⁹

It is not enough that the Commission provide the Companies a hearing if, in so doing, it restricts the scope of review to a single issue, such as a change in tax expense. The Companies should be permitted to present evidence on other relevant factors that may adversely affect their opportunity to earn a fair return on their property used and useful in providing public utility service.²⁰ Indeed, the changes in federal income tax law made by the TCJA are not an unalloyed benefit for regulated utilities and, in fact, may adversely affect utilities’ financial metrics and cost of capital, as Moody’s Investors Services recognized in its Rating Action report issued on January 19, 2018²¹:

Tax reform is credit negative for US regulated utilities because the lower 21% statutory tax rate reduces cash collected from customers, while the loss of bonus depreciation reduces tax deferrals, all else being equal. Moody’s calculates that the recent changes in tax laws will dilute a utility’s ratio of cash flow before changes in working capital to debt by approximately 150-250 basis points on average, depending to some degree on the size of the company’s capital expenditure programs. From a leverage perspective, Moody’s estimates that debt to total capitalization ratios will increase, based on the lower value of deferred tax liabilities.

Single-issue ratemaking occurs “when only one element of the general ratemaking equation is examined between rate cases and the customers’ rates are adjusted to reflect only a change in

¹⁹ See, e.g., *Pa. P.U.C. v. Laurel Pipe Line Co.*, 370 A.2d 1251 (Pa. Cmwlth. 1977) (In a rate proceeding, a sufficient record must be made to support the Commission’s findings.).

²⁰ See *Pennsylvania Gas and Water Co. v. Pennsylvania Pub. Util. Comm’n*, *supra*.

²¹ www.moodys.com/research/Moodys-changes-outlooks-on-25-US-regulated-utilities.

that element.”²² As the Commonwealth Court has previously held, “[s]ingle-issue ratemaking is similar to retroactive ratemaking and, in general, is prohibited if it impacts on a matter that is normally considered in a base rate case.”²³ As the Commonwealth Court also held, prohibited single-issue ratemaking occurs when there is a “line by line examination” of “particular items of expense or revenue” and a utility’s rates are adjusted based on an “isolated item of revenue or expense . . . without more.”²⁴ Attempting to adjust the Companies’ base rates to reflect only those changes related to the TCJA’s reduction in the federal corporate income tax rate directly impacts matters that are “normally considered in a base rate case” and, therefore, is squarely within the definition of prohibited “single-issue ratemaking.”

In summary, any change in the Companies’ rates can only be made prospectively after first providing the Companies an opportunity for a fair hearing that satisfies the criteria discussed above. The Commission cannot avoid this legal requirement regardless of the specific rate adjustment mechanism it might select to reduce utilities’ rates.

D. Any Adjustment To The Companies’ Rates Should Be Implemented By A Rider Establishing A Rate Credit Expressed As A Percentage Reduction To Their Existing Base Rates

The fundamental requirements that must be observed before any change in the Companies’ rates may be undertaken have been explained above. The Companies recognize that the circumstances triggering a review of their base rates at this time (i.e., changes in the federal

²² *Petition of UGI Utilities, Inc. Elec. Div. For Approval Of Its Energy Efficiency And Conservation Plan*, Docket No M-2010-2210316 (Rec. Dec. issued July 13, 2011) 2011 Pa. PUC LEXIS 1690, *28.

²³ *Pennsylvania Indus. Energy Coalition v. Pa. P.U.C.*, 653 A.2d 1336, 1350 (1994). In that case, the Commonwealth Court determined that a Section 1307 adjustment clause established to recognize the costs of implementing demand-side management (“DSM”) programs provided for the recovery of costs that were not considered in a base rate case because they were an entirely new category of costs being incurred for the first time in furtherance of newly-mandated DSM measures.

²⁴ *Phila. Elec. Co. v. Pa. P.U.C.*, *supra*, at 422.

corporate income tax rate) may bear on how an adjustment to their rates should be implemented. Considering such relevant factors as the cost and administrative burdens of different approaches, avoiding customer confusion, and maintaining the class revenue-to-revenue requirement relationship reflected in existing base rates, a properly adjudicated prospective rate change that adheres to the principles articulated above should, under the current circumstances, be implemented by approving a rider establishing a rate credit expressed as a percentage reduction to the Companies' existing base rates.

The Companies would file tariff riders to become effective ninety days after the Commission enters a final order approving the approach proposed by the Companies in these Comments. The Companies would use the intervening ninety-day period to quantify changes in the Companies' revenue requirements related to the effects of the TCJA and any material offsetting adjustments, to develop the terms of the tariff riders, and to calculate the rate adjustments thereunder in conformity with the terms of the riders set forth above. In addition, the Companies would be willing to commit: (1) to track the tax benefits derived from the TCJA from its effective date (January 1, 2018) to the date their rider-based rate adjustments become effective (the "Tracking Period"); and (2) within sixty days after the end of the Tracking Period, to file modifications to their respective Long-Term Infrastructure Improvement Plans ("LTIIP") to increase their expenditures for reliability-related infrastructure improvements in amounts equal to the tax benefits calculated for the Tracking Period. Such increases would constitute "eligible property" under Sections 1350, 1353 and 1357 of the Public Utility Code²⁵ and could be included in rate base in subsequent base rate cases. In this way, customers would directly benefit by

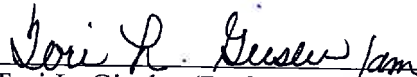
²⁵ 66 Pa.C.S. §§ 1350, 1353 and 1357.

targeting the tax effects of the TCJA for the Tracking Period to increased investment in plant and equipment that will enhance the reliability and resiliency of the Companies' distribution systems.

III. CONCLUSION

The Companies appreciate the opportunity the Commission has provided to offer these Comments on the issues identified in its February 12, 2018 Secretarial Letter and look forward to working with the Commission and interested stakeholders to achieve an appropriate result that respects the fundamental legal requirements discussed above and implements the Companies' proposal set forth in Section II.D. *supra*.

Respectfully submitted,



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Dated: March 9, 2018

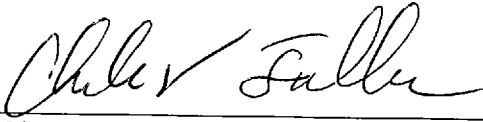
**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

RE: TAX CUTS AND JOBS ACT : DOCKET NO. M-2018-2641242
OF 2017 :

VERIFICATION

I, Charles V. Fullum, hereby state that the facts above set forth are true and correct to the best of my knowledge, information and belief, and that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa.C.S. § 4904 (relating to unsworn falsification to authorities).

Date: 3/8/2018



Charles V. Fullum
Director, Rates & Regulatory Affairs

**METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY, WEST PENN POWER COMPANY
TAX CUTS AND JOBS ACT (TCJA)
Docket No. M-2018-2641242**

TCJA Set I, No. 1

“How does the reduction in the corporate Federal Income Tax rate from 35% to 21% affect your federal tax obligations for calendar year 2018 and subsequent tax years? Please quantify your response as to the effect on both current and deferred tax obligations.”

RESPONSE:

Two key provisions of the TCJA will materially affect the Companies' federal income tax liability in 2018 and subsequent tax years. The change in the federal corporate income tax rate from 35% to 21% would, all other things being equal, have the effect of reducing the Companies' tax liabilities. However, the elimination of bonus depreciation for 2018 (and subsequent years) will increase the Companies' federal taxable income by deferring depreciation deductions from the year new plant and equipment is placed in service and the next approximately two years (under the 40% and 30% bonus depreciation that otherwise would have been in effect in 2018 and 2019, respectively) to later years in the tax lives of such property and equipment. Thus, the reduction in income tax liability related to the change in the tax rate will be offset in part by an increase in taxable income.

See CONFIDENTIAL Appendices B through E to the Companies' Comments dated March 9, 2018 for the quantification of the impact of the TCJA on each of the Companies.

**METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY, WEST PENN POWER COMPANY
TAX CUTS AND JOBS ACT (TCJA)
Docket No. M-2018-2641242**

TCJA Set I, No. 2

“If a reduced tax obligation is passed through to ratepayers, explain the methodology to be used to compute the reduction, the rate mechanism to accomplish the reduction, and the allocation among customer classes.”

RESPONSE:

For the reasons set forth in Section II.B. of the Companies’ Comments dated March 9, 2018 addressing the issues the Commission identified in the February 12, 2018 Secretarial Letter (p. 2), any adjustment to the Companies’ rates to reflect changes in their federal income tax expense for 2018 resulting from tax law changes made by the TCJA should be effective on a prospective basis only (refer to TCJA Set I No. 3 for the Companies’ proposal for the tracking period). As explained in Section II.D. of the Companies’ Comments, the Companies would agree to institute tariff rider establishing rate credits, expressed as a percentage, to become effective on a going-forward basis ninety days following the issuance of a final Commission order approving the approach proposed by the Companies herein. The Companies would use the ninety days following the entry of the Commission’s order to develop and file tariff riders conforming to the terms proposed by the Companies. The Companies propose that the reduction in income tax expense be allocated among major customer classes in the same proportion as the distribution base rate revenue was allocated in developing the settlement rates in the Companies’ last base rate cases. This can be accomplished through a rate design that utilizes a percentage of base distribution revenue surcharge or credit.

**METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY, WEST PENN POWER COMPANY
TAX CUTS AND JOBS ACT (TCJA)
Docket No. M-2018-2641242**

TCJA Set I, No. 3

“If any of the potential tax savings from the reduced federal corporate tax rate can be used for purposes other than to reduce customer rates, provide details on how and where those tax savings can be used.”

RESPONSE:

Refer to the Companies’ response to Data Request No. 2, which addresses the mechanism they recommend employing to adjust their rates on a prospective basis (as required by applicable Pennsylvania law, as explained in Section II.B. of their Comments filed on March 9, 2018 at this docket) to reflect changes in federal income tax expense resulting from the tax law changes made by the TCJA. If the approach described above and in Section II.D. of their Comments is approved by the Commission, the Companies would also commit to modify their existing Long Term Infrastructure Improvement Plans (“LTIIPs”) to increase their LTIIP expenditures by the amount of the reduction in federal income tax expense that will have accrued between January 1, 2018 (the effective date of the TCJA) and the date that their proposed tariff riders become effective. As also explained in Section II.D. of their Comments, the amounts thus added to their LTIIPs would constitute “eligible property” for purposes of their distribution system improvement charges and would be included in their rate base in future electric distribution base rate cases. Under the Companies’ recommended approach, the tax expense reduction accruing between January 1, 2018 and the effective date of their tariff riders would directly benefit customers by increasing and accelerating the Companies’ investments in property to enhance to reliability and resiliency of their distribution systems.

**METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY, WEST PENN POWER COMPANY
TAX CUTS AND JOBS ACT (TCJA)
Docket No. M-2018-2641242**

TCJA Set I, No. 4

“Does the company have any Net Operating Losses (NOL) as of 12/31/17? Please quantify the impact of the Tax Cuts and Jobs Act (TCJA).”

RESPONSE:

Yes, the Companies had NOLs recorded on their books of account as of December 31, 2017. Because NOLs carryforwards represent taxable losses that are not used to reduce federal income tax liability in a given year (because there is not sufficient taxable income against which such NOLs can be off-set), the tax-affected NOLs (NOLs multiplied by the applicable tax rate) constitute deferred tax assets. Such deferred tax assets are properly deducted from accumulated deferred income taxes related to tax-timing differences from liberalized depreciation (“ADIT”) because deferred tax assets represent the portion the ADIT recorded on the Companies’ books that has not yet been monetized (i.e., not used as deductions to reduce income taxes payable). The reduction in the federal income tax rate from 35% to 21% under the TCJA reduces the deferred tax assets derived from the NOLs on the Companies’ books, and the amount of the reduction is quantified below for each Company. The Companies intend to reflect the lost value of the NOLs over a prospective ten-year period (and make associated, ratable reductions in their deferred tax assets) as shown in CONFIDENTIAL Appendices B through E to the Companies’ Comments filed on March 9, 2018 at this docket.

Met-Ed had NOLs as of December 31, 2017, and, as a result of the TCJA, Deferred Tax Assets relating to such NOLs were reduced by \$3,699,478.

Penelec had NOLs as of December 31, 2017, and, as a result of the TCJA, Deferred Tax Assets relating to such NOLs were reduced by \$15,744,996.

Penn Power had NOLs as of December 31, 2017, and, as a result of the TCJA, Deferred Tax Assets relating to such NOLs were reduced by \$245,023.

West Penn had NOLs as of December 31, 2017, and, as a result of the TCJA, Deferred Tax Assets relating to such NOLs were reduced by \$7,477,887.

**METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY, WEST PENN POWER COMPANY
TAX CUTS AND JOBS ACT (TCJA)
Docket No. M-2018-2641242**

TCJA Set I, No. 5

“Does the company have any Deferred Tax Liabilities as of 12/31/17? Please quantify the impact of the Tax Cuts and Jobs Act (TCJA).”

RESPONSE:

Under Accounting Standards Codification (ASC) 740 -- Income Taxes, in order to comply with generally accepted accounting principles, the Companies are required to recognize the effect of tax law changes during the accounting period when such changes are enacted, which, for the TCJA, is calendar year 2017. Thus, the Companies were required to make appropriate entries and disclosures reflecting the tax law change in their 2017 year-end financial statements. More specifically, deferred tax assets and liabilities were remeasured at the lower tax rate and reflected in the quarter ended December 31, 2017. As required by ASC 740, existing deferred income taxes are to be adjusted for changes in tax rates and allocated to tax expense. However, if it is probable that the effect of the change in income tax rates will be recovered or refunded in future regulated rates, a regulated utility should record a regulatory asset or liability as opposed to an increase or decrease to deferred tax expense.

The impact of the TCJA to Met-Ed was recorded as follows:

DR. 190/282/283 Deferred Tax Liability \$148,835,595
DR. 410/411 Deferred Tax Expense \$28,771,315
CR. 254 Regulatory Liability \$177,606,910

The impact of the TCJA to Penelec was recorded as follows:

DR. 190/282/283 Deferred Tax Liability \$162,063,951
DR. 410/411 Deferred Tax Expense \$44,340,098
CR. 254 Regulatory Liability \$206,404,049

The impact of the TCJA to Penn Power was recorded as follows:

DR. 190/282/283 Deferred Tax Liability \$49,730,835
DR. 410/411 Deferred Tax Expense \$4,869,103
CR. 254 Regulatory Liability \$54,599,938

The impact of the TCJA to West Penn was recorded as follows:

DR. 190/282/2/83 Deferred Tax Liability	\$145,716,126
DR. 410/411 Deferred Tax Expense	\$4,149,996
CR. 254 Regulatory Liability	\$149,866,122

**METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY, WEST PENN POWER COMPANY
TAX CUTS AND JOBS ACT (TCJA)
Docket No. M-2018-2641242**

TCJA Set I, No. 6

“Are there any impacts on riders/surcharges resultant from the TCJA? If so, please explain.”

RESPONSE:

Yes. The TCJA affects the Companies’ existing riders in two ways. First, the pretax return on eligible property that is recoverable under the Companies’ respective Distribution System Improvement Charge (“DSIC”) and Smart Meter Technology Charge (“SMT”) Riders would have to be calculated based on a 21% federal corporate income tax rate after January 1, 2018. However, currently, both the DSIC and SMT Riders of all the Companies are set at zero. The DSIC and SMT Riders are the only riders that take federal income taxes into account in calculating charges to customers.

Second, the reduction in the federal income tax rate impacts the Companies’ federal income taxes associated with unbilled revenues and over-collections and under-collections from 2017 under their riders. If an over-collection occurred during 2017, the associated increase in the Companies’ income was reflected as taxable income in 2017 and taxed at 35%. When the over-collection is returned to customers in 2018, the resulting diminution in taxable income produces a corresponding tax benefit calculated at 21%. The resulting difference should be recorded as a regulatory asset and recovered in charges to customers in 2018 with appropriate gross up for taxes. Similarly, if the Companies had under-collections in any rider-related charges for 2017, they received a tax benefit equal to the difference between the 35% and 21% tax rates, which should be recorded as a regulatory liability and returned to customers in charges calculated for 2018. The recovery or refund of the tax effects associated with over or under-collections that existed as of December 31, 2017 require changes in the terms of the riders under which such over or under-collections accrued. Accordingly, the Companies will be filing a petition to modify all of their affected tariff riders to allow for the tax effects of the over or under-collections to be appropriately reflected in charges to customers in 2018.

**METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY, WEST PENN POWER COMPANY
TAX CUTS AND JOBS ACT (TCJA)
Docket No. M-2018-2641242**

TCJA Set I, No. 7

“Are there any other changes made in the TCJA that will impact the company? If so, please explain.”

RESPONSE:

The two most material changes made by the TCJA, which were discussed previously, consist of the following:

- A reduction of the federal corporate income tax rate from 35% to 21%.
- The elimination of bonus depreciation on qualified property acquired and placed into service after September 27, 2017. Under prior law, the Companies would have been eligible for 40% bonus depreciation in 2018 and 30% bonus depreciation in 2019. As a result, the Companies’ taxable income will increase under the TCJA and their deferred taxes will decrease.

The TCJA also made the following changes, the impact of which (if any) on the Companies is also indicated below:

- Business interest payments: Business interest deductions are limited to 30% of taxable earnings before interest, taxes, depreciation and amortization. However, regulated utilities are not subject to this limitation, and, therefore, this limitation has no impact on the Companies.
- Corporate Alternative Minimum Tax (“AMT”): The corporate AMT is being phased out for tax years beginning after December 31, 2017. For tax years beginning in 2018 through 2020, the limitation on utilization of the AMT credit is increased by 50%, and AMT credit carryforward becomes a refundable credit. For tax years beginning in 2021, the limitation on the utilization of the AMT credit is increased to 100% (i.e., eliminating the effect of the AMT). AMT is non-jurisdictional and will not impact the Companies.
- Section 162(m) deduction for certain executive compensation: The TCJA repealed the performance-based compensation and expands Commission exceptions to the section 162(m) \$1 million deduction limitation to include chief financial officer compensation. Historically, the Companies have not proposed any adjustment to deductions for certain executive compensation – meaning that the amount of executive compensation reflected in rates as an expense has been reflected as an allowable expense in the calculation of current federal income

taxes. Given that historical regulatory treatment, the Companies would see no current impact to this change on ratemaking.

- Entertainment expenses: Eliminates deductions for business-related entertainment (such as tickets to sporting events, golf outings, etc.), which were previously deductible at 50%. To the extent the underlying expenses have been excluded from ratemaking historically, the same expenses have been excluded from the calculation of taxes for ratemaking. Therefore, logically this would have no current impact on ratemaking.

**METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY, WEST PENN POWER COMPANY
TAX CUTS AND JOBS ACT (TCJA)
Docket No. M-2018-2641242**

TCJA Set I, No. 8

“What test year should be used to quantify the new the 21% federal corporate tax rate to be effective 1/1/18?”

RESPONSE:

The Companies recommend using a 2018 test year to calculate the effects of the 21% federal corporate tax rate because the 21% tax rate, elimination of bonus depreciation and other tax law changes made by the TCJA became effective on January 1, 2018.

Because the TCJA was not effective until January 1, 2018, restating rate case data from the Companies' last base rate cases (which employed a fully projected future test year ended December 31, 2017, and was the result of a black box settlement) would not accurately depict the effects of the tax law changes on the Companies in 2018 and beyond. Also, recalculating taxes at a federal income tax rate different from the one in effect in 2017 after the financial statements for that year have been finalized would not provide accurate results. For example, the TCJA eliminated bonus depreciation on property placed in service in 2018. Consequently, calculating the effect of eliminating bonus depreciation based on plant additions for a period prior to 2018 is not a realistic scenario for depicting the prospective effects of the TCJA for 2018 and subsequent years.

**METROPOLITAN EDISON COMPANY, PENNSYLVANIA ELECTRIC COMPANY,
PENNSYLVANIA POWER COMPANY, WEST PENN POWER COMPANY
TAX CUTS AND JOBS ACT (TCJA)
Docket No. M-2018-2641242**

TCJA Set I, No. 9

“Please provide the following information regarding your last Commission approved rate case:

- a. Docket Number
- b. Date filed
- c. Approved Rate of Return
- d. Approved Increase in Annual Revenues
- e. Allocation of Approved Increase Among Major Customer Classes
- f. Effective Date of new rates”

RESPONSE:

- a. Metropolitan Edison Company: Docket No. R-2016-2537349
Pennsylvania Electric Company: Docket No. R-2016-2537352
Pennsylvania Power Company: Docket No. R-2016-2537355
West Penn Power Company: Docket No. R-2016-2537359
- b. All four Companies filed their distribution base rate cases on April 28, 2016.
- c. A rate of return was not determined because the Companies’ rate cases were resolved by black box settlements.
- d. Metropolitan Edison Company’s approved increase in annual base rate operating revenues was \$90.5 million.
Pennsylvania Electric Company’s approved increase in annual base rate operating revenues was \$94.6 million.
Pennsylvania Power Company’s approved increase in annual base rate operating revenues was \$27.5 million.
West Penn Power Company’s approved increase in annual base rate operating revenues was \$60.6 million.
- e. Allocation of approved increase among major customer classes from the last distribution rate cases are as follows:

Met-Ed		
RS	\$ 64,207,383	71.10%
GSV	\$ 136,383	0.15%
GSS	\$ 4,922,970	5.45%
GSM	\$ 8,086,832	8.96%
MS	\$ 16,893	0.02%
OL	\$ 212,371	0.24%
BORD	\$ 11,970	0.01%
GSL	\$ 3,059,784	3.39%
GP	\$ 7,151,996	7.92%
TP	\$ 1,089,341	1.21%
Rider L	\$ 6,952	0.01%
STLT	\$ <u>1,396,928</u>	1.55%
TOTAL	\$ 90,299,803	

Penelec		
RS	\$ 64,333,671	68.18%
GSV	\$ 243,799	0.26%
GSS	\$ 5,530,129	5.86%
GSM	\$ 10,873,184	11.52%
H	\$ 73,016	0.08%
OL	\$ 893,675	0.95%
BORD	\$ 31	0.00%
GSL	\$ 3,777,073	4.00%
GP	\$ 5,706,540	6.05%
LP	\$ 1,083,164	1.15%
Rider L	\$ 33,374	0.04%
STLT	\$ <u>1,817,522</u>	1.93%
TOTAL	\$ 94,365,178	

Penn Power		
RS	\$ 19,085,585	69.61%
GSR	\$ 18,952	0.07%
GS	\$ 1,675,091	6.11%
GM	\$ 3,121,598	11.38%
GS Large	\$ 1,073,530	3.92%
PNP	\$ 12,552	0.05%
OL	\$ 195,575	0.71%
GP	\$ 1,582,456	5.77%
GT	\$ 403,301	1.47%
Rider L	\$ -	0.00%
STLT	\$ <u>250,025</u>	0.91%
TOTAL	\$ 27,418,665	

West Penn		
RS10	\$ 49,678,721	82.13%
GS10	\$ 146,066	0.24%
GS20	\$ 3,159,568	5.22%
GP30	\$ 2,732,072	4.52%
GP35	\$ 847,486	1.40%
OL	\$ 640,088	1.06%
PP40	\$ 1,820,272	3.01%
PP44	\$ -	0.00%
PP46	\$ 481,093	0.80%
PSU	\$ 31,514	0.05%
Rider L	\$ 959	0.00%
STLT	\$ <u>949,596</u>	1.57%
TOTAL	60,487,435	

f. New rates for all four Companies took effect January 27, 2017.

APPENDIX B

CONFIDENTIAL

APPENDIX C

CONFIDENTIAL

APPENDIX D

CONFIDENTIAL

APPENDIX E

CONFIDENTIAL

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

RE: TAX CUTS AND JOBS ACT OF 2017 : DOCKET NO. M-2018-2641242

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true and correct copy of the foregoing document upon the individuals listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).


Service by first class mail, as follows:

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Dated: March 12, 2018



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