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October 25, 2013

VIA HAND DELIVERY

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

Re: Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge - Docket No. P-2012-2338282

Dear Secretary Chiavetta:

On October 24, 2013, the Main Brief of Columbia Gas of Pennsylvania, Inc. was filed in the above-referenced proceeding. However, Appendix "A" was inadvertently omitted from that filing. Therefore, enclosed for filing is the corrected Main Brief which includes Appendix "A."

An electronic copy of Appendix "A" has been provided to the Administrative Law Judges and the parties.

We apologize for the oversight in not including the Appendix with the Brief filed previously.

Copies will be provided as indicated on the Certificate of Service.

Respectfully submitted,

Michael W. Hassell

MWH/jl
Enclosures

cc: Honorable Mark A. Hoyer
Honorable Jeffrey Watson

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge	:	Docket No. P-2012-2338282

MAIN BRIEF OF COLUMBIA GAS OF PENNSYLVANIA, INC.

TO ADMINISTRATIVE LAW JUDGES MARK A. HOYER AND JEFFREY WATSON:

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I. BACKGROUND

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. As relevant to this proceeding, Act 11 authorizes electric distribution companies ("EDCs"), natural gas distribution companies ("NGDCs"), water utilities, wastewater utilities and city natural gas distribution operations to establish a distribution system improvement charge ("DSIC"). Prior to the adoption of Act 11, water utilities charged a DSIC pursuant to Section 1307(g) of the Public Utility Code, which was repealed by Act 11.

Act 11 provides utilities with the ability to implement a 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. Eligible property for natural gas distribution companies is defined in § 1351 of the statute. *See* 66 Pa.C.S. § 1351(2). As a precondition to the initial implementation of a DSIC, each utility must file and obtain approval of a Long-Term Infrastructure Improvement Plan ("LTIIP") that is consistent with the provisions of § 1352 of the statute. *See* 66 Pa.C.S. § 1352(a).

On April 5, 2012, the Commission held a working group meeting for discussion and feedback from stakeholders regarding its implementation of Act 11. The purpose of the meeting was to address certain key implementation issues in advance of the issuance of a Tentative Implementation Order. On May 10, 2012, the Commission issued its Tentative Implementation Order addressing and incorporating input from the stakeholder meeting at Docket No. M-2012-2293611. The Commission solicited comments from interested parties. Comments were filed by many interested parties, including Columbia Gas of Pennsylvania ("Columbia" or "the Company"), the Office of

Consumer Advocate ("OCA"), Pennsylvania State University ("Penn State"), and the Columbia Industrial Intervenors ("CII") on May 31, 2012.

On August 2, 2012, the Commission issued its Final Implementation Order establishing procedures and guidelines necessary to implement Act 11. The Final Implementation Order adopts the requirements established in Act 11, provides additional standards that each utility must meet in developing an LTIIP and DSIC, and gives guidance to utilities for meeting the Commission's standards. The Final Implementation Order also included a model form of DSIC tariff (the "model tariff").

II. PROCEDURAL HISTORY

On December 7, 2012, Columbia filed an LTIIP pursuant to Section 1352 of the Public Utility Code, 66 Pa.C.S. § 1352. On December 27, 2012, CII filed Comments on the LTIIP. On January 3, 2013, the OCA filed Comments on the LTIIP.

On January 2, 2013, pursuant to Section 1353, Columbia filed a Petition for Approval of a DSIC. 66 Pa.C.S. § 1353. As part of the Petition, Columbia included a form of DSIC tariff consistent with the model tariff, along with supporting direct testimony. On January 22, 2013, the OCA filed an Answer, Notice of Intervention and Formal Complaint and Public Statement. Also on January 22, 2013, the Office of Small Business Advocate ("OSBA") filed an Answer and Notice of Intervention, CII filed a Petition to Intervene and an Answer to the DSIC Petition, and Penn State filed a Petition to Intervene.

On January 22, 2013, Columbia filed Reply Comments in response to the OCA's comments to Columbia's LTIIP.

Formal Complaints were filed by G. Thomas Smeltzer on February 1, 2013, and Joan Howard on March 6, 2013.

By Order entered March 14, 2013, the Commission approved Columbia's LTIIP and DSIC. The Commission approved the DSIC subject to refund, pending final resolution of issues raised in the parties' filings and identified in the Commission's Order.[1] In addition, the Commission dismissed the Formal Complaint of G. Thomas Smeltzer.

On March 20, 2013, Columbia filed its compliance filing, as directed by the Commission in its March 14 Order. Also on March 20, 2013, the Bureau of Investigation and Enforcement ("I&E") filed a Notice of Appearance. The Commission's Secretary issued a letter on April 9, 2013, wherein the Commission determined that suspension was no longer appropriate and authorized the tariff to become effective as of April 1, 2013, subject to refund.

A prehearing conference was held on May 21, 2013, where a procedural schedule was established. Pursuant to the procedural schedule, parties filed direct, rebuttal, surrebuttal, and rejoinder testimony. A hearing was held on September 19, 2013. Main Briefs for the parties are due on October 24, 2013 and Reply Briefs are due on November 22, 2013.

III. LEGAL STANDARD

As the petitioner or moving party, Columbia has the burden of proof in this matter. Section 332(a) of the Public Utility Code requires the proponent of a rule or order "to bear the ultimate burden of persuading the Commission, by a preponderance of substantial evidence, that the relief sought is proper and justified under the

[1] The issues identified by the Commission included DSIC recovery of costs for replacement of customer-owned service lines, the impact of accumulated deferred income taxes, the calculation of state income taxes, and Return on Equity. No party submitted testimony to challenge DSIC recovery of costs for replacement of customer-owned service lines. Moreover, no party has challenged the Return on Equity established in the Commission's March 14 Order (9.7%). Thus, of the issues identified by the Commission in its March 14 Order, only ADIT and calculation of state income taxes are at issue.

circumstances." 66 Pa.C.S. § 332(a); *Motheral, Inc. v. Duquesne Light Co.*, 2001 Pa. PUC LEXIS 4 at 9; citing *Se-Ling Hosiery v. Margulies*, 70 A.2d 854 (Pa. 1954). A "preponderance of the evidence" means that one party must present evidence which is more convincing by even the smallest amount, than the evidence presented by an opposing party. *See Se-Ling Hosiery.* Substantial evidence is "relevant evidence that a reasonable mind may 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." *Murphy v. Pa Department of Public Welfare, White Haven Center,* 480 A.2d 382 (Pa. Cmwlth. 1984).

If a petitioner has met its burden by a preponderance of substantial evidence and met its *prima facie* case, the fact finder must then determine whether a respondent has submitted evidence of co-equal value or weight in order to counter or refute the applicant's case. If a respondent has provided co-equal evidence in response to the applicant's case, the burden of proof cannot be deemed to have been satisfied unless the party bearing the burden presents additional evidence causing its position to be supported by a preponderance of the evidence. Thus, with competing evidence, a petitioner must meet its burden of proof by a preponderance of substantial evidence, based on the overall weight of the evidence.

IV. SUMMARY OF ARGUMENT

In this case, the OCA has proposed that Columbia's DSIC should include an adjustment to DSIC-eligible plant for Accumulated Deferred Income Tax ("ADIT"), and should not include a gross-up for state income taxes. These proposals are not supported by Act 11 or record evidence in this proceeding. OCA's proposals to include an ADIT adjustment and to eliminate the state income tax gross-up contradict the plain language

of Act 11. In addition, such proposals are directly contrary to the stated intent of the General Assembly. Legislative history demonstrates that the General Assembly intended that the DSIC provisions in Act 11 continue the prior methodology for calculating water DSICs, which have been in effect for over 16 years. The evidence in this proceeding, uncontested by OCA, is that the Commission has not reflected either of OCA's proposals in its prior implementation of the water DSIC. Further, the legislative history clearly shows that the General Assembly rejected a proposal to amend the water DSIC mechanism to include tax benefits in the DSIC calculation. OCA's proposal does not conform to the General Assembly's intent in their enactment of Act 11.

In addition to being inconsistent with the intent of the General Assembly, OCA's proposal regarding ADIT would not conform to the Commission's Final Implementation Order, and is unnecessary. The Commission's Final Implementation Order instructed that the DSIC was to be a simple mechanism that is easy to audit. Including a deduction for ADIT would complicate the calculation of the DSIC rate. In addition, the earnings cap provides adequate protection for consumers from concerns that ADIT would result in Columbia overearning its allowed return.

OCA's proposal to exclude the state income tax gross-up in the DSIC formula is based upon a position that incremental tax deductions associated with DSIC-eligible plant would eliminate state tax expense. Such position is fundamentally unfair, and would result in a double counting of tax deductions available to Columbia. In order to obtain accurate results, a full state income tax calculation would need to be conducted, which is inconsistent with the intent to have a simple surcharge mechanism. Any concern that available tax deductions would result in Columbia overearning its allowed return is resolved by the earnings cap.

In addition, the OCA and Penn State have proposed modifications to tariff provisions regarding the application of the DSIC to customers with competitive options. Columbia supports Penn State's proposed modification, which clearly identifies that a customer may not be charged the DSIC if the customer has a competitive alternative, whether or not that competitive alternative has physically been constructed, if the customer is receiving discounted rates. OCA disputed the need to distinguish between those customers with installed competitive alternatives and those customers with competitive alternatives not physically installed, and further disputed that these customers should be completely excluded from the DSIC. Columbia's language that separately identifies competitive customers with and without physically installed alternatives is not overly broad. Further, completely excluding such customers from the DSIC is consistent with both the Commission's Final Implementation Order and Columbia's practice with other surcharge mechanisms. The proposed modification by OCA should be rejected, and the revised language set forth in Section V.D. of this brief should be approved.

For the reasons explained in this Main Brief, Columbia requests that the ALJs approve the calculation mechanism for the Company's DSIC as filed, reject the OCA's proposed modifications, and modify the language relating to the treatment of competitive customers as set forth in Section V.D.

V. ARGUMENT

A. ACT 11 SHOULD BE INTERPRETED AND APPLIED TO ALL *UTILITIES IN THE SAME MANNER AS THE WATER DSIC.*

The primary issue in this proceeding concerns OCA's proposals to modify the DSIC calculation to: (1) deduct from the DSIC-eligible property balance an amount for

ADIT and (2) to eliminate from the calculation of pre-tax return any gross-up for state income taxes due to asserted incremental tax deductions on DSIC-eligible plant. As a matter of law, such proposals must be rejected as contrary to the intent of the Pennsylvania General Assembly in enacting Act 11.

The primary objective in statutory interpretation in the Commonwealth of Pennsylvania is to discern the intent of the General Assembly. The Statutory Construction Act of 1972 ("Statutory Construction Act") provides that "the object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly." 1 Pa.C.S. § 1921. As the courts have noted, "it is incumbent that the reviewing court endeavor to ascertain the intent of the Legislature." *Commonwealth v. Cox*, 603 Pa. 223, 283, 983 A.2d 666, 703 (2009). In order to ascertain the intent of the General Assembly, the ruling body should first look at the plain language of the statute. *Commonwealth v. Segida*, 604 Pa. 103, 108, 985 A.2d 871, 874 (2009). When the language of the statute is free from all ambiguity, the letter of the statute is to be followed. 1 Pa.C.S. § 1921(b). However, if the words are not explicit, then intent may be gleaned from the contemporaneous legislative history. 1 Pa.C.S. § 1921(c)(7). Legislative history may include previous drafts of house bills, as well as statements made by legislators during the time of the statute's enactment. *See Commonwealth v. Wilson*, 529 Pa. 268, 602 A.2d 1290 (1992) (Court relied on statements made by legislature during the enactment process and recorded in the Legislative Journal to determine legislative intent). Applying the language of the statute and the legislative history associated with its enactment, the Commission should conclude as a matter of law that the General Assembly intended that the DSIC mechanism previously adopted for water utilities should continue. Based upon the legislative intent, the Commission

should further conclude that OCA's proposed tax modifications to the DSIC formula are contrary to Act 11 and must be rejected.

The plain language of the DSIC provision makes clear the General Assembly intended to adopt the DSIC formula, previously used by water utilities, and to reject the tax modification proposed by OCA. The statute enacted by the General Assembly embraces all of the concepts originally applicable to the water DSIC. As explained by Columbia witness Krajovic, and as is evident by a comparison of the DSIC provisions in Act 11 and the prior water utility model DSIC tariff, Act 11 adopted the water DSIC formula. Columbia St. No. 1-R, p. 3; Columbia Ex. NJDK-R1. For example, provisions related to computation of the DSIC contained in Section 1357 and the customer protection provisions contained in Section 1358 are substantially the same as, and in many cases identical to, the model water DSIC tariff.[2] For 16 years, the water utility DSIC formula did not contain either the ADIT deduction or the state income tax adjustments proposed by OCA, and no language was added in the adoption of Act 11 to incorporate either of these changes. The Pennsylvania Supreme Court has held that in determining legislative intent it is not appropriate to "supply omissions in the statute, especially where it appears that the item may have been intentionally omitted." *Mt. Village v. Bd. of Supervisors*, 582 Pa. 605, 874 A.2d 1, 22 (Pa. 2005), citing *Kusza v. Maximonis*, 363 Pa. 479, 70 A.2d 329, 331 (Pa. 1950). As Columbia will explain below,

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[2] As just one example, Section 1357(b)(1) provides as follows:

> The pretax return shall be calculated using the Federal and State income tax rates, the utility's actual capital structure and actual cost rates for long-term debt and preferred stock as of the last day of the three-month period ending one month prior to the effective date of the distribution system improvement charge and subsequent updates.

This language is virtually identical to the following provision of the Commission's model water DSIC tariff, which provided:

> Pre-tax return: The pre-tax return will be calculated using the state and federal income tax rates, the Company's actual capital structure and actual cost rates for long-term debt and preferred stock as of the last day of the three-month period ending one month prior to the effective date of the DSIC and subsequent updates.

Columbia Ex. NJDK-R1.

the General Assembly's omission of an ADIT adjustment was intentional. The fact that neither of OCA's modifications appear in the language of the statute should be taken as a clear demonstration that the General Assembly intended that neither modification be included in the DSIC mechanism adopted in Act 11.[3]

If there were any uncertainty with regard to the intent of the General Assembly in the statutory provisions, and there is not, it would be resolved in Columbia's favor based upon a review of the legislative history associated with Act 11. That legislative history makes it readily apparent that the General Assembly specifically considered, and rejected, the OCA's tax-related proposals. Columbia witness Nancy Krajovic provided legislative history relevant to this issue in her rebuttal testimony, including excerpts from the House Journal, wherein the implementation of the DSIC was discussed. The House Journal documents indicate that an amendment was proposed that would have modified the calculation of the DSIC. The sponsor of the proposed amendment emphasized that the intent of her change was to "offset" the charge by incorporating "tax benefits" in the final DSIC calculation. *See* Exhibit NJDK-R3, Legislative Journal p. 1909. This amendment was rejected by the General Assembly. *Id.* at p. 1911. Therefore, no reflection of purported tax benefits, such as ADIT or the elimination of the state tax gross-up, was intended to be incorporated in the final version of Act 11. Explained another way, the omission of OCA's proposed tax modifications from the statute was intentional, and should not be added to the statute through a subsequent interpretation.

In addition, the legislative history makes it clear that the General Assembly relied on the water DSIC mechanism, as it had been implemented by the Commission, as the foundation for the DSIC mechanism authorized in Act 11. The legislative history

[3] The language of the statute refers to using the applicable state income tax rate. 66 Pa C.S. § 1357(b)(1). This language is identical to the language used in the water DSIC. The statutory tax rate has always been used in the application of the water utility DSIC. Columbia St. No. 1-R, pp. 3-4.

indicates House Bill 1294, which eventually became Act 11, was specifically amended, to "memorialize in statute the current PUC procedure and process used to evaluate water utility requests for DSIC." *Id.* at p. 155. (emphasis added). The General Assembly's specific reference to the historical water DSIC makes the Commission's treatment of ADIT and state income taxes in water DSICs relevant to determining how to apply Act 11 in this proceeding.

The water DSIC was first implemented by the Commission in 1997. As indicated in Exhibit NJDK-R1, when the Commission implemented the DSIC it provided the water utilities with model tariff language. The model tariff language did not provide for ADIT to be included in calculating the DSIC. Columbia St. No. 1-R, p. 8. Further, witnesses for the Company and for the OCA agree that no water utility in the state of Pennsylvania has included ADIT in calculating its DSIC. *Id.*, OCA St. No. 1-S, p. 3. In addition, witnesses for the Company and OCA also agree that all water utilities have done a gross-up for state income tax using the full statutory tax rate as part of their calculation of DSIC rates. Columbia St. No. 1-R, pp. 3-4. The prior history of water utility DSICs was directly referenced by the General Assembly when it enacted Act 11. Therefore, in accordance with the provisions of Section 1921(c)(7) of the Statutory Construction Act, the DSIC provisions of Act 11 must be interpreted consistent with the Commission's past practice with the water DSIC.[4]

OCA Witness Catlin asserts that, in determining how to apply Act 11, the Commission should look at DSIC mechanisms developed in other states, either through

[4] Section 1921(c)(8) of the Statutory Construction Act further provides that the intention of the General Assembly may be ascertained by considering legislative and administrative interpretations of a statute. The Commission previously interpreted the provisions of the predecessor water DSIC statute to not include OCA's proposed tax offsets, and the legislature reaffirmed this determination in adopting the DSIC.

statute or state utility commission orders. OCA Statement No. 1-S, pp. 2-3. This assertion does not comport with proper statutory interpretation. The Statutory Construction Act does not generally provide for consideration of an issue by another jurisdiction as a basis for determining legislative intent. In *Elder v. Orluck*, 511 Pa. 402, 515 A.2d 517, 522 (1986), the Court noted that it was not appropriate to consider another jurisdiction's statute where there was no indication that the General Assembly based Pennsylvania legislation on legislation adopted in other jurisdictions. The OCA has not argued, and cannot argue, that the General Assembly relied upon any other jurisdiction in developing the DSIC provisions in Act 11. It is clear that the General Assembly based the DSIC provisions of Act 11 upon the Pennsylvania water DSIC, which, as explained above, does not include the modifications proposed by OCA.[5]

The rules of statutory interpretation in Pennsylvania are clear, and require the Commission to interpret the DSIC provisions of Act 11 consistent with the intent of the General Assembly. The evidence presented by Columbia has shown that the OCA's recommendations with regard to deducting ADIT and disallowing any state income tax gross-up are inconsistent with the legislative intent of the General Assembly when it enacted Act 11. Further, the OCA's argument that the Commission should look to other states rather than adhere to the clear directives from the General Assembly is inconsistent with the rules of statutory interpretation, and should be rejected.

The legislative intent in adopting Act 11 was to adopt the water utility DSIC mechanism, and to reject proposals to incorporate tax modifications. Under the rules of

[5] Section 1927 of the Statutory Construction Act provides that statutes uniform with those of other states shall be interpreted and construed to effect their general purpose to make laws uniform among jurisdictions. However, as discussed in section V.B. of this brief, there is no uniformity among jurisdictions on DSIC-type provisions. Therefore, this provision is inapplicable. *See Allegheny County Sportman's League v. Rendell*, 860 A.2d 10 (Pa. 2004).

statutory interpretation, OCA's proposals to revise the DSIC mechanism must be rejected.

B. OCA'S PROPOSAL TO MODIFY THE DSIC FOR AN ADIT OFFSET COMPLICATES THE FORMULA AND IS UNNECESSARY.

ADITs are created as a result of normalization of certain deductions for federal income tax purposes. Federal tax rules allow tax depreciation deductions at higher rates than for book purposes. Under the repair allowance deduction, 100% of the investment in certain qualifying property may be deducted in the year of installation. Columbia St. No. 2-R, p. 2. Property not eligible for the repair allowance deduction is depreciated using the Modified Accelerated Cost Recovery System ("MACRS"). *Id.* at p. 3. Finally, if bonus depreciation is permitted, the first year tax deduction is higher than it would have been under normal accelerated depreciation rates. Currently, the federal tax laws permit a 50% bonus depreciation deduction in the first year of an asset's tax life. *Id.* at p. 3. The excess of federal tax depreciation deductions over book depreciation deductions reduces income taxes paid to the federal government. *Id.* However, the tax reduction may not be passed through to customers, but may be deducted from rate base. The excess, when multiplied by the federal tax rate, determines the ADIT associated with an asset for each tax year. The base rate process deducts the then current balance of ADIT on all tax vintages from rate base. Columbia St. No. 2-RJ, p. 2.

Consistent with the water DSIC, Columbia's DSIC calculation does not include additional ADIT on DSIC plant as an offset to eligible plant to be reflected in the DSIC. The OCA has proposed that the Commission require Columbia to include incremental ADIT. As explained above, this proposal is inconsistent with the legislative intent of Act 11 and must be rejected. In addition, such a proposal is inconsistent with the

Legislature's and Commission's intent to adopt a simple surcharge mechanism. Furthermore, such provision is unnecessary because the ADIT offset is already considered in the customer safeguard provisions to ensure customers are not charged unreasonable rates.

As explained in the previous section, the ADIT adjustment is not authorized by Act 11 and should be rejected. Nevertheless, the Commission's prior practice for excluding the ADIT adjustment provides an additional basis for rejecting it. The legislative history makes it apparent that the General Assembly intended for the Commission to continue to use its historic practice for the water DSIC. As noted, the Commission adopted a model tariff for implementation of Act 11. The model tariff language is virtually identical to the model tariff language used by the Commission in its 1996 water DSIC Orders. Columbia St. No. 1-R, p. 2. The model tariff from 1996 did not include ADIT in the calculation of the DSIC; therefore, the model tariff for Act 11 does not include ADIT. *Id.* at p. 3. Further, as described in Columbia's direct and supplemental direct testimony, the Company's tariff adopted the Commission's model tariff. *Id.* at pp. 2-3. Thus, like the water DSIC that Columbia's tariff was based upon, ADIT is not included in the calculation of Columbia's DSIC rate. The OCA has acknowledged that no water utility in Pennsylvania has included ADIT in its DSIC. *Id.* at p. 3. Columbia's proposed mechanism, which is consistent with the Commission's historic practice of not including ADIT, is consistent with the long applied water DSIC.

Not only is the Commission's historic practice clear on the issue of ADIT, the Commission directly addressed this issue in its Final Implementation Order. In its comments to the Tentative Implementation Order, OCA argued that the DSIC calculation should include an adjustment for ADIT to recognize the difference between

the utilities' tax depreciation and book depreciation on plant additions reflected in the DSIC. In response, the Commission held:

> [T]he DSIC is intended to be a straightforward mechanism which is easy to calculate, easy to audit and which does not require a full rate case analysis. Inclusion of an ADIT adjustment would be inconsistent with that goal and would likely invite litigation over its calculation. Moreover, we note that the water DSIC, used successfully for over 15 years, did not include an ADIT adjustment. And, in any event, consumers remain protected against over earnings by the earnings cap under Section 1358(b)(3) which captures the revenue impact of all other adjustments and insures that the DSIC does not result in unreasonable rates.
>
> Therefore, the Commission declines to adopt the OCA proposal to include, in the DSIC calculation, an adjustment for accumulated deferred income taxes. The adjustment, which was not previously used in the DSIC by the water industry, would add unnecessary complexities to the DSIC and, accordingly, will not be included in the model tariff.

Final Implementation Order at p. 39 (internal citations omitted). It is quite apparent from this language that the Commission did not intend to include an adjustment for ADIT. In its resolution of this issue, the Commission provided three reasons that it did not include an adjustment for ADIT in the DSIC calculation. The first is that the DSIC mechanism was intended to be straightforward and easy to calculate. The second, which has already been addressed in this brief, is that the water DSIC historically did not include ADIT. The third is that ADIT is already accounted for as part of the earnings cap.

OCA's proposal to include in the DSIC an offset to plant for ADIT would violate the concept of a straightforward and easy to calculate surcharge mechanism. The purpose of a surcharge mechanism is to establish a simple adjustment mechanism that does not require examination of every component that would be considered in a full base rate case proceeding. *See, e.g., Dorothy Gill v. The Bell Telephone Company of*

Pennsylvania, C-00935402 (April 22, 1994) (The State Tax Adjustment Surcharge, a § 1307 mechanism, was adopted to provide a simple, expeditious mechanism to recover certain utility expenses). In contrast, base rate case calculations have many complexities, and reflect all of the changes in revenues, expenses, plant additions and offsetting rate base deductions. In an analogous context, the Commonwealth Court has recognized that non-base rate cases do not require submission of the full extent of revenues, expenses, rate base and rate of return as is required in a general base rate case. In *Popowsky v. Pa. P.U.C.*, 683 A.2d 958 (Pa. Cmwlth. Ct. 1996) ("*Popowsky*"), the Court considered an appeal from a Commission Order that authorized a non-general rate increase to recover costs associated with a change in accounting for post-retirement benefits other than pensions. OCA argued that the utility was required to present all of the evidence that would be required to support a change in base rates. The Court disagreed, and stated:

> "In response to such an argument, we would agree with the PUC that the statutory and regulatory scheme do not make the same full-blown standards applicable. If such a high standard applied, there would be no significant difference between non-general rate filings under Section 1308(b) and general rate filings under Section 1308(d). To the contrary, because of the modest nature of non-general rate filings, as required by the statute, we believe the PUC may determine whether the public utility's rates are just and reasonable based on the general information required under 52 Pa. Code § 53.52(b). That the non-general rate filing may be contested does not increase Equitable's evidentiary burden or limit the PUC's discretion."

Id. at 962. Similarly here, it would defeat the purpose of Act 11's DSIC surcharge provisions to incorporate ADIT adjustments into the rate calculation. This is because the determination of ADIT is not a simple calculation. There are several reasons for the complexity.

First, as acknowledged by OCA witness Catlin and as further explained by Columbia witness Fischer, whether and to what extent Columbia has any ADIT balance not already reflected in base rates depends in part upon its overall tax position. OCA St. No. 1, p. 7; Columbia St. No. 2-R, p. 4. As explained above, ADIT is generated by tax depreciation deductions that exceed book depreciation deductions. Columbia St. No. 2-R, p. 5. However, in recent years Columbia has generated tax deductions that exceed its income, resulting in tax losses. *Id.* at p. 4. As a result, Columbia has not been able to benefit from all available accelerated depreciation deductions. The result is that Columbia has substantial tax loss carryforwards. Therefore, Columbia cannot take tax deductions, and thereby receive the benefit of ADIT, on new plant additions until these tax loss carryforwards have been utilized. *Id.* The result, as conceded by Mr. Catlin, is that no ADIT adjustment can be included at this time, due to prior and ongoing tax losses. OCA St. No. 1, p. 7. This situation can recur in the future at any time, depending upon available tax deductions under federal law, thereby complicating the determination of ADIT. OCA's own concession in this proceeding, that an ADIT offset was not proper at this time, demonstrates that the adjustment is not easy to calculate, and could invite litigation over the utility's past, present, and future income tax status.

The determination of ADIT for purposes of quarterly DSIC filings is further complicated by the seasonal nature of the gas utility business and the differing deductions available. Columbia's actual tax status (*i.e.*, whether it is in a positive tax position or a tax loss position) cannot be known until after the end of the tax year. It is only at that time that the Company will know its taxable income (or loss) before depreciation deductions, as well as the applicable deductions (*i.e.*, repair allowance, bonus depreciation and/or accelerated depreciation) available for the mix of plant

additions actually installed. Columbia St. No. 2-R, p. 5. However, the DSIC is calculated on a quarterly basis, and the seasonality of gas utility income is such that in some quarters the utility may report taxable income or loss that may not be representative of the full tax year. *Id.* Thus, any determination of ADIT would involve estimates that would require subsequent true ups. To inject estimates into the DSIC plant balance used in the calculation would be contrary to the use of known, historic balances envisioned by the statute.[6] This is inconsistent with the "straightforward" calculation intended for the DSIC.

Finally, the determination of any ADIT deductions is complicated by the fact that, as to plant already reflected in base rates, or plant reflected in a DSIC, the ADIT balance may decline because tax depreciation deductions have reached the turnaround point.[7] This is particularly the case for plant that is subject to the repair allowance deduction or a bonus depreciation deduction, which can turn around within a few years of the creation of the ADIT. *Id.* at p. 4. Such ADIT balance reductions can offset, in whole or in part, any new ADIT balances created from new DSIC-eligible plant.

It is important to emphasize that the DSIC mechanism established by Act 11 does not ignore ongoing changes in the total ADIT balance. As the Commission recognized in its Final Implementation Order, the impact of ADIT is already factored into the DSIC through the calculation of the earnings cap. The earnings cap prohibits Columbia from exceeding its allowable rate of return. The Company's DSIC will be reset to zero if the data included in the most recent Annual or Quarterly Earnings report filed with the

[6] Under Section 1357, the DSIC is to include plant additions actually placed in service.

[7] When book depreciation deductions for an asset exceed tax deductions, the federal ADIT balance declines. Columbia St. No. 2-R, p. 4. This is known as the "turnaround point." For property subject to the repairs allowance deduction, and property that previously was subject to a 100% bonus depreciation deduction, the turnaround begins immediately, as there are no further tax deductions available. *Id.* at p. 4.

Commission shows that Columbia would earn a rate of return that would exceed the allowable rate of return used to calculate its fixed costs under the DSIC as described in the pre-tax return section. Columbia St. No. 1-R, p. 4. As shown in Exhibit NJDK-R2, the Company's calculation of rate base for earnings report purposes includes the current book amount of ADIT. *Id.* Thus, in order for Columbia to get the benefit of a DSIC, it must be in an under-earning position after taking into consideration the very tax matters that the OCA is concerned about. Columbia St. No. 1-RJ, p. 3. Since earnings are reviewed quarterly, the earnings cap adequately addresses the concern associated with ADIT for plant additions under the DSIC, without the complication of reviewing these issues in each quarterly DSIC filing.

The OCA has argued that changed circumstances exist which make the inclusion of ADIT, outside of the earnings cap, appropriate at this time. This argument is flawed. While changes have occurred in tax benefits since the initial water DSIC, those changes occurred prior to the enactment of Act 11. Thus, the tax changes were known to the General Assembly before it adopted Act 11. Columbia St. No. 2-RJ, p. 1. Further, there is clear indication in the legislative history that the General Assembly was aware of the very tax benefits which the OCA seeks to address here. In response to the recognized tax benefits, the General Assembly determined that it was appropriate to continue to use the water DSIC, and denied an amendment that would have acknowledged the changed circumstances that the OCA relies upon. The OCA cannot support its proposal by relying on changed circumstances.

In support of its argument that ADIT should be included in the DSIC calculation, the OCA also points to the practice of utilities in other states. As a primary matter, this is not appropriate statutory interpretation. As explained previously, the practices of

other states, unless specifically identified by the General Assembly in the legislative history, are irrelevant to a determination of how a Pennsylvania statute should be construed. Further, the jurisdictions that the OCA has identified have mechanisms that are dissimilar from the Pennsylvania mechanism in a number of critical ways.

Taking the two jurisdictions that the OCA put the greatest emphasis on in its testimony, Maryland and Massachusetts, the differences between the mechanisms are dramatic. The OCA has emphasized these two jurisdictions because Columbia's affiliates have, or are seeking approval of, DSIC-type mechanisms in those jurisdictions. Looking first at Maryland, the mechanism includes the recovery of property taxes, a gross-up for bad debt expense, and an allocation of the underlying revenue requirement based on rate class percentage of revenue. Columbia St. No. 1-RJ, p. 3. Further, as Ms. Krajovic testified at the hearing, Maryland's mechanism is a fully projected mechanism, and not a backward looking mechanism such as the Pennsylvania DSIC. Tr. at p. 43. These provisions are not part of Pennsylvania's statutory DSIC mechanism.

Unlike the Pennsylvania DSIC, the Massachusetts mechanism was not created by statute or regulation, and was instead the result of a specific proceeding. Columbia St. No. 1-RJ, p. 2. The mechanism includes the recovery of property taxes and assumes that operations and maintenance savings will occur that are associated with the investments. *Id.* at p. 3. There is no overall cap on the charges for the Massachusetts mechanism, although the annual increase cannot exceed 1.0% of Columbia Gas of Massachusetts' total revenues. *Id.* In calculating total revenues, however, gas cost revenues for the prior year are included in the calculation. *Id.* Again, these provisions are not part of Pennsylvania's statutory DSIC mechanism.

Critically, in neither Maryland nor Massachusetts are utilities limited by the imposition of an earnings cap. Columbia St. No. 1-RJ, p. 3. As discussed previously, the Commission has placed great importance on the earnings cap in negating the need to include ADIT in the DSIC calculation. Thus, not only is it inappropriate under the general rules of statutory interpretation to look to other states in interpreting a Pennsylvania statute, but the mechanisms in the other states vary so significantly from the Pennsylvania DSIC that they provide no relevant guidance in judging the reasonableness of the ADIT adjustment. Clearly, it would be improper to rely upon such other mechanisms to add a base rate component that reduces the DSIC charge while ignoring other base rate components that would increase the DSIC charge. The analysis underlying the OCA's proposal to include ADIT is fundamentally flawed, and thus OCA's proposal should be rejected.

C. THE STATE TAX GROSS-UP INCLUDED IN THE COLUMBIA DSIC IS APPROPRIATE.

The OCA has proposed that the state income tax gross-up included in Columbia's DSIC calculation be disallowed. Specifically, the OCA argues that the amount of state income tax that will be paid on the income produced by the DSIC should be reduced to zero. OCA reaches this result by reflecting incremental flow-through tax deductions for accelerated depreciation and the repair allowance on DSIC-eligible plant additions. As explained in Section V.A. of this brief, OCA's proposal is contrary to the intent of the General Assembly in enacting the statute. OCA's proposal also should be rejected because it violates the Commission's determination in its Final Implementation Order, and because it creates inaccurate tax results.

As explained previously in this brief, historically the water DSIC included the same state tax gross-up proposed by Columbia as part of the DSIC. As described

previously, the historic approach applied by the Commission to the water DSIC is determinative to this inquiry because the legislative history indicates that it was the intent of the General Assembly to embrace the procedure and process used for the water DSIC. In addition, the Commission's Final Implementation Order, consistent with the historic DSIC approach, did not adjust the state tax gross-up in its discussion of taxes. As previously noted, the Commission intended the DSIC to be a straightforward mechanism which is easy to calculate. Including a full and accurate calculation of state taxes would require the Company to provide a full rate making calculation, which could potentially require recalculating the Company's other tax liabilities and deductions. Columbia St. No. 2-R, p. 7.

OCA's incremental deduction proposal also should be rejected because it would incorporate inaccurate tax adjustments into the DSIC. As described in great detail in the testimony of Columbia witness Fischer, elimination of the state income tax gross-up through an "incremental" deduction approach improperly ignores state tax depreciation and repairs deductions that were reflected in the Company's prior base rate case. *Id.* at pp. 6-7. The specific tax deductions reflected in base rates, such as the repairs allowance deduction and bonus depreciation, are one time deductions related to test year plant additions that are no longer available to the Company after the year in which they are taken. *Id.* at p. 7. However, they are representative of ongoing operations. In addition, under accelerated depreciation procedures, the amount of the depreciation deduction on each tax vintage declines over time and such reductions are offset by increases in deduction for current plant additions. *Id.* Treating one-time tax deductions and accelerated depreciation deductions in base rates as if they continue into the future, while claiming that deductions associated with new plant in the DSIC should be viewed

as "incremental," results in a double counting of depreciation and repairs deductions. *Id.* at p. 8. Columbia's witness Fisher provided a clear example of the unfairness of OCA's proposal. Columbia's current base rates reflect a $55 million repair allowance deduction in calculating state income taxes. This deduction is a one-time deduction and thus, for state income tax purposes, Columbia will receive no further repair allowance deduction related to that property after the initial year that base rates are in effect. However, under OCA's proposal, if Columbia can claim a $55 million repair allowance deduction on DSIC eligible plant added after the rate case test year, that deduction would be considered "incremental" and would eliminate any state tax gross-up. *Id.*, OCA St. No. 1-S, p. 6. In such event, Columbia would be denied an opportunity to earn a fair return on DSIC plant, because the $55 million deduction would be counted twice (once in base rates and once in the DSIC) even though Columbia would only receive one $55 million annual deduction. Columbia St. No. 2-R, p. 8.

As demonstrated by the foregoing, OCA's "incremental" approach is fundamentally unfair. The only way to correct such unfairness would be to undertake a full state tax calculation as part of each DSIC. Only in this way can the changing mix of current state tax deductions be taken into account. However, a full state tax calculation is directly contrary to the General Assembly's and the Commission's intent that the DSIC be calculated in a simple, straight forward manner.

As explained in the prior section of this brief, the DSIC mechanism does factor in benefits from state tax depreciation deductions. Tax depreciation deductions allowed for Pennsylvania Corporate Net Income Tax ("PaCNIT") purposes are reflected in the calculation of PaCNIT in the Company's earnings reports. Columbia St. No. 1-R, pp. 4-

5. Thus, if Columbia is overearning its authorized return as a result of tax depreciation deductions or other benefits, it is not permitted to charge the DSIC.

Columbia's inclusion of a state tax gross-up is consistent with the legislative intent of Act 11 and with the historic calculation of the water DSIC. Further, the OCA's proposal to remove the state tax gross-up would result in improper tax calculations which double count deductions, or would require a much more complicated and extensive calculation than the Commission intended in its Final Implementation Order. Therefore, the OCA's proposal regarding the state tax gross-up should be rejected.

D. OCA'S PROPOSAL TO MODIFY LANGUAGE IN THE DSIC TARIFF REGARDING COMPETITIVE CUSTOMERS SHOULD BE REJECTED.

In its DSIC tariff, Columbia included language regarding the application of the DSIC to its customer classes. Columbia's tariff provides that:

> The DSIC shall be applied equally to all customer classes, except that the Company may reduce or eliminate the Rider DSIC to any customer with competitive alternatives or potential competitive alternatives and customers having negotiated contracts with the Company, if it is reasonably necessary to do so.

Columbia's language was based on the Commission's discussion of competitive customers in its Final Implementation Order. The OCA has challenged this language. Particularly, the OCA has argued that the proposed language may allow Columbia to exclude customers from the DSIC when they do not have viable competitive alternatives. Columbia has shown that its language is reasonably tailored to ensure Columbia's ability to exclude competitive customers from the DSIC, without being overbroad. The OCA's position should be rejected.

In its Final Implementation Order, the Commission addressed the issue of competitive customers. The Commission provided that:

> "...Utilities should have the flexibility to not apply the DSIC surcharge to customers with competitive alternatives and customers having negotiated contracts from the utility. Where the customer has negotiated rates based on competitive alternatives, it would be contrary to the contract terms and counterproductive in the long term to add costs that may induce the customer to leave the system and provide no support for infrastructure costs.

Final Implementation Order at p. 46. This language clearly allows Columbia to exclude competitive customers from the DSIC. Columbia's proposed tariff language ensures that it has the flexibility to not apply the DSIC to customers who either already receive negotiated rates, or who have the capacity to negotiate competitive rates because of a potential competitive alternative that has not yet been built. Columbia St. No. 1-R, p. 7. It is the language applicable to these latter customers that the OCA is disputing.

OCA witness Catlin has objected to Columbia's identification of customers with "potential competitive alternatives." Mr. Catlin initially indicated a concern that the phrase "potential competitive alternatives" was too broad, as there can be many customers with "potential" competitive alternatives who are currently paying full tariff rates. OCA St. No. 1-S, p. 4. Mr. Catlin proposed to delete the phrase "potential competitive alternatives" and add the phrase "who are paying flexed or discounted rates." Columbia supported the latter addition, but opposed the suggested deletion. The OCA has acknowledged that this dispute is primarily one of semantics. OCA St. No. 1-S, p. 4. The OCA does not disagree that in a situation where a viable competitive alternative exists, even if it has not yet been constructed, Columbia should have the ability to exclude that customer from the DSIC. *Id.*

Columbia's proposed language identifying potential competitive customers ensures that the Company can negotiate with competitive customers who may not currently have a constructed competitive option, but could have such an option but for

their ability to reach a discounted rate agreement with Columbia. Penn State supported Columbia's inclusion of potential competitive customers, and noted that the OCA's language would put customers in an "untenable position of having to hold discussions with potential competitors or to commit to another alternative before being eligible to enter into a flex agreement with Columbia and not be subject to the DSIC." Penn State St. No. 2, p. 2. The OCA did not dispute that it is in the best interest of Columbia and its customers to avoid having a competitive customer construct and bypass the Columbia system. When presented with this scenario, Mr. Catlin merely concluded that his definition of "competitive alternative" included customers where facilities would still need to be constructed in order for them to bypass the Columbia system. OCA St. No. 1-S, at pp. 4-5. Columbia's DSIC language eliminates any uncertainty about whether the DSIC is applicable to such a competitive customer.

Penn State proposed in its direct testimony that Columbia should strengthen the language regarding competitive customers, to provide that the Company "shall not apply" the DSIC. Penn State St. No. 1, p. 5. The OCA, however, has argued that this language is not appropriate, and that the Company should seek to include DSIC charges where it is possible to do so. OCA St. No. 1-R, at p. 2. Penn State's proposed language that the DSIC shall not apply to customers with competitive alternatives is consistent with Columbia tariff language exempting competitive customers from other surcharges, such as the State Tax Adjustment Surcharge. Columbia St. No. 1-R, p. 7. Therefore, the Company supports Penn State's revision.

Columbia notes that OCA's objection to Penn State's proposed language does not achieve a distinguishable result, as there is no basis to conclude that Columbia can charge a DSIC to customers with discounted rates. Columbia seeks to negotiate the

highest possible rates with its competitive customers. As Columbia already is obtaining the most revenue that it can from competitive customers, it is not possible to charge such customers the DSIC. The Commission acknowledged in its Final Implementation Order that having competitive customers leave the system would inflict a harm upon Columbia and its other customers. Final Implementation Order at p. 46. The Commission has also previously recognized that customers who may have competitive options should be carved out of certain riders, such as the State Tax Adjustment Surcharge. Columbia St. No. 1-R, p. 7.

Based on the evidence presented in this proceeding, the final language on competitive customers in the Company's tariff should provide as follows:

> The DSIC shall be applied equally to all customer classes, except that the Company shall not apply the Rider DSIC to any customer with competitive alternatives, or potential competitive alternatives, who is taking service at flexed or discounted rates and to customers having negotiated contracts with the Company.

Penn State St. No. 3, p. 4. This language would incorporate the additional language that the parties have agreed upon, would allow Columbia to address all customers with the ability to exercise competitive alternatives, whether or not they had been constructed yet, and would clearly exclude those identified customers from being charged the DSIC. This language provides the best resolution of the various positions of the parties on this issue, and should be approved.

VI. CONCLUSION

For the foregoing reasons, Columbia respectfully requests that its calculation mechanism for the Distribution System Improvement Charge be approved as filed, and that the modifications proposed by the OCA be denied. Columbia further requests that the tariff language related to the treatment of competitive customers be modified as set forth in Section V.D of this brief.

Respectfully submitted,

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A

APPENDIX "A"

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge	:	Docket No. P-2012-2338282

PROPOSED FINDINGS OF FACT

1. 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.

2. Act 11 authorizes electric distribution companies ("EDCs"), natural gas distribution companies ("NGDCs"), water utilities, wastewater utilities and city natural gas distribution operations to establish a distribution system improvement charge ("DSIC").

3. On May 10, 2012, the Commission issued its Tentative Implementation Order addressing and incorporating input from the stakeholder meeting at Docket No. M-2012-2293611.

4. Comments to the Tentative Implementation Order were filed by Columbia Gas of Pennsylvania ("Columbia" or "the Company"), the Office of Consumer Advocate ("OCA"), Pennsylvania State University ("Penn State"), and the Columbia Industrial Intervenors ("CII") on May 31, 2012.

5. On August 2, 2012, the Commission issued its Final Implementation Order establishing procedures and guidelines necessary to implement Act 11.

6. The Final Implementation Order also included a model form of DSIC tariff (the "model tariff").

7. On December 7, 2012, Columbia filed an LTIIP pursuant to Section 1352 of the Public Utility Code, 66 Pa.C.S. § 1352.

8. On January 2, 2013, pursuant to Section 1353, Columbia filed a Petition for Approval of a DSIC. 66 Pa.C.S. § 1353. As part of the Petition, Columbia included a form of DSIC tariff consistent with the model tariff, along with supporting direct testimony.

9. On March 20, 2013, Columbia filed its compliance filing, as directed by the Commission in its March 14 Order.

10. The Statutory Construction Act of 1972 ("Statutory Construction Act") provides that "the object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly." 1 Pa.C.S. § 1921.

11. Act 11 adopted the water DSIC formula. Columbia St. No. 1-R, p. 3; Columbia Ex. NJDK-R1.

12. The General Assembly considered a proposed amendment to include tax benefits, and rejected that amendment. Exhibit NJDK-R3, Legislative Journal p. 1909-1911.

13. The General Assembly specifically omitted tax benefits from Act 11. Exhibit NJDK-R3, Legislative Journal p. 1909-1911.

14. The General Assembly adopted the Commission's procedure and process for the water DSIC. Exhibit NJDK-R3, Legislative Journal p. 155.

15. No water utility in the state of Pennsylvania has included ADIT in calculating its DSIC. *Id.*, OCA St. No. 1-S, p. 3.

16. The model tariff language did not provide for ADIT to be included in calculating the DSIC. Columbia St. No. 1-R, p. 8.

17. All water utilities have done a gross-up for state income tax using the full statutory tax rate as part of their calculation of DSIC rates. Columbia St. No. 1-R, pp. 3-4.

18. Under the repair allowance deduction, 100% of the investment in certain qualifying property may be deducted in the year of installation. Columbia St. No. 2-R, p. 2.

19. Property not eligible for the repair allowance deduction is depreciated using the Modified Accelerated Cost Recovery System ("MACRS"). *Id.* at p. 3.

20. Bonus depreciation is permitted, the first year tax deduction is higher than it would have been under normal accelerated depreciation rates. Currently, the federal tax laws permit a 50% bonus depreciation deduction in the first year of an asset's tax life. *Id.* at p. 3.

21. The excess of federal tax depreciation deductions over book depreciation deductions reduces income taxes paid to the federal government. *Id.*

22. The base rate process deducts the then current balance of ADIT on all tax vintages from rate base. Columbia St. No. 2-RJ, p. 2.

23. The model tariff language is virtually identical to the model tariff language used by the Commission in its 1996 water DSIC Orders. Columbia St. No. 1-R, p. 2.

24. The model tariff from 1996 did not include ADIT in the calculation of the DSIC; therefore, the model tariff for Act 11 does not include ADIT. *Id.* at p. 3.

25. Columbia's tariff adopted the Commission's model tariff. *Id.* at pp. 2-3.

26. No water utility in Pennsylvania, using the Commission's model tariff, has included ADIT in its DSIC. *Id.* at p. 3.

27. The Commission excluded ADIT from the DSIC in its Final Implementation Order. Final Implementation Order at p. 39.

28. Whether and to what extent Columbia has any ADIT balance not already reflected in base rates depends in part upon its overall tax position. OCA St. No. 1, p. 7; Columbia St. No. 2-R, p. 4.

29. ADIT is generated by tax depreciation deductions that exceed book depreciation deductions. Columbia St. No. 2-R, p. 5.

30. Columbia has generated tax deductions that exceed its income, resulting in tax losses, and has not been able to benefit from all available accelerated depreciation deductions. *Id.* at p. 4.

31. Columbia cannot take tax deductions, and thereby receive the benefit of ADIT, on new plant additions until these tax loss carryforwards have been utilized. *Id.*

32. No ADIT adjustment can be included at this time, due to prior and ongoing tax losses. OCA St. No. 1, p. 7.

33. Columbia's actual tax status (*i.e.*, whether it is in a positive tax position or a tax loss position) cannot be known until after the end of the tax year. It is only at that time that the Company will know its taxable income (or loss) before depreciation deductions, as well as the applicable deductions (*i.e.*, repair allowance, bonus depreciation and/or accelerated depreciation) available for the mix of plant additions actually installed. Columbia St. No. 2-R, p. 5.

34. The DSIC is calculated on a quarterly basis, and the seasonality of gas utility income is such that in some quarters the utility may report taxable income or loss that may not be representative of the full tax year. *Id.*

35. Any ADIT deductions are complicated by the fact that, as to plant already reflected in base rates, or plant reflected in a DSIC, the ADIT balance may decline because tax depreciation deductions have reached the turnaround point, particularly for plant that is subject to the repair allowance deduction or a bonus depreciation deduction, which can turn around within a few years of the creation of the ADIT. *Id.* at p. 4.

36. The Company's DSIC will be reset to zero if the data included in the most recent Annual or Quarterly Earnings report filed with the Commission shows that Columbia would earn a rate of return that would exceed the allowable rate of return used to calculate its fixed costs under the DSIC as described in the pre-tax return section. Columbia St. No. 1-R, p. 4.

37. The Company's calculation of rate base for earnings report purposes includes the current book amount of ADIT. *Id.;* Exhibit NJDK-R2.

38. In order for Columbia to get the benefit of a DSIC, it must be in an under-earning position after taking into consideration the very tax matters that the OCA is concerned about. Columbia St. No. 1-RJ, p. 3.

39. The tax changes that result in ADIT were known to the General Assembly before it adopted Act 11. Columbia St. No. 2-RJ, p. 1.

40. There is clear indication in the legislative history that the General Assembly was aware of the very tax benefits which are at issue in this proceeding. Exhibit NJDK-R3, Legislative Journal p. 1909-1911.

41. Other jurisdictions have DSIC-type mechanisms that differ significantly from the Pennsylvania DSIC. Columbia St. No. 1-RJ, pp. 2-3.

42. In Maryland, the mechanism includes the recovery of property taxes, a gross-up for bad debt expense, and an allocation of the underlying revenue requirement based on rate class percentage of revenue, which are not included in Pennsylvania. Columbia St. No. 1-RJ, p. 3.

43. Maryland's mechanism is a fully projected mechanism, and not a backward looking mechanism such as the Pennsylvania DSIC. Tr. at p. 43.

44. Unlike the Pennsylvania DSIC, the Massachusetts mechanism was not created by statute or regulation, and was instead the result of a specific proceeding. Columbia St. No. 1-RJ, p. 2.

45. The Massachusetts mechanism includes the recovery of property taxes and assumes that operations and maintenance savings will occur that are associated with the investments. Columbia St. No. 1-RJ, at p. 3.

46. There is no overall cap on the charges for the Massachusetts mechanism, although the annual increase cannot exceed 1.0% of Columbia Gas of Massachusetts' total revenues. Columbia St. No. 1-RJ, at p. 3.

47. Gas cost revenues are included in the calculation of revenues for setting the annual increase for the prior year, which is not included in Pennsylvania. Columbia St. No. 1-RJ, at p. 3.

48. Neither Maryland nor Massachusetts impose an earnings cap. Columbia St. No. 1-RJ, p. 3.

49. The water DSIC included the same state tax gross-up proposed by Columbia as part of the DSIC. Columbia St. No. 1-R, pp. 3-4.

50. The Commission's Final Implementation Order, consistent with the historic DSIC approach, did not adjust the state tax gross-up in its discussion of taxes. *See* Final Implementation Order.

51. Including a full and accurate calculation of state taxes would require the Company to provide a full rate making calculation, which could potentially require recalculating the Company's other tax liabilities and deductions. Columbia St. No. 2-R, p. 7.

52. Elimination of the state income tax gross-up through an "incremental" deduction approach improperly ignores state tax depreciation and repairs deductions that were reflected in the Company's prior base rate case. Columbia St. No. 2-R, pp. 6-7.

53. The specific tax deductions reflected in base rates, such as the repairs allowance deduction and bonus depreciation, are one time deductions related to test year plant additions that are no longer available to the Company after the year in which they are taken. Columbia St. No. 2-R, p. 7.

54. Under accelerated depreciation procedures, the amount of the depreciation deduction on each tax vintage declines over time and such reductions are offset by increases in deduction for current plant additions. Columbia St. No. 2-R, p. 7.

55. Treating one-time tax deductions and accelerated depreciation deductions in base rates as if they continue into the future, while claiming that deductions associated with new plant in the DSIC should be viewed as "incremental," results in a double counting of depreciation and repairs deductions. Columbia St. No. 2-R, p. 8.

56. The OCA's proposal would result double count the tax deductions available to Columbia. Columbia St. No. 2-R, p. 8.

57. A full state tax calculation is directly contrary to the General Assembly's and the Commission's intent that the DSIC be calculated in a simple, straight forward manner. Final Implementation Order

58. The DSIC mechanism does factor in benefits from state tax depreciation deductions, because tax depreciation deductions allowed for Pennsylvania Corporate Net Income Tax ("PaCNIT") purposes are reflected in the calculation of PaCNIT in the Company's earnings reports. Columbia St. No. 1-R, pp. 4-5.

59. Columbia's tariff provides that:

> The DSIC shall be applied equally to all customer classes, except that the Company may reduce or eliminate the Rider DSIC to any customer with competitive alternatives or potential competitive alternatives and customers having negotiated contracts with the Company, if it is reasonably necessary to do so.

60. The Commission provided that:

> "...Utilities should have the flexibility to not apply the DSIC surcharge to customers with competitive alternatives and customers having negotiated contracts from the utility. Where the customer has negotiated rates based on competitive alternatives, it would be contrary to the contract terms and counterproductive in the long term to add costs that may induce the customer to leave the system and provide no support for infrastructure costs.
>
> Final Implementation Order at p. 46.

61. Having competitive customers leave the system would inflict a harm upon Columbia and its other customers. Final Implementation Order at p. 46.

62. The Commission's Final Implementation Order allows Columbia to exclude competitive customers from the DSIC. Final Implementation Order at p. 46.

63. The Commission has previously identified that customers who may have competitive options should be carved out of certain riders, such as the State Tax Adjustment Surcharge. Columbia St. No. 1-R, p. 7.

64. Columbia's tariff exempts competitive customers from other surcharges, such as the State Tax Adjustment Surcharge. Columbia St. No. 1-R, p. 7.

65. Columbia's proposed tariff language ensures that it has the flexibility to not apply the DSIC to customers who either already receive negotiated rates, or who have the capacity to negotiate competitive rates because of a potential competitive alternative that has not yet been built. Columbia St. No. 1-R, p. 7.

PROPOSED CONCLUSIONS OF LAW

1. Act 11 does not provide for an adjustment to DSIC-eligible plant for Accumulated Deferred Income Taxes.

2. Act 11 does not provide for an adjustment to the calculation of the state income tax gross up for incremental tax depreciation deductions.

3. The General Assembly clearly intended to adopt the water utility DSIC procedure in enacting Act 11.

4. The General Assembly clearly rejected a proposal to amend the water DSIC procedure that would have included tax benefits in the DSIC calculations.

5. A surcharge mechanism is intended to be a simple mechanism, and is not required to reflect all components that would be reflected in a base rate proceeding.

6. Competitive customers receiving discounted rates, including customers who have viable, but not installed, alternatives, are not subject to the DSIC.

PROPOSED ORDERING PARAGRAPHS

It is hereby ordered that:

1. OCA's proposal to adjust the DSIC mechanism for ADITs is denied.

2. OCA's proposal to disallow the state income tax gross up is denied.

3. Columbia's tariff will be revised to provide as follows:

   The DSIC shall be applied equally to all customer classes, except that the Company shall not apply the Rider DSIC to any customer with competitive alternatives, or potential competitive alternatives, who is taking service at flexed or discounted rates and to customers having negotiated contracts with the Company.

4. In all other respects, Columbia's DSIC tariff is approved as filed.

CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing have been served upon the following persons, in the manner indicated, in accordance with the requirements of § 1.54 (relating to service by a participant).

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