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July 22, 2022

BY ELECTRONIC FILING

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

Re: Distribution System Improvement Charge - Implementation Order to address all issues pertaining to the distribution system improvement charge calculations required in the Pennsylvania Supreme Court's decision in McCloskey v. Pa. PUC, 255 A.3d 416 (Pa. 2021); Docket No. M-2012-2293611; **COLUMBIA WATER COMPANY'S COMMENTS**

Dear Secretary Chiavetta:

Enclosed for filing with the Pennsylvania Public Utility Commission are the Comments of Columbia Water Company.

Regarding contacts for the working group that will take place after the comment period, please include the undersigned as well as David Lewis (dlewis@columbiawater.net).

Very truly yours,

/s/ Whitney E. Snyder

Thomas J. Sniscak
Whitney E. Snyder
Counsel for the Columbia Water Company

WES/das
Enclosures
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BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Distribution System Improvement Charge - Implementation Order to address all issues pertaining to the distribution system improvement charge calculations required in the Pennsylvania Supreme Court's decision in *McCloskey v. Pa. PUC*, 255 A.3d 416 (Pa. 2021)	: : : : : : :	Docket No. M-2012-2293611

COMMENTS OF COLUMBIA WATER COMPANY

Pursuant to the Commission's April 22, 2022 Secretarial Letter, Columbia Water Company (CWC) submits the following comments regarding application of 66 Pa. C.S. § 1301.1 as the Supreme Court interpreted it in *McCloskey v. Pa. PUC*, 255 A.3d 416 (Pa. 2021)(*McCloskey*) to CWC's Distribution System Improvement Charge (DSIC).

I. Introduction

The Commission should allow utilities flexibility and optionality in how to apply Section 1301.1 to their respective DSICs. The "Effective Tax Rate" method proposed by the Office of Consumer Advocate in the *McCloskey* proceeding appears to be an efficient and straightforward method of implementation for CWC at this time. However, CWC reserves its rights to explore other methodologies that other parties to this proceeding may submit.

The General Assembly did not give the Commission the authority to order refunds of any differential accruing from application of Section 1301.1 to the DSIC from the effective date of Section 1301.1 to the present. Specifically, to the extent a differential has accrued to a utility from applying pre 1301.1 ratemaking methodologies to its DSIC (ie., not applying 1301.1 to the DSIC), Section 1301.1(b) already provides the solution – that differential must be used 50% "to support reliability or infrastructure related to the rate-base eligible capital investment as determined by the

Commission" and 50% "for general corporate purposes." 66 Pa. C.S. § 1301.1(b). Thus, the General Assembly has already mandated that any differential accruing to a utility during the period the utility did not apply Section 1301.1 to its DSIC is not subject to refund, but instead must be used consistent with Section 1301.1(b). The General Assembly did not provide the Commission with the authority to order utilities to issue refunds in this circumstance, but instead solved this timing issue by specifying how the differential should be used.

II. Background

On June 12, 2016, Act 40 was signed into law, which added Section 1301.1 to the Public Utility Code and states as follows:

> 1301.1. Computation of income tax expense for rate-making purposes.
> (a) Computation. —If an expense or investment is allowed to be included in a public utility's rates for ratemaking purposes, the related income tax deductions and credits shall also be included in the computation of current or deferred income tax expense to reduce rates. If an expense or investment is not allowed to be included in a public utility's rates, the related income tax deductions and credits, including tax losses of the public utility's parent or affiliated companies, shall not be included in the computation of income tax expense to reduce rates. The deferred income taxes used to determine the rate base of a public utility for ratemaking purposes shall be based solely on the tax deductions and credits received by the public utility and shall not include any deductions or credits generated by the expenses or investments of a public utility's parent or any affiliated entity. The income tax expense shall be computed using the applicable statutory income tax rates.
> (b) Revenue use. —If a differential accrues to a public utility resulting from applying the ratemaking methods employed by the commission prior to the effective date of subsection (a) for ratemaking purposes, the differential shall be used as follows:
> (1) Fifty percent to support reliability or infrastructure related to the rate base eligible capital investment as determined by the commission; and
> (2) Fifty percent for general corporate purposes.
> (c) Application. —The following shall apply:
> (1) Subsection (b) shall no longer apply after December 31, 2025.
>
> (2) This section shall apply to all cases where the final order is entered after the effective date of this section.

66 Pa. C.S. § 1301.1(a)-(c).

In 2021, the Pennsylvania Supreme Court ruled that Section 1301.1 applied to the Distribution System Improvement Charge (DSIC) and altered the manner in which the DSIC had been previously calculated. *McCloskey v. Pa. PUC*, 255 A.3d 416 (Pa. 2021). The Court remanded the proceeding to the PUC to determine proper implementation of the decision, including revision of the existing DSIC formula and whether refunds should be issued.

On April 22, 2022, the Commission issued a Secretarial letter that requested interested parties submit comments on the following topics:

> • Changes to be made to the current model DSIC tariff, including the necessary computation, reconciliation and other language to implement the directive of the Court to recognize incremental Accumulate Deferred Income Taxes (ADIT) and state tax depreciation deductions for accelerated depreciation in quarterly calculations of DSIC charges.
>
> • Elements of the formula required for calculating quarterly DSIC updates needed to determine: (1) the state income tax effects of book-tax timing differences created by placing in service eligible property included in the DSIC calculation; and (2) ADIT that reflects the book-tax timing differences created by placing in service eligible property included in the DSIC, and to do so that such revisions to the formula for calculating the DSIC do not require unduly complicated computations but permit reasonable review and audit of DSIC charges and their supporting calculations;
>
> • Determination of the revisions to the DSIC calculations and the potential refund/recoupment of overcharges dated back to August 2016, the date that Act 40 added Section 1301.1 to the Code:
>
> ▪ Should a refund/recoupment be required;
>
> ▪ Timing of any required refund/recoupment (When should the recoupment begin?)
>
> ▪ Amortization period of any refund/recoupment;
>
> ▪ Impact of the refund/recoupment on the utilities DSIC cap for each utility;
>
> ▪ Should interest be applied, and if so, at what rate and the weighting for when interest is to be applied; and
>
> • Standards to establish a reconciliation process for timing differences and issues for determining the proper level of ADIT and state income taxes for book-tax timing issues created by placing in service eligible property included in the DSIC.

April 22, 2022 Secretarial Letter at 3. Accordingly, CWC submits the following comments.

III. CWC COMMENTS

A. Changes to Current DSIC Tariff and Elements of the Formula

Columbia Water agrees with the Office of Consumer Advocate (OCA) "Effective Tax Rate" proposed modification as an appropriate way for the DSIC to factor in tax benefits. Using this method, the DSIC factors in Section 1301.1 by using the effective tax rate paid by a utility instead of the statutory tax rate to modify the revenue conversion facto (or tax multiplier) used to calculate the pre-tax rate of return (PTTR) in the DSIC formula. For Columbia Water, this appears at this time to be the most efficient way to modify its DSIC, particularly because Columbia Water effectively pays a zero percent tax rate. Utilizing this method only requires one modification to Columbia Water's Tariff, which as shown below, is to change the definition of Pre-Tax Return to utilize the Company's effective tax rate instead of the statutory tax rate.

The modification to the actual calculation then occurs in the supporting worksheets as follows (utilizing Columbia Water's actual May 2022 DSIC calculations as an example):

CURRENT:

THE COLUMBIA WATER COMPANY
DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC") CALCULATION
EFFECTIVE MAY 1, 2022

Weighted Cost of Capital at 3/31/2022

	Per Books	Capital Structure	Cost Rate	Weighted Average Cost Rates	Tax Multiplier	Rev Req
Debt	5,624,290	27.56%	3.21%	0.88%	-	0.88%
Equity	14,781,959	72.44%	9.80%	7.10%	1.406	9.98%
	20,406,249	100.00%		7.98%		10.87%

Note: The cost rate of debt is the Company's actual cost rate. The equity cost rate is the equity return rate calculated by the Commission staff and presented in the latest Quarterly Report on the Earnings of Jurisdictional Utilities. The tax multiplier is calculated as follows: 1/[(1 - PA Tax Rate) x (1- Fed. Tax Rate)] where the PA tax rate is 9.99% and the Fed. Tax rate is 21%.

AS MODIFIED:

THE COLUMBIA WATER COMPANY
DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC") CALCULATION
EFFECTIVE MAY 1, 2022

Weighted Cost of Capital at 3/31/2022

	Per Books	Capital Structure	Cost Rate	Weighted Average Cost Rates	Tax Multiplier	Rev Req
Debt	5,624,290	27.56%	3.21%	0.88%	-	0.88%
Equity	14,781,959	72.44%	9.80%	7.10%	1.000	7.10%
	20,406,249	100.00%		7.98%		7.98%

Note: The cost rate of debt is the Company's actual cost rate. The equity cost rate is the equity return rate calculated by the Commission staff and presented in the latest Quarterly Report on the Earnings of Jurisdictional Utilities. The tax multiplier is calculated as follows: 1/[(1 - Columbia Effective PA Tax Rate) x (1- Columbia Effective Fed. Tax Rate)] where the PA tax rate is 9.99% and the Fed. Tax rate is 21%.

Below is CWC's Computation of DSIC tariff pages with proposed redline modifications[1]:

Effective Date: The DSIC will become effective for bills rendered on and after ~~November 1, 2002~~[Effective Date].

Computation of the DSIC

Calculation: The initial **DSIC**, effective ~~June 21, 2003~~[Effective Date], shall be calculated to recover the fixed costs of eligible plant additions that have not previously been reflected in the Company's rates or rate base and have been placed in service by ~~October 15, 2002~~[Effective Date]. Thereafter, the DSIC will be updated on a quarterly basis to reflect eligible plant additions placed in service during the three-month periods ending one month prior to the effective date of each DSIC update. Thus, changes in the DSIC rate will occur as follows:

Effective Date Of Change	Date To Which DSIC-Eligible Plant Addition Reflected
February 1	December 31
May 1	March 31
August 1	June 30
November 1	September 30

Determination of Fixed Costs:

The fixed costs of eligible distribution system improvement projects will consist of depreciation and pre-tax return, calculated as follows:

Depreciation: The depreciation expense will be calculated by applying to the original cost of DSIC-eligible property the annual accrual rates employed in the Company's last base rate case for the plant accounts in which each retirement unit of DSIC-eligible property is recorded.

Pre-Tax Return: The pre-tax return will be calculated using the ~~**statutory** state and federal income tax rates~~ Company's effective tax rate, 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. The cost of equity will be the equity return rate approved in the Company's last fully-litigated base rate proceeding for which a final order was entered not more than two years prior to the effective date of the DSIC. If more than two years shall have elapsed between the entry of such a final order and the effective date of the DSIC, then the equity return rate used in the calculation will be the **equity return rate calculated by the Commission** in the most **recent** Quarterly Report on the Earnings of Jurisdictional Utilities released by the Commission.

[1] Columbia Water is reflecting here only the portions of its DSIC tariff that would be modified under this proposal.

Columbia Water notes that it believes utilities should have options regarding how tax benefits are incorporated into the DSIC. Utilities each face different challenges when it comes to making this change to the DSIC[2] and the Commission should not require a one-size fits all solution, but instead allow any method that is just and reasonable to incorporate tax benefits into the DSIC.

B. Section 1301.1(b) Does Not Allow For Refund Of Differentials

Section 1301.1 specifies that if utility accrues a differential because it applied the ratemaking methods that the Commission used to apply prior to Section 1301.1, then that differential is used specifically 50% for reliability or infrastructure and 50% for general corporate purposes.

> (b) Revenue use.--*If a differential accrues to a public utility* ***resulting from applying the ratemaking methods employed by the commission prior to the effective date of subsection (a)*** for ratemaking purposes, *the differential shall be used as follows*:
>
> (1) fifty percent to support reliability or infrastructure related to the rate-base eligible capital investment as determined by the commission; and
>
> (2) fifty percent for general corporate purposes.

66 Pa. C.S. § 1301.1(b). Thus, the General Assembly has already mandated what the Commission and utilities must do if a differential occurs from the application of Section 1301.1(b) – not order utilities to issue refunds to customers, but instead for utilities to use the differential for infrastructure or reliability and corporate purposes.

The General Assembly wisely recognized that there would be a timing issue in the application of Section 1301.1 – that rates would not just automatically change to incorporate Section 1301.1 on the effective date but instead past Commission rate methodologies would

[2] Columbia Water notes the First Energy companies set forth various reasons against using the Effective Tax Rate methodology. Columbia Water takes no position as to those issues as applied to the First Energy companies.

continue to be used until a rate was in fact changed to comply with Section 1301.1. To resolve this issue, the General Assembly provided for a look back period to the Section 1301.1 effective date and mandated that any difference between what a utility charged under past ratemaking methodology and what it would have charged if it had applied Section 1301.1 would go to a specific use and not be refunded to customers.

Regarding application of Section 1301.1(b), like the specific application of Section 1301.1 to utility DSICs and consistent with CWC's comments above, the Commission should allow utilities flexibility in the method for determining the amount of the differential. CWC at this time favors applying the Effective Tax Rate method to its past DSIC revenues to determine the differential. Then, a utility can either show that it has already used the differential revenues for the purposes stated in 1301.1(b), or the utility can use other existing funds to satisfy any past shortfalls in appropriate use of the differential. This is a simple, efficient way of fulfilling the mandate in Section 1301.1(b) that any differential accrued due to use of past Commission rate methodologies be used 50% for infrastructure and reliability and 50% for general corporate purposes.

IV. CONCLUSION

CWC appreciates the Commission's consideration of these Comments. CWC respectfully requests the Commission allow Columbia to modify its DSIC tariff using the Effective Tax Rate methodology (or any other just and reasonable methodology that may be presented) and that the Commission adhere to Section 1301.1 and find that any differential resulting from application of past Commission rate methodology be used 50% for infrastructure and reliability and 50% for general corporate purposes.

Respectfully submitted,

/s/ Whitney E. Snyder

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