IN THE
COMMONWEALTH COURT OF PENNSYLVANIA

NO. 1549 CD 2018

TANYA J. MCCLOSKEY, ACTING CONSUMER ADVOCATE,
Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

ADVANCE FORM BRIEF OF INTERVENOR UGI UTILITIES, INC. – ELECTRIC DIVISION

Appeal from the Order of the Pennsylvania Public Utility Commission At Docket No. R-2017-2640058, *et al.*, Order Entered October 25, 2018

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TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. COUNTER-STATEMENT OF SCOPE AND STANDARD OF REVIEW 3

III. COUNTER-STATEMENT OF QUESTIONS PRESENTED.....5

IV. COUNTER-STATEMENT OF THE CASE 6

V. SUMMARY OF ARGUMENT 8

VI. ARGUMENT 12

A. THE COMMISSION PROPERLY RELIED ON END OF YEAR DATA IN SETTING UGI ELECTRIC'S RATES PURSUANT TO ACT 11.....13

1. The Plain Language of Act 11 Permits And Contemplates The Use Of End of Year Data. 16

2. OCA's Position Would Undermine Legislative Intent. 21

3. OCA's Statutory Construction And Interpretation Of The Public Utility Code Is Clearly In Error. 24

4. OCA's Argument Is Inconsistent With The Basic Structure Of The Code.26

5. OCA's Argument Is Inconsistent With The Fundamental Roles of The Legislature And Commission In Regulating Public Utilities. 29

6. OCA's Application Of The Just And Reasonable Standard Is Legally Flawed And Factually Deficient. 31

7. OCA's Argument Is Inconsistent With Long-Standing Practice And Precedent. 35

8. The Commission's Decision To Use End Of Year Data Is Supported By Substantial Evidence And Does Not Constitute An Abuse Of Agency Discretion. 38

B. THE COMMISSION PROPERLY CONCLUDED THAT UGI ELECTRIC SATISFIED THE USE OF PROCEEDS REQUIREMENTS OF ACT 40.....48

1. OCA's Approach Is Not Required By Act 40. 50

2. The Commission's Determination As To Act 40 Is Supported By Substantial Evidence And Does Not Constitute An Abuse Of Discretion.54

VII. CONCLUSION.....60

TABLE OF AUTHORITIES

Page

United States Supreme Court Decisions

Duquesne Light Co. v. Barasch, 488 US 299 (1989) .....*passim*

FPC v. Hope Natural Gas Co., 320 US 591 (1944).....33

Permian Basin Area Rate Cases, 390 US 747 (1968).....33

Pennsylvania Court Decisions

Allegheny Cnty. Port Auth. v. Pa. PUC, 237 A.2d 602 (Pa. 1967) 3

Allied Mechanical and Electrical, Inc. v. Pennsylvania Prevailing Wage Appeals Board, 923 A.2d 1220 (Pa. Cmwlth. 2007) 39

Barasch v. Pa. PUC, 507 Pa. 561, 493 A.2d 653 (Pa. 1985) 50

Borough of E. McKeesport v. Special/Temporary Civil Service Commission, 942 A.2d 274 (Pa. Cmwlth. 2008) 4

Chambersburg Gas Co. v. Pub. Serv. Comm'n, 176 A. 794 (Pa. Super. 1935) 39

Chartiers Valley Joint Schools v. Cnty. Bd. of Sch. Dirs. of Allegheny Cnty., 418 Pa. 520, 211 A.2d 487 (Pa. 1965) 29

City of Lancaster (Water) v. Pa. PUC, 769 A.2d 567 (Pa. Cmwlth. 2001) 4

City of Pittsburgh v. Pa. PUC, 400 A.2d 672 (Pa. Cmwlth. 1979).....12

Columbia Gas v. Pa. PUC, 613 A.2d 74 (Pa. Cmwlth. 1992) 14, 27

Commonwealth v. Charles, 270 Pa. Super. 280, 411 A.2d 527 (Pa. 1979).....21

Commonwealth v. Cox, 603 Pa. 223, 983 A.2d 666 (Pa. 2009) 22

Commonwealth v. Wilson, 529 Pa. 268, 602 A.2d 1290 (1992).....54

Continental Telephone Co. of Pa. v. Pa. PUC, 548 A.2d 344 (Pa. Cmwlth. 1988)50

County of Chester v. Philadelphia Electric Company, 420 Pa. 422, 218 A.2d 331, (Pa. 1966) 3

Dee-Dee Cab, Inc. v. Pa. PUC, 817 A.2d 593, 598 (Pa. Cmwlth. 2003) 59

Del. River Port Auth. v. Pa. PUC, 145 A.2d 172 (Pa. 1958) 3

Elder v. Orluck, 511 Pa. 402, 515 A.2d 517 (Pa. 1986) 37

Emporium Water Co. v. Pa. PUC, 955 A.2d 456 (Pa. Cmwlth. 2008) 4

Energy Conservation Council, 995 A.2d 465, 479 (Pa. Cmwlth. 2010) 39

Feingold v. Bell of Pa., 383 A.2d 791, 794 (Pa. 1977).....3

Germantown Cab Co. v. Phila. Parking Auth., 171 A.3d 315 (Pa. Cmwlth 2017).29

Green v. Pa. PUC, 473 A.2d 209 (Pa. Cmwlth. 1984).....13

Heck v. Zoning Hearing Bd., 397 A.2d 15 (Pa. Cmwlth. 1979) 25

HIKO Energy, LLC v. Pa. PUC, 163 A.3d 1079 (Pa. Cmwlth 2017) 30, 40, 44

Kusza v. Maximonis, 363 Pa. 479, 70 A.2d 329 (Pa. 1950) 21

Kyu Son Yi v. State Board of Veterinary Medicine, 960 A.2d 864 (Pa. Cmwlth. 2008) 39

Lower Paxton Twp. v. Pa. PUC, 317 A.2d 917 (Pa. Cmwlth. 1974) 22

Met-Ed Indus. Users Group v. Pa. PUC, 960 A.2d 189 (Pa. Cmwlth. 2008) 39

McCloskey v. Pa. PUC, 127 A.3d 860 (Pa. Cmwlth. 2015) 31

Mt. Village v. Bd. of Supervisors, 582 Pa. 605, 874 A.2d 1 (Pa. 2005) 21

Pa. Elec. Co. v. Pa. PUC, 509 Pa. 324, 502 A.2d 130 (Pa. 1985) 12, 33

Pennsylvania Gas and Water Co., Water Division v. Pa. PUC, 381 A.2d 996 (Pa. Cmwlth. 1977) 28

Popowsky v. Pa. PUC, 550 Pa. 449, 706 A.2d 1197 (Pa. 1997) 3

Popowsky v. Pa. PUC, 669 A.2d 1029 (Pa. Cmwlth. 1995) 4

Popowsky v. Pa. P.U.C., 869 A.2d 1144 (Pa. Cmwlth. 2005) 13, 27, 30

Popowsky v. Pa. P.U.C., 589 Pa. 605, 910 A.2d 38 (Pa. 2006) 3

Program Admin. Servs. v. Dauphin County Gen. Auth., 593 Pa. 184, 928 A.2d 1013, (Pa. 2007) 31

Seeger v. Allstate Ins. Co., 776 F. Supp. 986 (M.D. Pa. 1991) 25

The Bell Telephone Co. of Pennsylvania v. Pa. PUC, 408 A.2d 917 (Pa. Cmwlth. 1979) 36

Administrative Agency Decisions

Implementation of Act 11 of 2012, 2012 Pa. PUC LEXIS 1223 (August 2, 2012) 22

In the Matter of Application of Kentucky-American Water Company, 2010 Ky. PUC LEXIS 1479 (Ky. PSC 2010) 50, 51

Northern States Power Company dba Xcel Energy, 253 PUR 4th 40 (Minn. PUC 2006) 51

Pa. PUC v. Pennsylvania Power Co., 58 Pa PUC 305, 60 PUR4th 593 (Pa. PUC 1984) 37

Pa. PUC, et al., v Pennsylvania Power & Light Co., 54 Pa PUC 645 (Pa. PUC 1981) 37

Pa. PUC, et al., v. PPL Gas Utilities Corp., 2007 Pa. PUC LEXIS 779 (Pa. PUC 2007) 50

Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge, 2018 Pa. PUC LEXIS 147 (Pa. PUC 2018) 52

Re Delmarva Power and Light Company, 278 PUR 4th 419 (Md. PSC 2009) 51

Re SourceGas Distribution LLC, 280 PUR 4th 226 (Neb. PSC 2010) 51

Washington Utilities and Transportation Commission v. PacifiCorp dba Pacific Power & Light Co., 257 PUR 4th 380 (Wash. UTC 2007).....51

Pennsylvania Statutes

1 Pa.C.S. § 1921 21

1 Pa.C.S. § 1921(c)(5) 35

1 Pa.C.S. § 1921(c)(7) 54

1 Pa.C.S. § 1932 26

1 Pa.C.S. § 1933 25

1 Pa.C.S. § 1936 24

66 Pa.C.S. § 101, *et. seq.*. 3, 29,

66 Pa.C.S. § 102 6

66 Pa.C.S. § 315(e) ..... *passim*

66 Pa.C.S. § 1301 ..... *passim*

66 Pa.C.S. § 1301.1 ..... *passim*

66 Pa.C.S. § 1301.1(a) ..... *passim*

66 Pa.C.S. § 1301.1(b) ..... *passim*

66 Pa.C.S. § 1308(d) 6, 17

66 Pa.C.S. § 1311 ..... 26, 28

66 Pa.C.S. § 1315 ..... *passim*

66 Pa.C.S. § 1316 26

66 Pa.C.S. § 1323 26

66 Pa.C.S. § 1326 26

66 Pa.C.S. § 1328 26

66 Pa.C.S. § 1330 26

66 Pa. C.S. § 1352(6) 23

66 Pa.C.S. § 2803 6

66 P.S. § 1141 24

Miscellaneous

83 Ill. Admin. Code. §§ 287.20 and 285.2005(e) 38

Act 11 of Feb. 14, 2012, Pub. L. 72, No. 11 ("Act 11") ..... *passim*

Act 40 of 2016, Pub. L. 332 ("Act 40") .....*passim*

Article III, section 1 of the 1913 Public Service Law 24

House Journal, 2016-117 (Rep. Godshall) 53, 54

Pa. Const. art. II, § 1 29

Public Hearing In Re: House Bill 1436 Before the Pa. H. of Rep. Consumer Affairs Comm., Tr. 5:3-4 and 9:11-10:16 (Pa. 2015). 51

Statutory Construction Act of 1972 21

Webster's New World Dictionary (2d ed. 1980) 18

I. INTRODUCTION

Pending before this Honorable Court is a Petition for Review filed by the Office of Consumer Advocate ("OCA") seeking review of the Opinion and Order of the Respondent Pennsylvania Public Utility Commission ("PUC" or "Commission") entered on October 25, 2018 at Docket No. R-2017-2640058 ("Order"). Therein, UGI Utilities, Inc. – Electric Division ("UGI Electric" or the "Company") was granted a rate increase in the amount of $3.201 million, effective October 27, 2018, based on a Fully Projected Future Test Year ending September 30, 2019. As relevant to this appeal, the Commission: (1) approved UGI Electric's reliance on end of year data for a Fully Projected Future Test Year pursuant to Act 11 of Feb. 14, 2012, Pub. L. 72, No. 11 ("Act 11"); and (2) determined that UGI Electric complied with the use of proceeds requirement of Act 40 of 2016, Pub. L. 332 ("Act 40").

OCA raises two issues in this appeal. First, OCA challenges the Commission's use of end of year data for the Fully Projected Future Test Year. Second, OCA alleges that the Commission failed to properly determine the use of proceeds requirement in Act 40. Importantly, OCA's appeal relates solely to these two issues and does not challenge the overall rate increase approved by the Commission as unjust and unreasonable.

UGI Electric submits this Brief for Intervenor in opposition to OCA's Petition for Review and in support of the Commission's well-reasoned Order. As to each issue, OCA simply refuses to acknowledge the plain language of controlling amendments to the Public Utility Code ("Code") and ignores clear and substantial evidence supporting the Commission's Order. For the reasons explained below, and set forth in the brief of the Commission, the Petition for Review should be denied, and the Commission's Order should be affirmed.

II. COUNTER-STATEMENT OF SCOPE AND STANDARD OF REVIEW

The Commonwealth Court's scope of review of a Commission order is to determine whether the Commission's findings of fact are supported by substantial evidence, whether an error of law was committed or whether constitutional rights were violated. *Popowsky v. Pa. PUC*, 589 Pa. 605, 622, 910 A.2d 38, 48 (Pa. 2006).

The Commission is a "creature of statute" and, therefore, "has only those powers which are expressly conferred upon it by the Legislature" through the Code, 66 Pa.C.S. Section 101 *et seq.* and related statutes and "those powers which arise by necessary implication." *Feingold v. Bell of Pa.*, 383 A.2d 791, 794 (Pa. 1977) (citing *Allegheny Cnty. Port Auth. v. Pa. PUC*, 237 A.2d 602 (Pa. 1967); *Del. River Port Auth. v. Pa. PUC*, 145 A.2d 172 (Pa. 1958)). The Commission's jurisdiction includes rates, rules of service, hazards to public safety from utility facilities, and installation and location of utility facilities. *County of Chester v. Philadelphia Electric Company*, 420 Pa. 422, 425-26, 218 A.2d 331, 333 (Pa. 1966). The Commission's interpretation of the Code should be given great weight and deference, and will not be reversed unless clearly erroneous. *Popowsky v. Pa. PUC*, 550 Pa. 449, 462, 706 A.2d 1197, 1203 (Pa. 1997) ("*Popowsky*").

Pertinent to this appeal, this Court has recognized that ratemaking involves "complex financial determinations and weighing and interpreting statistical and

economic evidence, [which] is within the PUC's area of expertise." *Emporium Water Co. v. Pa. PUC*, 955 A.2d 456, 461 (Pa. Cmwlth. 2008). In its interpretation of the ratemaking provisions of the Code, the Commission is "vested with discretion to decide what factors it will consider in setting or evaluating a utility's rates." *Popowsky v. Pa. PUC (Pa. Cable Television Association)*, 669 A.2d 1029, 1040 (Pa. Cmwlth. 1995). When a decision involves an issue within the Commission's purview, such as ratemaking, decisions are left to the discretion of the Commission as long as there is a rational basis for the Commission's methodology. *Emporium Water Co. v. Pa. PUC*, 955 A.2d 456, 461 (Pa. Cmwlth. 2008).

Moreover, when reviewing a Commission decision, the Court should not substitute its judgment for that of the Commission when substantial evidence supports the Commission's decision on a matter within the Commission's expertise. *City of Lancaster (Water) v. Pa. PUC*, 769 A.2d 567 (Pa. Cmwlth. 2001). Substantial evidence is sufficient evidence that a reasonable mind might accept as adequate to support a conclusion. *Borough of E. McKeesport v. Special/Temporary Civil Service Commission*, 942 A.2d 274, 281 (Pa. Cmwlth. 2008). In short, the reviewing court must take notice of "the deference due the [Commission] in a function peculiarly within its area of expertise." *Popowsky*, 706 A.2d at 1202.

III. COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. Whether the Commission properly concluded that Act 11 of the Public Utility Code authorizes the use of end of year data to establish public utility rates?

Suggested answer: Yes.

2. Whether the Commission's decision to approve the use of end of year data is supported by substantial evidence?

Suggested answer: Yes.

3. Whether the Commission properly concluded as a matter of law and within the scope of its delegated discretion that UGI Electric satisfied the requirements of Act 40 regarding use of proceeds associated with a consolidated tax adjustment?

Suggested answer: Yes.

IV. COUNTER-STATEMENT OF THE CASE

This matter is a Petition for Review in the nature of an appeal from the Commission's October 25, 2018 Order adopting, in relevant part, the Recommended Decision ("RD") of Administrative Law Judges Steven K. Haas and Andrew M. Calvelli (the "ALJs") issued on August 24, 2018.

UGI Electric provides electric distribution services to approximately 61,800 customers in a service territory that spans portions of Luzerne and Wyoming Counties. (UGI Electric St. 1, p. 3; R. ___.) UGI Electric is a "public utility" and an "electric distribution company" ("EDC") as those terms are defined under the Code, 66 Pa.C.S. §§ 102 and 2803.

Pursuant to the provisions of 66 Pa.C.S. § 1308(d), on January 28, 2018, UGI Electric filed tariffs and supporting data to increase its rates for electric distribution service. UGI Electric requested approval of an increase in annual jurisdictional distribution operating revenues of $9.254 million, revised during the course of the proceeding to $7.705 million. In accordance with Section 315(e) of the Code, supporting data for the requested revenue increase was based on a Fully Projected Future Test Year, reflecting end of year data for all elements of the ratemaking formula (revenues, operating expenses, depreciation, taxes, capital investment and return on capital). (UGI Electric St. 1, pp. 3-5; R. ___.) On August 24, 2018, the ALJs issued their RD. The RD recommended an overall

increase in base rates of $2.789 million. (RD at 136; R.____.) As relevant to this appeal, the RD accepted the Company's use of end of year data for the Fully Projected Future Test Year to determine the allowed revenue increase, and found that UGI Electric fully complied with the use of proceeds requirement of Act 40. All parties filed Exceptions and Replies to Exceptions. On October 25, 2018, the Commission entered its Order, approving a rate increase of $3.201 million, and in relevant, part unanimously adopted the RD's findings on Act 11, 66 Pa.C.S. § 315(e), and Act 40, 66 Pa.C.S. § 1301.1.[1] (Order at 25-26, 152; R.____.) On November 26, 2018, OCA filed its Petition for Review.

[1] Other issues were litigated, including: rate of return; items in rate base; operating and maintenance expenses; federal income tax; rate structure and rate design; and reporting issues.

V. SUMMARY OF ARGUMENT

OCA presents two important challenges regarding recent amendments to 66 Pa.C.S. § 315(e) (regarding use of a Fully Projected Future Test Year) and 66 Pa.C.S. § 1301.1 (abolishing consolidated tax adjustments). In each instance, the legislature adopted significant amendments to the Code, which the Commission, as it must, has faithfully applied in carrying out its statutory obligation to establish just and reasonable rates. As to each challenge, OCA seeks to avoid the plain language of the relevant statutory provisions and the Commission's well-supported expert interpretation of its own enabling legislation, thereby interfering with and undermining the purpose of both Acts. In addition, OCA ignores the clear and convincing evidence presented by UGI Electric as to each issue, asking the court to instead reweigh the evidence and reject the Commission's well supported factual findings. OCA's arguments should be rejected, and the Commission's decision should be affirmed.

Section 315(e). Act 11, amending Section 315(e) of the Code, provides for a Fully Projected Future Test Year, as part of comprehensive legislation designed to reduce regulatory lag and support critically needed replacement of aging utility infrastructure. The plain language of Section 315(e) provides that all facilities projected to be in service "during," *i.e.*, at any time within, the Fully Projected Future Test Year may be included in rate base. Following this plain language, the

Commission approved UGI Electric's use of end of year data, including capital investment, to establish new rates. OCA proposed an average year methodology and contended, as it does now, that use of end of year data would allow rates to reflect plant that is not yet in service and allow a utility to initially overearn its allowed rate of return resulting in unjust and unreasonable rates.

As explained below, OCA's proposal should be rejected because: (1) it is patently inconsistent with the plain language of Section 315(e), which specifically authorizes and contemplates use of end of year data, specifically recognizes that not all plant will be in service on the date rates go into effect, and specifically permits all facilities added during the Fully Projected Future Test Year to be included in rate base; (2) it would undermine the fundamental goal of Act 11 to reduce regulatory lag in order to encourage investment in aging utility infrastructure; (3) it violates several well-established principles of statutory construction and is fundamentally inconsistent with the basic structure of the Code and the proper role of the General Assembly and the Commission in regulating public utility rates; (4) it is inconsistent with long-standing Commission precedent regarding test year ratemaking and the timing of the inclusion of plant in rates; (5) it improperly applies the just and reasonable rate standard to a single element of the ratemaking formula contrary to long-standing federal and state appellate precedent; and (6) the Commission's use of end of year data is fully supported by

substantial evidence. OCA's central argument that use of end of year data will result in "overearning" is based on fundamentally flawed factual premises and is patently inconsistent with the plain language of the statute permitting public utilities to include in rate base (and thereby earn a return of and on) all facilities projected to be in service during the Fully Projected Future Test Year. In essence, OCA argues that UGI Electric is overearning because it complied with the plain language of the statute and included in rate base all facilities projected to be placed in service during the Fully Projected Future Test Year. Compliance with the plain language of a statute does not and cannot result in "overearning" or unjust and unreasonable rates.

Section 1301.1. In 2016, the legislature enacted Act 40, adding Section 1301.1 to the Code. Specifically, the legislature amended the Code: (1) to abolish the consolidated tax adjustment ("CTA"); and (2) to require utilities in a base rate case to calculate a hypothetical CTA which would have applied if the adjustment had not been abolished and use 50% of the proceeds for infrastructure improvement projects and 50% for general corporate purposes.

The RD and the Commission unanimously determined that UGI Electric fully complied with the relevant statutory provisions of Act 40. The Commission credited sworn testimony from the Company's expert witness, which definitively states that the proceeds from the CTA will be used for the indicated statutory

purposes. OCA improperly seeks to second guess the Commission's fact finding on this issue. This Court need not and should not step in to reweigh the evidence. Further, even if OCA were correct, the proper remedy would be a remand for further proof of compliance, rather than to adopt OCA's proposal to reinstitute the CTA that was abolished by Act 40.

UGI Electric respectfully requests that this Court affirm the Commission's decision, both as to Act 11 and Act 40.

VI. <u>ARGUMENT</u>

All public utility rates must be just and reasonable. 66 Pa.C.S. § 1301. Rates are just and reasonable when, on an overall basis, they provide the public utility with a fair opportunity to earn a fair return on investments made to serve the public. *See, e.g.*, *City of Pittsburgh v. Pa. PUC*, 400 A.2d 672, 674 (Pa. Cmwlth. 1979). Just and reasonable rates are defined through Commission and court decisions, as governed or changed by legislative enactments. In determining whether rates are just and reasonable courts should examine the overall effect of a rate order, and not individual elements used to determine rates. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989) ("*Duquesne*"); *Pa. Elec. Co. v. Pa. PUC*, 509 Pa. 324, 502 A.2d 130 (Pa. 1985).

The standard applied by the Commission for determining just and reasonable rates under traditional rate of return regulation is reflected in the well-established "ratemaking formula:"

RR = E + D + T + (RB x ROR), where

RR = revenue requirement
E = operating expenses
D = depreciation
T = taxes
RB = rate base (capital investment)
ROR = rate of return on rate base

Act 11 amended the Code with respect to the proper determination of rate base (RB). Specifically, Act 11 permits utilities to include in rate base (RB) and thereby

earn a return on all facilities placed into service during the Fully Projected Future Test Year. Act 40 amended the Code with respect to the proper determination of taxes (T). Specifically, Act 40 ended the CTA in the determination of federal income tax expense.

A. THE COMMISSION PROPERLY RELIED ON END OF YEAR DATA IN SETTING UGI ELECTRIC'S RATES PURSUANT TO ACT 11.

Act 11 was adopted in order to address regulatory lag. In Pennsylvania, as well as most states, the Commission employs cost-of-service ratemaking principles to develop an overall revenue requirement for a defined annual period, or "test year," and then designs rates to afford a utility a reasonable opportunity to recover all reasonable expenses and to earn a return of and on prudent capital investments in facilities used to provide public utility service. The test year reflects a one-year snapshot of a utility's revenues, expenses, rate base and capital costs. *See Popowsky v. Pa. PUC*, 869 A.2d 1144 (Pa. Cmwlth. 2005); *Green v. Pa. PUC*, 473 A.2d 209, 213-215 (Pa. Cmwlth. 1984). Test year data are subject to reasonable adjustments to reflect ongoing, normal operations during the period new rates are expected to be in effect. Under long-standing Commission precedent, end of test year conditions are used to determine the allowed annual revenue requirement. This better reflects the financial condition of the utility during the period rates are in effect.

In Pennsylvania, the original test year used to establish the allowed annual revenue requirement, referred to as an "Historic Test Year", covered the twelve-month period ending before a base rate case was filed, and thus no projections of future conditions were permitted. This resulted in considerable "regulatory lag" because rates were set based on a utility's historical circumstances, and not its circumstances when new base rates would be in effect. In 1978, the legislature amended the Code to permit the use of the twelve-month period following the historic test year – the "Future Test Year," which ended shortly before new rates took effect. *See, e.g., Columbia Gas v. Pa. PUC*, 613 A.2d 74, 76 (Pa. Cmwlth. 1992). The use of a Future Test Year resulted in rates being set at or near the end of a fully litigated base rate case, and so rates were established on a test year that continued to lag the actual conditions during which the rates would be effective. The use of the Future Test Year resulted in less, but still substantial, regulatory lag.

In times of increased capital spending to replace aging infrastructure, the issue of regulatory lag becomes a significant problem. A utility's annual revenue requirement will continue to increase each year as it makes significant new capital investments, but it will have its allowable annual revenue requirement set based on stale data from test years that have already elapsed. This lag prevents a utility with a large, ongoing capital improvement program from being able to earn the allowed return on its investment. The General Assembly sought ways to address regulatory

lag, in order to encourage significantly expanded investments to replace and upgrade aging utility infrastructure.

Act 11 addressed the issue of regulatory lag in two complementary ways. First, it amended the Code to allow the use of the Fully Projected Future Test Year. As a result, base rates will reflect the expected operating conditions during the twelve month period after rates go into effect. The General Assembly recognized, however, that even this change would only provide an opportunity for a public utility to earn a reasonable return on accelerated capital investments for a short period of time, and could result in serial base rate case filings. Thus, Act 11 also adopted complementary statutory provisions authorizing:

a. Long-term Infrastructure Improvement Plans ("LTIIP") to establish multi-year plans for accelerated capital investments with Commission review and approval;
b. Annual filings to allow Commission review of LTIIP progress; and
c. Use of a distribution system improvement charge ("DSIC") upon Commission approval, providing an opportunity for public utilities to earn a return on and of LTIIP investments made beyond the levels included in base rates (presumably set using the newly authorized Fully Projected Future Test Year).

These complementary Act 11 provisions encouraged public utilities to accelerate capital investments by reducing the need to file serial base rate cases, which would otherwise be triggered by a substantial multi-year capital investment plan of the sort that is now approved in LTIIPs.

OCA contends that the Commission erred when it established rates for UGI Electric based on end of year plant balances for the Fully Projected Future Test Year. OCA Br. at 32. Specifically, OCA contends that use of end of year data will permit UGI Electric to initially overearn its allowed rate of return resulting in unjust and unreasonable rates in violation of Section 1301 of the Code. Instead, OCA supports the use of an average test year. OCA Br. at 30-31. OCA's position ignores the plain language of the statute, the clear intent of the General Assembly, well-established principles of statutory construction, and long-standing judicial and Commission precedent. As explained below, OCA's arguments should be rejected, and this Court should affirm the Commission's determination.

1. The Plain Language of Act 11 Permits And Contemplates The Use Of End of Year Data.

It is undisputed that Act 11 specifically permits, and indeed, fully contemplates, that the Commission may employ end of year plant balances for a Fully Projected Future Test Year. The RD in adopting end of year data, found that "the plain language and policy of Act 11 supports UGI Electric's position." (RD at 19; R.____.)

Act 11 amended Section 315(e) of the Code to add the Fully Projected Future Test Year, as follows:

> (e) Use of future test year. – In discharging its burden of proof the utility may utilize a future test year or a fully projected future test year, which shall be the 12-month period beginning with the first month that the new rates will be placed in effect after application of the full suspension period permitted under section 1308(d) (relating to voluntary changes in rates). The commission shall promptly adopt rules and regulations regarding the information and data to be submitted when and if a future test period or a fully projected future test year is to be utilized. Whenever a utility utilizes a future test year or a fully projected future test year in any rate proceeding and such future test year or a fully projected test year forms a substantive basis for the final rate determination of the commission, the utility shall provide, as specified by the commission in its final order, appropriate data evidencing the accuracy of the estimates contained in the future test year or a fully projected future test year, and the commission may after reasonable notice and hearing, in its discretion, adjust the utility's rates on the basis of such data. Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the commission may permit facilities which are projected to be in service during the fully projected future test year to be included in the rate base.

66 Pa.C.S. § 315(e) (underline indicating language added by Act 11). The plain language of the statute allows utility rates to reflect the full "12-month period beginning with the first month that the new rates will be placed in effect." More specifically, utilities employing a Fully Projected Future Test Year may include in rate base all facilities placed in service "during" that 12-month period. This, of

course, would include the full amount of all facilities added at any time "during" the year, beginning with the first day of the year and ending with the last day of the year.

The definition of the term "during" is "throughout the entire time of." *During*, Webster's New World Dictionary (2d ed. 1980). Thus, all plant added "throughout the entire time of" the year, whether on the first day of the year or the last day of the year, is added "during" the year and should be fully reflected in rates. By analogy, consider a basketball game in which one team scores a point in the last second to win a game. Any reasonable person would have to agree that this last second point was scored "during" the game. Without some further instruction in the plain language of the statute, the term "during" clearly encompasses the inclusion of all plant placed in service at any time within the test year.

Despite this plain language, OCA contends that the Commission's result is improper because when new rates take effect they will initially reflect plant that is not yet in service, and the utility will initially overearn its allowed rate of return, resulting in rates that are not just and reasonable. Indeed, Section 1315 prohibits utilities from including certain property in rates before it is placed in service:

> Except for such nonrevenue producing, nonexpense reducing investments as may be reasonably shown to be necessary to improve environmental conditions at existing facilities or improve safety at existing facilities

> or as may be required to convert facilities to the utilization of coal, the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.

66 Pa.C.S. § 1315. However, OCA fails to note that Act 11 specifically provides that Section 1315 does not apply to claims for plant in service in a Fully Projected Future Test Year:

> Notwithstanding section 1315 (relating to limitation on consideration of certain costs for electric utilities), the commission may permit facilities <u>which are projected to be in service during the fully projected future test year</u> to be included in the rate base.

66 Pa.C.S. § 315(e) (emphasis added). Through this provision, it is clear that the General Assembly specifically considered OCA's "in service" issue and chose to allow rates based on a Fully Projected Future Test Year to reflect plant that was not yet in service when rates initially go into effect as long as such plant will be placed into service "during" the 12-month period thereafter.

OCA itself candidly admits that the Fully Projected Future Test Year permits a utility to include in its rate base plant that goes into service during the 12 month period after rates initially go into effect. OCA states:

> OCA does not dispute that when read together, these two provisions provide that when a FPFTY is used to project an electric utility's revenues, expenses, and rate base eligible capital investments, an electric utility will be permitted to include in its rate base projected plant and investments that are not used and useful on the day that rates go into effect.

OCA Br. at 32. Reduced to its essence, OCA contends that UGI Electric is "overearning" because it complied with the plain language of Section 315 and included in rate base all facilities projected to be in service during the Fully Projected Future Test Year. Compliance with a clear statutory provision cannot, by definition, result in "overearning" or unjust and unreasonable rates.

Applied to this proceeding, OCA's methodology will exclude from rate base and disallow cost recovery on approximately $14.55 million associated with capital investments and infrastructure projects that will be placed in service during the Fully Projected Future Test Year.[2] This result is plainly contrary to the express provisions of Section 315, which permits a utility to include facilities projected to be in service during the Fully Projected Future Test Year, and would disallow cost recovery for 50% of the capital investment made during the Fully Projected Future Test Year, in violation of the plain language of the statute.

[2] UGI Electric's projected plant balance at the end of the Fully Projected Future Test Year was $188,423,000. (Order at 20; R.___.) OCA's average method is based on the average of the beginning of year plant balance ($159,319,636) and the end of year balance ($188,423,000), *i.e.*, $173,871,318. (UGI Electric St. 4-R, p. 2; R.___.; updated for rebuttal) Thus, OCA's approach would effectively disallow cost recovery of $14,551,682 ($188,423,000-$173,871,318).

The Pennsylvania Supreme Court has held that 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)). There is nothing in Act 11 compelling the use of OCA's average methodology. Section 315(e) clearly says the calculation should reflect a "fully projected" year. It does not provide for a "partially projected" year, "average plant", or any other adjustment to end of year plant in service. Rather, Act 11 says, simply and directly, that plant added "during" the Fully Projected Future Test Year may be included in rate base.[3] Adoption of OCA's average approach would effectively nullify Section 315(e).

2. OCA's Position Would Undermine Legislative Intent.

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

[3] The doctrine of *expressio unius est exclusio alterius* – the inclusion of a specific matter in a statute implies the exclusion of other matters – supports the Commission's conclusion that OCA's proposed additions are not required by law. *See, e.g.*, *Commonwealth v. Charles*, 270 Pa. Super. 280, 411 A.2d 527, 530 (Pa. 1979) (explaining that "[t]he maxim, *expressio unius est exclusio alterius*, establishes the inference that, where certain things are designated in a statute, 'all omissions should be understood as exclusions.'").

ascertain the intent of the Legislature." *Commonwealth v. Cox*, 603 Pa. 223, 283, 983 A.2d 666, 703 (Pa. 2009).

The General Assembly passed Act 11 to reduce regulatory lag and thereby encourage public utilities to replace aging infrastructure. *See Implementation of Act 11 of 2012*, 2012 Pa. PUC LEXIS 1223 at *4-5, 7, 90 (Order entered Aug. 2, 2012) (purpose of Act 11 was "to reduce regulatory lag due to the use of rate case inputs that are outdated by the time new base rates become effective"). The RD identified the legislative intent, finding "Act 11 fundamentally altered ratemaking in Pennsylvania by adopting the FPFTY to reduce the risks associated with regulatory lag." Regulatory lag is a major concern that must be addressed in order to promote infrastructure improvement programs that ensure that safe and reliable service is available in Pennsylvania. *See, e.g., Lower Paxton Twp. v. Pa. PUC*, 317 A.2d 917, 921 (Pa. Cmwlth. 1974) (recognizing regulatory lag as an important variable the Commission should address in the ratemaking process). In this proceeding, the Commission stated it "has long recognized regulatory lag as an important variable that should be addressed in the ratemaking process." (Order at 23; R.____.) OCA does not deny that the legislative objective in passing Act 11 was to reduce regulatory lag and thereby facilitate utility replacement of aging infrastructure.

Aging utility infrastructure is a major issue for UGI Electric and all public utilities in the Commonwealth. For example, "UGI Electric has recently accelerated investment in the repair, replacement or improvement of aged and aging distribution infrastructure…the Company's investment in the repair, replacement or improvement of aged and aging distribution infrastructure has been increased by over 100% compared to historic baseline levels, contributing to rate base growth." (UGI Electric St. 1, p. 5; R.___.) From 2015 to 2016, the Company's distribution replacement and betterment spending increased by 54%. Between 2016 and 2017, it increased by an additional 6%. (UGI Electric St. 3, p. 13; R.___.) UGI Electric is investing far more in repairing and replacing aging facilities, in order to maintain and improve its current quality of service.

Aging infrastructure is a major statewide issue for gas, electric, water, and wastewater companies alike. Act 11 has many provisions that clearly focus on this critical infrastructure replacement. Section 1352(6) of the Code, for instance, provides that an LTIIP must specify: "The manner in which the replacement of aging infrastructure will be accelerated and how the repair, improvement or replacement will ensure and maintain adequate, efficient, safe, reliable and reasonable service." 66 Pa.C.S. § 1352(6).

OCA's approach does not meaningfully accomplish the General Assembly's goal of addressing regulatory lag. The practical effect of OCA's methodology is to

create a "Partially" or "Average" Projected Future Test Year, which dramatically understates the total plant additions and other expenses for the test year. As noted above, for UGI Electric, a small utility by Pennsylvania standards, OCA's approach will understate the Company's total plant by approximately $14.55 million at the end of the test year. *Infra*. at 20.

3. OCA's Statutory Construction And Interpretation Of The Public Utility Code Is Clearly In Error.

OCA concedes that Section 315(e) of the Code permits use of end of year data for a Fully Projected Future Test Year, but argues the use of the end of year data should not be permitted because it would produce rates that are not just and reasonable pursuant to Section 1301. OCA Br. at 32. This argument is fundamentally inconsistent with well-established principles of statutory construction.

First, it is well established that later enacted amendments to a statutory scheme control previously enacted provisions. 1 Pa.C.S. § 1936. The "just and reasonable" standard in Section 1301 has been part of the Code and its predecessor statutes since 1913.[4] Act 11's modification of Section 315(e) in 2012 was a

[4] The language reflected in 66 Pa.C.S. § 1301 establishing the just and reasonable standard is similar to the standard adopted in Article III, section 1 of the 1913 Public Service Law that "[i]t shall be lawful for every public service company to demand, collect and receive fair, just and reasonable prices, rates, fares, tolls, charges, or other compensation for each and every service rendered or to be rendered by it to any person or corporation." In addition, the language is similar to the standard adopted in 1937 at 66 P.S. § 1141 which provided: "Every rate made,

specific refinement and interpretation of the just and reasonable standard. This later enactment must control.

Second, 1 Pa.C.S. § 1933 provides that specific statutory provisions control over general ones. *See, e.g., Heck v. Zoning Hearing Bd.*, 397 A.2d 15, 17 (Pa. Cmwlth. 1979) ("*Heck*"). Whenever a general provision in a statute is in conflict with a specific provision in the same or another statute, the two shall be construed, if possible, so that effect may be given to both, and if the conflict between the two provisions is irreconcilable, the specific provision shall prevail and shall be construed as an exception to the general provision. *See, e.g., Seeger v. Allstate Ins. Co.*, 776 F. Supp. 986 (M.D. Pa. 1991). It is well-established that specific statutory provisions act as exceptions to general statutory provisions, particularly when the specific provision is adopted after the general provision. *See, e.g., Heck*, 397 A.2d at 17 (Pa. Cmwlth. 1979).

Act 11 is a specific amendment interpreting and defining application of the general just and reasonable rate standard in Section 1301. Contrary, to OCA's argument, Section 1301 must be read and applied in light of Section 315(e), not vice-a-versa.

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demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission."

4. OCA's Argument Is Inconsistent With The Basic Structure Of The Code.

The ratemaking provisions of the Code are contained largely in Chapters 3, 5 and 13. These provisions must be interpreted as an integrated whole. *See* 1 Pa.C.S. § 1932 (statutes or parts of statutes are *in pari materia* when they relate to the same persons or things or to the same class of persons or things, and shall be construed together, if possible, as one statute). While Section 1301 establishes the general standard for ratemaking, other subsequently adopted sections of the Code include exceptions and adjustments to the just and reasonable standard that must be read together and so applied by the Commission and the courts.

The Code contains many examples of the legislature establishing rules and guidance as to what constitutes "just and reasonable" rates. Some notable examples include: (1) Section 1301.1, which amended the Code to reverse judicial precedent regarding consolidated tax savings adjustments; (2) Section 1311, which amended the Code to require the use of original cost instead of fair value to determine rate base; (3) Section 1316, prohibiting recovery of certain employee expenses and advertising expenses in rates; (4) Section 1323, dealing with recovery of new generation costs in rates; (5) Section 1326, prohibiting standby charges; (6) Section 1328, establishing certain rules for setting public fire hydrant rates; (7) Section 1330, providing for certain forms of alternative ratemaking. In each instance, the legislature has updated the ratemaking process to more

specifically define what constitutes just and reasonable rates and how such rates are to be set.

Act 11 is one of the most recent amendments to the general just and reasonable rate standard. Prior to Act 11, utilities were not permitted to recover capital costs through a Section 1307 automatic adjustment clause, and were limited to use of a future test year. *See, e.g., Popowsky v. Pa. PUC*, 869 A.2d 1144 (Pa. Cmwlth. 2005); *Columbia Gas v. Pa. PUC*, 613 A.2d 74 (Pa. Cmwlth. 1992). In order to reduce regulatory lag and facilitate investment in aging utility infrastructure, the legislature amended the Code to create the DSIC and authorize the use of the Fully Projected Future Test Year in setting base rates. In each case, the legislature properly acted to amend and further refine what constitutes just and reasonable rates.

In arguing that rates established using end of year data for the Fully Projected Future Test Year are not just and reasonable, OCA turns the Code on its head. The specific adjustments adopted by the General Assembly define, interpret, limit, or alter the just and reasonable standard, not vice-a-versa. Section 315 specifically contemplates that all facilities placed into service during the Fully Projected Future Test Year may be included in rate base on which the utility is allowed to earn a return. This is a specific amendment to the more general just and reasonable standard. Under OCA's interpretation, the more specific and more

recent legislative determination by the General Assembly authorizing the use of end of year data in the formulation of just and reasonable rates would be discarded.

Taken to its logical limits, OCA's analysis would prevent the legislature from effectively amending the just and reasonable rate standard. For example, prior to 1984 under long-standing judicial precedent, the Commission had authority to use fair value to determine rate base valuation. *See, e.g.*, *Pennsylvania Gas and Water Co., Water Division v. Pa. PUC*, 381 A.2d 996, (Pa. Cmwlth. 1977). Adoption of Section 1311 altered this precedent and mandated that original cost be used to determine rate base. 66 Pa.C.S. § 1311 ("The value of the property of the public utility included in the rate base shall be the original cost of the property when first devoted to the public service less the applicable accrued depreciation as such depreciation is determined by the commission.") Under OCA's view, a utility could challenge Section 1311's original cost requirement by arguing that it did not produce "just and reasonable" rates. This simply makes no sense.

Act 11 is not unique in its modification of the Commission's ratemaking practices; it reflects the General Assembly's regular exercise of its authority to adjust the practices and policies that govern utility rates and to further define what constitutes just and reasonable rates.

5. OCA's Argument Is Inconsistent With The Fundamental Roles of The Legislature And Commission In Regulating Public Utilities.

OCA's argument that Section 1301 of the Code regarding just and reasonable rates controls Section 315(e) regarding use of a Fully Projected Future Test Year also is fundamentally inconsistent with the proper role of the legislature in regulating public utilities, and the role of the Commission in effectuating legislative intent. OCA Br. at 32.

Legislative power in Pennsylvania is vested with the General Assembly. Pa. Const. art. II, § 1. In exercising this power, the General Assembly "must make the basic policy choices" and may "impose upon others the duty to carry out the declared legislative policy in accordance with the general provisions of the statute." *See Chartiers Valley Joint Schools v. Cnty. Bd. of Sch. Dirs. of Allegheny Cnty.*, 418 Pa. 520, 211 A.2d 487, 492 (Pa. 1965); *see also Germantown Cab Co. v. Phila. Parking Auth.*, 171 A.3d 315, 330-331 (Pa. Cmwlth 2017). Through its legislative power, the General Assembly has established the Commission and defined its powers and duties. 66 Pa.C.S. § 101 *et seq*.

With respect to rates, the General Assembly enacted Section 1301, establishing the broad, general rule that rates must be "just and reasonable." This general standard has been subsequently defined, interpreted, and applied in three

ways: (1) Commission interpretation; (2) judicial interpretation; and (3) further legislative amendments to the Code.

The Commission routinely applies the Code in the course carrying out its statutory obligations thereunder. Those interpretations are entitled to great deference and should not be reversed unless clearly erroneous. As this Court recently found, "[t]he PUC's interpretations of the Public Utility Code, the statute for which it has enforcement responsibility… are entitled to great deference and should not be reversed unless clearly erroneous." *HIKO Energy, LLC v. Pa. PUC*, 163 A.3d 1079, 1094-1095 (Pa. Cmwlth 2017) ("*HIKO*"). On occasion, the Commission's determination of just and reasonable rates is appealed to the appellate courts, which establish binding precedent on the Commission. Finally, the legislature may step in and amend the Code to interpret or define Section 1301, either as a general policy matter or to overturn Commission or court precedent.

A good example of this process is the use of the DSIC. The General Assembly first authorized a DSIC that applied only to water utilities. *See* 66 Pa.C.S. § 1307(g) (repealed). The Courts determined that the DSIC was an exception to the normal ratemaking process that was available only to water utilities, and rejected its use by other utilities as being unjust and unreasonable. *Popowsky v. Pa. PUC*, 869 A.2d 1144, 1157 (Pa. Cmwlth. 2005). In 2012, the General Assembly passed Act 11, which made the DSIC available to gas, electric,

and wastewater utilities. Upon enactment, the Commission authorized the use of the DSIC for non-water utilities, and this Court affirmed that its use produces just and reasonable rates. *McCloskey v. Pa. PUC*, 127 A.3d 860 (Pa. Cmwlth. 2015).

The role of the Court is to ensure that the will of the General Assembly is effectuated so long as a statute is constitutional. Specifically, "it is the Legislature's chief function to set public policy and the courts' role to enforce that policy, subject to constitutional limitations." *Program Admin. Servs. v. Dauphin County Gen. Auth.*, 593 Pa. 184, 192, 928 A.2d 1013, 1017-1018 (Pa. 2007). OCA asks this Court to improperly deprive the General Assembly of its authority to establish public policy, where the plain language of the statute and the legislative intent are clear. Further, OCA asks this Court to limit the Commission's exercise of discretion in carrying out the will of the General Assembly, with no showing that the Commission has abused its discretion. The Court should reject this approach.

6. OCA's Application Of The Just And Reasonable Standard Is Legally Flawed And Factually Deficient.

Even if the Court were to accept OCA's reliance on the just and reasonable standard, which it should not for the reasons previously stated, OCA's application of that standard does not comport with decades of analysis on how to determine whether rates are just and reasonable. Further, OCA's overearning argument must fail when considered in light of the record evidence.

a. Proper Application Of The Just And Reasonable Standard Considers The "Total Effect" Of A Rate Order And Not Individual Elements Of Ratemaking.

The standard for assessing whether rates are just and reasonable is set forth by the United States Supreme Court in *Duquesne*. In that case, a Pennsylvania public utility, Duquesne Light Company, sought to include in rates the costs associated with the cancellation of the construction of a nuclear power plant. The Commission rejected this claim and excluded the costs from rates. Duquesne appealed and the case was ultimately resolved by the United States Supreme Court which addressed the question of whether the exclusion of a specific cost item (nuclear plant cancellation costs) resulted in rates that were unjust and unreasonable. The Court rejected Duquesne's interpretation of the just and reasonable standard, as follows:

> [C]ircumstances may favor the use of one ratemaking procedure over another. The designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors. The Constitution within broad limits leaves the States free to decide what ratesetting methodology best meets their needs in balancing the interests of the utility and the public.

Duquesne, 488 U.S. at 316. Under *Duquesne*, the states are accorded the discretion to decide how to determine just and reasonable rates in light of the specific circumstances they seek to address. Any determination regarding whether

resulting rates are just and reasonable must look at the total effect of rates in the light of proper statutory analysis. *Id*. at 314.

In *Duquesne*, the Supreme Court held that "the economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result." *Id.*; *see also Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968) ("[N]either law nor economics has yet devised generally accepted standards for the evaluation of rate-making orders"). The Court observed:

> [W]e reaffirm these teachings of [*FPC v. Hope Natural Gas Co*., 320 US 591, 602 (1944)]: '[I]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry. . . is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.' *Id*. at 602.

Id. at 314. In *Pa. Elec. Co. v. Pa. PUC*, 509 Pa. 324, 329, 502 A.2d 130, 133 (Pa. 1985), the Pennsylvania Supreme Court adopted the same standard, and held that the "focus of inquiry is properly upon the 'total effect' of the rate order, rather than upon the rate-setting method employed." This Court must consider the total impact of the rates in determining whether rates are just and reasonable.

OCA's argument that unjust and unreasonable rates are produced when using an end of year <u>method</u>, rather than an average <u>method</u>, for calculating the Fully Projected Future Test Year is essentially the same argument that was rejected in *Duquesne*. A reviewing court will not find rates to be unjust and unreasonable

unless the overall impact of a rate order is unreasonable. Here, the Commission granted UGI Electric an increase of $3.201 million, less than 50% of its revised requested request of $7.705 million. (Order at 188; R.___.) OCA does not contend that this overall increase is unjust and unreasonable and has not raised this issue on appeal. Selection of competing ratemaking methods is a matter of Commission discretion, which will not be overturned unless the overall result of the ratemaking results in unjust and unreasonable rates.

b. OCA's Analysis Is Factually Wrong And Is Premised Entirely On Its Own Erroneous Interpretation Of Section 315.

In addition to these legal errors, OCA's contention that rates based on end of year data results in "overearning" is factually wrong and inconsistent with the plain language of Act 11. As explained below in Section VI.A.8, OCA's argument is based on the faulty premise that rates should be evaluated on a monthly basis as opposed to an annual basis and incorrectly assumes that new rates will only be in effect for one year. The Commission properly rejected these premises and approved the Company's use of end of year data.

Moreover, OCA's overearning argument assumes that overearning occurs whenever rates reflect plant not yet in service. As explained in detail above, this analysis is inconsistent with the plain language of Section 315 specifically permitting utilities to include in rate base (and earn a return on) facilities not yet in

service. Reduced to its core, OCA makes the clearly erroneous argument that UGI Electric is overearning because it followed the plain language of Act 11. The Commission properly rejected OCA's "overearning" argument and that decision is clearly supported by substantial evidence and should be affirmed.

7. OCA's Argument Is Inconsistent With Long-Standing Practice And Precedent.

OCA argues that the rates developed by the Commission based on end of year data improperly reflect plant not yet in service and that such rates are not just and reasonable. (OCA Br. at 36-37.) This argument is inconsistent with the Commission's long-standing ratemaking practices and extensive precedent. As a result, OCA's argument should be rejected.

a. OCA Ignores The Long History Of Ratemaking Based On The End Of Year Data.

OCA has not, and cannot, cite to a Pennsylvania case where the Commission has ever used an average rate base approach. On the contrary, the Commission has consistently used end of year data to establish rates. When the General Assembly enacted Act 11, it did not create a separate provision for the Fully Projected Future Test Year. Instead, the General Assembly added the Fully Projected Future Test Year to Section 315(e), the existing statute authorizing the Future Test Year. Former law, including other statutes upon the same or similar subjects, are relevant to interpreting newly enacted statutes. 1 Pa.C.S. § 1921(c)(5). In this instance, the

prior body of law includes Commission precedent pertaining to its use of end of Future Test Year data in setting rates. The Commission, as affirmed by the Courts of Pennsylvania, consistently used end of year data in calculating just and reasonable rates under Section 315(e). *See, e.g.*, *The Bell Telephone Co. of Pennsylvania v. Pa. PUC*, 408 A.2d 917 (Pa. Cmwlth. 1979). Based upon this relevant history and the lack of express language to the contrary, the Commission correctly concluded that the General Assembly did not intend to change the Commission's long-standing reliance on end of year data.

OCA argues that the Commission's historic practice should be rejected because overearning was not a concern with the Future Test Year. This argument is factually incorrect. This Court heard cases on the just and reasonable standard prior to Act 11 that were premised on overearning. It is simply incorrect to say that overearning was not a concern prior to the adoption of Act 11.

b. OCA's Position Ignores The Historic Application Of The Just And Reasonable Standard To Plant Not Yet In Service.

OCA contends that rates reflecting plant not yet in service cannot be just and reasonable, because it will allow the recovery of costs the utility has not yet incurred. This contention ignores long-standing precedent where the Commission has included land and plant in rates before it is placed into utility service.

Prior to the passage of Section 1315, which largely prohibited the inclusion of plant in rates before it was placed into service, the Commission reflected in rates certain construction work in progress that was projected to be in service in the first six months after the end of the future test year. *See, e.g., Pa. PUC v. Pennsylvania Power Co.*, 58 Pa PUC 305, 60 PUR4th 593 (1984). This was also true for land held for future use. *See, e.g., Pa. PUC, et al., v Pennsylvania Power & Light Co.*, 54 Pa PUC 645 (1981). Further, even Section 1315 permits certain categories of plant not yet in service to be reflected in rates. *See* 66 Pa.C.S. § 1315; Section VI.A.1 *supra*.

OCA's argument regarding the inclusion of plant in rates before it is placed into service is inconsistent with the Code, the plain language of Section 315(e), and long-standing Commission precedent and should be rejected.

c. OCA's Reliance On Illinois Case Law Should Be Rejected.

In support of its position, OCA calls the Court's attention to a case involving the Illinois Commerce Commission. OCA Br. at 39. The Pennsylvania courts have held that the practices and policies of other jurisdictions have little or no relevance in the interpretation of Pennsylvania law. *See Elder v. Orluck*, 511 Pa. 402, 515 A.2d 517 (Pa. 1986) (noting 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).[5]

Further, looking at one isolated element from Illinois ratemaking is neither proper nor probative. Different jurisdictions adopt very different approaches to the numerous major and minor components included in the ratemaking process.[6] It is the totality of all of these adjustments that is relevant to a determination on whether rates are just and reasonable. *See, e.g.*, *Duquesne*, 488 U.S. at 314 (1989). It is neither appropriate nor informative to cite to one provision of a jurisdiction's ratemaking practice without looking at other issues and aspects of that jurisdiction's overall ratemaking policy.

8. The Commission's Decision To Use End Of Year Data Is Supported By Substantial Evidence And Does Not Constitute An Abuse Of Agency Discretion.

OCA argues that the Commission's decision was not supported by substantial evidence. OCA Br. pp. 40-42. OCA's argument simply ignores the voluminous record relied upon by the Commission which was discussed in detail in its Order. *See* OCA Br., App. A pp. 18-26.

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[5] The Commission's Order fully considered and rejected the relevance of OCA's argument. (Order at 25-26; R.___.)

[6] While the Court should reject the relevance of OCA's reference to the Illinois Commerce Commission decision on page 39 of OCA's brief, because it is inconsistent with the Court's longstanding treatment of cases from other jurisdictions, it is critical to note that the Illinois statute and regulations supporting that decision, 83 Ill. Admin. Code. §§ 287.20 and 285.2005(e), permits the use of a year-end rate base where certain evidentiary requirements are met.

In reviewing cases from the Commission, this Court has explained that a request to reweigh the evidence is improper. The Court has held:

> When reviewing a PUC decision, the Court should neither "substitute its judgment for that of the PUC when substantial evidence supports the PUC's decision on a matter within the commission's expertise," nor should it indulge in the process of weighing evidence and resolving conflicting testimony. Judicial deference is even more necessary when the statutory scheme is technically complex, as it is in this case.

Energy Conservation Council, 995 A.2d 465, 479 (Pa. Cmwlth. 2010) (citation omitted). It is well-established that any finding of fact necessary to support an adjudication of the Commission must be based upon substantial evidence. *Met-Ed Indus. Users Group v. Pa. PUC*, 960 A.2d 189, 193 n.2 (Pa. Cmwlth. 2008) (citing 2 Pa.C.S. § 704). Substantial evidence is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. *Borough of E. McKeesport*, 942 A.2d at 281. Although substantial evidence must be "more than a scintilla and must do more than create a suspicion of the existence of the fact to be established," *Kyu Son Yi v. State Board of Veterinary Medicine*, 960 A.2d 864, 874 (Pa. Cmwlth. 2008) (citation omitted), the "presence of conflicting evidence in the record does not mean that substantial evidence is lacking." *Allied Mechanical and Electrical, Inc. v. Pennsylvania Prevailing Wage Appeals Board*, 923 A.2d 1220, 1228 (Pa. Cmwlth. 2007) (citation omitted). Evidence supporting a different result than the one reached by the Commission is irrelevant so long as the record

contains substantial evidence supporting the Commission's decision. *HIKO*, 163 A.3d at 1094-1095.

As shown in the following sections, the Company produced substantial evidence that its methodology would result in just and reasonable rates, as well as evidence showing that OCA's methodology was flawed. The Commission properly credited the Company's testimony and rejected OCA's evidence.

a. The Commission's Order Is Supported By Substantial Evidence.

The Company produced substantial evidence in support of its position that the rates developed using the end of year method are consistent with Act 11, and that such rates are just and reasonable.

- Act 11 clearly contemplates that plant placed in service throughout the Fully Projected Future Test Year may be included in rate base. (UGI Electric St. 4-R, p. 5; R. ___.)
- The Company's rate base claim in this proceeding follows Act 11 and reflects all plant placed in service during the Fully Projected Future Test Year. (UGI Electric St. 4, pp. 5-7; R. ___.)
- The Company's end of year methodology reflects the well-established principal that rates are established on an annual basis, and not a monthly basis. (Tr. 136:6-137:16; R. ____.)
- UGI Electric's end of year method will produce rates that recover the full revenue requirement on an annual basis. (UGI Electric St. 2, pp. 3-4, 10-11; R. ___.)
- The Company's year-end methodology will reduce regulatory lag and is fully consistent with the underlying purpose of Act 11. (UGI Electric St. 4-R, pp. 3-4; R. ___.)

- The end of year method is consistent with prospective ratemaking and the fact that rates set in this proceeding will be in effect for three or more years. (UGI Electric St. 4-R, pp. 3-4; R. ___.)

- The Company will not overearn its allowed rate of return. (UGI Electric St. 4-RJ, p. 2-4; R. ___.)

In addition to the affirmative evidence supporting the use of the Fully Projected Future Test Year, the Commission also relied on substantial evidence showing that the alternative method proposed by OCA would not produce just and reasonable rates.

- Section 315(e) says nothing about the use of average plant in service additions during the FPFTY as suggested by I&E and OCA. (UGI Electric St. 4-R, p. 5; R. ___.)

- Under OCA's proposal, one-half of the plant placed in service during the Fully Projected Future Test Year would not be included in rate base, which is clearly contrary to Section 315(e) and accepted standards for public utility ratemaking. (UGI Electric St. 4-R, p. 5; R. ___.)

- It is undisputed that OCA's average methodology would deny any return on approximately $14.55 million for UGI Electric, which is the amount of plant added during the second half of the Fully Projected Future Test Year.

- The use of average plant in service complicates the alignment of test year plant with test year accumulated deferred income tax, accumulated depreciation, annualized depreciation expense, and the annualization of revenues and expenses. (UGI Electric St. 4-R, p. 4; R. ___.)

- The average methodology assumes that rates should be evaluated on a monthly basis, rather than an annual basis. OCA Br. 33-34; 36-37.

- The average method assumes that rates will only be effective for one year and utilities will file annual rate cases. (UGI Electric St. 4-RJ, p. 2; R. ___.)

UGI Electric produced substantial evidence showing that the rates developed using end of year data would be just and reasonable, and that OCA's method had serious deficiencies. The Commission relied upon this evidence to conclude that end of year data continues to produce just and reasonable rates when used in conjunction with the Fully Projected Future Test Year.

b. The Use Of End Of Year Data Is Appropriate Because Rates Are Established On An Annual Basis And Because Rates Are Presumed To Be In Effect For More Than One Year.

OCA's primary factual argument is that use of end of year data in a Fully Projected Future Test Year will result in "overearning" during the early months new rates are effective. This argument is based on two fundamentally flawed assumptions: (1) that rates should be evaluated on a monthly basis, rather than an annual basis; and (2) that rates will only be effective for one year and that utilities will file annual rate cases. The Company's method, as adopted by the Commission, correctly establishes prospective rates that are just and reasonable on an annual basis.

Rates in a test year are established based on a utility's <u>annual</u> revenue requirement. (UGI Electric St. 2, pp. 10-11; R. ___.) Rates set in this proceeding provide for 12 months' return of and on the approved rate base. (UGI Electric St. 2, pp. 3-4, 10-11; R. ___.) Rates are prospective in nature, with the anticipation

that rates will be in effect for more than one year. (UGI Electric St. 4-RJ, p. 2; R. ___.)

Over the course of an annual period, customers will pay exactly one year of revenue requirement associated with plant in service regardless of when particular plant is placed in service during the test year. (UGI Electric St. 4-RJ, pp. 3-4; R. ___.) For billing purposes, this annual requirement is divided and collected in 12 monthly increments, pursuant to the governing rate design, but this says nothing about when plant goes into service. All plant that is placed in service during the applicable test year is used and useful in providing service in that test year. The mere fact that the revenue requirement is billed monthly does not and cannot change that fact.

OCA's own witness, Mr. Morgan, agreed with this analysis. (Tr. 136:6-137:16; R. ____.) Mr. Morgan specifically testified as follows:

> Q. And, again, if we have a certain amount of plant in service, each month the customer would pay roughly, subject to the summer-winter differential, one-twelfth of the depreciation, annual depreciation and one-twelfth of the annual return over the course of that year?
>
> A. Yes. But at the end it will pay the equivalent of - - in this case you were saying 8 million, so they would pay the equivalent of the full rate increase.

(Tr. 137:9-16; R. ____.) Over the course of the Fully Projected Future Test Year, customers will pay the annual revenue requirement on all plant added during the Fully Projected Future Test Year, no more and no less.

Ratemaking is intended to be prospective in nature because rates are assumed to be in effect for more than one year. As a result, rates should reflect prospective conditions. The Commission's Order found that rates established in this proceeding will be in effect for at least three years. (Order at 59-60; R.___.) No party to this proceeding argued that rates would be in effect for only one year. (UGI Electric St. 4-R, pp. 3-4; R. ___.) Using end of year data best reflects the prospective conditions for the test year and the period beyond the test year, whereas the average methodology generates regulatory lag. *See* Brief For *Amicus Curiae* Energy Association Of Pennsylvania, at 25-27.

c. Substantial Evidence Shows That OCA's Average Methodology Clearly Denies Cost Recovery For Capital Projects During The Fully Projected Future Test Year.

OCA provides a list it claims supports its conclusion that the Commission's decision was not based on substantial evidence. OCA Br. at 40-42. In summary, this list includes: (1) evidence raised by witnesses in support of the average test year methodology, to the complete exclusion of evidence presented by the Company in support of the end of year method, and (2) claims that the Company failed to present legal arguments in its testimony. As to OCA's first argument, this

Court held in *HIKO* that the presentation of evidence in support of other conclusions does not negate the existence of substantial evidence in support of a Commission decision. OCA asks the court to reweigh the evidence, a result that should not be sanctioned.

As to OCA's second argument, legal arguments are not evidence. This case involved a legal issue of first impression impacting the calculation of rates. OCA merges the question of law – whether the Fully Projected Future Test Year may use an end of year or average basis – with the factual question of the rate impact of these two competing methodologies. Thus, OCA's "list" includes the assertion that there is "no evidence to demonstrate that the Act 11 FPFTY permitted the end-of-year methodology." This is clearly a question of law, and as explained in depth above, the plain language of Act 11 not only permits, but fully contemplates use of end of year data, a conclusion OCA itself candidly admits. *See* Section VI.A.1. *supra*. Even so, to the extent that this Court considers lay witness opinions on legal interpretation to be substantial evidence, all parties below made numerous primarily legal arguments regarding the nature of statutory interpretation, which the Commission discussed in its decision. (Order at 20-26; R. ___.)

Further, OCA acknowledges that its own proposal does not resolve the issue of reflecting plant in rates on Day 1 that is not yet in service. OCA Br. at 33. Using OCA's calculation, customers would be paying rates based on

approximately $12,000,000 of plant that is not yet in service, *i.e.*, the difference between the proposed average utility plant in service and the beginning of test year balance. While the average approach ameliorates OCA's concern, it still results in customers paying monthly rates in the beginning of the test year that reflect costs not yet incurred. The average test year methodology merely adds a different problem: OCA's proposal will dramatically understate the Company's costs for the second half of the test year.

OCA relies upon the testimony of I&E witness Ethan Cline, in stating "the end-of-year method allows the utility to earn 'a return of and a return on plant investments that will not fully materialize before the final day of the FPFTY.'" OCA Br. at 33 (citing I&E St. 3 at 7-8; R.____). What OCA fails to acknowledge is that the utility will not recover the full return of and return on plant investments for the Fully Projected Future Test Year until the last day of the year. Thus, the chart reproduced on page 34 of OCA's brief is deeply misleading, in that it fails to show the incremental nature of the rate recovery over the same 365 day period, where each month the utility recovers its revenues until it has reached the allowed annual amount on Day 365.[7]

[7] OCA's analogy to bank interest rates, found on pages 33 and 34, is not accurate. The revenues recovered from utility customers in monthly increments over a 12-month period reflect the total annual share per customer of the utility's cost of providing service. Pennsylvania rates are not established on a monthly basis. Adopting OCA's approach would be akin to investing with a bank that has committed to providing a 5% annual interest rate on the total investment, and finding at Day 365 that only a 2.5% return was received.

The fundamental factual and legal flaw in OCA's position is that it effectively excludes from rate base half of all plant added "during" the Fully Projected Future Test Year. Its "average" methodology is based on beginning of year and end year plant in service divided by two. This effectively excludes and denies any return on half of the plant placed in service during the test year (in this case more than $14.55 million). Thus, the effect of OCA's methodology is merely to produce a "Partial" or "Average" Projected Future Test Year, rather than the Fully Projected Future Test Year called for in Section 315(e). It is undisputed that OCA's method would exclude from rate base approximately $14.55 million in plant placed in service "during" the Fully Projected Future Test Year. *See* Brief For *Amicus Curiae* Energy Association Of Pennsylvania, at 25-27. This result is inconsistent with the plain language of Act 11 and the clear intention of the General Assembly, and should be rejected.

As described previously, utility rates are intended to be prospective, and to be in place for more than one year. OCA's average approach eviscerates this concept of prospective ratemaking by designing a test "year" that will only allow the utility to include in rates half its total cost of increased plant balances for the identified period. (UGI Electric St. 4-R, p. 5; R.___.) This should be contrasted with the Company's proposed methodology, which applied in 12 monthly increments, will ensure that customers pay the appropriate amount on an annual

basis and the Company will not experience the deficiency built into the average test year method. (*See* Tr. 136:6-137:16; R. ____.) OCA's average approach creates a fundamental mismatch in revenue and costs. (UGI Electric St. 4-R, p. 4; R____.)

B. THE COMMISSION PROPERLY CONCLUDED THAT UGI ELECTRIC SATISFIED THE USE OF PROCEEDS REQUIREMENTS OF ACT 40.

Act 40 was adopted by the General Assembly to end the use of the CTA in Pennsylvania ratemaking. The CTA was used prior to Act 40 to reduce utility federal tax allowances to reflect deductions of affiliated companies on consolidated returns. Act 40 provides:

> …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…

66 Pa.C.S. § 1301.1(a). Further, 66 Pa.C.S. § 1301.1(b), the provision governing OCA's challenge on appeal, provides:

> (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 <u>as determined by the commission</u>; and

(2) fifty percent for general corporate purposes.

66 Pa.C.S. § 1301.1(b) (emphasis added). OCA argues that the Commission erred as a matter of law and abused its discretion because it did not adopt OCA's proposal which would require utilities to show that hypothetical dollars associated with an abolished CTA were used for specific infrastructure projects. OCA's argument should be rejected for several reasons.

First, OCA's argument ignores the plain language of the statute. The use of the proceeds test proposed by OCA does not appear in the statute, and the Commission clearly acted within its discretion to reject OCA's new standard. Second, OCA ignores the sworn testimony of UGI Electric's primary expert ratemaking witness that the proceeds from the CTA will be used for the designated statutory purposes. Third, OCA's proposal ignores reality and would require a utility to prove that hypothetical dollars were used to fund specific infrastructure projects. Fourth, the remedy sought by OCA would effectively reinstitute the CTA in a different form, which is patently inconsistent with the plain language and underlying purpose of Act 40. Finally, if OCA's new test were to be adopted, and it should not be, the only lawful remedy would be a remand for further proceedings to provide UGI Electric with the opportunity to present evidence to meet OCA's new test. The Commission's Order therefore should be affirmed.

1. OCA's Approach Is Not Required By Act 40.

As part of its overall cost of service, a utility is permitted to recover in rates its federal income tax expense. *See, e.g.*, *Chambersburg Gas Co. v. Pub. Serv. Comm'n*, 176 A. 794, 805 (Pa. Super. 1935) ("In fixing rates…it is required that allowance be made for income tax paid…" (citations omitted)). For many years, the Commission and the courts, applying the so-called "actual taxes paid" doctrine, adopted a "consolidated tax adjustment" to reflect alleged tax savings arising from a utility's participation in its parent company's consolidated federal income tax return. *Barasch v. Pa. PUC*, 507 Pa. 561, 493 A.2d 653 (Pa. 1985); *Continental Telephone Co. of Pa. v. Pa. PUC*, 548 A.2d 344 (Pa. Cmwlth. 1988); *Pa. PUC, et al., v. PPL Gas Utilities Corp.*, 2007 Pa. PUC LEXIS 779 at *128-133 (Order entered Feb. 8, 2007) (litigating consolidated tax savings adjustment). As required by the courts, the CTA captured a portion of the deductions of unregulated affiliates of public utilities, including taxable losses, and gave those benefits to a utility's customers by offsetting the income tax expense that would be allowed in rates if calculated on a "stand alone" utility basis.

The CTA was widely criticized because it provided utility customers the benefits of tax deductions associated with expenses and related tax deductions incurred by unregulated affiliates where the expenses were not paid by utility customers. *See, e.g., In the Matter of Application of Kentucky-American Water*

Company, 2010 Ky. PUC LEXIS 1479 (Ky. PSC Dec. 14, 2010); *Re SourceGas Distribution LLC*, 280 PUR 4th 226 (Neb. PSC Mar. 9, 2010); *Re Delmarva Power and Light Company*, 278 PUR 4th 419 (Md. PSC Dec. 30, 2009); *Washington Utilities and Transportation Commission v. PacifiCorp dba Pacific Power & Light Co.*, 257 PUR 4th 380 (Wash. UTC June 21, 2007); *Northern States Power Company dba Xcel Energy*, 253 PUR 4th 40 (Minn. PUC Sep. 1, 2006). Based on these and other arguments the CTA has been widely rejected as an appropriate ratemaking adjustment by 45 other states and the FERC. *See Public Hearing In Re: House Bill 1436 Before the Pa. H. of Rep. Consumer Affairs Comm.*, Tr. 5:3-4 and 9:11-10:16 (Pa. 2015). Following the approach of these jurisdictions, the General Assembly enacted Act 40 to eliminate the CTA in Pennsylvania.

Act 40 has two subsections relevant to this appeal. As the Commission held in its Order:

> Section 1301.1(a) specifies how income tax expense is computed for ratemaking purposes in base rate cases, while Section 1301.1(b) specifies how utility operating income generated by the operation of Section 1301.1(a) must be used by the affected public utilities until December 31, 2025. Based on a plain reading of the statute, Section 1301.1(b) requires 50% of Act 40 savings be used for reliability or infrastructure purposes, and the other 50% of the Act 40 savings be used for general corporate purposes.

(Order at 152; R. _____.)

OCA has not disputed that the intent of the General Assembly was to terminate the CTA for ratemaking purposes in Pennsylvania through Section 1301.1(a). *See, e.g.*, *Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge*, 2018 Pa. PUC LEXIS 147 (Order entered April 19, 2018) ("…the intended purpose of Section 1301.1 was to move away from Pennsylvania's past practice of requiring a consolidated tax adjustment to a public utility's tax expenses when setting rates in a base rate proceeding."). In its appeal, OCA focuses its arguments exclusively on Section 1301.1(b).

Section 1301.1(b) directs how the additional revenue created by Section 1301.1(a) should be deployed. Specifically, subsection (b)(1) imposes an obligation (until 2025) on affected utilities to "use" 50% of the incremental utility operating income in vital infrastructure and reliability, while subsection (b)(2) makes clear there are no corresponding restrictions on the balance of the "differential," which may be "used" for "general corporate purposes." The RD, in rejecting OCA's interpretation, concluded that "[n]owhere does the statute state any particular requirements within the subcategories listed." (RD at 110; R. ___.)

Importantly, subsection (b)(1) states that the use of revenue requirement under (b)(1) shall be "as determined by the commission." 66 Pa.C.S. § 1301.1(b)(1). The General Assembly clearly recognized that the determination of how the funds covered by subsection (b)(1) are "used," is exclusively within the

discretion and specific expertise of the Commission. The Commission concluded that the plain language of 1301.1(b) "does not require public utilities to provide specific information concerning how the amounts would be used." (Order at 152; R. ____.) OCA asks this Court to ignore this deference and to read specific additional requirements into Act 40 that do not exist.

Further, the effect of OCA's argument would be to indirectly reinstitute the CTA. Specifically, OCA argues that Section 1301.1(b) requires that dollars previously associated with a CTA be credited to customers through a rate base reduction. Doing so merely shifts the CTA from a reduction in tax expense to a rate base reduction. The purpose of Act 40 was not to reduce revenues, but rather to eliminate the CTA and provide more overall funding for infrastructure improvements. Representative Godshall, the lead sponsor of HB 1436 (which became Act 40), made it clear that subsection (b)(1) deals with the targeted reinvestment of funds, rather than OCA's proposed rate base deductions, in saying: "[I]f there is any gain, 50 percent of that gain must go to infrastructure." House Journal, 2016-117 (Rep. Godshall).[8] In this regard, tax savings that are to be used for infrastructure development cannot be used for that purpose if they are taken

[8] The intent of the General Assembly 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 (Pa. 1992) (Court relied on statements made by legislature during the enactment process and recorded in the Legislative Journal to determine legislative intent).

away during the ratemaking process. Act 40 is designed to increase investment in critical infrastructure and reliability and to totally eliminate the CTA in any form. OCA's statutory construction would effectively reinstitute the CTA in another form and undermine the intent of Act 40.

The statutory construction advanced by OCA is not persuasive, and should not be adopted by this Court.

2. The Commission's Determination As To Act 40 Is Supported By Substantial Evidence And Does Not Constitute An Abuse Of Discretion.

OCA argues that the Commission has failed to meet the requirement that the dollars at issue be "used" for the statutorily defined purposes. To the contrary, the Commission's conclusion is a reasonable method for achieving the legislative goal of encouraging utilities to fund infrastructure repair and replacement, while also recognizing the practical realities of corporate finance and the rate making process, and is supported by substantial evidence.

a. OCA's "Used" Argument Is Factually Incorrect.

OCA argues that the Company has not shown it will use the Act 40 funds consistent with the statute. OCA Br. at 46-47. This is simply not the case.

Both the Commission's Order and the RD recognized that UGI Electric had provided substantial evidence in compliance with Act 40. Specifically, the Commission found that:

> UGI presented evidence to show that it has complied with Act 40's requirements. UGI's witness Anzaldo testified that the Company's pro forma capital additions for reliability or infrastructure projects in the FTY are $10.950 million and for the FPFTY are $11.770 million, which is greater than 50% of the amount of what would have been the CTA under prior ratemaking principles, and that the Company's general corporate purpose expense will also exceed 50% of the tax benefit resulting from the elimination of the CTA.

(Order at 152; R. ___.) The RD noted that, in addition to meeting its *prima facie* showing:

> Mr. Anzaldo further responded to the criticisms of OCA witness Morgan in his Rebuttal Testimony, and explained '[i]n the case of UGI Electric, both its capital expenditure expense and general corporate purpose expense exceed the fifty percent thresholds referenced in 66 Pa.C.S. § 1301(b) by wide margins, and thus UGI Electric is fully entitled to recover tax expense in the manner authorized by Act 40 without reduction.'

(RD at 111; R. ___.) The evidence relied upon by the Commission was from the Company's expert ratemaking witness, who testified under oath that the Company "used" Act 40 funds in compliance with Section 1301.1(b). Specifically, Mr. Anzaldo testified to the following:

> Q. Does the Company's rate case claim in this case support the conclusion that <u>it is using</u> at least 50 percent of that revenue requirement amount to support reliability or infrastructure related capital investment?
>
> A. <u>Yes</u>, as shown in Schedule C-2 and as discussed in the direct testimony of Eric Sorber (UGI Electric Statement No. 3), UGI Electric's *pro forma* capital additions for reliability or infrastructure projects in the FTY is $10.950

> million and for the FPFTY is $11.770 million. This expenditure level is greater than 50% of the amount of what would have been the consolidated tax savings adjustment under prior ratemaking principles.
>
> Q. Does the Company's rate case claim in this case support the conclusion that <u>it is using</u> at least 50 percent of that revenue requirement amount to support general corporate purposes?
>
> A. <u>Yes.</u> The Company's general corporate purpose expense will also exceed 50% of the tax benefit resulting from elimination of the consolidate tax adjustment. Indeed, the Company anticipated an operating expense budget of more than $81 million in operating expenditure to be used to render electric distribution service; 50 percent of the consolidated tax adjustment revenue requirement would equate to only $37,700.

(UGI Electric St. 2, p. 25; R. ___) (emphasis added). In response to questions that specifically asked if the Company was "using" the Act 40 revenue for each of the designated subcategories, the Company's expert ratemaking witness affirmed that the funds are "used" in the manner specified by the statute. The Commission properly relied on this affirmative evidence and, consistent with the discretion granted to it, concluded that the Company had met its obligations under Act 40.

OCA's argument appears to be that the Commission cannot base its decision upon an affirmation by a witness that the funds are being "used" in the manner specified by the statute. This argument completely ignores the text of the statute, and attempts subordinate the Commission's authority to determine, in its expert

judgment, whether a utility has complied with subsection (b) to the extra-statutory requirements advanced by OCA.

b. OCA's Approach Would Improperly Require Utilities To Prove That Hypothetical Dollars Are Used For Specific Infrastructure Projects.

Before the Commission, OCA argued that dollars associated with the CTA should be "earmarked" to support eligible capital investment. (OCA St. 1, p. 23; R. ___.) On appeal, OCA argues that the Company must show a "specific plan" for the calculated CTA. OCA Br. at 46-47. The plain language of Act 40 does not contain an "earmark" or specific plan requirement. Rather, it simply states that 50% of the calculated amount shall be used for infrastructure projects and 50 percent for general corporate purposes, the uses of which Mr. Anzaldo confirmed in his testimony. Consistent with this analysis, UGI Electric properly demonstrated the use of these proceeds by comparing the incremental revenue produced by elimination of the CTA to its overall infrastructure budget for the Fully Projected Future Test Year. No further proof is required, and no further proof is practical when dealing with hypothetical dollars. OCA's attempt to expand the statutory test into a "specific plan" requirement was properly rejected by the Commission.

c. OCA's Proposal Clearly Provides The Wrong Remedy.

OCA's argument would have the Court believe that its dispute with the Commission is over whether these dollars from an abolished CTA were actually "used" for a specific purpose. OCA Br. at 46. This is not the case. The resolution OCA seeks from this Court is for the funds to be "used" to *mitigate the potential rate impact* to consumers by having the dollars formerly included in the CTA be deducted from rate base, and thereby used to reduce customer rates. OCA Br. at 48. The Commission rightly concluded that OCA's proposal is simply an end run around Act 40 that would re-implement the CTA as a rate base reduction, rather than a direct reduction to tax expense.

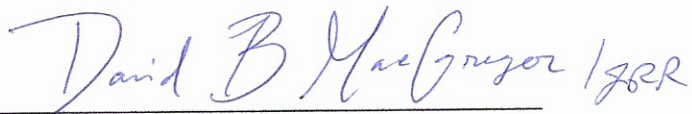
To the extent that OCA seeks to reduce rates by 50% of the dollars that would have previously been reflected in the CTA, that result is clearly inconsistent with the legislative intent of Act 40. The impact of OCA's interpretation would reduce revenue generated by customers, rather than provide capital that could be used for infrastructure. Deducting any part of the CTA "differential" from a utility's rate base undermines the elimination of the CTA and the underlying goal of spurring increased infrastructure investment. The Court should not be persuaded by OCA's arguments, which plainly contradict the intent of the General Assembly.

Finally, should this Court order the Commission to adopt an evidentiary standard which is not mandated by Act 40, then the Court should remand this issue to the Commission for further fact finding on the use of the $75,400 at issue. Any other resolution would violate UGI Electric's right to procedural due process of law. *See, e.g.*, *Dee-Dee Cab, Inc. v. Pa. PUC*, 817 A.2d 593, 598 (Pa. Cmwlth. 2003), *appeal denied*, 836 A.2d 123 (Pa. 2003).

VII. CONCLUSION

OCA has failed to show that its proposed adjustments are required by law or are necessary to ensure just and reasonable rates. Substantial evidence supports the Commission's conclusion that OCA's proposed adjustments are not necessary in order to achieve just and reasonable rates, and are not required by Act 11 and Act 40. Therefore, OCA's proposals were correctly rejected by the Commission. OCA's appeal should be denied, and the Commission's Order affirmed.

Respectfully submitted,



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CERTIFICATE OF COMPLIANCE

Counsel for UGI Utilities, Inc. – Electric Division hereby certifies that, pursuant to Pa.R.A.P. No. 2135(d), the preceding Advance Form Brief of Intervenor UGI Utilities, Inc. – Electric Division is produced using 14-point font in the text and 12-point font in the footnotes and contains 13,777 words. This word count relies on the word count of the computer program used to prepare this brief. The word count is less than the total words permitted under Pa.R.A.P. No. 2135(a)(1).

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