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REDACTED (PUBLIC) VERSION

September 4, 2013

Via Email and Overnight Delivery

Kristi Izzo, Secretary
Board of Public Utilities
44 South Clinton Avenue, 9th Floor
Trenton, NJ 08625-0350

Re: **In the Matter of the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment**
Docket No. EO12121072

Dear Secretary Izzo:

Please accept this submission on behalf of Jersey Central Power & Light Company ("JCP&L") in response to the Board of Public Utilities' ("Board" or "BPU") July 25, 2013 "Notice of Opportunity to Provide Additional Information" ("July 25 Notice") in the above-referenced matter.

JCP&L is pleased to provide the additional information requested in the July 25 Notice. In addition to these comments, JCP&L has also joined in supplemental comments that the New Jersey Utilities Association ("NJUA") is filing on behalf of a number of its member companies.

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Request for Confidential Treatment

Much of the information requested in the July 25 Notice is highly-confidential federal income tax data of JCP&L and other FirstEnergy affiliates, including unregulated entities. Accordingly, JCP&L requests confidential treatment of this submission pursuant to the Board's regulations implementing the Open Public Records Act (*N.J.S.A.* 47:1A-1.1 *et seq*.; "OPRA"). Pursuant to *N.J.A.C.* 14:1-12.1(b), proprietary commercial or financial information is exempt from disclosure under OPRA. The federal income tax data that the Board has requested here clearly constitutes such proprietary commercial or financial information. FirstEnergy does not publicly release such tax data of unregulated entities because it contains sensitive financial data which, if publicly released, could impact such entities' ability to compete in competitive markets. If such tax return information were publicly available, business competitors could use the information to gain economic advantage. In addition, the general rule of IRS code section 6103 is that tax returns and tax return information are confidential and not subject to public disclosure.

Consequently, JCP&L is providing both an unredacted (confidential) and redacted (public) version of this submittal. In support of the request for confidential treatment, JCP&L is also filing the Affidavit of Mark A. Mader. The July 25 Notice states that the Board plans to post the responses on its web site. Given the confidential nature of the information sought, JCP&L specifically requests that the Board post only the redacted version of this submittal on its web site.

Response to the Board's Requests

a. *A copy of any tax sharing agreement relating to the filing of a consolidated income tax return.*

A copy of the "Intercompany Tax Allocation Agreement" of FirstEnergy Corp. and subsidiary companies is provided on Attachment A, which has been designated **Confidential**.

b. *The year in which the utility was first included in a consolidated tax return;*

JCP&L and its predecessor entities have been included in a federal consolidated income tax return since the 1960s.

[This space is intentionally blank]

c. *The total amount paid by the utility to its parent company for federal income taxes in each year since 1991;*

Please refer to the schedule below. This schedule includes JCP&L's share of taxes due and payable in accordance with the FirstEnergy Corp. Intercompany Tax Allocation Agreement provided in response to "Request a." above. FirstEnergy Corp (parent) pays the Internal Revenue Service on behalf of the consolidated group, of which JCP&L is a member. JCP&L is required to reimburse the parent for its share of tax liability due or receive a refund for tax benefits.

Jersey Central Power and Light

Year	Amount of Federal Income Tax Payments	
1991	54,199,337	
1992	51,099,033	
1993	42,085,572	
1994	44,373,880	
1995	86,325,012	
1996	89,913,409	
1997	128,367,381	
1998	138,780,958	
1999	163,226,256	
2000	-	*
2001	-	*
2002	65,744,022	
2003	967,427	
2004	52,062,051	
2005	11,994,445	
2006	63,094,164	
2007	136,429,118	
2008	102,637,258	
2009	57,332,539	
2010	113,871,881	
2011	-	*

*2000,2001 and 2011 tax reflected net benefits therefore cash was received not paid

d. *The total amount paid by all members of the consolidated income tax group to the parent company relating to federal income taxes, in each year since 1991*

The information requested in subpart (d) is not readily available.

e. *The amount paid to each loss company by the parent, in each year since 1991;*

A schedule of taxes paid to each loss company from 1991 through 11/6/2001 is provided on Attachment E-1 (**Confidential**) and from 11/7/2001-2011 is provided on Attachment E-2 (**Confidential**).

f. *The total amount paid by the consolidated entity to the IRS for federal income taxes in each year since 1991;*

Below is a listing of actual federal income taxes paid/(received) by the Consolidated group reflected on a tax return basis for each year since 1991. Please note that this information has been designated as **Confidential**.

Confidential

[redacted]

g. *The amount of bonus depreciation taken by each member of the consolidated income tax group in each year since 1991;*

Please refer to Attachment G, which has been designated as **Confidential**. Please note that 2001 is the first year in which bonus depreciation was applicable.

h. *The amount of Alternative Minimum Taxes paid by the consolidated income tax group in each year since 1991;*

Below is a listing by year of the Alternative Minimum tax paid by the consolidated income tax group. Please note that this information has been designated as **Confidential**.

Confidential

[redacted]

i. *The amount of any tax loss carryforward available to the consolidated group and the period(s) over which these tax loss carryforwards are available to be used by the consolidated group;*

FirstEnergy Corp and its subsidiaries' consolidated federal NOL carryforward as of 2011 is $1.8 billion, which includes approximately $500 million from the former Allegheny Energy and its subsidiaries. IRS code and regulations allow a 20 year carryforward. JCP&L notes that different portions of the consolidated federal NOL carryforward amount accrued at different times, so that the 20 year carryforward period expires at different times for different portions of the carryforward.

j. *A brief description of each company included in the consolidated income tax group since 1991, along with an indication of whether each company is regulated or non-regulated;*

Please refer to the information provided in Attachment J.

k. *The reason why a company that was previously included in the consolidated income tax group is no longer included in the group;*

A schedule of companies no longer in the consolidated group of which JCP&L is a member and the reason is provided on Attachment K.

l. *All workpapers and calculations relating to the calculation of the CTA as requested in the Notice;*

Please refer to the Company's response to Question 3 in the Board's March 6, 2013 "Notice of Opportunity to Comment." Note that the calculation that JCP&L provided in its May 3, 2013 response was modeled on the adjustment proposed by Rate Counsel's witness in the recently concluded 2011-2012 Atlantic City Electric Company base rate case. It bears emphasis that JCP&L does not agree with or support such a calculation. Please see Attachment L (provided on a disk), which is designated **Confidential**, for the associated workpapers.

m. *The federal income taxes (both current and deferred) reported by the consolidated income tax group on the parent company's Annual Report, by year since 1991;*

Below is a listing of actual federal income taxes (both current and deferred) reported by the consolidated income tax group on the parent company's Annual Report, by year since 1991. Please note that taxes were not separately reported as state or federal until 1999; therefore, the reported tax data through 1998 reflects both federal and state taxes. This information has been designated as **Confidential**.

CONFIDENTIAL

[REDACTED]

n. *The federal income taxes (both current and deferred) by the utility, by year since 1991;*

JCP&L notes that this request is unclear, and appears to be missing a word before the parenthetical phrase. JCP&L has assumed that the request meant to ask for "The federal income taxes <u>reported</u> . . . ." Accordingly, please refer to the listing below. Please note that

JCP&L does not report deferred federal income taxes separately from deferred state income taxes. This information has been designated **Confidential**.

CONFIDENTIAL

[redacted]

Source - FERC FORM 1

Note: - Federal Taxes Only are not available for Deferred Income Taxes - All Years

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Supplemental Documents

In addition to providing responses to the information requests in the July 25 Notice, JCP&L is also providing the Board with copies of the Direct and Rebuttal Testimony of James I. Warren in the Company's pending base rate case, BPU Docket No. ER12111052. Mr. Warren's testimony provides an overview of JCP&L's fundamental position opposing the application of any consolidated tax adjustment in ratemaking proceedings, as well as JCP&L's views with regard to various other, secondary consolidated tax adjustment issues, which will provide the Board with additional, relevant information in this generic proceeding.

Respectfully submitted,

/s/ Gregory Eisenstark
Gregory Eisenstark

Encls.
c: (redacted version only)
Stefanie Brand, Director, Division of Rate Counsel
Babette Tenzer, DAG
Jerome May, Director, Division of Energy
Tricia Caliguire, Chief Counsel
Mark Beyer, Chief Economist

Jersey Central
Power & Light
A FirstEnergy Company

300 Madison Avenue
P.O. Box 1911
Morristown, NJ 07962-1911

STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

In the Matter of the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment	BPU Docket No. EO12121072 **AFFIDAVIT OF CONFIDENTIALITY**

Mark A. Mader, of full age, being duly sworn upon his oath, deposes and says:

1. I am the Director of Rates and Regulatory Affairs for Jersey Central Power & Light Company ("JCP&L" or "Company"). I am duly authorized to make this Affidavit of Confidentiality on behalf of JCP&L. I am making this Affidavit in support of JCP&L's Request for Confidentiality in the above-captioned matter.

2. JCP&L is requesting confidential treatment with respect to certain JCP&L information and data provided in the above-captioned matter. More specifically, the Board of Public Utilities' ("Board" or "BPU") July 25, 2013 "Notice of Opportunity to Provide Additional Information" ("July 25 Notice") seeks certain federal tax information and data of JCP&L and affiliated entities.

3. JCP&L seeks to maintain as confidential and exempt from public disclosure the following parts of its response to the July 25 Notice:

- The responses to requests (a), (d), (e), (f), (g), (h), (m) and (n) (referred to hereinafter at "Confidential Information")

Each of these responses contains confidential tax data for JCP&L and/or unregulated FirstEnergy affiliates. FirstEnergy does not publicly release such tax information regarding unregulated entities because it contains sensitive financial data which, if publicly released, could impact such entities' ability to compete in competitive markets. If such tax return information were publicly available, business competitors could use the information to gain economic advantage. In addition, the general rule of IRS code section 6103 is that tax returns and tax return information are confidential and not subject to public disclosure. JCP&L does not disclose such information to the public, nor has this information been made publicly available through any other filings made to the Board.

4. By way of substantiating the claim of confidentiality, I hereby verify that:

(a) JCP&L has taken measures to prevent the disclosure of the Confidential Information to others, by restricting its dissemination outside of the Company.

(b) The Confidential Information is not contained in materials which are routinely made available to the general public, such as Initial and Final Orders in contested case adjudications, press releases, speeches, pamphlets and educational materials.

(c) The Confidential Information has not been disclosed to others except pursuant to confidentiality agreements on a strict need-to-know basis, in which case the recipients of such need-to-know disclosures are professionally obliged to refrain from making further disclosure.

(d) No specific relevant confidentiality determinations have previously been made by the Board, the Board's custodian, or any other state or federal agency or court of competent jurisdiction regarding the Confidential Information.

(e) JCP&L desires that the Confidential Information provided hereunder be treated as confidential on an indefinite basis.

5. I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

Mark A. Mader

Sworn to and subscribed before me
this 4th day of September, 2013.

Notary Public

FLORA L AASUM
ID #2208312
NOTARY PUBLIC
STATE OF NEW JERSEY
My Commission Expires December 18, 2017

PRIVILEDGED - DO NOT RELEASE

[Execution Copy]

FIRSTENERGY CORP. AND SUBSIDIARY COMPANIES

INTERCOMPANY INCOME TAX ALLOCATION AGREEMENT

[redacted]

Attachment E-1 (Confidential)

Schedule of Taxes Paid to Loss Companies

[redacted]

Attachment E-2 (Confidential)

Schedule of Taxes Paid to Loss Companies

[redacted]

Attachment E-2 (Confidential)

Schedule of Taxes Paid to Loss Companies

[redacted]

Attachment G (Confidential)

GPU Inc/FirstEnergy Corp Consolidated Group

	Applicable Years Bonus Depreciation								
	2001 Pre Merger	2001 Post Merger	2002	2003	2004	2008	2009	2010	2011

[redacted]

	Regulated Non-Regulated	Services Provided
FirstEnergy Corp	Non-Regulated	Holding Company
FE Service Co.	Non-Regulated	Operating Service Company
Ohio Edison	Regulated	Electric Light and Power
Apollo	Non-Regulated	Low income Housing Partnership
OES Capital	Non-Regulated	Fianance Customer Energy Program
OES Ventures	Non-Regulated	Business Ventures
OES Finance	Non-Regulated	Fianancing
OES Fuel	Non-Regulated	Nuclear Fuel Financing
OES Nuclear	Non-Regulated	Ownership Nuclear Facilities
Pennsylvania Power Company	Regulated	Electric Light and Power
Cleveland Electric Illuminating	Regulated	Electric Light and Power
Centerior Funding Corp	Non-Regulated	Accounts Receivable Factoring
Toledo Edison Company	Non-Regulated	Electric Light and Power
Toledo Edison Capital	Non-Regulated	Fianancing
FirstEnergy Properties	Non-Regulated	Real Estate
BSG Properties Inc	Non-Regulated	Real Estate
FirstEnergy Ventures Corp.	Non-Regulated	Holding Company
Bay Shore Power Company	Regulated	Electric Plant Ownership
Centerior Power Enterpriese	Regulated	Technology Development
Centerior Communications Holding,Inc	Non-Regulated	Holding Company
Fiber Venture Equity	Non-Regulated	Communication Services
Centerior Energy Service Inc	Non-Regulated	Testing and Repair Services
Advanced Technologies Development Corp	Non-Regulated	Telecommunications
FirstEnergy Telecommunication Corp	Non-Regulated	Telecommunications
FirstEnergy Fuel Marketing Co	Non-Regulated	Fuel Marketing
FirstEnergy Solutions Corp	Non-Regulated	Energy Related Services
FE Aircraft leasing Corp	Non-Regulated	Owns Aircraft Leased by FE Solutions

	Regulated Non-Regulated	*Services Provided*
Penn Power Energy	*Regulated*	*Energy Marketers*
FirstEnergy Generation Corp	*Non-Regulated*	*Electric Generation and Sales*
FirstEnergy Generation Mansfield Unit 1	*Non-Regulated*	*Electric Generation and Sales*
FirstEnergy Nuclear Generation Corp	*Non-Regulated*	*Operate Nuclear Generation Plants*
Centerior Service Co.	*Non-Regulated*	*Service Company*
American Transmission Systems, Inc	*Regulated*	*Electric Transmission and Distribution*
FE Acquisitions	*Non-Regulated*	*Service Company*
Mid Atlantic Energy Development co.	*Non-Regulated*	*Energy Development*
FirstEnergy Nuclear Operating Co	*Non-Regulated*	*Operate Nuclear Generation Plants*
Marbel Energy Corp	*Non-Regulated*	*Oil and Gas Production*
The Northeast Ohio Operating Co	*Non-Regulated*	*Holding Company*
Northeast Ohio Natural Gas Corp	*Non-Regulated*	*Natural Gas Distribution*
Marbel Holdco	*Non-Regulated*	*Holding Company*
FirstEnergy Securities Transfer Co	*Non-Regulated*	*Securities Transfers*
Roth Brothers	*Non-Regulated*	*Heating and Cooling*
RPC Mechanical	*Non-Regulated*	*Heating and Cooling*
Ancoma, Inc	*Non-Regulated*	*Heating and Cooling*
Spectrum Control Systems	*Non-Regulated*	*Heating and Cooling*
The Hattenbach Company	*Non-Regulated*	*Heating and Cooling*
Edwards Electrical & Mechanical	*Non-Regulated*	*Heating and Cooling*
Colonial Mechanical Company	*Non-Regulated*	*Heating and Cooling*
L.H Cranston & Sons, Inc	*Non-Regulated*	*Heating and Cooling*
Dunbar Mechanical	*Non-Regulated*	*Heating and Cooling*
Webb Technologies	*Non-Regulated*	*Heating and Cooling*
Elliott Lewis Corp	*Non-Regulated*	*Heating and Cooling*
A.A. Duckett, Inc	*Non-Regulated*	*Heating and Cooling*
Sautter Crane Rental, Inc	*Non-Regulated*	*Heating and Cooling*
E.L. Enterprises, Inc.	*Non-Regulated*	*Heating and Cooling*
Modern Air Conditioning Co	*Non-Regulated*	*Heating and Cooling*
Airdex Air Conditioning Co.	*Non-Regulated*	*Heating and Cooling*

	Regulated Non-Regulated	Services Provided
RL Anderson, Inc	Non-Regulated	Heating and Cooling
FE Lease Holding, Inc	Non-Regulated	Radio License Holding Corp.
GPU Service	Non-Regulated	Service Company
GPU Nuclear	Non-Regulated	Nuclear Service Company
Jersey Central Power & Light Co.	Regulated	Electric Utility Company
JCP&L Pref Cap	Non-Regulated	Investment Company
JCP&L Transition Holding	Non-Regulated	Investment Company
JCP&L Transition Funding	Non-Regulated	Accounts Receivable Factoring
JCP&L Transition Funding II	Non-Regulated	Securitization
JCP&L Transition	Non-Regulated	Investment Company
Metropolitan Edison	Regulated	Eletric Utility
Meted Funding LLC	Non-Regulated	Accounts Receivable Factoring
York Haven Power	Regulated	Eletric Utility
Meted Preferred Capital II	Non-Regulated	Investment Company
Pennsylvania Electric Company	Regulated	Eletric Utility
Penelec Funding LLC	Non-Regulated	Accounts Receivable Factoring
Nineveh Water Company	Regulated	Water Company
Penelec Preferred Capital Co II	Non-Regulated	Investment Company
Waverly Electric and Power Co.	Regulated	Eletric Utility
Saxton Nuclear Experimental Corp	Regulated	Nuclear Research
GPU Advanced Resources	Non-Regulated	Energy Services
GPU Telecom(FE Fiber Holdings)	Non-Regulated	Exempt Telecommunications Company
GPU Diversified Holding	Non-Regulated	Holding Company
GPU Distributed Power	Non-Regulated	Electric Company (Inactive)
GPU Enertech	Non-Regulated	Investment Holding Company
GPU Power Co.	Non-Regulated	Investment Finance Company
Hanover Energy Corp	Non-Regulated	Investment Company
Guaracachi America	Non-Regulated	Foreign Utility Company
EI Barranquilla	Non-Regulated	Foreign Utility Company
Barranquilla Lease Holding, Inc.	Non-Regulated	Foreign Holding Company

	Regulated Non-Regulated	Services Provided
International Power Advisors, Inc.	*Non-Regulated*	*Foreign Holding Company*
Austin Cogeneration Corporation	*Non-Regulated*	*Cogeneration*
GPU International (formerly Energy Iniatives)	*Non-Regulated*	*Cogeneration*
Elmwood Energy Corporation	*Non-Regulated*	*Cogeneration*
Camichino Energy Corporation	*Non-Regulated*	*Cogeneration*
Geddes Cogeneration Corporation	*Non-Regulated*	*Cogeneration*
Geddes II Corporation	*Non-Regulated*	*Cogeneration*
EI Selkirk, Inc.	*Non-Regulated*	*Cogeneration*
EI Fuels Corporation	*Non-Regulated*	*Utility Service*
EI Services, Inc.	*Non-Regulated*	*Cogeneration*
NCP Commerce, Inc	*Non-Regulated*	*Cogeneration*
NCP Lake Power, Inc.	*Non-Regulated*	*Investment*
NCP Gem, Inc.	*Non-Regulated*	*Investment*
NCP Dade Power, Inc.	*Non-Regulated*	*Cogeneration*
NCP Pasco, Inc.	*Non-Regulated*	*Investment*
NCP Perry, Inc.	*Non-Regulated*	*Cogeneration*
NCP Houston Power, Inc.	*Non-Regulated*	*Investments*
Northeast Energy Corp.	*Non-Regulated*	*Cogeneration*
Northeast Cogen. Inc.	*Non-Regulated*	*Cogeneration*
GPU Generation Service-Pasco, Inc.	*Non-Regulated*	*Investment Company*
GPU Power Phillipines, Inc.	*Non-Regulated*	*Holding Company*
GPU International Asia, Inc	*Non-Regulated*	*Holding Company*
NCP Energy, Inc.	*Non-Regulated*	*Holding Company*
NCP ADA Power, Inc.	*Non-Regulated*	*Cogeneration*
GPU Capital Inc.	*Non-Regulated*	*Foreign Utility Company*
GPU Electric, Inc.	*Non-Regulated*	*Foreign Utility Company*
GPU Australia Holdings, Inc.	*Non-Regulated*	*Foreign Service Company*
VicGas Holdings, Inc.	*Non-Regulated*	*Foreign Investment Company*
Victoria Electric Holdings, Inc.	*Non-Regulated*	*Foreign Investment Company*
Victoria Electric, Inc.	*Non-Regulated*	*Foreign Distribution Holding Company*

	Regulated Non-Regulated	Services Provided
Austran Holdings, Inc.	*Non-Regulated*	*Foreign Transmission Holding Company*
E. I. UK Holdings, Inc.	*Non-Regulated*	*Foreign Utility Company*
Aquila Sterling Holdings, Inc	*Non-Regulated*	*Foreign Utility Company*
GPU Argentina Holdings, Inc.	*Non-Regulated*	*Foreign Investment Company*
MYR Group, Inc.	*Non-Regulated*	*Electrical Contracting*
The L.E. Myers Co,	*Non-Regulated*	*Electrical Contracting*
Hawkeye Construction, Inc	*Non-Regulated*	*Construction*
Harlan Electric Company	*Non-Regulated*	*Electrical Contracting*
Power Piping Co	*Non-Regulated*	*Electrical Contracting*
Sturgeon Electric Co.	*Non-Regulated*	*Electrical Contracting*
Comtel Technology, Inc	*Non-Regulated*	*Electrical Contracting*
D.W. Close Company	*Non-Regulated*	*Electrical Contracting*
Lemco Construction , Inc	*Non-Regulated*	*Inactive Subsidiary of MYR Group*
Papico Inc	*Non-Regulated*	*Inactive Subsidiary of MYR Group*
MFR, Inc	*Non-Regulated*	*Inactive Subsidiary of MYR Group*
Myers Internations, Inc	*Non-Regulated*	*Inactive Subsidiary of MYR Group*
American Health & Diet Co	*Non-Regulated*	*Inactive Subsidiary of MYR Group*
American Diet Counselors, Inc	*Non-Regulated*	*Inactive Subsidiary of MYR Group*
Cybertol Inc.	*Non-Regulated*	*Inactive Subsidiary of MYR Group*
Col-El-Co, Inc	*Non-Regulated*	*Inactive Subsidiary of MYR Group*
Great Southwestern Construction , Inc	*Non-Regulated*	*Electrical Contracting*
MYR Power, Inc.	*Non-Regulated*	*Construction*
MYR Com, Inc	*Non-Regulated*	*Electrical Contracting*
Element Merger Sub, Inc	*Non-Regulated*	*FE and AYE Merger*
Allegheny Energy Inc.	*Non-Regulated*	*Holding Company*
Allegheny Energy Service Corporation	*Non-Regulated*	*Business Services*
Allegheny Energy Supply Company LLC	*Non-Regulated*	*Electric Power Generation*
Acadia Bay Energy Company LLC	*Non-Regulated*	*Electric Services*
AE Supply renaissance Southwest LLC	*Non-Regulated*	*Funding*
Buchanan Energy Company of VA. LLC	*Non-Regulated*	*Electric Services*

	Regulated Non-Regulated	Services Provided
Allegheny Energy Supply Dev. Service LLC	*Non-Regulated*	*Develop Elecric Generation Facilities*
Allegheny Generating Company	*Regulated*	*Electric Power Generation*
Allegheny Energy Supply Capital LLC	*Non-Regulated*	*Assist Debt Issue and Guarantee*
Allegheny energy Transmission LLC	*Non-Regulated*	*Electric Services*
AET PATH Company LLC	*Non-Regulated*	*Finance/Credit Services*
PATH W.V, Transmissin Company LLC	*Non-Regulated*	*Electric Transmission*
AYE Series Potomac Applachian Transmission LCC	*Non-Regulated*	*Finance/Credit Services*
PATH Allegheny Transmission Co. LLC	*Non-Regulated*	*Finance/Credit Services*
PATH Allegheny MD Transmission Co. LLC	*Regulated*	*Electric Services*
PATH Allegheny VA Transmission Co. LLC	*Regulated*	*Electric Services*
PATH Allegheny Land Acquisition Co	*Non-Regulated*	*Land Acquisition*
Trans Allegheny Interstate Line Company	*Regulated*	*Electric Services*
Allegheny Ventures Inc	*Non-Regulated*	*Miscellaneous Electric Services*
Allegheny Communication Connect Inc	*Non-Regulated*	*Communication Services*
Allegheny Communication Connect of VA LLC	*Non-Regulated*	*Communication Services*
AFN Finance Company No w LLC	*Non-Regulated*	*Finance/Credit Services*
Green Valley Hydro LLC	*Non-Regulated*	*Electric Power Generation*
Monogahela Power Company	*Regulated*	*Electric Services*
MP Renaissance Funding LLC	*Non-Regulated*	*Finance/Credit Services*
The Potomac Edision Company	*Regulated*	*Electric Services*
PE Renaissance Funding LLC	*Non-Regulated*	*Finance/Credit Services*
PE Environmental Funding LLC	*Non-Regulated*	*Finance/Credit Services*
PE Transferring Agent LLC	*Non-Regulated*	*Financial Investment Activities*
West Penn Power Company	*Regulated*	*Electric Service*
The West VA. Power and Transmission Co	*Non-Regulated*	*Lessors of Real Property*
Allegheny Pittsburgh Coal Company	*Non-Regulated*	*Coal Mining*

Companies Leaving Consolidated Group

Companies Leaving Consolidated Group	Reason why Company No Longer in Consolidated Group
A.A. Duckett, Inc	Sold
Advanced Technologies Development Corp	Merged
Airdex Air Conditioning Co.	Sold
American Diet Counselors, Inc	Sold
American Health & Diet Co	Sold
Ancoma, Inc.	Sold
Aquila Sterling Holdings, Inc	Dissolved
Austin Cogeneration Corporation	Dissolved
Austran Holdings, Inc.	Dissolved
Barranquilla Lease Holding, Inc.	Sold
BSG Properties Inc	Merged
Camichino Energy Corporation	Sold
Centerior Communications Holding,Inc	Dissolved
Centerior Energy Service Inc	Merged
Centerior Power Enterpriese	Merged
Centerior Service Co.	Merged
Col-El-Co, Inc	Sold
Colonial Mechanical Company	Sold
Comtel Technology, Inc	Sold
Cybertol Inc.	Dissolved
D.W. Close Company	Sold
Dunbar Mechanical	Sold
E. I. UK Holdings, Inc.	Dissolved
E.L. Enterprises, Inc.	Dissolved
Edwards Electrical & Mechanical	Sold
EI Barranquilla	Sold
EI Fuels Corporation	Sold
EI Selkirk, Inc.	Sold
EI Services, Inc.	Sold
Elliott Lewis Corp	Sold
Elmwood Energy Corporation	Sold
FE Acquisitions	Dissolved
Fiber Venture Equity	Merged
FirstEnergy Fuel Marketing Co	Merged
FirstEnergy Securities Transfer Co	Dissolved
FirstEnergy Telecommunication Corp	Dissolved
Geddes Cogeneration Corporation	Sold
Geddes II Corporation	Sold
General Portfolio Corp.	Merged
GPU Advanced Resources	Dissolved
GPU Argentina Holdings, Inc.	Abandoned
GPU Australia Holdings, Inc.	Dissolved
GPU Brasil, Inc.	Dissolved
GPU Capital Inc.	Dissolved
GPU Distributed Power	Dissolved
GPU Electric, Inc.	Dissolved
GPU Enertech	Merged
GPU Genco	Merged
GPU Generation Service-Pasco, Inc.	Sold
GPU Inc.	Merged
GPU International (formerly Energy Iniatives)	Sold
GPU International Asia, Inc	Dissolved
GPU Power Phillipines, Inc.	Dissolved
GPU Service	Merged
Great Southwestern Construction, Inc.	Sold
Guaracachi America	Sold

Companies Leaving Consolidated Group

Companies Leaving Consolidated Group	Reason why Company No Longer in Consolidated Group
Hanover Energy Corp	Dissolved
Harlan Electric Company	Sold
Hawkeye Construction, Inc	Sold
International Power Advisors, Inc.	Dissolved
JCP&L Pref Cap	Dissolved
JCP&L Transition	Dissolved
JCP&L Transition Holding	Dissolved
L.H Cranston & Sons, Inc	Sold
Lemco Construction, Inc	Sold
Marbel Holdco	Merged
Meted Preferred Capital II	Dissolved
Met-Ed Preferred Capital Inc.	Dissolved
MFR, Inc	Sold
Mid Atlantic Energy Development co.	Merged
Modern Air Conditioning Co	Sold
Myers Internations, Inc	Sold
MYR Com, Inc	Sold
MYR Group, Inc.	Sold
MYR Power, Inc.	Sold
NCP ADA Power, Inc.	Dissolved
NCP Brooklyn Power, Inc.	Sold
NCP Commerce, Inc	Dissolved
NCP Dade Power, Inc.	Sold
NCP Energy, Inc.	Dissolved
NCP Gem, Inc.	Sold
NCP Houston Power, Inc.	Sold
NCP Lake Power, Inc.	Sold
NCP New York, Inc.	Sold
NCP Pasco, Inc.	Sold
NCP Perry, Inc.	Sold
Nineveh Water Company	Dissolved
Northeast Cogen. Inc.	Dissolved
Northeast Energy Corp.	Dissolved
Northeast Ohio Natural Gas Corp	Merged
OES Finance	Dissolved
OES Fuel	Merged
OES Nuclear	Merged
Papico Inc	Sold
Penelec Preferred Capital Co II	Dissolved
Penn Power Energy	Merged
Power Piping Co	Sold
RL Anderson, Inc.	Sold
Roth Brothers	Sold
RPC Mechanical	Sold
Sautter Crane Rental, Inc	Sold
Saxton Nuclear Experimental Corp	Dissolved
Spectrum Control Systems	Sold
Sturgeon Electric Co.	Sold
The Hattenbach Company	Sold
The L.E. Myers Co.	Sold
The Northeast Ohio Operating Co	Merged
VicGas Holdings, Inc.	Dissolved
Victoria Electric Holdings, Inc.	Dissolved
Victoria Electric, Inc.	Dissolved
Webb Technologies	Sold
York Haven Power	Sold

Schedule of Taxable Income/(Loss)

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		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Jan 1-Nov 6th 2001	Nov 7-Dec31st 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Estimated 2012	(1) Cumulative
	GPU, INC.																								
	General Portfolio Corp.																								
	Met-Ed Preferred Capital Inc.																								
	Penelec Preferred Capital Inc.																								
	GPU Genco																								
	Hanover Energy Corporation																								
	GPU International (formerly Energy Iniatives)																								
	Elmwood Energy Corporation																								
	Camchino Energy Corporation																								
	Geddes Cogeneration Corporation																								
	Geddes II Corporation																								
	EI Selkirk, Inc.																								
	EI Fuels Corporation																								
	EI Services, Inc.																								
	NCP ADA Power, Inc.																								
	NCP Energy, Inc.																								
	NCP Commerce, Inc																								
	NCP Lake Power, Inc.																								
	NCP Gem, Inc.																								
	NCP Dade Power, Inc.																								
	NCP Pasco, Inc.																								
	NCP Perry, Inc.																								
	NCP Houston Power, Inc.																								
	Northeast Energy Corp.																								
	Northeast Cogeneration Inc.																								
	GPU Generation Service-Pasco, Inc.																								
	FirstEnergy Corp																								
	FE Service Co.																								
A	Ohio Edison Company																								
	OES Capital																								
	OES Ventures																								
	OES Fuel																								
	OES Finance																								
	OES Nuclear																								
A	Cleveland Electric Illumination																								
	CX Fund																								
	CEI Financing Trust																								
A	Penn Power																								
A	Toledo Edison																								
	Toledo Edison Capital																								
	FE Properties																								
	BSG Properties																								
	FE Ventures																								
	Bayshore Power																								
	CX Power																								
	CX Communication																								
	Fiber Venture Equity																								
	CX Energy Service																								
	Advanced Technology																								
	FE Telecommunication																								
	FirstEnergy Solutions																								
	Penn Power Energy																								
	FE Generation																								
	Centerior Energy Service (E group)																								
	Centerior Funding																								
	Aircraft Leasing																								
A	American Transmission Systems																								
	FE Acquisitions																								
	Mid Atlantic Energy Development Co.																								
	Mansfield Generation																								
	FE Nuclear Generation																								
	FE Nuclear Operating Company																								
	Marbel Energy Corp																								
	Marbel Holdco																								
	NEO Natural Gas Corp.																								
	FE Telecom Corp																								
	FE Facilities																								
	Roth Brothers																								
	RPC Mechanical																								
	Ancoma																								
	Spectrum Control Systems																								
	Hattenbach Company																								
	Edwards Electrical & Mechanical																								
	Colonial Mechanical																								
	Webb Technologies																								
	LH Cranston																								
	Dunbar Mechanical																								

Schedule of Taxable Income/(Loss)
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												Jan 1-Nov 6th	Nov 7-Dec31st											Estimated	(1)
		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Cumulative
	Elliott Lewis																								
	AA Duckett																								
	Modern AC Co																								
	Airdex AC																								
	RL Anderson																								
	FE License Holding																								
	GPU Service																								
	GPU Nuclear																								
A	Jersey Central Power & Light Co.																								
	JCP&L Preferred Capital																								
	JCP&L Transition Holding																								
	JCP&L Transition Funding																								
	JCP&L Transition																								
A	Metropolitan Edison Company																								
A	York Haven Power																								
	Meted Preferred Capital II																								
A	Pennsylvania Electric Company																								
A	Nineveh Water Company																								
	Penelec Preferred Capital II																								
A	Waverly Electric and Power Co.																								
A	Saxton Nuclear Experimental Corporation																								
	GPU Advanced Resources																								
	GPU Telecom(FE Telecom Services)																								
	GPU Diversified Holding																								
	GPU Distributed Power																								
	GPU Enertech Holdings																								
	GPU Power Co.																								
	Guaracachi America																								
	EI Barranquilla																								
	Barranquilla Lease Holding, Inc.																								
	International Power Advisors, Inc.																								
	GPU Power Philippines, Inc.																								
	GPU International Asia, Inc																								
	GPU Capital Inc.																								
	GPU Electric, Inc.																								
	GPU Australia Holdings, Inc.																								
	VicGas Holdings, Inc.																								
	Victoria Electric Holdings, Inc.																								
	Victoria Electric, Inc.																								
	Austran Holdings, Inc.																								
	E. I. UK Holdings, Inc.																								
	GPU Argentina Holdings, Inc.																								
	MYR Group, Inc.																								
	Comtel Technology Inc																								
	D.W. Close Company, Inc																								
	Great Southwestern Construction																								
	Harlan Electric Company																								
	Power Piping Co																								
	Sturgeon Electric Co.																								
	Hawkeye Construction, Inc																								
	MYR Com, Inc.																								
	MYR Group, Inc.																								
	MYR Power, Inc.																								
	Papico Inc																								
	The L.E. Myers Co.																								
	AE Inc.																								
	AE Service Corp																								
	AYE Supply																								
	Acadia Bay Energy																								
	AE Renaissance SW																								
	Buchanan Energy Company																								
	AE Development Services																								
A	AE Generation																								
	Allegheny Energy Supply Capital																								
	Allegheny Transmission																								
	AET PATH Company																								

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		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Jan 1-Nov 6th 2001	Nov 7-Dec31st 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Estimated 2012	(1) Cumulative
A	PATH Allegheny Transmission																								
	PATH Maryland																								
A	PATH Virginia																								
A	TRAIL Company																								
	AE Ventures																								
	Allegheny Communication Connect																								
	ACC Virginia																								
	AFN Finance																								
	Green Valley																								
A	Monogahela Power Company																								
	MP Renaissance Funding																								
A	Potomac Edison Company																								
A	West Penn Power																								
	West Virginia Power and Trans Co																								
	Allegheny Pittsburgh Coal Company																								
	Total Taxable Income(Loss)																								
	Alternative Minimum Tax																								

(2)
(2)
(2)
(4)

(3)
(4)
(5)

(5)

(1)-(5) See "CraneMethod" tab.

Schedule of Taxable Income/(Loss)
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		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Jan 1-Nov 6th 2001
	GPU, INC.											
	GPU Service Inc.											
	GPU Nuclear Inc.											
	General Portfolio Corp.											
A	**Jersey Central Power & Light Company**											
	JCP&L Preferred Capital Inc.											
	JCP&L Transition, Inc.											
	JCP&L Transition Holdings, Inc.											
A	**Metropolitan Edison Company**											
A	**York Haven Power Company**											
	Met-Ed Preferred Capital II Inc.											
	Met-Ed Preferred Capital Inc.											
A	**Pennsylvania Electric Company**											
A	**Nineveh Water Company**											
	Penelec Preferred Capital II Inc.											
A	**Waverly Electric Light & Power Company**											
	Penelec Preferred Capital Inc.											
A	**Saxton Nuclear Experimental Corporation**											
	GPU Advanced Resources Inc.											
	GPU Telcom Services Inc.											
	GPU Diversified Holdings, Inc											
	GPU Enertech Holdings, Inc											
	GPU Genco											
	GPU Power, Inc.											
	Hanover Energy Corporation											
	Guaracachi America, Inc.											
	EI Barranquilla, Inc.											
	Barranquilla Lease Holding, Inc.											
	International Power Advisors, Inc.											
	Austin Cogeneration Corporation											
	GPU Power Philippines, Inc.											
	GPU International Asia, Inc											
	GPU Power Ireland, Inc.											
	NCP Brooklyn Power, Inc.											
	NCP New York, Inc.											
	GPU Capital Inc.											
	GPU Electric, Inc.(formerly EI Energy)											
	Victoria Electric, Inc.											
	Victoria Electric Holdings, Inc.											
	GPU Australia Holdings, Inc.											
	Austran Holdings, Inc.											
	E. I. UK Holdings, Inc.											
	GPU Brasil, Inc.											
	VicGas Holdings, Inc.											
	GPU Argentina Holdings, Inc.											
	MYR Group, Inc.											
	Comtel Technology Inc											
	D.W. Close Company, Inc											
	Great Southwestern Construction											
	Harlan Electric Company											
	Hawkeye Construction, Inc											
	MYR Com, Inc.											

Schedule of Taxable Income/(Loss)
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	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Jan 1-Nov 6th 2001
MYR Group, Inc.											
MYR Power, Inc.											
Power Piping Co.											
Sturgeon Electric Co.											
The L.E. Myers Co,											
GPU International (formerly Energy Iniatives)											
Elmwood Energy Corporation											
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Geddes II Corporation											
EI Selkirk, Inc.											
EI Fuels Corporation											
EI Services, Inc.											
NCP ADA Power, Inc.											
NCP Energy, Inc.											
NCP Commerce, Inc											
NCP Lake Power, Inc.											
NCP Gem, Inc.											
NCP Dade Power, Inc.											
NCP Pasco, Inc.											
NCP Perry, Inc.											
NCP Houston Power, Inc.											
Northeast Energy Corp.											
Northeast Cogeneration Inc.											
GPU Generation Service-Pasco, Inc.											
Total Taxable Income(Loss)											C
Tax Rate 35%											
Tax Liability(benefit) including credits											
Carryback Claim for refund											
Alternative Minimum Tax											

Schedule of Taxable Income/(Loss)

Attachment L
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		Nov 7-Dec31st 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Estimated 2012
	FirstEnergy Corp												
	FE Service Co.												
A	**Ohio Edison Company**												
	OES Capital												
	OES Ventures												
	OES Fuel												
	OES Finance												
	OES Nuclear												
A	**Cleveland Electric Illumination**												
	CX Fund												
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	Toledo Edison Capital												
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	FE Telecommunication												
	FirstEnergy Solutions												
	Penn Power Energy												
	FE Generation												
	Centerior Energy Service (E group)												
	Centerior Funding												
	Aircraft Leasing												
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	FE Acquisitions												
	Mid Atlantic Energy Development Co.												
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	NEO Natural Gas Corp.												
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	Colonial Mechanical												
	Webb Technologies												
	LH Cranston												
	Dunbar Mechanical												
	Elliott Lewis												
	AA Duckett												
	Modern AC Co												

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		Nov 7-Dec31st 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Estimated 2012
	Airdex AC												
	RL Anderson												
	FE License Holding												
	GPU Service												
	GPU Nuclear												
A	Jersey Central Power & Light Co.												
	JCP&L Preferred Capital												
	JCP&L Transition Holding												
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	Barranquilla Lease Holding, Inc.												
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	GPU Capital Inc.												
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	GPU Australia Holdings, Inc.												
	VicGas Holdings, Inc.												
	Victoria Electric Holdings, Inc.												
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	Austran Holdings, Inc.												
	E. I. UK Holdings, Inc.												
	GPU Argentina Holdings, Inc.												
	MYR Group, Inc.												
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	The L.E. Myers Co.												
	AE Inc.												
	AE Service Corp												

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		Nov 7-Dec31st 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Estimated 2012
	AYE Supply												
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	AE Renaissance SW												
	Buchanan Energy Company												
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	Allegheny Energy Supply Capital												
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	Allegheny Pittsburgh Coal Company												
	Total Taxable Income(Loss)												
	Tax Rate 35%												
	Tax Liability(benefit) including credits												
	Carryback Claim for refund												
	Alternative Minimum Tax												

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Redacted

Direct testimony of Andrea C. Crane on Behalf of Rate Counsel, page 36
BPU Docket No. ER11080469 (Atlantic City Electric rate case)

Q.

A.

EXHIBIT JC-11

BEFORE THE
NEW JERSEY BOARD OF PUBLIC UTILITIES

JERSEY CENTRAL POWER & LIGHT COMPANY

Direct Testimony

of

James I. Warren,
Miller & Chevalier

On Behalf of

Jersey Central Power & Light Company

Re: Issues Related to Consolidated Tax Adjustments

DIRECT TESTIMONY OF JAMES I. WARREN

I. Introduction

Q. Please state your name and business address.

A. My name is James I. Warren. My business address is 655 Fifteenth Street, N.W., Washington, D.C. 20005.

Q. By whom are you employed and in what capacity?

A. I am a member of the law firm of Miller & Chevalier Chartered ("Miller").

Q. Please describe your current responsibilities at Miller.

A. I am engaged in the general practice of tax law. I specialize in the taxation of and the tax issues relating to regulated public utilities. Included in this area of specialization is the treatment of taxes in regulation.

Q. On whose behalf are you submitting this testimony?

A. I am submitting this testimony on behalf of Jersey Central Power and Light Company ("JCP&L" or the "Company").

Q. Please describe your professional background.

A. For more than 20 years, I have been involved in the provision of tax services almost exclusively to companies in various segments of the utility industry. I joined Miller in February of 2012. For the three years prior, I was a partner in the law firm Winston & Strawn and for the five years prior to that, I was a partner in the law firm Thelen Reid Brown Raysman & Steiner LLP and predecessor firms. Before that, I was affiliated with the international accounting firms of Deloitte LLP (October 2000 – September 2003), PricewaterhouseCoopers LLP (January 1998 – September 2000) and Coopers & Lybrand (March 1979 – June 1991) and the law firm Reid & Priest LLP (July 1991 – December 1997). At each of these professional services firms, I provided tax services primarily to electric, gas, telephone and water industry clients. My practice has included tax planning for the acquisition and transfer of business assets, operational tax planning and the representation of clients in tax controversies with the Internal Revenue Service ("IRS") at the audit and appeals levels. I have often been involved in procuring private letter rulings or technical advice from the IRS National Office. On several occasions, I have represented one or more segments of the utility industry before the IRS and/or the Department of Treasury regarding certain tax positions adopted by the federal government. I have testified before several Congressional committees and subcommittees and at Department of Treasury hearings regarding legislative and administrative tax issues of significance to the utility industry. I am a member of the New York, New Jersey and District of Columbia Bars and also am licensed as a Certified Public Accountant in New York and New Jersey. I am a member of the American Bar Association, Section of Taxation where I am a past chair of the Committee on Regulated Public Utilities.

Q. Have you testified in any regulatory proceedings?

A. Yes I have. I have testified regarding tax, tax accounting and regulatory tax matters before a number of regulatory bodies including the Federal Energy Regulatory Commission ("FERC") and the utility commissions in Florida, Arkansas, Louisiana, Nevada, Delaware, West Virginia, New Jersey, the District of Columbia, the City of New Orleans, New York, Connecticut, Ohio, California, Maryland, Pennsylvania, Missouri, Illinois, Kentucky, Vermont Tennessee, Indiana and Texas.

Q. Please describe your educational background.

A. I earned a B.A. (Political Science) from Stanford University, a law degree (J.D.) from New York University School of Law, a Master of Laws (LL.M.) in Taxation from New York University School of Law and a Master of Science (M.S.) in Accounting from New York University Graduate School of Business Administration.

Q. What is the purpose of your testimony?

A. JCP&L has prepared its tax and tax-related schedules (including its computation of rate base) submitted in this case in accordance with what it believes to be sound economics and accounting and generally accepted regulatory principles – that is, without regard to the tax consequences attributable to income or costs that are not included in the computation of its regulated rates. Because costs incurred by other companies within the federal consolidated tax group of which the Company is a member are not included in that computation, the Company has not considered the tax consequences of such costs. In other words, the schedules do not include a consolidated tax adjustment ("CTA"). The purpose of my testimony is to support the Company's position regarding the regulatory effects of its being included in a consolidated federal income tax return and to explain why reflecting a CTA would be inappropriate.

II. <u>JCP&L's Consolidated Tax Filing</u>

Q. Does JCP&L file as a member of a consolidated tax group for federal income tax purposes?

A. Yes it does and it has for many years. Currently, it files as part of a consolidated tax group of which FirstEnergy Corp. ("FE") is the common parent. Prior to November 7, 2001, it filed as part of a consolidated tax group of which GPU, Inc. ("GPU") was the common parent. Since 1991, the number of members in the consolidated tax groups of which JCP&L has been a member has varied from about 15 corporations to over 85 corporations. This wide variation has been caused by acquisitions, dispositions, mergers, liquidations and various other transactions.

Q. Why do groups of affiliated corporations file consolidated tax returns?

A. The filing of a federal consolidated income tax return is elective. Most groups of affiliated corporations that are eligible to file on a consolidated basis elect to do so. The major reason is that it allows a business enterprise to structure itself for legal and business purposes without having to take into account federal tax implications. For example, if it is important to insulate one specific operation from another (for example, for legal liability, regulatory or financing reasons), the two operations can be conducted in separate corporations filing a consolidated tax return with virtually the same tax consequences as if they were divisions of the same corporation. However, were they divisions, they would not have achieved their legal liability insulation, regulatory and financing goals. The consolidated return mechanism allows structural flexibility without imposing a tax cost.

Q. What are some of the consequences of filing as a member of a consolidated tax group and being treated for tax purposes as a division instead of a separate entity?

A. There are many consequences. I will mention a few of the more important ones. Just as would be the case were the separate corporations to be divisions of a single corporation, sales from one member to another member do not produce gains or losses that are immediately taxable. Capital losses of one member (which can only be deducted against capital gains) can offset capital gains of another member. And, most significantly for CTAs, tax losses of one member can offset taxable income of another member. I shall hereafter refer to this very important feature as "Income Netting."

Q. Can JCP&L or any of its consolidated group affiliates choose to be included or not included in the FE consolidated tax return?

A. No. If a group chooses to file a consolidated tax return, all eligible affiliates must be included in the return. Thus, while a group can decide to file or not to file a consolidated return, once it elects to file, there can be no picking and choosing among the affiliated corporations. And, incidentally, once a group elects to file a consolidated return, it can only revoke the election with the permission of the IRS for good cause shown.

Q. Is the fact that JCP&L is included in a group of corporations that files a consolidated tax return an unusual situation?

A. No it is not. The vast preponderance of large U.S. businesses operating in corporate form file consolidated federal income tax returns. And as far as publicly traded corporations are concerned, I do not know of a single one that does not file as part of a consolidated tax group – some groups having hundreds of members. The practice of filing consolidated income tax returns is prevalent across all industry groups. So FE, as a large, publicly traded business operating in corporate form, does exactly what the rest of commercial America does when it comes to income tax filing.

Q. So is there anything unique or exotic about JCP&L's tax filing posture?

A. No there is not. Consolidated return filing is a routine business practice. Moreover, as I shall describe in more detail hereafter, the FE consolidated tax group, including JCP&L, allocates and reports the effects of consolidated filing precisely the way most groups handle them. In other words JCP&L does nothing unusual simply because it happens to be subject to regulated ratemaking.

III. The Regulatory Significance of Consolidated Tax Filing

Q. What is the significance of the practice of consolidated tax filing for this proceeding?

A. The practice of consolidated tax filing raises three issues (or potential issues) for a utility rate proceeding. The first is, whether or not filing on that basis produces a benefit for the group. If it does produce a benefit, the second issue is how that benefit should be measured. Once a group benefit is perceived and measured, the final issue is how much of the benefit, if any, should be allocated to the utility whose rates are being set.

Q. What is the Company's position with regard to these three issues?

A. The Company believes that filing on a consolidated basis produces no tax benefit that couldn't be produced by alternative means – particularly by operating in a divisional, rather than a corporate, structure. As a consequence, there exists no consolidated tax benefit which should be subject to measurement and allocation. However, if the Board of Public Utilities ("Board" or "BPU") continues to believe that such a benefit exists, the Company believes that its measurement for any particular year should be the difference between the tax liability the group actually pays and the sum of the tax liabilities the members of the group would have paid had they not filed on a consolidated basis. Critically, this latter amount must be calculated by applying the tax law governing the computation of taxes to determine each member's tax liability for each year. Only then will the quantification process produce even an arguably accurate result. Finally, any tax benefit deemed to exist as a result of consolidated filing should be assigned to those members who produced the tax losses that, in turn, produced the benefits. In short, the Company contends that there should be no CTA and, for that reason, has not included one in its filing.

Q. To your knowledge, is there any requirement imposed by an order of this Board, any BPU regulation or filing requirement or any decision of any New Jersey court that requires a utility to include a CTA in its regulatory filing?

A. No, not to my knowledge.

Q. To your knowledge, is there any statute, regulation or decision of any New Jersey court that compels the Board to impose a CTA?

A. No, not to my knowledge.

Q. Please explain.

A. As far as I am aware, there are only four New Jersey court decisions that address CTAs.[1] None of these mandates a CTA but, instead, only empower the BPU to consider the effect

[1] *New Jersey Power & Light Company,* 9 N.J. 498, 89 A.2d 26 (1952); *Lambertville Water Company,* 153 N.J. Super. 24, 378 A.2d 1158 (1977); *Toms River Water Company,* 158 N.J. Super. 57, 385 A.2d 862 (1978) and *New Jersey Bell Telephone Company,* 162 N.J. Super. 60, 392 A.2d 216 (1978).

of consolidated tax filing in the setting of rates. Further, the most recent of these cases was decided in 1978 – more than 30 years ago. And, finally, none of these decisions addressed a CTA anything like the one that the BPU has imposed since 1991. Subject to constitutional limits, the Board has broad discretion in the area – so long as it adequately justifies whatever it does.

A. <u>There Is No Consolidated Tax Benefit</u>

Q. You have stated that there is no benefit of consolidated filing because whatever benefits are achieved by filing on that basis could equally be achieved by other means. Please elaborate.

A. The most prominent feature of consolidated tax filing is Income Netting. The tax law restricts the use of tax losses (referred to in tax parlance as net operating losses or "NOLs"). In general, a corporation's NOL produced in any year may be carried back 2 and forward 20 years. This means that a year's NOL can be treated as an additional deduction applied to the tax returns the corporation filed in the prior two years and then, to the extent not absorbed in those past years, to tax returns filed in the subsequent 20 years. The application of the NOL to other years' tax returns takes place in chronological order. Thus, if a corporation produces taxable income in a given year and incurs an NOL within the subsequent two years, it can recompute its taxable income for the first year reflecting the NOL as an additional deduction, recalculate the tax due on that reduced taxable income amount, and receive a refund for the reduction. If, however, the corporation incurring the NOL produced no taxable income in the prior two years, it must wait to apply its NOL against future years' taxable income. In that event, the NOL does not produce a contemporaneous reduction in the corporation's tax liability (and a cash refund), but only a reduction in a future tax liability. In a consolidated tax return, the taxable incomes or losses of all group members are aggregated and netted in arriving at group taxable income. The consolidated group tax is computed by reference to this aggregated and netted amount. The tax law restrictions I mentioned above are applied to the group taxable income. Thus, in a situation where an individual group member might produce an NOL that would have been restricted by the carryback rules had it filed a separate tax return, because, in consolidated filing, that NOL becomes part of the aggregation and netting process, it might produce a contemporaneous tax benefit – that is, a current, rather than a future, reduction in the aggregate tax liability of the members of the group.

Q. Why is the acceleration of the use of the loss member's NOL to produce current cash not a benefit of consolidated filing?

A. A corporation could achieve the same result – the use of its tax deductions to produce current cash – in a number of other ways. Such a company could organize along alternative lines. Most obviously, it could operate as a division of a larger corporation or as a wholly-owned limited liability company (the existence of which is ignored for tax purposes). This would produce the same taxable income aggregation and netting as does filing on a consolidated basis. Another often-used way of monetizing tax deductions that a corporation is unable to use is to lease depreciable assets instead of owning them, extracting the benefits of accelerated tax depreciation through lower lease payments rather than higher tax deductions. In fact, addressing alternatives to the production of unusable tax losses is a routine aspect of tax planning. The bottom line is that consolidated filing does not provide any tax benefits that can't be procured by other means.

Q. Why don't the tax loss companies to which New Jersey CTAs apply implement these strategies?

A. The best way to answer this question is with another question: Why would a company producing tax losses it wouldn't have been able to use on an unconsolidated basis but which are, in fact, used in consolidation go through the effort and, perhaps, expense of implementing tax strategies to use tax losses that are already being used? Such strategies wouldn't actually provide any additional benefit. The Income Netting feature of consolidated filing makes it unnecessary to do anything. The obvious answer is that no reasonable company would expend time, effort and money to solve such a non-existent problem. .

Q. What is the point of your discussion regarding the ability of a loss corporation to "manage" its tax loss situation?

A. This goes to the validity of a fundamental CTA assumption. If a non-consolidated corporation has alternatives to the production of unusable NOLs available to it, then the filing of a consolidated return in which those losses are used produces no incremental benefit that would not have been available on an unconsolidated basis. In other words, no CTA is warranted. Hence, premising a ratemaking adjustment on the fact of consolidated filing represents the elevation of form over substance.

C. <u>Quantification Of Any Consolidated Tax Benefit</u>

Q. In the event that the Board perceives that a consolidated tax benefit exists, how should it be quantified?

A. If a consolidated tax benefit exists, the benefit of consolidated filing should logically equal the difference between what the tax the group would pay if it filed on a consolidated basis and the sum of the taxes that would be imposed on each of the affiliates if they filed on an unconsolidated basis. It is the tax law that determines how much tax would be due where the group files on a consolidated basis. Similarly, if the group elected not to file on a consolidated basis, it is the tax law that would determine how much tax each member must pay. It would, therefore, seem self-evident that the quantification of any consolidated tax benefit must be based on the application of the tax law. Failure to respect the tax law will simply not accurately quantify the benefit. Thus, the substitution of some "regulatory version" of the tax law for the "real" tax law will distort the calculation of the benefit.

Q. Doesn't the Board have discretion in this regard?

A. The Board is empowered to consider the effects of consolidated filing. However, in my view, this does not include the authority to impute a tax benefit that does not, in fact, exist. The effects of consolidated filing are controlled by the tax law and only the tax law. While the Board can consider those effects, it cannot manufacture them. Any quantification of a consolidated tax benefit must, therefore, follow the dictates of the tax law.

D. **<u>The Allocation Of Any Consolidated Tax Benefit</u>**

Q. Assuming the existence of a consolidated tax benefit and assuming it is properly quantified, in what way should the benefit be allocated?

A. I believe the proper principle to apply to allocate a consolidated tax benefit is the "benefits follow burdens" principle.

Q. Please explain this principle.

A. Our federal tax system imposes a tax on "taxable income." "Taxable income" is a net number. It is revenue reduced by designated expenses. For a corporation engaged in a business activity, almost all expenses are permitted to reduce taxable income. In fact, the ability to reduce taxable income is an inherent characteristic of a deductible expense. If you incur the expense, you reduce your taxable income. Even individual taxpayers experience this phenomenon. Anyone who owns a house and pays interest on the mortgage and property taxes knows that, as a direct result of making those payments, he or she reduces his or her taxable income and resulting tax liability. If he or she does not make the payments, there is no reduction. The tax benefit cannot rationally be separated from the underlying cost. This characteristic is at the foundation of the "benefits follow burdens" principle.

Q. In the mortgage and property tax illustration, to whom do the tax benefits of the mortgage interest and property tax deductions belong?

A. I think that any person who pays interest on a mortgage and property taxes would rightfully feel aggrieved were the tax benefit resulting from the payment of these items to be assigned to some third party who bore no part of the underlying expenditures or any risk associated with ownership of the property. Therefore, the tax benefits of the mortgage interest and property tax deductions clearly belong to the person who pays the mortgage interest and property taxes.

Q. How is this relevant to ratemaking?

A. It is the basis for the principle of "benefits follow burdens" that is an elemental tenet of most ratemaking. This principle dictates that the party that incurs a cost is entitled to the tax benefit that incurring the cost produces.

Q. How is the "benefits follow burden" principle most often evidenced in ratemaking?

A. It is most often implicated in the treatment of costs excluded for purposes of ratemaking.

Q. What is a cost excluded for purposes of ratemaking?

A. A cost excluded for purposes of ratemaking is a cost that the utility is precluded from recovering by statute, regulation or otherwise.

Q. What are examples of such costs?

A. Costs excluded for purposes of ratemaking may include promotional advertising costs, trade association dues, lobbying expenses or charitable contributions, depending on the jurisdiction.

Q. Are costs excluded for ratemaking purposes nonetheless tax-deductible?

A. The determination that a cost is or is not recoverable in rates has absolutely no bearing on its tax treatment. Nonetheless, as with the vast preponderance of expenditures incurred by utilities, most costs excluded for ratemaking purposes are tax-deductible. Certainly, for example, all of JCP&L's promotional advertising expenses are deductible.

Q. Do such excluded costs therefore reduce the taxes paid to taxing authorities?

A. Yes, they do. To the extent costs are tax deductible, whether or not excluded for purposes of ratemaking, they reduce taxable income. This reduction in taxable income will directly reduce the company's tax liability.

Q. In your experience, where recovery of a tax-deductible cost is excluded for purposes of ratemaking, what is the regulatory treatment afforded the tax benefit of that cost?

A. In my experience, the universal treatment afforded the tax benefit of such a cost is that the benefit is allocated to shareholders and not to ratepayers. It is my understanding that this has uniformly been the treatment applied to JCP&L's costs of this type.

Q. Are you aware of any regulatory jurisdiction in which this is not the case?

A. No, I am not.

Q. Has the New Jersey Supreme Court addressed the treatment of excluded costs in the calculation of the tax expense element of cost of service?

A. Yes it has. The rule in New Jersey is that the tax benefit of a cost that is excluded from ratemaking by this Board *cannot be* factored into the setting of rates. This rule was established by the New Jersey Supreme Court more than 50 years ago in the case of *Hackensack Water Company v. BPU.*[2] In that case, the BPU allowed the recovery of only $456,442 of a $779,892 cost but incorporated the $779,892 amount in computing the utility's tax expense. The Court held that only the recoverable amount, $456,422, could be used in the setting of rates.

Q. Again, what is the principle that underlies this regulatory treatment?

A. It is the "benefits follow burdens" principle. The tax benefit is an inherent attribute of the cost. It is, therefore, allocated to whoever bears that cost. In the case of disallowed costs, the tax benefit is allocated to shareholders who bear the cost of the expenditure and not to the ratepayers who do not.

Q. To your knowledge, is this a controversial proposition?

A. No, not to my knowledge.

Q. What are the implications of the "benefits follow burdens" principle for the allocation of consolidated tax benefits?

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[2] 172 A2d 651, 35 N.J. 239 (1961).

A. An NOL, the tax attribute that produces a consolidated tax benefit through Income Netting, occurs when a company's tax deductions exceed its taxable income. Thus, an NOL consists entirely of a company's "net" tax deductions. The application of the "benefits follow burdens" principle requires that the tax benefit of a deduction be allocated to the party that bore the cost that produced the deduction. It would, therefore, require that any consolidated tax benefits be allocated to those companies that incurred the expenditures that produced the tax losses.

Q. In addition to the consistent application of regulatory principles, are there other reasons why any consolidated tax benefits should be allocated to the companies that incurred the costs that created the benefits irrespective of whether or not those companies could have used their NOLs had they filed on an unconsolidated basis?

A. Yes, there are at least four additional reasons:

1. The loss affiliate's NOL produces a current cash benefit and it is appropriate to compensate the loss affiliate when the cash is received;
2. The act of Income Netting extinguishes (*i.e.*, absorbs) the loss affiliate's NOL, a valuable tax attribute, forever and it is appropriate to compensate the loss affiliate for the NOL's consumption when the consumption occurs;
3. If the loss affiliate is not compensated, the money is, by default, retained by some other affiliate who is much less entitled to the funds; and
4. Compensating (that is, the payment of cash to) loss affiliates contemporaneously for their NOLs used to reduce the consolidated tax liability is, in fact, the

prevalent method of tax allocation among consolidated groups – including those that do not include utilities.

Q. Why does it make sense to allocate a consolidated tax benefit to a loss affiliate when the group receives the cash produced by using the affiliate's loss?

A. The fact is that the group's tax liability is reduced when the loss is produced and the loss affiliate should be compensated contemporaneously upon monetization of the tax benefit. Compensating the loss affiliate for the actual absorption of its loss when that loss is, in fact, absorbed recognizes the reality of the way things actually transpired rather than the way they would have transpired hypothetically had the loss affiliate not filed on a consolidated basis.

Q. Does it make commercial sense to allocate a consolidated tax benefit to an affiliate other than the loss affiliate until the loss affiliate could hypothetically use the loss?

A. No, it does not. There is no member of the group that is more entitled to the cash benefit than the affiliate that produced the tax loss. Tax losses do not occur in a vacuum. In all cases, they are the result of underlying economic activity. By far the most important feature is that each dollar of tax loss represents a dollar expended or a dollar of liability incurred by the tax loss member. In other words, each loss member suffered a substantive change in its economic position to produce the tax loss. And, obviously, no one would expend one dollar simply to produce a 35¢ tax benefit. By contrast, no member of the consolidated group producing positive taxable income, including JCP&L,

contributed anything whatsoever to the creation of any NOL that would be allocated to it by virtue of a CTA mechanism.

Further, through the regulatory process, customers are insulated from the risks of non-regulated undertakings. That is a responsibility both of this Board and of JCP&L. The risk of commercial failure in these non-regulated undertakings is, therefore, exclusively for the account of the shareholders. It is their wealth, not customer wealth, that is at stake. It is inequitable to strip out the favorable tax consequences of taking on those risks and to transfer them to non-risk-takers. Finally, no affiliate that produced taxable income, no matter how much, caused the group's tax liability to be reduced. Only the loss affiliates do that. Consequently, the group member that produces the tax loss has a far superior claim to the tax benefit of its own loss than does the group member that merely generates positive taxable income. The former is an active participant in the production of that benefit and should be paid for it. The latter is no more than a bystander.

Q. Do you have any objective evidence of the reasonableness of paying loss affiliates for their tax losses used in reducing the consolidated tax liability?

A. Outside of ratemaking, the allocation of consolidated tax benefits has another practical consequence. This allocation determines which companies get paid for the tax benefits they produce and when they get paid for them. In short, the allocation governs cash flow. In my 30 years of tax practice, I have seen many tax sharing procedures, policies and agreements. It has been my experience that paying loss affiliates for the use of their tax losses when they are used is by far the most prevalent structure used in such arrangements. And this is true both where the consolidated group has regulated affiliates and where it does not. A "payment for losses" system is standard business procedure. It is, in fact, the norm. The commercial norm across industries must be presumptively reasonable and a proper recognition of economic reality.

Q. What are the implications of this for CTAs?

A. A "payment for losses" system recognizes that the loss affiliate produces something of value, its tax loss, which generates current cash and is consumed for the benefit of the group. Payment for the use of this economic asset is appropriate. If the payment to a loss affiliate is viewed in this light, then there would be no allocation of a consolidated tax benefit to other than the loss affiliates and, consequently, no justification for the imposition of a CTA.

IV. Additional Support For The Company's Position Regarding CTAs

Q. Is there a reason why no consolidated tax benefit associated with the NOL of a non-regulated group member should be allocated to a regulated member?

A. Yes there is. Such a procedure would inappropriately import the effect of non-regulated transactions into the regulated utility ratemaking arena. The mathematics proves this beyond a doubt.

Q. How is this so?

A. Where a CTA is imposed, the results of non-jurisdictional operations will have a direct effect on the setting of jurisdictional rates. At the outset, the imposition of a CTA will reduce rates only if non-regulated affiliates produce tax losses. Consequently, if every single aspect of a New Jersey utility's operations remains absolutely constant, rates will vary depending solely on variations in the operational tax results of non-regulated affiliates. Due to a CTA, rates will be lower if non-regulated affiliates produce NOLs than if they do not. And, if, at some point after a CTA is imposed, all of a New Jersey utility's non-regulated affiliates begin to produce taxable income, that utility's revenue requirement will increase – even if regulated operations don't change one iota. Thus, whether a non-regulated affiliate leases or purchases an asset may make a difference to the Company's regulated utility customers. Whether a non-regulated affiliate claims all the deductions it can, depreciates its assets as quickly as it can, borrows additional amounts (increasing its interest deduction) or pays down debt (decreasing its interest deduction) all become matters of consequence to the Company's customers. Each one of the laundry list of decisions having tax implications that a non-regulated company makes in the normal course will potentially impact customer rates.

Q. What, then, do you believe regarding the relationship between CTAs and the principle of separation between regulated and non-regulated activities?

A. CTAs create a direct cause and effect relationship between the operations of non-regulated group members and utility rates. The directness of this relationship leaves no doubt as to the status of the historical division between regulated and non-regulated operations. CTAs breach the principle of separation. The breach of the separation between regulated and non-regulated is direct and mathematically demonstrable.

Q. Is JCP&L's position regarding the impropriety of a CTA consistent with the views of the vast preponderance of regulators in this country?

A. Yes it is.

Q. To your knowledge, in how many jurisdictions do regulators impose CTAs?

A. I believe that, other than New Jersey, there are only three jurisdictions that do so - Texas, Pennsylvania and West Virginia.

Q. And, to your knowledge, how many jurisdictions do not impose CTAs

A. It is my understanding that 49 regulatory jurisdictions (including FERC, the District of Columbia and the New Orleans City Council) do not. On this basis, I conclude that more than 90% of the country's regulatory jurisdictions do not subscribe to the imposition of comprehensive CTAs.

Q. Have there been any notable developments within the past two and a half years regarding CTAs?

A. Yes there have. I am aware of five final orders issued within the last 36 months in which regulators directly addressed proposals to adopt CTAs. Each of the five regulatory bodies definitively rejected the proposal. These orders were issued by the Public Service Commission of Maryland,[3] the District of Columbia Public Service Commission,[4] the

[3] *Delmarva Power and Light Company*, Order No. 83085 (December 30, 2009).

[4] *Potomac Electric Power Company,* Formal Case No. 1076 (March 2, 2010).

Kentucky Public Service Commission,[5] the Nebraska Public Service Commission[6] and, most recently, the Washington Utilities and Transportation Commission.[7]

Q. Are you aware of any regulators that have implemented a CTA scheme for the first time within that same time frame?

A. No I am not.

Q. Why do you believe that CTAs have been embraced in so few regulatory jurisdictions?

A. The idea of CTAs has been around for decades and have been widely and frequently proposed. The concept and availability of CTAs has not "gone under the radar." Clearly there has been ample opportunity for the adjustment to "catch on" if it was ever going to "catch on." Nevertheless, there have obviously been precious few "takers." I believe that most regulators have recognized, as has JCP&L, that CTAs are not based on sound regulatory and economic principles.

V. <u>Conclusion</u>

Q. Please summarize your position regarding the Company's tax and tax-related schedules filed in this proceeding.

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[5] *Kentucky-American Water Company,* Case No. 2010-00036 (December 14, 2010).

[6] *Source Gas Distribution,* Application No. NG-0060 (March 9, 2010).

[7] *Puget Sound Energy,* Docket UE-111048, UG-111049, Order 08 at 69-70 (May 7, 2012).

A. The Company has not reflected a CTA in its filing. It believes that there is no consolidated tax benefit subject to allocation and, even if, for the sake of argument, there was such a benefit, its proper allocation would not produce a CTA. This position is consistent with the applicable "benefits follow burdens" principle, the principle of separation of regulated and non-regulated operations and the practices of the vast preponderance of utility regulators throughout the country.

Q. Does this conclude your direct testimony?

A. Yes it does.

EXHIBIT JC-11 Rebuttal

BEFORE THE

NEW JERSEY BOARD OF PUBLIC UTILITIES

BPU Docket No. ER12111052

OAL Docket No. PUC16310-2012N

JERSEY CENTRAL POWER & LIGHT COMPANY

Rebuttal Testimony
of
James I. Warren,
Miller & Chevalier

On Behalf of

Jersey Central Power & Light Company

Re: Issues Related to Consolidated Tax Adjustments

Q. Please state your name and business address.

A. My name is James I. Warren. My business address is 655 Fifteenth Street, N.W., Washington, D.C. 20005.

Q. Are you the same James I. Warren who previously filed direct testimony on behalf of Jersey Central Power & Light Company ("JCP&L" or the "Company") in this proceeding?

A. Yes I am.

Q. What is the purpose of this testimony?

A. The purpose of this testimony is to respond to that portion of the direct testimony filed by Andrea C. Crane on behalf of the Division of Rate Counsel ("Rate Counsel") in which she proposes the imposition of a consolidated tax adjustment ("CTA"). Crane, Direct, page 5, line 5 through page 25, line 2. In filing its revenue requirements in this proceeding, the Company did not reflect the tax consequences attributable to costs that are not reflected in the setting of its rates – that is, for costs that are not funded and are not intended to be funded by its customers. These costs are primarily those incurred by other corporations with which JCP&L joins in the filing of a consolidated federal income tax return. The Company believes that, in this regard, its tax schedules incorporate proper and generally accepted ratemaking principles. In her direct testimony, Ms. Crane proposes that the Company reduce its rate base by approximately $511,000,000 to reflect the tax impact of costs of exactly this kind.

Q. How does Ms. Crane describe her proposed adjustment?

A. On page 13, line 7 of her direct testimony, she characterizes her proposed adjustment as "quite large."

Q. Do you concur with Ms. Crane's characterization?

A. Her characterization represents a monumental understatement. Her CTA is much more than "quite large" – it is massive. To my knowledge, this is the largest such adjustment that has ever been proposed - anywhere.

Q. Exactly how "quite large" is Ms. Crane's proposed CTA?

A. The following table puts her proposal in some numerical perspective using Rate Counsel's proposed figures (in thousands):

1	Rate Counsel Rate Base (From Sched. RJH-3)	$ 1,224,170
2	Rate Counsel CTA (From Sched. ACC-1)	$ 511,030
3	Rate Counsel Rate Base Before CTA (1 + 2)	$ 1,735,200
4	CTA As A Percentage of Rate Base (2/3)	29.5%
5	Rate Counsel Weighted Overall Cost of Capital (From Sched. MIK-1)	7.76%
6	Rate Counsel Allowed Return (1 X 5)	$ 94,996
7	Rate Counsel Weighted Cost of Debt (From Sched. MIK-1)	3.13%
8	Interest On Actual Rate Base (3 X 7)	$ 54,312
9	Equity Return (6 – 8)	$ 40,684
10	Weighted Equity Return Rate (9/3)	2.34%
11	Equity Return Rate	4.68%

Using Rate Counsel's own measurement criteria, Ms. Crane proposes to evaporate almost 30% of the Company's rate base. Furthermore, as the above table demonstrates, when measured against the level of rate base proposed by

Rate Counsel, Ms. Crane's CTA would permit the Company an opportunity to earn a mere 4.68% return on equity.

Q. Please summarize your testimony.

A. The BPU has not often spoken about CTAs. When it has, the guidance it has provided has proven insufficient to inform the parties to New Jersey rate cases regarding the circumstances under which a CTA is appropriate and, in those instances where one is, how it should be quantified. This lack of clarity effectively extends an open invitation to extreme proposals like the one offered by Ms. Crane in this proceeding. This results from a combination of circumstances. The starting point is, of course, the Board's acceptance of the unorthodox proposition that the tax benefits of costs having nothing to do with the provision of regulated service should be reflected in rates - a proposition rejected by the vast preponderance of its fellow regulators. It proceeds to the Board's acceptance, without sufficient discussion or description, of a template to quantify the consolidated tax benefits to be reflected in ratemaking that has the capacity to produce undeniably distorted results that bear little relationship to the actual benefits even arguably produced by consolidated filing. And it ends with the imposition of a penal cost rate (the weighted overall cost of capital) that is inconsistent with the construct, however misplaced, that underlies the CTA policy in the first place (imputed interest on a constructive affiliate loan) and results in the confiscation, rather than the sharing, of any benefits of consolidated filing. It is the confluence of these circumstances that provides Ms. Crane the leeway to propose that the Company be afforded the opportunity to earn 4.68%

on its equity. The fact that she makes such a proposal should, in and of itself, impel the Board to revisit its CTA policy and the application of that policy in this proceeding. While the Board has opened a generic hearing in Docket No. EO12121072 to do exactly this on a more generalized basis, the outcome of that proceeding may come too late to prevent an inequitable result here. Consequently, the issues must be addressed here and now.

Q. Is the BPU required to impose Ms. Crane's CTA in this proceeding?

A. No it is not. While the New Jersey courts have affirmed that the BPU can consider the impact of consolidated tax filing, they do not mandate any particular response. There is no designated consolidated tax savings identification process and no prescribed measurement process.

Q. Have the New Jersey courts ever considered a CTA anything like the one Ms. Crane proposes?

A. No they have not. The most recent judicial decision involving a review of a CTA was issued in 1978[1] – more than 30 years ago. Obviously, since the BPU first approved a CTA of the type Ms. Crane proposes in 1991, such a CTA has never been subjected to judicial scrutiny.

Q. Are there features of Ms. Crane's proposed CTA that, in your mind, are relevant to such a judicial review?

A. Yes there are. Ms. Crane proposes to eliminate more than half a billion dollars of rate base. The sheer magnitude of her proposal begs for scrutiny. Further, as

[1] *Toms River Water Company v.* BPU, 158 N.J. Super. 57 (App. Div. 1978).

she states on page 13, lines 9-13 of her testimony, she effectively denies the Company any federal or state income tax expense. The complete denial of an income tax expense is a clear indicator of an adjustment that should be subject to question. Finally, and as I will describe in more detail later on, her methodology can be demonstrated to grossly overstate the level of consolidated tax benefits even arguably allocable to JCP&L.

Q. On page 13, lines 9-13 of her testimony, Ms. Crane suggests there may be some linkage between her denial to the Company of any tax expense whatsoever and the fact that the FirstEnergy consolidated income tax group did not pay any income taxes in two of the last three years. Should there, in fact, be any linkage?

A. No, there should not be. It is important to address and dispel this notion at the outset. It is well understood that utility rates are set to allow the recovery of not only the taxes the utility will currently pay, but also the taxes that it will pay in the future as a result of economic events that have already occurred. These future taxes are referred to as deferred taxes. This approach to tax accounting is called normalization. New Jersey uses normalization tax accounting - as does every other regulatory jurisdiction. Thus, even a utility that does not file a consolidated tax return may well have a regulatory tax expense – deferred tax expense – that should be recognized for ratemaking purpose when it does not currently pay any taxes to a taxing authority. This is neither unusual nor controversial. The level of current tax payments is never a proxy for utility tax expense. This is so in New Jersey and everywhere else. Similarly, the fact that the FirstEnergy consolidated tax group may not have paid taxes in any particular year should have no bearing whatsoever on JCP&L's deferred tax expense. To the extent Ms. Crane suggests that her elimination of the Company's tax expense, its entire tax expense, is justified by a lack of consolidated tax payments, she completely ignores the accepted regulatory tax accounting policy and principles that are employed in New Jersey and around the country.

Q. At page 21, lines 1-13 of your direct testimony, you indicated that JCP&L's position regarding the impropriety of CTAs is consistent with the practices of the vast majority of regulators in this country. In fact, you pointed out that there are only three jurisdictions other than New Jersey that systematically impose CTAs. Does that remain true?

A. No it does not. There are now only two other such jurisdictions.

Q. Please explain what has transpired.

A. In that portion of my direct testimony, I listed the only three other jurisdictions of which I am aware that systematically impose CTAs – West Virginia, Pennsylvania and Texas. Texas was the only one of the three that employed a "time value" approach of the type proposed by Ms. Crane – though there were a number of important computational differences between her model and the model used in Texas. In the middle of June of this year, SB1364/HB711 was signed by the Governor of Texas. That legislation eliminated the ability of the Public Utility Commission of Texas to consider the tax consequences of expenses that are not reflected in the setting of rates. It thereby precludes CTAs in Texas. As a result, only New Jersey, West Virginia and Pennsylvania continue to entertain CTAs.

Q. And is New Jersey the only jurisdiction in the country that employs a CTA concept like the one proposed by Ms. Crane in this case?

A. Yes. New Jersey is alone in using this methodology.

Q. At several points in her testimony, Ms. Crane characterizes the FirstEnergy tax sharing agreement as a vehicle for the subsidization by regulated affiliates of unprofitable unregulated ventures. What is the relevance of the tax sharing agreement and do you agree with her characterization?

A. The FirstEnergy tax sharing agreement governs the flow of cash tax payments among the members of the consolidated group in satisfaction of the tax consequences of their operations. As a threshold matter, I have never maintained that the BPU should honor the tax sharing agreement simply because it exists. I maintain that payments under the tax sharing agreement should be respected because they are economically justified, consistent with the tax expense recorded on the books and records of the Company and, more importantly, are equitable.

Q. What aspect of the tax sharing agreement does Ms. Crane characterize as a subsidy?

A. Presumably, she is referring to the feature whereby members that produce tax losses are paid for those tax losses when and to the extent that they reduce the consolidated tax liability.

Q. Do you agree that such payments constitute a subsidy?

A. I do not. There are at least four sound reasons that support this position:

1. The affiliate's tax loss produces a current cash benefit and it is appropriate to compensate the loss affiliate when the cash is received;

2. The act of Income Netting extinguishes the loss affiliate's tax loss forever. This is a valuable tax attribute and it is appropriate to compensate the loss affiliate for the consumption of the tax loss when the consumption occurs;

3. If the loss affiliate is not compensated for the tax benefit of its loss, the money is, by default, retained by some other affiliate who is much less entitled to the funds; and

4. Compensating loss affiliates contemporaneously for the tax benefit of their losses is, in fact, the prevalent method of tax allocation among consolidated groups – including those that do not include utilities.

Q. Why does it make sense to pay a loss affiliate when the group receives the cash produced by the loss?

A. The fact is that the group's tax liability is reduced when the loss is produced, not at some later date when the loss affiliate would have received cash had it not filed as part of the consolidated return. Paying for the loss contemporaneously recognizes the reality of the way things actually transpired (on a consolidated basis) rather than the hypothetical way things might otherwise have transpired (on a non-consolidated basis).

Q. Does it make commercial sense to have an affiliate other than the loss affiliate hold the cash until the loss affiliate could hypothetically use the loss?

A. No, it does not. Which member of the group is more entitled to the cash than the affiliate that produced the tax loss? Tax losses do not occur in a vacuum. In all cases, they are the result of underlying economic activity. By far the most important feature is that each dollar of tax loss represents a dollar expended or a dollar of liability incurred by the tax loss member. In other words, each loss member suffered a substantive change in its economic position to produce the tax loss. And, obviously, no one would expend a dollar simply to produce a 35¢ tax benefit. By contrast, no member of the consolidated group producing positive taxable income, including the Company, contributed anything or assumed any risk whatsoever relative to the creation of any tax loss allocated to it by virtue of the CTA mechanism. Further, through the regulatory process, customers are insulated from the risks of non-regulated undertakings. That is, at least in part, the charge of this Board. The risk of commercial failure in these non-regulated undertakings is, therefore, exclusively for the account of the shareholders. It is their wealth, not customer wealth that is at stake. It is inequitable to strip out the tax consequences of taking on those risks and transferring them to non-risk-takers (*i.e.*, to customers of the regulated utility). Finally, no affiliate that produced taxable income, no matter how great, caused the group's tax liability to be reduced. Only the loss affiliate did that. Consequently, the group member that produces the tax loss has a far superior claim to the tax benefit of its own loss than does the group member that merely generates positive taxable income. The former is an active participant in the production of that benefit and paid for the benefit - $1 for each 35¢ of benefit. The latter paid nothing and is no more than a completely passive bystander.

Q. Do you have any objective evidence of the reasonableness of paying loss affiliates for their tax losses when they are used to reduce the consolidated tax liability?

A. In my more than 30 years of tax practice, I have seen many tax sharing procedures, policies and agreements. It has been my experience that paying loss affiliates for the use of their tax losses when they are used is by far the most prevalent structure used in such arrangements. And this is true both where the consolidated group has regulated affiliates and where it does not. A "payment for losses" system is standard business procedure. It is, in fact, the norm. The commercial norm across industries must be presumptively reasonable. There are no subsidies - just an economically justifiable and equitable way of accounting for a consolidated cost.

Q. On page 22, lines 17-19, Ms. Crane states that a utility's ratepayers are the source of the tax payments made by JCP&L to its parent company. Is that a meaningful statement?

A. No it is not. Every business that has customers, whether it is regulated or non-regulated, ultimately has to recover its costs (including its income tax costs) if it wants to survive. The source of every such business's ability to pay its costs is its revenues. And, ultimately, the source of every such business's revenues is its customers. Thus, while Ms. Crane's observation regarding the source of JCP&L's tax payments may be factually correct, as it would be for any business, it is the answer to the wrong question. The critical question in a utility context is, as it has always been, what are the utility's legitimate costs to provide electric service, including its tax expense. The source of its tax payments is irrelevant. I maintain that a CTA is not part of a legitimate assessment of a utility's tax cost. Ms. Crane disagrees. Again, the vast preponderance of regulators agrees with my position.

Q. Please describe the remainder of your testimony.

A. The remainder of my testimony addresses a number of profound inaccuracies, methodological flaws and other problems with Ms. Crane's CTA calculation, even if her CTA approach were otherwise deemed appropriate.

Q. Does this discussion indicate that you accept (or might accept) the principle of a CTA if it is calculated in a way that avoids the pitfalls you describe hereafter?

A. Absolutely not. My direct testimony is dedicated almost entirely to the proposition that a CTA, any CTA, is economically unjustified, inequitable and conflicts with generally accepted ratemaking principles. However, irrespective of my basic beliefs regarding CTAs, I believe that the very serious issues I see with Ms. Crane's RECO Template (as defined below) need to be brought to light to demonstrate not only the inequity of the result, but the fundamental flaws of the computation itself.

Q. How did Ms. Crane derive the $511 million amount by which she proposes to reduce JCP&L's rate base?

A. On page 10, lines 19-21 of her testimony, she states that she used the methodology approved by the Board in Rockland Electric Company, BPU Docket No. ER02100724 ("RECO Template").

Q. Are you familiar with that methodology?

A. Yes, I am.

Q. On page 11, line 6 through page 12, line 8 of her testimony, Ms. Crane describes her calculation. Is it consistent with the RECO Template?

A. The general approach is consistent. However, there are a number of circumstances present in this case that were not present in RECO or in any prior case in which the Board addressed CTAs. Thus, the Board has not considered, never mind provided guidance with respect to, any of these different circumstances. Ms. Crane, however, made assumptions regarding the treatment and incorporated them into her calculations. As I proceed with my discussion of her proposal, I will indicate where she incorporated her speculations to fill voids in the Board's methodology.

Q. Before you address the detail of Ms. Crane's calculation, please provide an overview of the RECO Template.

A. The RECO Template attempts to quantify with respect to each group member the tax losses that member would not have been able to use had it filed on an unconsolidated basis but which were, in fact, used in consolidation. The tax benefit of the total of these "otherwise unusable" tax losses is the presumptive "consolidated tax savings" (that is, it is the excess of the total tax the members would have paid had they not filed a consolidated tax return over the consolidated tax actually paid). Since the BPU first employed this approach in 1991, the "tax savings" are computed for the period starting in 1991. This "savings" is then apportioned to each of the group members who produced aggregate taxable income for the period which, the theory goes, enabled those “otherwise unusable” tax losses to be used.

Q. How are the "savings" allocated to the New Jersey utility treated in ratemaking?

A. The theory underlying the ratemaking treatment for these "savings" is somewhat murky. What is clear is that, to the extent that the New Jersey utility's tax payments under its tax sharing agreement went to compensate its affiliates for their "otherwise unusable tax losses," those payments are deemed to have created "loans". These constructive loans are reflected as a reduction in rate base.

Q. Are there really any loans?

A. No there are not. They are a construct. The loans are fictional and are contrived only for ratemaking purposes. It is not reflected for financial reporting, tax reporting or any other purpose.

Q. Does the RECO Template actually measure what it is intended to measure?

A. The RECO Template is not a technically sophisticated tool. This is because, as applied by Ms. Crane, it does not incorporate the tax rules applicable to tax losses. As a consequence, it fails to measure the actual capacity of any single company to use its own tax losses and, consequently, does not accurately identify the extent to which the constructive loans which underpin the CTA theory should be imputed.

Q. Specifically, what flaws have you identified in the way Ms. Crane applies the RECO Template to JCP&L in this proceeding?

A. I have identified at least six major problems with the RECO Template as Ms. Crane has applied it to JCP&L in this proceeding. These are:

1. Failure to observe the tax law with regard to the treatment of tax losses;
2. Failure to incorporate the economic consequences of net operating loss carryforwards ("NOLCs");
3. Consideration of tax results even in years that could not impact current year tax losses;
4. Freezing forever tax benefits provided by companies that are no longer part of the consolidated tax group;
5. Failure to incorporate the impact of JCP&L's transition from a BPU-regulated, vertically-integrated electric company (including generation, transmission and distribution) to the regulation by the BPU of only its distribution operations; and
6. Failure to eliminate tax losses of other regulated group members in her CTA calculation.

__**Failure to Observe the Tax Law**__

Q. Please describe this problem.

A. In order to calculate the aggregate "tax savings," a determination must be made of the extent to which any group member could or could not have used its own tax losses should one pretend that it did not participate in a consolidated tax filing. In fact, this assessment is absolutely fundamental to calculating the "tax savings." Embedded in Ms. Crane's application of the RECO Template to JCP&L is the presumption that a tax loss produced in any year by any group member can offset taxable income produced in any year by any other group member. This presumption completely ignores that the tax rules restrict the ability to use tax losses in a number of ways. Most relevant are the following two rules:

1. A tax loss incurred after 1997 can be carried back 2 years and forward 20 years. A tax loss incurred before 1998 can be carried back 3 years and forward 15 years; and

2. A tax loss incurred by a group member can only offset the taxable income of another group member that was a member when the loss was generated.

Q. Please provide an illustration of how the RECO Template as applied by Ms. Crane fails to take these rules into account.

A. Assume that JCP&L operated as a stand-alone entity for 5 years and, at the beginning of 2006, it is acquired by FirstEnergy. FirstEnergy has one affiliate, Corp Y. In each of the first 5 years, JCP&L produces $300 of taxable income. In 2006, it produces $0 taxable income. In 2006, FirstEnergy produces $500 of taxable income and Corp Y produces a $400 tax loss. Assume a 35% tax rate.

Based on these facts, the RECO Template as applied by Ms. Crane would appear as follows:

	2001	2002	2003	2004	2005	2006	Total
JCP&L	$300	$300	$300	$300	$300	$0	$1,500
FirstEnergy						$500	$500
Corp Y						($400)	($400)

Q. What would the RECO Template calculate JCP&L's consolidated tax benefit to be?

A. Corp Y would not have been able to use its $400 tax loss produced in 2006 without having participated in the consolidated tax return. Thus, that tax loss would produce the entire consolidated tax benefit. The benefit of that loss, $140, ($400 X 35%) would be allocated between JCP&L and FirstEnergy based on their relative total taxable incomes per the schedule. On that basis, JCP&L would be allocated ¾ ($1,500/$2,000) of the benefit. Under the BPU CTA construct, JCP&L would be considered to have made a loan to Corp Y in the amount of $105 ($140 X 75%).

Q. What is the problem with this result?

A. The problem is that it is impossible. Under the first of the two tax rules I set out above, Corp Y's 2006 tax loss could only be carried back two years – not the 5 years presumed by the RECO Template. Thus, only $600 of JCP&L's taxable income from earlier years was available to absorb Corp Y's 2006 tax loss. The template erroneously assumes $1,500 was available. Under the second of the two tax rules, ***none*** of JCP&L's taxable income in any of the years on the schedule could possibly have offset any portion of Corp Y's 2006 tax loss because JCP&L's pre-2006 taxable income was produced prior to the time JCP&L and Corp Y were members of the same consolidated group. In other words, the facts do not support the construct that JCP&L made any loan whatsoever to Corp Y, let alone a loan of $105.

Q. Do both of these problems with the application of the RECO Template arise in JCP&L's situation?

A. Yes, they do. Ms. Crane places no limits whatsoever on tax loss utilization during the 21 years (1991-2011) on her schedule. For example, though the tax losses incurred by FirstEnergy affiliates after the GPU acquisition could not, by law, be offset by JCP&L's pre-acquisition income, she presumes they can be. This results in a grossly inaccurate measurement of the "tax savings."

Q. Why is it important to observe the tax rules in computing "consolidated tax savings?"

A. The purpose of the exercise is to compare the results of two scenarios: the consolidated tax paid by the group and the total tax that would be paid by the group members under stand-alone filings. Each of these results is dictated by the tax law. Clearly, the regulators cannot cause a tax loss to be carried back any further than the tax law allows no matter what they do. Thus, application of the tax rules is critical to measuring what the process is intended to measure.

<u>Failure to Consider the Economic Consequences of an NOLC</u>

Q. Does the FirstEnergy consolidated tax group have an NOLC as of the end of 2011?

A. Yes, it does. As of the end of 2011, I am advised that it has a NOLC of approximately $1.3 billion.

Q. What does the existence of an NOLC mean economically?

A. A consolidated NOLC indicates that not all of the tax losses of the individual group members have been used to offset group taxable income. Utilization must await the future generation of additional consolidated taxable income. The inability to use all of the group's losses means that those losses carried over and, hence, produced no incremental cash for the group.

Q. To the extent that the unused losses were generated by non-regulated affiliates, what are the implications for the CTA calculation?

A. By definition, an NOLC has not yet offset taxable income. Thus, to the extent that any of the consolidated NOLC is comprised of non-regulated affiliate tax losses, then these could not possibly have offset another member's taxable income. Since affiliates are compensated for the absorption of their tax losses only when those losses are used to reduce the group's consolidated tax liability, the affiliates would not have been compensated for the use of such tax losses. Without utilization, there is no incremental cash for the group or for any member of the group – including the member who produced the loss. Consequently, there is no logic that would support the creation of a constructive loan and its consequential reduction of rate base on account of tax losses that comprise an NOLC.

Q. Can you provide a simple illustration of this principle?

A. Yes. Assume that Parent and Utility file a consolidated tax return. Utility produces $100 of taxable income and Parent produces a $1,000 tax loss which cannot be carried back. The applicable tax rate is 35%. Thus, on a consolidated basis no tax is paid and there is a $900 NOL carryforward. Utility pays Parent $35 ($100 X 35%) – which represents the tax consequences of its operations for the period. If one were to attempt to calculate a rate base CTA based on these facts, the rate base offset must be limited to $35 – not the $350 ($1,000 X 35%) tax effect of Parent's tax loss. This is because only $100 of that loss was used to offset Utility's taxable income. The "loan" can simply not be any greater than $35. The other $900 of the loss provided no current tax benefit to anyone and, hence, could not have produced a consolidated tax benefit. It wouldn't matter if Parent's tax loss was $1 million or even $1 billion. Even based on the flawed theory behind the RECO Template, the consolidated benefit could be no greater than $35. This is very basic economics - and common sense.

Q. In calculating her $511 million proposed CTA, does Ms. Crane distinguish between tax losses that have been used to reduce the group's tax liability and those that have not?

A. No, she does not. She treats all tax losses the same – even those that have not yet produced a benefit.

Q. Has the BPU addressed the treatment of NOLCs in the calculation of CTAs?

A. So far as I am aware, in none of the four instances in which the BPU adopted a CTA in a fully litigated case, did the consolidated groups involved have an NOLC. Thus, this is not an issue that the BPU has addressed.

<u>Consideration of Tax Results of Years that Could Not Impact Current Year Tax Losses</u>

Q. What years are reflected on Ms. Crane's version of the RECO Template which she used to calculate her CTA proposal?

A. All years from 1991 through 2011. That is a total of 21 years.

Q. Does this raise an issue regarding the accuracy of the results produced by the template?

A. It does.

Q. What is the significance of the tax loss carryforward period?

A. As I stated earlier in my testimony, under the tax law, tax losses incurred in years prior to 1998 can be carried forward 15 years and those incurred after 1997 can be carried forward 20 years. After that, they expire. Thus, a tax loss incurred in 1990 would have expired at the end of 2005, a 1991 loss at the end of 2006, a 1992 loss at the end of 2007, a 1993 loss at the end of 2008, a 1994 loss at the end of 2009, a 1995 loss at the end of 2010 and a 1996 loss at the end of 2011.

Q. What are the implications of this for the calculation of a CTA using the RECO Template?

A. As indicated above, under the tax law, any otherwise unusable losses from years prior to 1997 could not possibly offset taxable income produced after 2011 (the latest year used by Ms. Crane in her CTA computation) by the loss-generating company. Thus, any constructive "loan" (using the Board's analogy) reflected on her RECO Template that was created at any time prior to 1997 and which did not reverse by 2011 (within the tax law carryforward period), can never reverse. This means it will either remain a rate base reduction in perpetuity or the Board can make the reasonable presumption that the loss was or would have been used by the company that generated it before it expired.

Q. But was the tax loss, in fact, used by the company that generated it prior to its expiration?

A. Bear in mind that the loss carryforwards (*i.e.*, the otherwise unusable losses) employed in the CTA calculation are complete fictions. They do not, in fact, exist and never have. Those tax losses were actually used in consolidation. The tax losses that drive the CTA calculation are the hypothetical losses that would have existed had the loss companies filed on an unconsolidated, or stand-alone, basis. Any company that had a real loss carryforward expiring would find a way (of which there are many) to use it. Of course, most of these techniques involve at least some cost or inconvenience to implement. Thus, a company wouldn't implement such a strategy unless there was an actual loss expiring – in which case it would be cost-justified. It would make no sense for the Board to require a company to spend the money to salvage a hypothetical loss that exists only for purposes of the CTA calculation.

Q. Has the BPU ever addressed this situation?

A. The last fully litigated order in which the Board imposed a CTA, RECO, involved the CTA computation years 1991 through 2001. Thus, the earliest year's tax losses (1991) had not yet come up against the 15-year expiration limit (2006). Consequently, the Board has never been in a position in which this has been an issue.

Q. In the absence of Board authority, is there any other guidance as to how to handle this situation?

A. While there are very few jurisdictions that impose CTAs, the Public Utility Commission of Texas ("PUCT"), the single other jurisdiction that, until recently, used a CTA similar to the rate base offset CTA that has been imposed in New Jersey, has addressed this issue. In the Texas CTA computation, affiliate tax losses only remained in the calculation for the duration of the carryforward period. This policy was articulated in a memorandum from Commissioner Judy Walsh to her fellow commissioners explaining the method that the PUCT ultimately adopted and that continued to be used until CTAs were statutorily prohibited. She stated:

> Based upon the tax principle that losses can be carried forward for 15 years, we have looked at a period of 15 years. For each company, any income generated by that company was offset against any losses, to reflect that the company had covered its own losses before the test year.

Q. What is the practical effect of ignoring the tax law regarding limitations on NOLCs?

A. The loss carryforward limitations in fact exist in the tax law. Without a carryforward limitation, 100 years from now we might well be calculating CTAs that reflect carryforwards of a fictional tax loss that was actually used 100 years ago and which, had it not been used, would have expired 80 or more years prior. Yet we would still be treating it as if it had the capacity to offset taxable income of the company that generated it now or at some time in the future. This seems ludicrous to me. Even under the Board's fundamentally flawed policy, it makes much more sense to follow the former Texas procedure in this regard and eliminate a fictional loss from the calculation when it would have expired.

<u>Sold, Merged or Liquidated Members</u>

Q. How are members that are sold, liquidated or merged out of existence reflected on Ms. Crane's RECO Template?

A. A consolidated group member that is sold, liquidated or merged simply disappears prospectively from the RECO Template on its date of sale, merger or liquidation. Thus, to the extent that, prior to the sale, merger or liquidation, it had constructive loans extended to it under the CTA construct, after the transaction those constructive loans can never be repaid. The entity evaporates from the calculation. In the case of mergers and liquidations, even if, after the transaction, the operation that produced the prior losses produces taxable income, the constructive loan can never be undone.

Q. Has the Board addressed the treatment of sold, merged or liquidated members?

A. So far as I am aware, it has never addressed it explicitly. As is clear from the history of the consolidated groups of which JCP&L has been a member (between 15 to over 85 members), this is an important issue.

<u>Any CTA Should be Computed Only by Reference to JCP&L's Distribution Operations</u>

Q. Does Ms. Crane's RECO Template take into account the fact that rates in this proceeding are only being set for JCP&L's distribution operations?

A. No, it doesn't. As its basis for allocating the constructive loans, Ms. Crane's RECO Template incorporates JCP&L's total taxable income for each of the years 1991 through 2011. In fact, for many years reflected on the RECO Template, the JCP&L corporate entity housed generation operations. Further, in all years reflected on the RECO Template, it housed (and continues to house) transmission operations. Thus, the taxable income upon which Ms. Crane's allocation is based includes income from non-jurisdictional businesses. It is improper to allocate constructive loans to JCP&L's distribution business based on the Company's taxable income from both its jurisdictional and non-jurisdictional operations. In doing so, the RECO Template quantifies a CTA amount allocable to JCP&L that far exceeds the portion of the constructive loans applicable to JCP&L's electric distribution business – the business for which rates are being set in this proceeding. This is not only inequitable, but patently wrong from a ratemaking perspective.

<u>The Elimination From the CTA Calculation of the Tax Losses of Other Regulated Entities</u>

Q. On pages 19 of her direct testimony, Ms. Crane states that no distinction should be made between regulated and non-regulated loss affiliates. Do you agree?

A. No, I do not. The regulators that set rates for any utility having a tax loss will appropriately reflect any benefits that loss produces in the rates of that utility. Indeed, I believe that this is what this Board does routinely. Consequently, the benefits of the tax loss will be embedded in the rates in that jurisdiction. If, as Ms. Crane proposes, another jurisdiction takes that same tax loss and reflects it in the rates of its utility, then the same tax loss will have reduced customer rates twice – once in each of the two jurisdictions. I refer to this as a "double dip." This Board should not be a party to such a blatantly inequitable procedure.

Q. Is there another reason why regulated affiliate tax losses should not be considered in calculating a CTA?

A. Yes there is. By incorporating the tax losses of regulated affiliates into her CTA calculation, Ms. Crane proposes to provide to New Jersey customers the benefit of tax losses that are attributable to accelerated depreciation claimed on regulated assets – not New Jersey regulated assets but assets of regulated affiliates in other jurisdictions. Though the IRS has concluded that CTAs in general do not present a problem under the tax normalization rules, that conclusion is premised on the understanding that the source of CTA benefits is not accelerated depreciation on regulated assets. In a 1991 memorandum addressing CTAs and normalization, the Chief Counsel of the Internal Revenue Service stated:

> These arguments do raise a concern that a consolidated tax adjustment might be used to offset a utility's deferred tax reserve from normalization *or might be used to flow through the accelerated depreciation benefit of another regulated utility in the same consolidated group*. These concerns are worthy of further study. Until they are resolved we can only say with confidence that consolidated tax adjustments do not violate normalization, provided that the adjustments are applied only to the extent of current ratemaking tax expense and not to the deferred tax reserve applicable to accelerated depreciation on public utility property, *and provided that the taxable income of any other regulated utilities used in the calculation of the adjustments is computed on a normalized basis*. (Emphasis added.)

However, by incorporating the tax losses of regulated affiliates, Ms. Crane's CTA calculation strays outside of the general safe harbor; hence, a problem.

Q. What does Ms. Crane state with regard to the "regulated/non-regulated" issue?

A. On page 19, lines 16-18 of her testimony, she states:

> Moreover, it is abundantly clear from the Board Orders that consolidated income tax adjustments do not distinguish between losses generated by regulated or unregulated entities.

Q. Do you agree that the Board's Orders are "abundantly clear?"

A. I do not. My review of the BPU's orders discussed earlier in this testimony leads me to precisely the opposite conclusion – that is, that the Board has never addressed a situation in which regulated affiliate tax losses were a factor in a CTA computation. In fact, I would say that the treatment is abundantly *unclear*.

Q. What does Ms. Crane state with regard to the potential application of the normalization rules to CTAs?

A. On page 23 of her testimony, she addresses the issue by stating that (1) during the past 20 years, no New Jersey CTA has been held by the IRS to violate the tax normalization rules and (2) that I know of no IRS ruling or request for a ruling that indicates that any rate base method CTA is problematic under the normalization rules.

Q. Is Ms. Crane correct in these regards?

A. She is – but that is irrelevant to the matter at hand. I know of no Board order imposing a CTA in which the benefits of regulated affiliate tax losses were "double dipped" as she proposes in this case. Thus, there has been no violative order for the IRS to identify upon audit, nor which could be the subject of an IRS ruling request. Further, if the Board were to issue such an order, the financial accounting and tax rules now in effect would require the Company to disclose the normalization issue to both its shareholders and the IRS if the Company and its outside auditors deem it more likely than not that a normalization violation has occurred. In the event that this Board is inclined to accept this aspect of Ms. Crane's CTA proposal, I would strongly recommend that it do so only after the Company requests and obtains a private letter ruling from the IRS indicating that such a calculation methodology would not give rise to a normalization violation.

Q. To your knowledge, do the two other jurisdictions that impose CTAs recognize the normalization issue you describe and adjust their calculations accordingly?

A. Yes they do. And so did Texas before CTAs were legislatively precluded.

Q. What would be the effect of reducing JCP&L's rate base by any consolidated tax benefit allocated to it in this proceeding?

A. The effect would be to impute an interest charge on the constructive loan from JCP&L to its affiliates at a rate equal to JCP&L's weighted overall cost of capital.

Q. Is it necessary that the interest rate on the deemed affiliate loan be set at the utility's weighted overall cost of capital?

A. There is nothing that requires that. In fact, it is unlikely that any affiliate producing a tax loss would choose to accelerate the monetization of that tax loss if the consequence of doing so is an obligation to pay interest on the amount monetized at the weighted overall cost of capital of its utility affiliate. Such a loan would be just too expensive. Therefore, in practice, the utility's weighted overall cost of capital overstates by far the value of such a perceived benefit. In Texas, until recently the only other jurisdiction in which the regulators impute a constructive loan on account of consolidated tax filing, the interest cost associated with the deemed loan was equal to the utility's weighted cost of long term debt. Thus, using the same view of consolidated filing and even employing similar (but not identical) quantification mechanics, Texas's imposition, while just as theoretically objectionable as New Jersey's, was materially less damaging to its utilities.

Q. Do CTAs provide any of the benefit of consolidated filing to companies producing tax losses?

A. No, they do not. BPU CTA theory has it that a New Jersey utility is deemed to make a loan to its parent in the amount of its allocated share of the benefit of the affiliate tax losses that would not have been used absent consolidation. By virtue of the treatment of the allocated consolidated benefit as a rate base reduction, the interest on the deemed loan is calculated at the utility's weighted overall cost of capital. When a utility loans money to an affiliate at the utility's weighted overall cost of capital, it is in no way sharing the benefit of the principal with that affiliate. In truth, the affiliate could likely borrow at a significantly lower cost elsewhere; hence, the constructive loan would never occur in the real world. Thus, the rate base offset CTA procedure assigns 100% of the benefit of consolidated filing to companies that produce taxable income. It assigns no portion of the benefit to companies that produce tax losses.

Q. Please further explain why it is that New Jersey's CTA is unbalanced in its allocation of the benefits of consolidated filing.

A. In the computation of the CTA, the standard against which consolidated results are compared is the position each loss affiliate would have occupied had it filed on an unconsolidated basis. To the extent a loss affiliate receives cash in excess of its "unconsolidated", or stand-alone, tax position it is treated as if it had received a loan on which it must pay interest. Giving effect to the imputation of this interest, the loss affiliate is no better off than if it had filed on an unconsolidated basis and borrowed some money from a bank. In short, it does not benefit from the consolidated filing in any way. By contrast, the taxable members of the group, such as the utility affiliate, receive imputed interest – interest they would not have received had they filed on an unconsolidated basis. Further, as proposed by Ms. Crane, this interest is imposed at a penal rate (the utility affiliate's weighted-average cost of capital) rather than a more commercially reasonable rate.

Q. If the taxable affiliates are better off than if they had filed on an unconsolidated basis and the loss affiliates are no better off, what must one conclude?

A. Logic compels the conclusion that all of the benefits of consolidated filing are being provided to the taxable affiliates and none are being provided to the tax loss affiliates.

Q. Is this appropriate?

A. It is inequitable and unreasonable. Without the taxable affiliates, the monetization of losses might be deferred until some later time. However, without the tax losses produced by the loss affiliates, there would be nothing to monetize and, hence, no tax benefits – at all. Whatever the case, any CTA methodology that does not provide for all members of the consolidated group (including the members producing the tax losses in the first place) to equally share in the resulting tax benefits, not just those members with positive taxable income, is clearly not reasonable.

Q. Please summarize your testimony.

A. My primary position remains the one I expressed in my direct testimony – the BPU should conform to the generally-accepted ratemaking principle that, where a cost is not recognized in ratemaking, its tax consequences should not be either. In other words, it should not impose a CTA in this proceeding. Of the 53 jurisdictions of which I am aware (the fifty states, FERC, D.C., and the City of New Orleans), New Jersey is one of only three that accepts the propriety of CTAs. This is not happenstance. The concept is flawed and the vast preponderance of regulators, recognizing this, has acted accordingly. If the Board continues to defy the conventional wisdom and also continues to use the "RECO Template" approach, it will not be aligned with a single one of its regulatory colleagues. Not only will it have adopted a flawed concept, but it will have implemented that flawed concept in a grossly inaccurate and inequitable fashion. The Board should recognize the problems with the RECO Template approach that I have described above and, at a bare minimum, take whatever steps are necessary to accurately measure and fairly apportion whatever benefits of consolidated filing it deems to exist.

Q. Does that conclude your testimony?

A. Yes it does.