SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
Docket No. A-1153-14T1

IN THE MATTER OF THE BOARD'S REVIEW OF THE APPLICABILITY AND CALCULATION OF A CONSOLIDATED TAX ADJUSTMENT	) On Appeal from the) October 22, 2014; November 3,) 2014 and December 17, 2014) Orders of the New Jersey Board) of Public Utilities)) BPU DKT. NO. EO12121072) Civil Action

BRIEF OF APPELLANT
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PUBLIC VERSION

Table of Contents

Table of Authorities

Agency Orders

PRELIMINARY STATEMENT

While the subject of this case – the appropriate ratemaking treatment of savings that result from the filing of consolidated income tax returns by utility holding companies – appears complicated, the issues are actually quite simple. When regulated utility rates are set, an allowance is made for the utility's federal income tax liability. Ratepayers thus pay in their rates the utility's full federal income tax obligation. However, the taxes collected from ratepayers are for the most part not then paid to the IRS. When utilities are subsidiaries of larger holding companies, they pay those taxes over to their parent corporation, which then files a consolidated tax return for all of its subsidiaries. When it does so, it uses the utility's positive taxable income to offset losses from other subsidiaries and thus reduces the overall tax liability of the consolidated income tax group. The result in some instances is that ratepayers are paying tens of millions of dollars for taxes while the holding companies are paying no federal income tax or are getting refunds.

Since the 1950's, our courts have said that it is impermissible for these utilities to recover "hypothetical" tax expenses that are not then used to pay taxes. I/M/O the Revision in Rates Filed by New Jersey Power & Light Company, Increasing its Rates for Electric Service, 9 N.J. 498 (1952).

The Appellate Division has found that the utilities must share with ratepayers the benefits that the consolidated income tax group receives by filing a consolidated tax return. In re Lambertville, 153 N.J. Super. 24, 28 (App. Div. 1977), rev'd in part on other grounds, 79 N.J. 449 (1979).

The Consolidated Income Tax Adjustment ("CTA") at issue in this case is the mechanism the Board of Public Utilities ("BPU" or "Board") has used since the 1950's to provide that shared benefit to ratepayers. The currently-used formula was developed in the 1990's and has resulted in recent years in some adjustments that are extremely large. For this reason, the Board initiated a proceeding to reexamine the use of a CTA and the current formula for calculating it.

The Order at issue in this case reaffirms the use of a CTA, but modifies it so significantly that in calculations done by Rate Counsel's expert using the modified CTA, nearly all of the electric and gas utilities in the state will have a CTA of zero. (Aa196) Rate Counsel maintains that the Board failed to explain the basis for the specific revisions it has chosen and that the record does not support those changes. Rate Counsel also maintains that a formula that results in a zero CTA is contrary to law and causes ratepayers to, once again, pay hypothetical income tax expenses that are impermissible and result in unjust and unreasonable rates. Finally, Rate Counsel also maintains

that if the Board desires to announce a new policy on consolidated income taxes, it must do so utilizing the rulemaking procedures of the Administrative Procedure Act ("APA"). Since it has not done so here, the Order should be vacated and the matter remanded for the Board to utilize those procedures. The Board must be required as part of that process to provide the basis for its revisions, and to ensure that the unfairness recognized by our Supreme Court over 60 years ago of charging ratepayers for hypothetical taxes that never get paid, is not brought back as a result of its decision.

STATEMENT OF FACTS AND PROCEDURAL HISTORY[1]

1. Base Rate Case Overview

Generally, a New Jersey utility will file a Petition seeking an increase in distribution rates when the utility decides that an increase in base rates is needed. A Petition seeking an increase in rates is filed with the Board with all supporting documentation. A copy of the filing is provided to Rate Counsel.

Rate Counsel is a statutory intervenor in all cases where a utility seeks an increase in rates. Rate Counsel hires financial, accounting and engineering experts to review the utility filings, to draft discovery, and to file testimony with either the Office of Administrative Law ("OAL") or the Board, in support of their findings. Ultimately the Board will make the final determination on the amount of increase the utility can implement in base rates.

The Board's authority to set rates is not unfettered. The statutory standard prescribing the rate-making authority of the Board provides that the Board may fix "just and reasonable" rates. N.J.S.A. 48:2-21(b)(1). The Supreme Court of New Jersey has held that "The justness and reasonableness of a particular rate of fare can only be determined after an examination of a

[1] For the purpose of clarity and the convenience of the Court, Rate Counsel has combined the Procedural History and Statement of Facts in this brief.

company's property valuation which constitutes its rate base; its expenses, including income taxes and an allowance for depreciation and the rate of return developed by relating its income to the rate base." I/M/O The Petition of Public Service Coordinated Transport, 5 N.J. 196, 216 (1950).

The determination of an adequate rate base is fundamental in the setting of just and reasonable rates. Id. at 217. Rate base is the value of the assets used in supplying utility service to customers. The rate base is the amount to which the rate of return is applied to determine the utility's allowed return, including profit. Equally important is the necessity of determining the reasonableness of the items of expense to be allowed in computing the operating and net income of the utility. Id. at 222. "A utility in a rate proceeding must bear the burden not only of proving the amount of its operating and other expenses, but also the burden of proving the basis of the charges to its expense accounts and the propriety of including such charges for rate-making purposes." Id.

2. Consolidated Tax Adjustment ("CTA")

In New Jersey, when a utility comes in for a distribution rate increase, included in the utility's distribution rates is an allowance for income tax expense. This tax expense is calculated as if the utility filed its federal income taxes on a

stand-alone basis, applying the statutory tax rate to the utility's operating income before taxes. If the utility is an affiliate of a larger holding company, however, that utility will not file its federal income tax return on a stand-alone basis but rather files as a part of a consolidated tax group. By filing a consolidated return, the tax loss benefits generated by one member of the consolidated group can be shared with the other group members, resulting in an overall reduction in the consolidated group's effective federal income tax rate. Generally, based on tax sharing agreements entered into between the utility and its parent company, the utility will pay to the parent company the amount of tax it would pay if it filed on a stand-alone basis. (Aa122) A portion of those funds are then contributed to the members of the consolidated group that incurred tax losses. Thus, filing a consolidated return lowers the holding company's overall tax liability.

In order to address this subsidy, and to ensure ratepayers share in the tax benefits, the BPU has, since 1951, used a consolidated tax adjustment when setting rates for New Jersey utilities. I/M/O the Revision in Rates Filed by New Jersey Power & Light Company, Increasing Its Rates For Electric Service, Supra, 9 N.J. at 528. In that case, the New Jersey Supreme Court reviewed a utility's claim that the Board had improperly imposed an adjustment to reflect federal income tax

savings resulting from the filing of a consolidated return. The Court found that the adjustment was necessary and appropriate to ensure that New Jersey ratepayers were not asked to pay for hypothetical expenses.

The consolidated tax adjustment methodology that has been utilized by the Board since 1991 is referred to as the "rate base method," and provides that when a utility participates in a consolidated tax filing, the utility's rate base is reduced by the accumulated tax benefits allocated to the utility based on the utility's share of total positive taxable income. (Aa17, Aa19) I/M/O the Petition of New Jesey Natural Gas Company for Approval of Increased Base Rate Tariff Rates and Charges for Gas Service and Other Tariff Revisions Consolidated Taxes, BPU Dkt. Nos. GR89030335J- Phase II, GR90080786J, Decision and Order, (November 26, 1991).

This rate base method does not directly reduce the income tax expense included in a utility's revenue requirement, but rather treats these accumulated benefits as cost free capital. The BPU's current rate base methodology used to calculate a consolidated tax adjustment was adopted by the Board in the Rockland Electric case, ("the Rockland methology"). (Aa40, Aa45-47) I/M/O the Verified Petition of Rockland Electric Company for Approval of Changes in Electric Rates, its Tariff for Electric Service, its Depreciation Rates, and for Other

Relief, BPU Docket Nos. ER02100724, Final Decision and Order, (April 20, 2004).

Briefly, the "Rockland methodology" requires finding the aggregated amount of taxable income or loss for each affiliate from 1991 through the rate case test year. Then, for each year, the taxable income or loss for the group of companies that had an aggregated (1991-present) taxable loss is then multiplied by that year's annual federal income tax rate, in order to determine the annual income or loss for the year. The annual tax benefit for those companies that had aggregated net losses is then aggregated. The resulting aggregate benefit is then allocated among all the companies that had a 1991-present aggregated positive taxable income, based on each entity's share of the aggregated positive taxable income. Under the Rockland methodology, the utility's allocated share is then deducted from the utility's rate base. By deducting this amount from rate base, the Board is treating the allocated tax benefit amount as an interest free loan. It is not the allocated benefit that is returned to ratepayers, only the carrying costs. The contributions or savings are retained by the holding company.

3. Generic Proceeding

On January 23, 2013, the Board opened a generic proceeding to "review its policies with respect to the use of the

consolidated tax adjustment in base rate cases." I/M/O the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment, BPU Docket No. EO12121072, Order Opening a Generic Proceeding, (Jan. 23, 2013). (Aa49) In this Order the Board directed its staff (hereinafter "Board Staff" or "Staff") to convene a generic proceeding to review the consolidated tax adjustment issues. The Board listed the issues to be reviewed as:

1) the use by the Board of the consolidated tax savings policy;
2) how to calculate the amount of savings that arise from filing a consolidated return;
3) how these savings should be equitably shared between the regulated company and the ratepayers; and
4) if a rulemaking proceeding should be undertaken to establish utility wide or state wide standards with respect to the implementation of a consolidated tax adjustment policy.

(Aa49-50)

The Board Order also found that until the Board "makes a final determination on the consolidated tax adjustment issues, the current consolidated tax savings policy shall apply." Id. at 2. (Aa50)

On March 6, 2013, Board Staff issued a Notice of Opportunity to comment. (Aa65) In that Notice, Board Staff recognized that an appropriate initial step would be "to gather information and data from all interested parties." Staff then set out the following questions:

1. Please explain your company or organization's position on whether the Board should utilize a CTA.

2. If the Board continues the use of CTA, please describe and detail what changes to CTA methodology, if any, should be adopted by the Board.

3. Please calculate a CTA for your company utilizing the current Board methodology set forth in the Board's April 20, 2004 order, *I/M/O the Verified Petition of Rockland Electric company for the Recovery of its Deferred Balances and the Establishment of Non-Delivery Rates Effective August 1, 2003 and I/M/O the Verified Petition of Rockland Electric Company for Approval of Changes in Electric Rates, its Tariff for Electric Service, its Depreciation Rates, and for Other Relief*, BPU Docket Nos. ER02080614 and ER02100724.

4. If applicable, please provide the actual amount of the CTA included in your company's last base rate case. (Aa65-66)

Staff requested that the parties respond by May 3, 2013 and advised the parties that additional questions may be presented after the Staff's review of the initial responses. Staff concluded "Following this review, Board Staff will announce a schedule for hearings to provide all interested parties with the opportunity to provide testimony on the CTA issue." (Aa66)

On May 3, 2013, comments were filed by Rate Counsel, six of the State's regulated utilities and the New Jersey Utilities Association ("NJUA").

On July 25, 2013, Staff issued a Notice of Opportunity to Provide Additional Information. (Aa68) In that Notice, Staff requested additional information in the form of responses to questions initially raised in Rate Counsel's May 3, 2013

comments. Staff directed that this information should be provided by September 4, 2013 and advised the parties that additional questions may be presented after the Staff's review of the initial responses. Staff concluded "Following this review, Board Staff will announce a schedule for hearings to provide all interested parties with the opportunity to provide testimony on the CTA issue." (Aa69)

Ten of the state's utilities and NJUA responded to Staff's request for additional information. The utilities filing comments were: Atlantic City Sewerage Company, Rockland Electric Company ("Rockland"), South Jersey Gas, New Jersey American Water ("NJAW"), Jersey Central Power and Light Company ("JCP&L"), Atlantic City Electric Company ("ACE"), New Jersey Natural Gas ("NJNG"), United Water, Public Service Electric and Gas Company ("PSE&G"), and Elizabethtown Gas.

On November 1, 2013, BPU's Chief Counsel sent out a request to all utilities for additional consolidated tax data. (Aa72) In addition, the Notice requested comment on the impact of a recent federal court ruling affirming the IRS treatment of cross-border leases. The Notice directed that responses should be provided no later than November 15, 2013. Responses were provided by Elizabethtown Gas, NJNG, ACE,JCP&L, Rockland, NJAW, United Water, South Jersey Gas, PSE&G, and Alteva,Inc. Century Link d/b/a United Telephone declined to provide the requested

information, advising the Board that it was not subject to the Board's rate regulation and not a party to this proceeding. Environmental Disposal Corp. and Gordon's Corner Water Company advised the Board they did not file a consolidated tax return.

On June 18, 2014, Board Staff requested comments on its proposed modifications to the Board's current CTA policy. (Aa75) Specifically Staff proposed that "the current CTA remain in effect" with the following modifications:

1. The revised time period for the calculation of the savings would look back five years from the beginning of the test year,

2. The savings allocation method would allow 75 percent of the calculated savings to be retained by the company and 25 percent of the calculated savings to be allocated to the ratepayers, and

3. Transmission assets of the electric distribution companies would not be included in the calculation of the CTA.

(Aa76-76)

Staff requested that comments to this proposal be filed no later than August 18, 2014. The Notice did not include the language from the two prior notices indicating that stakeholders would have an opportunity to testify at future hearings.

Comments were filed by Rate Counsel (Aa175-196), Elizabethtown Gas (Aa130-132), NJNG (Aa133-134), United Water (Aa135-136), Aqua (Aa137-138), NJAW (Aa139-141), ACE (Aa142-144), JCP&L (Aa145-151), Associated Construction Contractors of New Jersey (Aa152-153), NJUA (Aa154-162), New Jersey Large

Energy Users Coalition ("NJLEUC") (Aa163-172), and the Utility and Transportation Contractors Association of New Jersey. (Aa173-174).

On October 22, 2014, the Board issued an order adopting Staff's modification to the CTA as proposed. (Aa51) A corrected order was issued on November 3, 2014 with a Board Secretary's letter advising the parties that the only change from the original order was a corrected docket number. (Aa77). On December 17, 2014, the Board advised the parties that the November 3 corrected order contained language that was not in the original order, language that had not been adopted by the Board. (Aa104) Accordingly, the Board reissued the original order with the corrected docket number. The December 17, 2014 order ("Board Order" or "Order")) is the subject of the instant appeal.

ARGUMENT

POINT I

THE BOARD'S DECISION FAILS TO SATISFY THE MINIMUM REQUIREMENTS OF DUE PROCESS, IN THAT IT IS NOT BASED ON CREDIBLE EVIDENCE IN THE RECORD AND THE BOARD FAILED TO ARTICULATE THE REASONS FOR ITS DECISION.

It is well established that a court cannot properly exercise its duty to review an agency decision unless it is advised of the considerations underlying the action taken. A statement of the reasons for an agency's action is thus a minimum requirement of due process. Riverside Gen. Hosp. v. Hosp. Rate Setting Comm'n, 98 N.J. 458, 468 (1985). "The orderly functioning of the process of review requires that the grounds upon which the administrative agency acted be 'clearly disclosed and adequately sustained.'" Application of Plainfield-Union Water Co. v. Mountainside, 11 N.J. 382, 396 (1953) (quoting SEC v. Chenery Corp., 318 U.S. 80, 94 (1943)). Similarly, it is well-established that, at a minimum, an agency's decision must be based on "sufficient credible evidence present in the record." Close v. Kordulak Bros., 44 N.J. 589, 599 (1965). A court "examine[s] an agency's findings to determine whether they are supported by substantial credible evidence." Executive Com'n on Ethical Standards v. Salmon, 295 N.J. Super. 86,97 (App. Div. 1996).

In this case, the Board adopted without modification and with little explanation Staff's proposed modifications to the Board's current methodology for calculating the CTA. After carefully setting out the positions of the various parties, the Board adopted Staff's recommendation without addressing any of the counter arguments made. The parties to this proceeding, and presumably the reviewing court, are thus left to wonder why the Board adopted Staff's proposal without modification.

1. The Adoption of a Five Year Look Back Period is Arbitrary and Has No Support in the Record.

In adopting Staff's proposal to use a five year look-back period for the CTA calculation, the Board merely noted:

> The Board can find no rational basis for the unending extension of the review period, and believes that the implementation of a shorter, fixed review period is necessary to return the impact of the CTA to that which was originally intended. The shorter look-back period will mean that the tax adjustment will more closely reflect the current economic state of the utility at the time the CTA is applied.

(Aa113)

There is nothing in the comments filed with the Board that supports the use of a five year look-back period. Both Rate Counsel and NJLEUC supported a twenty year look-back period as more consistent with tax law and regulatory policy.[2] Rate Counsel argued that a five year look-back period provides a

[2] Under IRS regulations, tax losses incurred in years prior to 1998 can be carried forward fifteen years and those incurred after 1997 can be carried forward twenty years. After that, the carry forward expires. Internal Revenue Code 26 U.S.C. 172.

distorted picture of the true economic activity of the utility and the holding company and results in the collection of millions of dollars each year from ratepayers for the payment of hypothetical income tax expense. Rate Counsel suggested that a twenty year look-back period was more consistent with federal tax laws which allow losses to be carried forward for 20 years.(Aa185-187)

NJLEUC also argued against the five year look-back period. NJLEUC argued that a five year period was an unduly limited and arbitrary time period which has no basis in the record, tax law or utility regulatory policy. (Aa167-168) NJLEUC argued that the limited period would not fully reflect the tax contribution of utility ratepayers. NJLEUC urged the Board to set a twenty year look-back period consistent with the pertinent provision of the federal tax code. Indeed, no party filing comments provided any rational basis for the use of a five year look back period.

The Board did not address Rate Counsel and NJLEUC's proposal for a twenty year look-back period. Nor did the Board provide s single cite to the record to support a five year look-back period. The Board merely noted its' "belief" that "a shorter, fixed review period is necessary to return the impact of the CTA to that which was originally intended," and that the "shorter look-back will mean that the tax adjustment will more closely reflect the current economic status of the utility at

the time the CTA is applied". (Aa113) While the Board's reasoning may provide a justification for a shorter look-back period, it does not explain or support the selection of a five year period. Certainly five years is a shorter look-back period than that utilized in the "Rockland method," but so is ten years, fifteen years and even twenty years. The Board's vague reasoning could apply to any fixed time period shorter than the current look-back period which goes back to 1991.

Moreover, although it is unclear what the current Board considers the original "intent" of the CTA, the intent of the previous Boards in establishing the CTA can be found in those prior Board orders. The Board's intent in implementing a CTA was to ensure that the utility's ratepayers would share in the tax benefits resulting from the utility's participation in a consolidated tax filing. I/M/O the Petition of New Jersey Natural Gas Company for Approval of Increased Base Tariff Rates and Charges for Gas Service and Other Tariff Revisions Consolidated Taxes, BPU Docket Nos. GR89030335J –Phase II, GR90080786J, Decision and Order, (November 26, 1991), p.5 (The consolidated tax adjustment was necessary to pass along to ratepayers their fair share of savings which arise from the filing of a consolidated tax return.) (Aa17, Aa19-20) See also, I/M/O the Petition of Atlantic City Electric Company for Approval of Amendments to Its Tariff to Provide for an Increase

in Rates and Charges for Electric Service Phase II, BPU Docket No. ER90091090J, Order Adopting in Part and Modifying in Part the Initial Decision, (Oct. 20, 1992) (Utility ratepayers are entitled to have rates reflect a computation of net tax benefits derived as a consequence of utility net income.) (Aa23, Aa27) I/M/O the Petition of Jersey Central Power and Light Company for Approval of Increased Base Tariff Rates and Charges for Electric Service and Other Tariff Revisions, BPU Docket No. ER91121820J, Decision and Order, (June 15, 1993) ("Ratepayers who produce the income that provides the tax benefits should share in those benefits"), (Aa32, Aa36) I/M/O The Verified Petition of Rockland Electric Company for Approval of Changes in Electric Rates, Its Tariff for Electric Service, Its Depreciation and for Other Relief, BPU Docket No. ER02100724, Final Decision and Order, (April 20, 2004) ("The Board continues to believe that if a utility is part of a conglomerate which profits by consequential tax benefits from the utility's contributions, the utility customers are entitled to have a computation of their fair share of those benefits reflected in their utility rates.") (Aa40, Aa47) There is nothing in these prior orders to suggest that the implementation of a CTA was intended to "reflect the current economic state of the utility."

Furthermore, it is unclear what the Board means by "the current economic state of the utility." The utility is a

regulated entity whose rates for the provision of utility service are set by the Board. When setting utility rates, the Board will calculate a revenue requirement based on the operating expenses of the utility along with an allowance for profit. The CTA enters into this calculation but the CTA does not reflect the "current economic state" of the utility. The consolidated tax group's income tax liability is impacted by the economic state of the holding company and its affiliates and also by IRS regulations, by legislative actions, and by organizational decisions made by the holding company. Thus, the CTA should reflect the economic state of the consolidated tax group over the entire twenty year IRS carry forward period, not the truncated look back period adopted by the Board.

Indeed, the five year look-back period produces volatile results and does not give an accurate picture of the actual taxes paid over time by the holding company. Using a five year look-back period, negative net income of one or two years can easily outweigh the positive income of the prior years resulting in no consolidated tax adjustment. The five year look-back period thus provides a distorted picture of the true economic activity of the utility and the holding company and results in the collection of millions of dollars each year from ratepayers for the payment of hypothetical taxes.

In sum the Board's adoption of Staff's proposal to use a five year look-back period has no support in the record, is arbitrary and capricious and in many instances, results in no CTA at all. (Aa196) Rate Counsel's proposed twenty year look-back period has a basis in tax law and is sound regulatory policy. The Board's proposed five year look-back policy should be rejected by this Court.

2. The Board Failed to Provide Any Factual or Legal Basis to Support the Implementation of Staff's 75%/25% "Sharing" Proposal.

The Board said even less about the reasons for adopting the 75%/25% sharing. There is no statement from the Board on why the 75%/25% sharing allocation was adopted. The Board merely found that:

> The calculated tax adjustment based on that review period shall be allocated so that the revenue requirement of the company is reduced by 25% of the adjustment.

First, it should be noted that the CTA is a rate base adjustment, not a revenue requirement adjustment.[3] It may be that this paragraph should have read that rate base should be reduced by 25% of the calculated adjustment, not revenue requirement. This is a huge difference. For example, as seen

[3] Revenue Requirement is the amount of revenue a utility must collect from ratepayers sufficient to allow the utility to pay operating expenses, taxes and to earn a profit. The rate base is the total assets used by the utility to provide utility service. The allowed return is calculated by applying the utility's allowed rate of return to the rate base.

on the attachment to Rate Counsel's filed comments, (Aa196) Rockland's CTA calculated over a five year look back period, is $15.8 million. If 25% of this CTA is deducted from rate base, the resulting rate base deductions would be $3.95 million. Assuming a cost of capital of 7.5% and a revenue multiplier of 1.69, a rate base deduction of $3.95 million would result in a revenue requirement reduction of approximately $500,000.[4] However, if the utility's revenue requirement is reduced by 25% of the CTA, the resulting adjustment is a $3.96 million reduction in revenue requirement. (25% of $15.8 million). At the very least, this matter should be remanded so that the Board can clarify this aspect of the Order.

In addition, the Board failed to provide even the slightest indication of why the 75%/25% "sharing" allocation is reasonable. In fact, it is not. The Board's current rate base methodology already results in a significant sharing between a utility and its ratepayers. As noted by the Board in an earlier case:

> The rate base method endorsed in this proceeding by Staff and Rate Counsel essentially treats the tax benefits derived by the holding company as cost free capital contributed by ratepayers. By providing a rate base adjustment, ratepayers are credited with the carrying costs of those contributions, prospectively, reflecting the present value benefits of being able to use the tax losses sooner rather than later or never because of [utility] income. . . . . [t]his method

[4] $3.95 million X 7.5% return X 1.69 tax gross-up.

> represents a sharing approach, since only the carrying costs are credited to ratepayers, while the contributions or savings themselves are retained by [the holding company]. I/M/O the Petition of Atlantic City Electric Company for Approval of Amendments to Its Tariff to Provide for an Increase in Rates and Charges for Electric Service Phase II, BPU Docket No. ER90091090J, Order Adopting in Part and Modifying in Part the Initial Decision, p.6, (Oct. 20, 1992) (Aa28)

The Board never addressed the fact that the rate base method already represents a sharing approach since only the carrying costs are credited to ratepayers, while the contributions or savings themselves are retained by the holding company. In fact, as discussed in Rate Counsel's comments, (Aa187-190) for most utilities, the Rockland methodology used by the Board already results in the majority of the CTA benefit being retained by shareholders. The 75%/25% sharing mechanism does not allocate 25% of the total CTA benefit to ratepayers, but allocates to ratepayers 25% of the benefit that they would have received under the Rockland methodology. Thus ratepayers will only receive 25% of the former benefit. For example, if a utility would have received 20% of the benefit under the Rockland methodology, it would receive only 5.0% (25% X 20%) of the benefit under 75%/25% mechanism.

Furthermore, the Board never explained why it rejected Rate Counsel's argument for at least a 50%/50% sharing. Rate Counsel proposed that, if the Board determined to reduce ratepayers'

share of the consolidated tax benefit, ratepayers should receive at least half of the benefit that would have been calculated under the Rockland methodology. Since the Rockland methodology already includes significant sharing for most companies, Rate Counsel's recommendation would also result in a significant reduction in the benefit going to ratepayers, but at least it is somewhat more equitable than Staff's proposed 75%/25% allocation. It is ratepayers who are paying millions of dollars in tax expense collected by the utility each year which is not going to the IRS but is being passed on to an unregulated affiliate. To allow a greater portion of the benefit to go to shareholders is inequitable and arbitrary and should not have been adopted by the Board.

3. Transmission Assets Should Be Included In The CTA Calculation.

The Board also determined to remove electric utility transmission assets from the calculation of the CTA. The Board simply decided it "was not appropriate" to include electric transmission assets in the CTA calculation as "those earnings are not subject to the Board's jurisdiction." (Aa114)

The Board failed however to address Rate Counsel's concern that if transmission assets are excluded from the Board's consolidated tax calculation, ratepayers will never receive tax

benefits accrued through the use of ratepayer funds. As noted, it is well-established law in New Jersey that the savings associated with a utility's participation in a consolidated tax group must be shared with the utility's customers. I/M/O the Revision in Rates Filed by New Jersey Power & Light Company, Increasing Its Rates For Electric Service, 9 N.J. 498 (1952). If the transmission assets are not included in the CTA calculation, the billions of dollars of ratepayer revenues associated with this large and rapidly growing asset class will provide no tax benefit whatsoever to ratepayers who pay for those assets. The proper focus for the CTA calculation is the revenues (or losses) generated by the respective utilities for all services rendered, rather than the nature of the assets or their regulatory status.

In spite of these concerns and without any reference to them in its decision and order and without any proper evidence before it, the Board adopted the Staff proposed modifications to the CTA calculations.

The final Order also fails to explain why the Board believes that electric utilities are allowed to exclude certain assets while other utility proposals do not receive similar special treatment. In filed comments, NJAW Company notes that the transmission exclusion "provides substantial CTA mitigation" to the electric utilities yet "provides no mitigation to other

utilities." (Aa140) New Jersey Natural Gas Company also notes the "incremental mitigation to electric utilities that has not been extended to non-regulated [Renewable Energy] investments." (Aa133-134) Similarly, Elizabethtown Gas argues that "other modifications to the calculation of CTAs, analogous to the exclusion of transmission assets" for electric utilities may be appropriate for other utilities. (Aa132) The Board simply granted the electric utility transmission assets special treatment without setting forth any reasons for denying the other utility assets similar exclusions.

4. The BPU's Findings That The CTA Discourages Investment in The State Are Arbitrary and Not Supported By the Record.

Finally, Rate Counsel questions two "findings" in the Board Order that are not supported by the record. The Board "found" that:

> changes in the Internal Revenue Code to incentivize wind, solar, renewables, manufacturing, and research and development have caused the CTA to increase to the point that continued use in its current form will discourage investment which is contrary to the State's policies for energy and economic growth. P.11-12 (Aa114)

The Board also found that "the policy change is being made to encourage economic growth and improve the investment climate in the state." Id.

Notably, although NJUA suggested that "the CTA may negatively impact investment in utility infrastructure," (Aa155) not one of the utilities filing comments in response to the Staff's proposal even suggested that the utility had been deterred from investing in its infrastructure due to the Board's CTA policy. NJNG posited that its non-regulated subsidiaries may be discouraged from renewable energy investment in the state because tax benefits (paid for by utility ratepayers) would have to be shared with utility ratepayers. (Aa134) UTCA admitted it was "not familiar with the intricacies of the CTA calculation" but UTCA nonetheless was certain "that the CTA is a barrier to investment." (Aa174) Similarly ACCNJ argued that "the CTA is a barrier to investment across all areas of critical utility infrastructure . . . ." (Aa152) Neither UTCA nor ACCNJ provided any data to support their arguments. The Board made no determination of how the CTA deters investment and provided no instances of a utility not investing in infrastructure because of the CTA. The Board merely concluded that the CTA "in its current form" will discourage investment. (Aa114)

Although the Board made this finding, it is unclear what, if anything, the change to the CTA's "current form" will do to address this "problem." The Board does not suggest that the 75%/25% sharing will encourage investment while a 50%/50% sharing would not. Nor does the Board suggest that a five year

look-back period will encourage investment but a ten year period would not. There is nothing in the record to show that this, or any proposed modification would encourage additional utility investment in infrastructure.

Moreover, there are many ways that the Board has to encourage investment in utility infrastructure and the Board has implemented many of them. For example the high return on investment allowed by the Board certainly encourages the state's utilities to invest in their infrastructure.[5] The Board has also allowed accelerated recovery for infrastructure investment to encourage infrastructure spending[6] There is nothing in the record in this proceeding to suggest that utilities will invest more in utility infrastructure because the Board has modified the CTA calculation. The only thing that is sure is that ratepayers will pay higher rates.

In this regard, the Board's findings fail to recognize the flip side of this coin. Higher utility rates will also discourage investment in the State, just on a broader scale. Energy intensive businesses may be discouraged from further investment in a state with some of the highest electric rates in the country. The loss of these large customers will impact the entire state, not just one utility. Smaller businesses and

[5] See, e.g., http://www.state.nj.us/bpu/pdf/boardorders/2014/20140423/4-23-14-IIA.pdf (Board Order adopting 9.75% return on equity for Atlantic City Electric Company.)
[6] See, e.g., http://www.state.nj.us/bpu/pdf/boardorders/2014/20140521/5-21-14-2I.pdf (Board Order approving $1.0 billion PSE&G Energy Strong Infrastructure Program.)

residential customers will also be impacted and may have less disposable income, resulting in less spending which in turn will negatively impact other New Jersey businesses and municipalities. Yet none of these negative impacts were discussed by the Board in its Order. It simply concluded that the CTA discourages investment. This is arbitrary and unsupported by the record. It further supports the need for a remand here.

In conclusion, the Board's new CTA calculation fails a fundamental requirement of due process -- it is not based on sufficient credible evidence in the record. In re Musick, 143 N.J. 206 (1996). In order to withstand challenge on appeal, the Board's decision must be based on credible evidence in the record, may not be arbitrary and capricious, and must be in accordance with applicable law. Id. In this proceeding, the absence of evidence in the record to support the Board's decision makes appellate review impossible, makes the Order arbitrary and requires that it be remanded. Avant Indus., v. Kelly, 127 NJ Super. 550,553 (App. Div. 1974)(citation omitted).

POINT II

THE CTA FORMULA ADOPTED IN THE BOARD ORDER ELIMINATES THE CTA FOR THE MAJORITY OF ELECTRIC AND GAS COMPANIES, REQUIRING RATEPAYERS TO PAY HYPOTHETICAL INCOME TAX EXPENSES IN RATES IN VIOLATION OF SETTLED NEW JERSEY CASE LAW, AND CONTRARY TO THE BOARD'S STATUTORY OBLIGATION TO SET JUST AND REASONABLE RATES.

New Jersey law prohibits the Board from setting rates that require ratepayers to pay "hypothetical expenses" of a utility. I/M/O the Revision in Rates Filed by New Jersey Power & Light Co., Increasing Its Rates For Elec. Serv., 9 N.J. 498, 528 (1952). Accordingly, the New Jersey Supreme Court has made clear that the savings associated with a utility's participation in a consolidated tax group must be shared with the utility's customers. In New Jersey, the Board has historically chosen the consolidated tax adjustment as the method of implementing this sharing required by the courts.

In New Jersey Power & Light, the New Jersey Supreme Court reviewed a utility's claim that the Board had improperly imposed an adjustment to reflect federal income tax savings resulting from the filing of a consolidated return. The Court held that New Jersey utilities are allowed:

> . . . a deduction from gross income for actual operating expenses only (or actual normalized operating expenses), and not for hypothetical expenses which did not and foreseeably will not occur. Thus it is entitled to an allowance for actual taxes and not for higher taxes that it would pay if it filed on a different basis.

Id. at 528 (emphasis in original).

This holding was relied upon by the Appellate Division in rejecting the claim of a water utility that the Board should allow in utility rates the full tax rate of 48% because that was the amount the utility paid to the parent company even if it was not what was actually paid in taxes. The Appellate Division found that the claimed tax payment did not accurately represent the amount of tax payable to the IRS and determined:

> If Lambertville is part of a conglomerate of regulated and unregulated companies which profits by consequential tax benefits from Lambertville's contributions, the utility consumers are entitled to have the computation of those benefits reflected in their utility rates.
>
> It is only the real tax figure which should control rather than that which is purely hypothetical.

In re Lambertville, 153 N.J. Super. 24, 28 (App. Div. 1977), rev'd in part on other grounds, 79 N.J. 449 (1979).

As noted, the Board has chosen to establish the consolidated tax adjustment for the State's utilities as the means of carrying out this judicial mandate. In a Jersey Central Power and Light Company base rate case the Board noted that the "Appellate Division has repeatedly affirmed the Board's policy of requiring utility rates to reflect a consolidated tax savings" and found that "ratepayers who produce the income that provides the tax benefits should share in those benefits." I/M/O the Petition of Jersey Central Power & Light Company for

Approval of Increased Base Tariff Rates and Charges for Electric Service and Other Tariff Revisions, BPU Docket No. ER91121820J (June 15, 1993), at p. 7. (Aa36) In discussing a CTA in an Atlantic City Electric base rate proceeding, the Board reasoned that:

> [t]he courts have on a number of occasions upheld such adjustments by the Board, indicating generally that a utility is not entitled to collect a certain amount of tax expense from ratepayers merely because that amount may have been paid to the holding company based upon the statutory income tax rate applied to utility income. To the extent that the utility is part of a larger conglomerate of regulated and unregulated companies which derives net tax benefits as a consequence of utility net income, the utility ratepayers are entitled to have rates reflect a computation of those benefits.

I/M/O the Petition of the Atlantic City Electric Company for Approval of Amendments to its Tariff to Provide for an Increase in Rates and Charges for Electric Service, Phase II, ER90091090J, (Oct. 20, 1992), at p. 5. (Aa27)

In a Rockland Electric Company base rate case, the Board recognized further that "[i]t is well-settled law and Board policy that consolidated tax savings are to be shared with customers." I/M/O the Verified Petition of Rockland Electric Company for the Approval of Changes in Electric Rates, its Tariff for Electric Service, its Depreciation Rates, and for Other Relief, BPU Docket No. ER02100724, Board Order (April 20, 2004), at p. 62. (Aa40)

The prohibition against charging ratepayers with hypothetical expenses is also derived from the Board's statutory

obligations. The Legislature has limited the Board to fixing rates that are "just and reasonable." N.J.S.A. 48:2-21(b). In determining the justness and reasonableness of a particular rate, courts will look to three aspects of a utility's property valuation: its rate base; its expenses, including income taxes and an allowance for depreciation; and the developed rate of return. Pub. Serv. Coordinated Transp. Co., 5 N.J. 196, 216 (1950). It is axiomatic that if any one of these three factors composing the revenue requirement "is not reasonably supported by the proofs, the rate of fare is unreasonable." Id. Moreover, by statute the utility bears the burden of proving that the "increase, change or alteration is just and reasonable." N.J.S.A. 48:2-21(d). Our Supreme Court has opined that without such evidence, "any determination of rates must be considered arbitrary and unreasonable." Pub. Serv. Coordinated Transp. Co., supra, 5 N.J. at 219.

Under the Board's new formula, the majority of New Jersey electric and gas ratepayers will continue to pay fictitious income tax expenses in rates while receiving no CTA benefit. (Aa196) As a result, the new CTA formula fails to meet the Board's statutory obligation to set just and reasonable rates. I/M/O the Revision in Rates Filed by Redi-Flo Corporation, 76 N.J. 21,(April 6, 1978)("N.J.S.A. 48:2-13 charges the Board with the task of overseeing the operations of public utilities…and

foremost among these responsibilities is its duty to ensure that rates are not excessive.")

The tax sharing arrangements of consolidated group members are generally governed by Tax Sharing Agreements ("Agreements") among the members of the consolidated group. Pursuant to these Agreements, subsidiaries with positive taxable income pay the amount of their stand-alone tax liability to the parent company. The parent company then pays the amount of taxes due by the consolidated group to the IRS. Any excess funds are then allocated by the parent company to the members of the consolidated income tax group with tax losses, resulting in a contractual means to have the regulated and profitable subsidiaries subsidize unregulated and unprofitable ventures. The CTA provides some compensation to ratepayers for this subsidization, and is a regulatory mechanism necessary for the Board to meet its statutory obligation to set just and reasonable rates. Without a CTA, ratepayers would be paying for fictitious expenses that the holding company would retain as excess profits, which would be unreasonable and contrary to the Board's statutory mandate to set just and reasonable rates.

There are three electric utilities, three gas utilities, and one combined gas/electric utility in New Jersey. Based on the calculations performed by Rate Counsel's expert below, using a 2012 test year, five of the seven – Public Service Electric &

Gas Company, Atlantic City Electric Company, Jersey Central Power & Light Company, South Jersey Gas Company, and Elizabethtown Gas Company - would not be subject to a consolidated tax adjustment under the new CTA formula.[7] (Aa196) PSE&G is the largest utility in the State, serving nearly three fourths of New Jersey's population.[8] A CTA formula resulting in no consolidated tax adjustment for five of the seven New Jersey gas and electric utilities serving the majority of New Jersey customers cannot be viewed as "just and reasonable" and is not consistent with the Board's statutory mandate.

The actual application of the CTA formula sheds light on how it fails this fundamental mandate. Consider first the amount of income taxes that many of these utilities' holding companies actually turn over to the IRS. In recent years, many of these holding companies have paid either zero dollars in income taxes to the IRS, or perhaps more stunningly, received very large refunds from the IRS. For example, **[Begin Confidential]** [redacted]

[7] This schedule is based on data up to 2012, the most recently provided data. Only Rockland Electric Company and New Jersey Natural Gas Company would receive a CTA under this formula. While the regulated water companies would receive CTAs under the new formula, the benefits to ratepayers would be minimal with the application of the proposed 75%/25% split in favor of shareholders.

[8] https://www.pseg.com/family/pseandg/index.jsp

[redacted] **[End Confidential]** (Aa182-183) This is just a representative sample of the many New Jersey utilities whose holding companies have either paid no income taxes to the IRS or received substantial tax refunds in recent years. Meanwhile, many of these same holding companies have such large tax loss carryforwards that they may not pay federal income taxes for the foreseeable future. For example, ACE's parent company had a tax loss carryforward of **[Begin Confidential]** [redacted] **[End Confidential**] as of 2013. Id. JCP&L's parent company had a tax loss carryforward of $1.1 billion as of the end of 2013. Id. South Jersey Gas Company's parent company had a tax loss carryforward of $317.7 million as of the end of 2013.

These holding companies have paid little or no taxes (or have received refunds) while New Jersey ratepayers have continued to pay annually federal income tax expenses in rates to the utility affiliate as if they were actually paying taxes to the IRS. In their most recent rate cases before the Board, ACE requested approximately $37.375 million in federal income tax expense from ratepayers, JCP&L requested approximately $79.59 million, and South Jersey Gas requested approximately

$43.087 million. (Aa183) Since they were (or will be) permitted to recover income tax expenses, regardless of what they actually pay to the IRS, their rates should reflect a CTA to recognize in part the contribution ratepayers are making to the reduction in the consolidated group's tax liability. However, under the CTA methodology contained in the Board Order, each of these utilities would now receive a CTA adjustment of $0.

The CTA formula in the Board's Order results in a gross inequity, in which ratepayers continue to pay completely fictitious income tax expenses that are used to subsidize unregulated ventures, without any recognition of this subsidization. Because of the large amounts of tax loss carryforwards on the books of these holding companies, this inequity would continue into the future. As a result, tens of millions of dollars will be collected from ratepayers for taxes while some of these companies collecting annually that money are either paying no tax or receiving millions of dollars in refunds from the IRS. Absent a CTA methodology that will result in adequate CTA adjustments for New Jersey's electric and gas utilities, the Board has failed to meet its obligation to set "just and reasonable" rates. N.J.S.A. 48:2-21(b).

POINT III

IN ADOPTING A NEW FORMULA FOR CALCULATING CONSOLIDATED TAX ADJUSTMENTS, THE BPU ENGAGED IN ADMINISTRATIVE RULEMAKING WITHOUT CONFORMING TO THE REQUIREMENTS OF THE ADMINISTRATIVE PROCEDURE ACT.

The Board's Order materially changes the methodology for calculating the CTA for every New Jersey regulated utility that participates in the filing of a consolidated income tax return. It is intended by the Board to apply prospectively in all future rate cases, and reflects a general policy decision by the BPU. Accordingly, while the Board may consider such changes in a generic proceeding such as this, its policy change must then be adopted as a rule, utilizing the rulemaking requirements of the Administrative Procedure Act ("APA"), N.J.S.A. 52:14B-1 to -31. Since the Board failed to follow these rulemaking requirements, the Board's Order should be overturned and the matter should be remanded for further proceedings.

While an administrative agency has latitude in choosing the means of fulfilling its statutory duties, that discretion is circumscribed by the specific requirements of the APA and by due process mandates generally. In re Request for Solid Waste Util. Customer Lists, 106 N.J. 508, 519 (1987); accord In re Provision of Basic Generation Serv. For Period Beginning June 1, 2008, 205 N.J. 339, 347 (2011). Formal agency action under the APA proceeds either as an "administrative adjudication" or an

"administrative rule." N.J.S.A. 52:14B-2. "Administrative adjudications" include final decisions from "contested cases" which implicate the legal rights of specific, individual parties, while the APA defines an "administrative rule" as "each agency statement of general applicability and continuing effect that implements or interprets law or policy, or describes the organization, procedure or practice requirements of any agency." Id. The option of informal agency action such as hybrid proceedings is available only when the APA does not require the heightened procedural requirements of a rulemaking. In re N.J.A.C. 7:1B-1.1, 431 N.J. Super. 100, 133 (App. Div. 2013).

If an agency determination constitutes an "administrative rule," then its validity turns on whether the agency has complied with the procedural mandates of the APA governing the promulgation of rules. Airwork Serv. Div. v. Dir., Div. of Taxation, 97 N.J. 290, 300 (1984). New Jersey courts apply the following multi-factor analysis in determining whether an agency action must be considered an administrative rule:

> (1) the determination has wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group;
>
> (2) the determination is intended to be applied generally and uniformly to all similarly situated persons;
>
> (3) it is designed to apply only to future cases;

(4) it prescribes a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authority;

(5) it reflects an administrative policy that (i) was not previously expressed in any official agency adjudication or rule, or (ii) constitutes a material change from a past agency position on the identical subject matter; and

(6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy.

Metromedia, Inc. v. Dir., Div. of Taxation, 97 N.J. 313, 331-32 (1984).

While the Metromedia criteria were originally developed to distinguish rulemaking from adjudication, they have now been extended "to provide a test of when rulemaking procedures are necessary in order to validate agency actions or determinations." Woodland Private Study Group v. State, 100 N.J. 62, 68 (1987). Although all six factors are present and point towards rulemaking in the current appeal, this is not a requirement in order for rulemaking procedures to be necessary. Id. at 68. The factors must be weighed, not tabulated. In re Request for Solid Waste Util. Customer Lists, supra, 106 N.J. at 518.

The Board's Order satisfies the first Metromedia factor, since the Order will affect every regulated New Jersey electric, gas, water and wastewater utility that participates in the filing of a consolidated income tax return with its holding

company. The affected group includes all of the State's regulated electric and natural gas utilities. There are also several water and wastewater utilities that would be affected. The Board Order gave specific instructions for ongoing base rate cases where the record was open, pending rate cases where the record had closed, and a general directive to "all other affected utilities…to include a calculation of the CTA, as modified in this Order, as part of their next base rate case petitions." (Aa114) The Board's determination thus has "wide coverage," encompassing a "large segment" of the regulated community and thus would constitute a "rule" under Metromedia's first factor. Metromedia, supra, 97 N.J. at 331.

For these same reasons the Board's Order "is intended to apply generally and uniformly to all similarly situated persons," satisfying the second Metromedia factor and supporting the view that the Board's action requires a rulemaking. The Board intended the changes it made to the calculation of the CTA to apply uniformly to all regulated utilities that participate in the filing of a consolidated income tax return. The Board Order provides uniform, generic changes to the CTA calculation that are applicable to all similarly situated utilities. The changes include limiting the look-back period for the calculation to five calendar years, and limiting ratepayers' benefit to only 25% of the calculated adjustment. These changes

will be uniformly applied to every regulated utility subject to a CTA in New Jersey. The third change, which excludes transmission assets of electric utilities from the CTA calculation, will be uniformly applied in the CTA formula by all four of the State's electric utilities. Thus, it is clear the Board intended its Order to apply "generally and uniformly" to all similarly situated utilities. Metromedia, supra, 97 N.J. at 331.

The Board Order states that these changes to its CTA policy are appropriately made by Board Order, rather than rulemaking, (Aa113) because "the calculation of the CTA will be company specific." This statement belies the uniform nature of the changes to the CTA formula set forth in the Board Order.[9] The Board intends these changes to apply equally and uniformly to every regulated utility subject to a CTA in future rate cases. In fact, every regulation is ultimately applied to specific cases once promulgated. That fact does not negate the broad applicability of a regulation or its treatment under Metromedia.

[9] In fact, it appears the Board recognized that its actions in this case are subject to the APA's requirements. The Board's January 23, 2013 Order initiating the proceeding raised the question of whether a rulemaking was necessary to establish statewide CTA standards. Meanwhile, on March 6, 2013, the Board Staff issued a notice stating that Board Staff would announce a schedule of "hearings to provide all interested parties with the opportunity to provide testimony on the CTA issues." (Aa93) While it is unclear whether these hearings were intended to be evidentiary hearings, such as would occur in an adjudication, or public hearings, as is the process in a rulemaking, in fact the Board never conducted any such hearings.

Since the Board Order would apply only to rate cases where the Board has not made a final decision, the third Metromedia factor also weighs in favor of rulemaking. The Board Order explicitly explains the three scenarios where the Board would implement the new CTA calculation, all of which are prospective: ongoing base rate cases where the record is currently open; ongoing base rate cases where the record is closed but the Board has not issued a final decision; and base rate cases that have not yet been filed. Moreover, unless specifically authorized by the Legislature the Board is generally prohibited from engaging in retroactive ratemaking, making the Board's Order presumptively prospective only. I/M/O Elizabethtown Water Co., 107 N.J. 440 (1987).

The fourth Metromedia factor also indicates that a rulemaking is necessary, since the Board's determination was not expressly provided for, nor clearly or obviously inferable from any statute. The use of a CTA in ratemaking is not provided for explicitly by statute but has been adopted by the Board as its chosen method of effectuating the prohibition against fictitious expenses mandated by law, thereby ensuring "just and reasonable" rates as required by statute. N.J.S.A. 48:2-21. The existing CTA formula has been in effect for over 20 years, and there is no reason the change announced in this case would be inferable from the statute. In fact, as discussed previously while the

Board Order states that "New Jersey regulated utilities, as part of holding companies, are required to reduce rates as a result of a CTA," (Aa114) the Board's determination in this matter will eliminate the CTA for most gas and electric utilities. (Aa196) This is "not expressly provided for, nor clearly or obviously inferable from any statute." Metromedia, Supra, 97 N.J. at 331-32.

There is also no question that changes of this magnitude would require a rulemaking under the fifth Metromedia factor. An examination of the practical effect of the Board's Order on the CTA formula sheds light on how significant and material the changes are. Under the existing formula, all seven of New Jersey's gas and electric utilities would be subject to a CTA. For some utilities, those rate base adjustments would be quite large, e.g., Atlantic City Electric Company ($214 million), JCP&L ($457 million). (Aa196) For other utilities, the current methodology results in a more modest CTA, but still would result in adjustment worth millions of dollars. Id. Under the new methodology, five of these seven gas or electric companies would receive no consolidated tax adjustment at all. The practical effect, therefore, is very significant and represents a material change that was not previously expressed by the agency. Under Metromedia, a rulemaking is required for changes of this magnitude.

Finally, the BPU's decision in this matter adopting a new CTA formula for prospective base rate cases satisfies the sixth Metromedia factor, as it reflects a "decision on administrative regulatory policy" that is a "general policy." Metromedia, supra, 97 N.J. at 331-32. The Board's decision in this matter is intended to have "continuing effect" in future base rate cases. See N.J.S.A. 52:14B-2(e) (definition of "administrative rule") Indeed, the Board Order provides filing requirements for whenever affected utilities file base rate cases in the future. See also In re Provision of Basic Generation Serv. For Period Beginning June 1, 2008, supra, 205 N.J. at 352 ("Finally, as for Metromedia factor six, the decision to pass through costs to ratepayers might be viewed as a "general policy" which was to be applied later in individual rate-recovery hearings.")

The Order states that the Board's CTA policy was initially implemented by Board order, and that "the Board believes that further modifications to the CTA policy should be made in the same manner as past modifications," which were also done by Board order. (Aa113) The Board's logic here is flawed. There is no question that an administrative agency has some flexibility in determining the appropriate procedure to use. "Subject to the strictures of due process and of the Administrative Procedure Act, an agency may choose how to proceed." In re Request for Solid Waste Util. Customer Lists,

supra,106 N.J. at 519. Generally, it may act formally pursuant to the rulemaking and "contested case" procedures set forth in the Administrative Procedure Act. N.J.S.A. 52:14B-2 et seq. It may also act informally. In re Solid Waste Utility Customer Lists, supra, 106 N.J. at 518. While an administrative agency may develop the law interpreting its statutory mission through case-by-case adjudication, when it has rulemaking authority "[th]e function of filling in the interstices of the Act should be performed, as much as possible, through this quasi-legislative promulgation of rules to be applied in the future." SEC v. Chenery Corp., 332 U.S. 194, 202 (1947). Even with a general rule in place, unforeseen issues may arise in cases that require case-by-case consideration. Id.

The Board has been applying some sort of CTA since as early as 1952. (Aa20) The current formula was developed in a series of rate cases between 1991 and 2004. I/M/O New Jersey Natural Gas (1991)(Aa17); I/M/O Atlantic City Electric Company (1992)(Aa23); I/M/O Jersey Central Power & Light Company (1993)(Aa32) I/M/O Rockland Electric Company (2004)(Aa40). In each of those cases, the Board considered the appropriate calculation of the CTA at the conclusion of the formal adjudication of a rate case. In each instance, the Board had before it a factual record and either an initial decision from an ALJ or a settlement agreed to by the parties. In each of

those cases, the Board's decision was based on the facts in the record as applied to the company before it. The only ruling that had application beyond the confines of the case at issue was the provision in the Rockland Order requiring Rockland to submit a consolidated tax adjustment in every future base rate case filing. Rockland at 64. (Aa47)

The fact that the Board has consistently followed these cases since then does not obviate the need for a rulemaking here. This case was neither an adjudication nor a rulemaking. It utilized an informal procedure to gather information and to allow the Board to consider the impact of the existing CTA formula in a generic manner. This type of generic proceeding is not necessarily improper. However, once the Board decides as a result of the information it has gathered to announce an "agency statement of general applicability and continuing effect that implements or interprets law or policy . . ." N.J.S.A. 52:14B-2(e), it must then follow the APA and adopt that general rule through rulemaking. As the New Jersey Supreme Court has stated, "If an agency determination constitutes an 'administrative rule' it must comply with the procedural requirements of the Administrative Procedure Act to be valid." Airwork, supra, 97 N.J. at 300. See also, Metromedia, supra, 97 N.J. at 338. Corp. v. State, Div. of State Lottery, 210 N.J. Super. 485, 498 (App.Div. 1986)

Accordingly, the Board was required to initiate a rulemaking if it sought to effectuate changes to its CTA policy for all New Jersey regulated utilities subject to a CTA. All six Metromedia factors indicate that rulemaking procedures are necessary in order for such Board action to be valid. The Board's Order should be vacated and the matter remanded to the Board for proper rulemaking consistent with the APA.

CONCLUSION

For all the foregoing reasons Rate Counsel respectfully requests that this Court reject the Board's revisions to the CTA calculation and remand this proceeding for a proper rulemaking pursuant to the Administrative Procedure Act.

Respectfully submitted,

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