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CASE MANAGEMENT

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August 19, 2014

Kristi Izzo, Secretary
Board of Public Utilities
44 South Clinton Avenue, 9th Floor
P.O. Box 350
Trenton, NJ 08625-0350

Re: In the Matter of the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment General Proceeding
BPU Docket Nos. EO12121072

Dear Secretary Izzo:

With regard to the above matter, I enclose Comments on behalf of the New Jersey Large Energy Users Coalition.

Copies of the Comments have been distributed via email to all parties involved.

Thank you for your courtesies in this regard.

Respectfully submitted,

Steven S. Goldenberg

SSG:jfp
Encl.

In the Matter of the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment Generic Proceeding Docket No. EO12121072

Comments of the New Jersey Large Energy Users Coalition

The New Jersey Large Energy Users Coalition ("NJLEUC") provides these Comments regarding staff's proposed modifications to the Board's Consolidated Tax Adjustment ("CTA") policy in response to the Board's June 18, 2014 Notice of Opportunity to Provide Additional Information in this docket.

Background

The Board has received a number of comments by the State's utilities opposing and seeking to eliminate or restrict the use of CTAs in utility rate cases. The arguments raised against CTAs portray New Jersey as out of step with other jurisdictions that have not adopted the CTA. However, what distinguishes New Jersey from these other jurisdictions is a long, clear and consistent series of appellate court precedents that authorize the Board to utilize a CTA in rate cases involving utilities that are parties to consolidated tax agreements.

The rationale underlying the courts' directive is compelling. It is a fundamental premise of utility ratemaking that a utility may pass along to customers only those expenses and costs that the utility actually incurs. If a utility were permitted to charge rates that are based on hypothetical, fictitious or inflated statements of operating expenses, such as inflated income taxes that exceed the taxes actually paid by the utility, it would result in rates that are not just and reasonable. Therefore, our Supreme Court has ruled that if the utility charges ratepayers for taxes as if the utility is paying full taxes on its income, the utility must share with ratepayers the savings that result from filing on a consolidated bases. 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).

In In re Lambertville Water Company, 153 N.J. Super 24 (App. Div. 1977), rev'd in part on other grounds, 79 N.J. 449 (1979), the Appellate Division rejected the utility's attempt to claim as an expense the maximum corporate income tax rate due to the benefits found to have been obtained by virtue of the utility's participation in a consolidated tax arrangement:

> We agree that Lambertville is not entitled to a deduction in the amount of 48% of net income merely because that is an amount paid to its parent company as a result of inter-company policy or agreement. Such payment does not truly represent the tax payable to the Internal Revenue Service. If Lambertville is part of a conglomerate of regulated and unregulated companies which profits by consequential tax benefits from Lambertville's contributions, utility customers 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. And the P.U.C. Commissioners therefore have the power and function to take into consideration the tax savings flowing from the filing of the consolidated return and determining what proportion of the consolidated tax is reasonably attributable to Lambertville.
>
> Lambertville, *supra,* 153 N.J. Super at 28, (citations omitted).

The appellate courts have also accorded the Board the authority and broad discretion to determine the method by which a utility's effective tax rate is determined. In Toms River Water Company v. Board of Public Utilities, 158 N.J. Super 57, 61 (App. Div. 1978), the Appellate Division, citing *Lambertville*, observed that "(w)e do not undertake to direct the Board to utilize any particular method in arriving at a just conclusion, except to note that the method to be utilized must have a rational relationship with the requisite objective namely, the determination of the actual tax liability".

Therefore, for more than 30 years, the Board has properly responded to the clear and consistent legal authority provided by these and other appellate precedents and implemented a CTA in each base rate case brought by the State's utilities. This unquestioned and continuing legal authority therefore clearly distinguishes New Jersey from other states which, for unexplained reasons, apparently permit their utility commissions to include phantom, fictitious expenses that overstate utility expenses and result in unjust and unreasonable rates and shareholder windfalls.

It is noteworthy that Pennsylvania, (in which FirstEnergy, perhaps the most vocal of the utilities in its opposition to the CTA, operates several utility-affiliates), has also long endorsed the use of CTAs in utility rate cases. An unbroken line of appellate decisions have held that utilities may pass along to customers only expenses or costs that are actually incurred, because any other approach would permit utilities to obtain inflated rates from customers under the guise of recovering operating expenses. See, Cohen v. Pennsylvania Public Utility Commission, 468 A.2d 1143, 1150 (1983) and Barasch v. Pennsylvania Public Utility Commission, 548 A.2d 1310, 1315 (1988). The Pennsylvania Supreme Court and Pennsylvania Public Utility Commission therefore have consistently adopted a more expansive CTA policy that attributes to ratepayers all tax savings—the actual taxes paid by the utility--that arise as a result of the utility's participation in a consolidated tax return. Barasch v. Pennsylvania Public Utility Commission, 493 A.2d 653, 656 (1985).

In contrast to the Pennsylvania approach, here the Board has adopted a "rate base" approach to the CTA that treats the tax benefits derived by a utility holding company under a consolidated tax agreement as cost-free capital contributed by utility ratepayers. This approach incorporates a sharing of consolidated tax benefits that compensates ratepayers for the time value of money that is deemed to have been "loaned" free of charge to the utility holding company. *See*, 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 dated October 20, 1992, I/M/O the Petition of Jersey Central Power and Light Co. for Approval of Increased Base Tariff Rates and Charges for Electric Service and Other Tariff Revisions, BPU Docket No. ER91121820J, Order dated June 15, 1993, and I/M/O the Petition of Jersey Central Power and Light Company for Review and Approval of an Increase in and Adjustments to Its Unbundled Rates and Charges for Electric Services, and for Approval of Other Proposed Tariff Revisions in Connection Therewith, BPU Docket No. ER02080506, Order dated May 17, 2004. These decisions required the affected utilities to include in customer rates a fair share of the tax benefits derived as a result of the utility's participation in a holding company consolidated tax arrangement.

The Board's current consolidated tax savings policy and methodology to determine the "fair share" and time value of ratepayer benefits in utility consolidated tax arrangements is set forth in 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 No. ER02100724, Final Decision and Order, April 20, 2004. While this policy is currently under review by the Board in I/M/O the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment, BPU Docket No. EO12121072, Order Opening Proceeding dated January 23, 2013, the Order makes clear that until a final determination is made regarding the CTA, this policy shall remain in effect.

Against this backdrop, the staff's straw proposals are concerning. On information and belief, the CTA methodology that staff proposes would result in a negligible, if not zero, CTA for many utilities that file consolidated tax returns. It has become a matter of public knowledge that in recent years some utility holding companies have paid no federal income taxes whatsoever and, in fact, have received significant tax refunds.[1] Thus, while certain utilities pay no federal income taxes, they continue to charge their ratepayers as if they do. Despite the fact that PEPCO was paying no federal taxes during the period, in its last rate case Atlantic City Electric requested more than $37 million in federal income tax expense from ratepayers. The payment of these phantom expenses are inconsistent with the case law and fundamental ratemaking principles and therefore result in unjust and unreasonable rates. The CTA lessens the impact of this tax inequity and therefore must be preserved in a manner that is fair to all stakeholders.

Utility Challenges to the CTA

In this proceeding and in recent rate cases, utilities have questioned the continuing viability of the Board's consolidated tax savings methodology, this in apparent response to the increasing size of proposed CTAs that have been calculated using the *Rockland* methodology. In

[1] See, attached Letter to the Editor by PEPCO CFO Anthony Kamerick, responding to a November 3, 2011 Washington Post article entitled "Many Firms Found to Avert Taxes". In the letter, Mr. Kamerick acknowledged that while PEPCO reported pre-tax earnings of about $690 million during the period, it paid no taxes because of changes to the federal tax code that were driven by certain governmental policy objectives.

the most extreme response to date, JCP&L has refused to include any CTA proposal in its pending rate case, in violation of the Board's CTA policy.

The utilities have raised a number of challenges to the CTA, predicated on New Jersey's "outlier" status vis-à-vis other jurisdictions that have not adopted the CTA, and the fact that the appellate precedents that authorize the Board to utilize the CTA in rate proceedings are "old". However, to state the obvious, these cases have never been overruled or limited in any fashion, so the fact that the cases were decided years ago does not diminish their continuing viability or the Board's obligation to comply with them.

The utilities also argue, among other things, that CTAs violate ring fencing principles, fail to adhere to the rate principle that benefits should follow burdens (e.g. the party that incurs costs should derive the benefit of those costs), and that the *Rockland* methodology is confiscatory because it utilizes an excessive carry forward period and is over-expansive in terms of the number of entities included in the consolidated tax group (e.g. due to the loss of certain companies through mergers and sale transactions).

NJLEUC will not address the various utility arguments in these Comments. However, the arguments regarding cost causation and the like notwithstanding, there can be no question that the positive cash flows generated by utility ratepayers offset and create tax value for the losses generated by affiliated companies within a consolidated tax group. While it has been suggested by some that loss-generating affiliates in consolidated tax arrangements have a superior entitlement to the resulting tax benefits than utility ratepayers who generate the offsetting positive cash flow, NJLEUC suggests that a more informed approach should recognize the symbiotic relationship that exists between the two, and properly compensate ratepayers for making possible a tax benefit that would not exist but for the revenues contributed by ratepayers. Indeed, it is the virtually assured positive taxable income contributed by the utilities that give their unregulated affiliates' net operating losses value and result in consolidated income tax savings.

Similarly, the suggestion that CTAs violate the Board's ring fencing policies is specious and ignores the obvious fact that consolidated tax arrangements by business conglomerates frequently involve the aggregation of regulated and non-regulated business enterprises for tax reporting purposes. It cannot seriously be argued that CTAs in any way cause the commingling of utility and non-utility operations or expose utility ratepayers to risks associated with investments unrelated to the provision of utility services by non-utility affiliates.

Staff Straw Proposals

1. The revised time period for the calculation of the savings would look back 5 years from the beginning of the test period.

NJLEUC opposes this proposal because it would establish an unduly limited and arbitrary time period that has no basis in the record, tax law or utility regulatory policy. This limited period would not fully reflect the tax contribution of utility ratepayers and the benefits ratepayers should receive in order for the resulting rates to be considered just and reasonable. NJLEUC

urges the Board to instead adopt a time period for CTAs that is consistent with the pertinent provision of the Internal Revenue Code, 26 U.S.C. 172. This provision permits consolidated tax groups to carry forward losses incurred prior to 1998 for a period of 15 years, and losses incurred after 1997 to be carried forward for 20 years. The provision therefore authorizes tax losses to be carried as potential offsets against gains realized in future tax years for the allotted 20 year carry-forward period. If the carried losses are not offset against gains during the 20 year period, the losses expire and would no longer be eligible to be used as part of a CTA.

NJLEUC acknowledges that the Board's current *Rockland* methodology, which permits CTAs to include tax losses incurred beginning in 1991, exceeds the capital loss carry-forward periods prescribed by the Internal Revenue Code, and will further expand with the passage of time. Fairness dictates that tax losses should not be taken into account in perpetuity but should be limited to the time periods prescribed by the Internal Revenue Code. Accordingly, NJLEUC recommends that the Board adopt a time period for calculation of the CTA that coincides with the 20 year time period established by the Internal Revenue Code for consolidated tax arrangements. There is no compelling policy or other reason for the Board to depart from the federal law in this regard.

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

NJLEUC opposes the proposed sharing arrangement as inadequate to fairly compensate ratepayers. NJLEUC is not aware of a record developed in any proceeding that would support a formula for the utilities and ratepayers to share CTA-related savings that departs from the current *Rockland* CTA methodology. *Rockland* already incorporates a "sharing approach" based upon a "rate base" method that essentially treats the tax benefits derived by the holding company as cost-free capital contributed by ratepayers, with the carrying costs associated with the "loan" credited to ratepayers.

It should be underscored that that the proposal is not for ratepayers to receive 25% of the total CTA benefit. Nor would ratepayers be compensated for a percentage of the actual excess of income taxes that are paid in rates relative to the utility's allocated share of the actual taxes paid under a consolidated tax arrangement. Rather, ratepayers are paid only an allocated share of the consolidated tax benefit based on the positive net income of the utility, which generally represents only a small fraction of the total tax benefit to the consolidated tax group. Ratepayers do not directly benefit from lower income tax expenses that result from consolidated tax arrangements, even though they pay full pro forma income tax expenses that may not ultimately be paid to the Internal Revenue Service. As noted, at least some utility holding companies have paid no federal taxes at all in certain tax years and, in fact, have received tax refunds.

The Board has deemed the current *Rockland* approach to reflect an equitable and appropriate sharing of consolidated tax benefits for ratepayers in future rate proceedings. *See*, I/M/O 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 dated October 20, 1992). The Board could have adopted the more expansive Pennsylvania "all CTA benefits to ratepayers" approach, which would impose a consolidated tax adjustment that results in a reduction to the pro forma income tax expense a utility is permitted to recover from ratepayers in its revenue requirement. However, the *Rockland* approach only partially compensates ratepayers for the revenues they generate, making it unreasonable for the Board to further reduce these benefits by 75%, particularly in such an arbitrary fashion. The proposed sharing arrangement would assure that the vast majority of any consolidated tax benefit would be allocated to the utility holding company.

In these circumstances, in which the Board has already limited the scope of the tax relief available to ratepayers, there is no basis for a further sharing of the CTA. Ratepayers should receive 100% of the benefit currently allocated to them under the *Rockland* methodology.

3. Transmission assets of the EDCs would not be included in the calculation of the CTA.

NJLEUC opposes the proposed removal of transmission-related utility assets from the calculation of the CTA. The fact that the Board does not have regulatory jurisdiction over utility transmission assets should have no bearing whatsoever on the tax ramifications associated with consolidated tax arrangements between aggregated groups containing both regulated and non-regulated entities.

It is no doubt the case that most consolidated tax arrangements—and certainly all involving New Jersey's utilities--include diverse businesses engaged in both regulated and non-regulated activities. Therefore, the proper focus of analysis for tax purposes should be on the tax gains (or, less likely, losses) generated by the utility's transmission assets, as opposed to the regulatory status of those assets. The utilities' Board-approved tariffs includes rates for transmission services and authorize the utilities to collect these rates from customers. The rates collected by the utilities for distribution, transmission and other services (as well as the utilities' purported tax expenditures) together comprise the positive revenues the utilities contribute to their respective consolidated tax groups.

Therefore, the proper focus for CTA calculation purposes is the revenues (or losses) generated by the respective utilities for all services rendered, rather than the nature of the assets that contribute the revenues or their regulatory status. The fact that the Federal Energy Regulatory Commission applies "formula"-based transmission rates that do not take into account CTAs should eliminate any possible concern that ratepayers could receive multiple tax benefits from the same transmission assets. Conversely, if transmission assets are not included in the Board's 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 these assets.

NJLEUC urges that utility transmission assets should remain included as a part of the calculation of the CTA.

Need for Rulemaking Proceeding

NJLEUC raises as an additional issue the need for the Board to implement a rulemaking proceeding to properly address the CTA on a generic basis. This proceeding is not adjudicative in nature and the decisions to be made regarding the future contours of CTAs in utility rate proceedings are broad and will apply to all of the State's utilities. Because the policies to be adopted in this proceeding would represent broad policy guidelines that would determine the nature and method of calculation of CTAs and would be generally applied on a prospective basis in future rate proceedings, NJLEUC suggests respectfully that the criteria and process to be adopted should be the subject of a rulemaking proceeding.

As defined by the Administrative Procedures Act, N.J.S.A. 52:14B-2(e), a "rule" means "each agency statement of general applicability and continuing effect that implements or interprets law or policy". The seminal case that guides determinations whether administrative decision-making should be deemed adjudicative, as between the parties to a specific proceeding, or an administrative rulemaking is Metromedia, Inc. v. Director, Division of Taxation, 97 N.J. 313 (1983). In that case, our Supreme Court observed that the nature of a rule is its "widespread, continuing and prospective effect", and the intention that it be applied as a general standard with widespread coverage, and "not otherwise expressly authorized by or obviously inferable from the specific language of the enabling statute". Metromedia, *supra*, 97 N.J. at 328-329. The Supreme Court noted that "where the subject matter of inquiry reaches concerns that transcend those of the individual litigants and implicate matters of general administrative policy, rule-making procedures should be invoked":

> ...an agency determination must be considered an administrative rule when all or most of the relevant features of administrative rules are present and preponderate in favor of the rule-making process. Such a conclusion would be warranted if it appears that the agency determination, in many or most of the following circumstances, (1) is intended to have wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group; (2) is intended to be applied generally and uniformly to all similarly situated persons; (3) is designed to operate only in future cases, that is, prospectively; (4) prescribes a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization; (5) reflects an administrative policy that (i) was not previously expressed in any official and explicit agency determination, adjudication or rule, or (ii) constitutes a material and significant change from a clear, past agency decision on administrative regulatory policy in the nature

> of the interpretation of law or general policy. These relevant factors can, either singly or in combination, determine in a given case whether the essential agency action must be rendered through rule-making or adjudication. *Id.* at 97 N.J. 331, 332.

It is readily apparent that the determinations to be made in this proceeding satisfy each of these factors. There is little question that the Board will articulate the specific standards for determinations regarding the nature and scope of CTAs in future utility rate proceedings. These standards would constitute an administrative policy declaration that could materially and significantly change the Board's current CTA policy as set forth in *Rockland* and its progeny, and apply prospectively and uniformly to all utilities. Rulemaking is therefore necessary and appropriate in this generic proceeding, whose purpose is to prescribe the standards to be applied to CTAs in future utility rate cases.

Respectfully submitted,

New Jersey Large Energy Users Coalition

By: ______________________

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Letters to the Editor

Pepco paid the federal taxes it owed

Advertisement

November 7, 2011

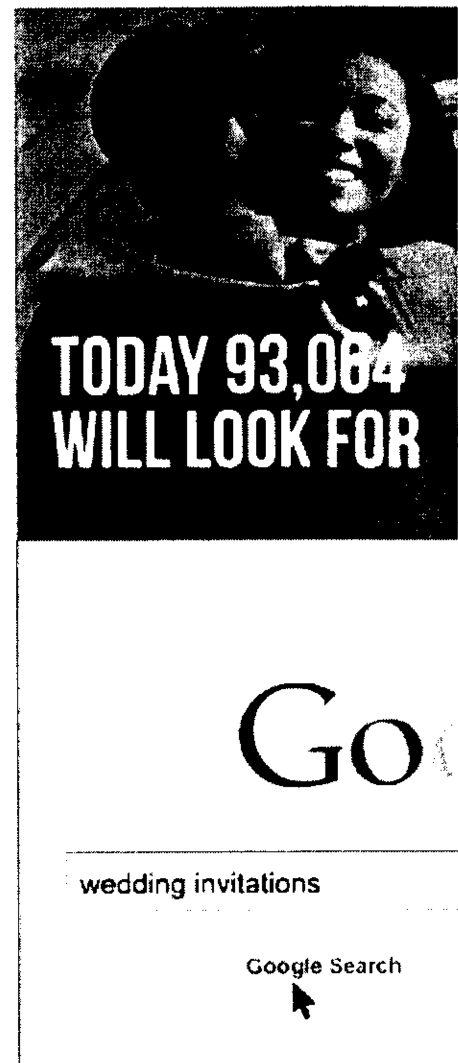
Regarding the Nov. 3 news story "Many firms found to avert taxes":

Those who have filed an individual tax return know one thing: The U.S. tax code is complicated. It is more complicated when a corporate tax return is filed.

Changes to the tax code are often driven by policy objectives. The mortgage interest deduction reduces taxes a homeowner pays and is designed to encourage homeownership.

During this economic downturn, policy objectives were developed to encourage economic investment and create jobs. One action was to allow greater accelerated depreciation on new capital investments. Policymakers

wanted to give companies incentives to invest and create jobs. In support of this objective, a company could deduct 50 percent of an investment in year one, lowering its federal taxable income and reducing the amount of taxes owed. These policy objectives are economic incentives, not "loopholes."



Over the three years noted in the article, Pepco Holdings made approximately $2 billion worth of capital investments inits infrastructure, which improved reliability. More than 50 percent was allowable as a current deduction against taxable income. By contrast, the company reported financial pre-tax earnings of approximately $690 million over this period. The accelerated depreciation of Pepco Holdings' capital investments and significant contributions the company made to the employee pension plan are the primary reasons for the negative tax rate computed in the study.

While accelerated depreciation reduced Pepco's federal income taxes, the company paid many other taxes. Between 2008 and 2010, it paid approximately $1.2 billion in real estate taxes, payroll taxes, personal property taxes, delivery taxes, use taxes and gross receipts tax. We are committed to supporting and investing in the communities we serve, and that includes paying the taxes we owe in accordance with all rules and regulations.

Anthony Kamerick, Washington

The writer is chief financial officer of Pepco Holdings.