SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
Docket No. A-003621-18

In the Matter of the Adopted Amendment to N.J.A.C. 14:1-5.12 (Tariff Filings or Petitions Which Propose Increases in Charges to Customers)	APPELLATE DIVISION **Docket No. A-003621-18** Civil Action On Appeal from the Rule Adopted by the New Jersey Board of Public Utilities in BPU Docket Nos. AX1750469, AX17050468, AX17111144

BRIEF OF APPELLANT
NEW JERSEY DIVISION OF RATE COUNSEL

STEFANIE A. BRAND, DIRECTOR
New Jersey Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, N.J. 08625
T(609)984-1460 F(609)292-2923

On the Brief:
Stefanie A. Brand, Director
Atty. ID No. 032331986, sbrand@rpa.nj.gov
Brian O. Lipman, Litigation Manager
Atty. ID No. 026711995, blipman@rpa.nj.gov
Christine M. Juarez, Assistant Deputy Rate Counsel
Atty. ID No. 026602003, cjuarez@rpa.nj.gov
Maura Caroselli, Assistant Deputy Rate Counsel
Atty. ID No. 028192007, mcaroselli@rpa.nj.gov

Dated: September 12, 2019

TABLE OF CONTENTS

TABLE OF JUDGMENTS

Rule

Intermediate Decision

TABLE OF AUTHORITIES

Cases

Statutes

Agency Orders

PRELIMINARY STATEMENT

While utility ratepayers are paying hundreds of millions of dollars each year in Federal income tax expense in rates, little if any of this money is being turned over by the public utilities to the Internal Revenue Service ("IRS"). Instead, the utilities, including some of the largest electric, gas and water public utilities operating in the State, file income taxes as part of a consolidated group with their parent and other subsidiaries, lowering the overall tax liability of the consolidated group. The consolidated tax adjustment ("CTA") is the mechanism used by the New Jersey Board of Public Utilities ("Board") to give ratepayers some relief from the disparity between taxes collected and taxes paid. However, the rule recently adopted by the Board, which is the subject of this appeal, has now altered the CTA to dramatically reduce the relief to ratepayers, thus forcing ratepayers to pay hundreds of millions of dollars each year in hypothetical income tax expenses which are never paid to the IRS, in violation of State Supreme Court precedent and Legislative policy.

Since the 1950's, our courts have held that it is impermissible for public utilities to recover "hypothetical" income tax expenses. The CTA at issue in this case is the mechanism the Board has used since the 1950's to provide

ratepayers with a share of the tax benefits derived from the filing of consolidated tax returns, thus avoiding the payment of hypothetical taxes by ratepayers. In 1991 the Board began use of a CTA formula known colloquially as the "Rockland Methodology" that eventually resulted in growing adjustments. The Board attempted to alter the Rockland Methodology through an order that was eventually reversed by the Appellate Division. The Board subsequently proposed and adopted the rule that is the subject of this appeal.

Rate Counsel maintains that there is no record evidence to support the rule's changes to the Board's CTA policy. Rate Counsel also maintains that a formula that results in negligible or zero CTAs for so many public utilities is contrary to law, causing ratepayers to pay impermissible hypothetical income tax expenses and resulting in unjust and unreasonable rates. Finally, Rate Counsel asserts that in conducting the rulemaking, the Board failed to comply with the requirements of the Administrative Procedure Act ("APA"). The Board also failed to comply with the prior Appellate Division decision that reversed the original Order adopting this same rule for failure to comply with the Administrative Procedure Act. Many of the required policy statements in the Board's Rule Proposal were deficient or simply incorrect, depriving Rate Counsel and other stakeholders the opportunity to offer thorough feedback. Moreover, the Board

failed to adequately respond to Rate Counsel's comments. Responses to comments must be meaningful, reasoned and supported. The Board's responses to Rate Counsel's comments were conclusory and unsupported.

For all of these reasons, the CTA rule adopted by the Board should be voided. The Appellate Division should ensure that when the Board promulgates rules, it does so based on record evidence, and in a manner complying both with the Legislature's intent that the Board set just and reasonable rates, and with the Appellate Division's directive that ratepayers receive due process under the APA. Because the Board's rulemaking did not satisfy any of these requirements, the CTA rule should be voided.

STATEMENT OF FACTS AND PROCEDURAL HISTORY[1]

1. Base Rate Case Overview

Generally, a New Jersey utility will file a Petition with the Board when it decides that an increase in base rates is needed for a utility to provide safe, adequate and proper service. A Petition seeking an increase in rates is filed with the Board with all supporting documentation and is based upon a test year, which generally concludes before the Board renders a decision. 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. N.J.S.A. 52:27EE-48. Rate Counsel hires financial, accounting and engineering experts to review utility filings, draft discovery, and file testimony before either the Office of Administrative Law ("OAL") or the Board.

Ultimately, the Board is the regulatory agency charged with making a final determination on the amount by which a utility can increase its base rates. The Board's authority to set rates is not unfettered. The Board's ratemaking authority is circumscribed by N.J.S.A. 48:2-21(b)(1), which requires rates set by the Board to be "just and reasonable." The Supreme Court

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

of New Jersey has held that "[t]he justness and reasonableness of a particular rate of fare can only be determined after an examination of a 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 Petition of Pub. Serv. Coordinated Transp., 5 N.J. 196, 216 (1950).

The determination of an adequate rate base is fundamental to the setting of "just and reasonable" rates. Id. at 217. Rate base is the value of the utility's assets used in supplying service to customers. In the ratemaking formula, the rate base is the amount to which the rate of return is applied to determine the utility's allowed profit. In addition to rate base, the ratemaking formula also includes a determination of the reasonable expenses of the utility. "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. at 222.

2. Consolidated Tax Adjustment ("CTA")

Included in a utility's expenses in setting base 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. For some of the larger regulated utilities in New Jersey, this income tax expense amounts to tens, if not hundreds, of millions of dollars paid by ratepayers each year. For example, in one of the few fully litigated rate cases decided by the Board in the past few years, based on its 2011 income Jersey Central Power & Light Company ("JCP&L") received an income tax expense allowance in rates of approximately $108,000,000 annually. I/M/O Verified Petition of Jersey Cent. Power & Light Co. for Review & Approval of Increases in and Other Adjustments to Its Rates & Charges for Elec. Serv., Order Adopting Initial Decision With Modifications & Clarifications, BPU Docket No. ER12111052, Order dated 3/18/15 ("2015 Rate Order") (RCa56).

If the utility is an affiliate of a larger holding company, however, as is the case for the New Jersey regulated energy and large water utilities, 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. (RCa61) 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. (RCa61) For many of these utility holding companies, these and other tax benefits have reduced their tax liability to $0. For example, a recently released report by the Institute on Taxation and Economic Policy ("ITEP"), a non-profit, non-partisan tax policy organization, noted that the holding companies of two of the largest electric utilities in New Jersey – Public Service Electric & Gas Company ("PSE&G") and JCP&L – each paid $0 in Federal income taxes in 2018.[2] Indeed, despite ratepayers paying at least the $108,000,000 in Federal income tax expense set in the 2015 Rate Order, JCP&L's parent company, First Energy, paid $0 in Federal income taxes in 2018.[3]

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. (RCa237) A portion of those funds are in turn contributed to the members of the consolidated group that incurred tax losses. The income from the regulated utility is necessary in order to give any value to the losses incurred by loss affiliates, and thus a necessary component in reducing the

[2] Institute on Taxation & Economic Policy Report, "Corporate Tax Avoidance Remains Rampant Under New Tax Law." See https://itep.org/notadime/.

[3] JCP&L had an interim rate case between 2015 and 2018 that ultimately settled, with its Federal income tax expense level set in that case.

consolidated group's overall tax liability. (RCa237) Accordingly, with the assistance of the income from the regulated utility, filing a consolidated return lowers the holding company's overall tax liability. (RCa237) Use of a consolidated return also shifts the risk of the holding company's riskier investments to ratepayers by having utility ratepayers fund losses for non-regulated entities.

In order to address this subsidy, and to ensure that ratepayers share in the tax benefits, the Board has, since 1951, used a CTA when setting rates for New Jersey utilities. In re N.J. Power & Light Co., 9 N.J. 498, 528 (1952). 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 tax return. The Court found that the adjustment was necessary to ensure that New Jersey ratepayers were not asked to pay for hypothetical income taxes. Id.

The CTA methodology that has been utilized by the Board since 1991 is referred to as the "rate base method." This method 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. I/M/O

Petition of N.J. Natural Gas Co. for Approval of Increased Base Rate Tariff Rates & Charges for Gas Serv. & Other Tariff Revisions Consolidated Taxes, BPU Docket Nos. GR89030335J – Phase II, GR90080786J, Decision & Order, 11/26/91 (RCa60).

This rate base method does not directly reduce the income tax expense included in a utility's revenue requirement, but instead treats these accumulated benefits as cost-free capital. The rate base methodology for calculating a CTA was adopted by the Board in a 1993 Jersey Central Power & Light Rate Case, I/M/O the Petition of Jersey Cent. Power & Light Co. for Approval of Increased Base Tariff Rates & Charges for Elec. Serv. And Other Tariff Revisions, Docket No. ER91121820J, Order dated 6/15/93 (RCa64), and reaffirmed by the Board in a subsequent Rockland Electric Company rate case (hereafter, referred to as the "Rockland Methodology"). I/M/O Verified Petition of Rockland Elec. Co. for Approval of Changes in Elec. Rates, its Tariff for Elec. Serv., its Depreciation Rates, & for Other Relief, BPU Docket Nos. ER02080614 & ER02100724, Decision & Order, 4/20/04. (RCa74) In affirming the Rockland Methodology, the Board noted that "[i]t is well-settled law and Board policy that consolidated tax savings are to be shared with customers." (RCa79)

Briefly, the Rockland Methodology is a calculation that first involves finding the cumulative amount of taxable income or loss for each affiliate. From the time of its inception in 1991 until the rule adoption, the Rockland Methodology used the cumulative taxable income from 1991 through the rate case test year. Then, for each year (1991-test year), the taxable income or loss for the group of companies that had a cumulative taxable loss is 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 benefits from 1991-test year for those companies that had cumulative net losses are then summed up over the period to determine the resulting total tax benefit.

The resulting total tax benefit is then allocated among all of the companies that had a 1991-test year cumulative positive taxable income, based on each income-positive entity's share of the cumulative 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 treats the allocated tax benefit as an interest free loan. Only the carrying costs are returned to ratepayers, not the underlying tax savings. 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 & Calculation of a Consolidated Tax Adjustment, BPU Docket No. EO12121072, Order Opening a Generic Proceeding, dated 1/23/13 (RCa16). In that Order, the Board directed its staff ("Board Staff") to convene a generic proceeding to review CTA issues (RCa17). 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." (RCa17).

Board Staff issued several requests for comment and information throughout the generic proceeding, with many parties including Rate Counsel and the regulated utilities providing responses. On March 6, 2013, Board Staff issued a Notice of Opportunity to Comment. (RCa83) In that notice, Board Staff stated that "[f]ollowing 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." (RCa84) On July 25, 2013, Board Staff issued a Notice of Opportunity to Provide Additional Information. (RCa177) On November 1, 2013,

the Board's Chief Counsel sent a request to all regulated utilities for additional consolidated tax data. (RCa180)

Despite the prior announcement from Board Staff, no public or evidentiary hearings were ever held on the CTA issues. Instead, approximately seven months after the last request for information, on June 18, 2014, Board Staff requested comments on its proposed modifications to the Board's current CTA policy. (RCa186) Specifically, Board 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.
>
> (RCa186 – RCa187)

Rate Counsel and other parties filed comments on Board Staff's proposal on August 18, 2014. Rate Counsel's comments advised Board Staff that:

> a. It is settled law in New Jersey that consolidated tax savings must be shared with the utility ratepayers who pay the income tax expense in rates.
>
> b. Board Staff's proposal did not comport with the Board's statutory obligation to set just and reasonable rates.

c. Despite ratepayers paying income tax expense in rates, many utility holding companies in recent years have paid $0 in income taxes to the IRS, with some receiving very large refunds instead.

d. Board Staff's selection of a five-year lookback period is arbitrary and does not give an accurate picture of a utility's actual tax experience.

e. Using the five year lookback period would result in no CTA for five of the seven gas and electric utilities, contrary to law.

f. Rather than a five year lookback, the Board should utilize a twenty-year lookback period, which is consistent with Federal tax laws on tax-loss carryforwards. Rate Counsel attached to the comments a chart showing the different impacts of using a 5, 15, and 20 year period.

g. The proposal to give 75% of calculated benefits to shareholders is unreasonable, because the CTA calculation already includes a sharing between ratepayers and shareholders and only compensates ratepayers for the time value of the benefit provided to the consolidated group. For example, Rate Counsel calculated JCP&L's tax benefit allocation to be 14.91%, with the remainder going to its parent and shareholders. Similarly, Atlantic City Electric Company's ("ACE") tax benefit allocation was 26.64%.

h. Transmission assets of the utility should continue to be included in the calculation of the CTA.

i. Any material changes to the Board's current CTA policy must be made through a rulemaking process.

(RCa236 – RCa257)

On October 22, 2014, the Board issued an order adopting Board Staff's modification to the CTA as proposed ("2014 CTA Order"). (RCa260) 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. On December 17, 2014, the Board advised the parties that the

November 3, 2014 corrected order contained language that was not in the original order that was never adopted by the Board. Accordingly, the Board reissued the original October 22, 2014 order with the corrected docket number. (RCa308) None of these Board orders addressed any aspects of Rate Counsel's filed comments.

On November 5, 2014, Rate Counsel filed a Notice of Appeal of the Board's CTA Order. (RCa325) On appeal, Rate Counsel argued that:

> 1. The 2014 CTA Order failed to satisfy the minimum requirements of due process, in that it was not based on credible evidence in the record and the Board failed to articulate the reasons for its decision;
>
> 2. The 2014 CTA Order violated the Board's statutory obligation to set just and reasonable rates; and
>
> 3. The Board engaged in administrative rulemaking without conforming to the requirements of the APA.
>
> (RCa334)

Following briefing and oral argument, the Appellate Division issued its decision on September 18, 2017. I/M/O the Board's Review of the Applicability & Calculation of a Consolidated Tax Adjustment, Docket No. A-1153-14T1, 2017 N.J. Super. Unpub. LEXIS 2315 (9/18/17) (hereinafter "2017 Appellate Division Decision"). (RCa23) The Appellate Division found that the Board engaged in administrative rulemaking without complying

with the APA's requirements, and accordingly reversed the 2014 CTA Order. (RCa25).

In the 2017 Appellate Division Decision, the Appellate Division found that all six factors set forth in Metromedia, Inc. v. Div. of Taxation, 97 N.J. 313 (1984) favored rulemaking. (RCa38) The Appellate Division held that "[a]lthough agencies enjoy leeway to choose among rulemaking, adjudicatory hearings, and hybrid informal proceedings...leeway is not a license to ignore the APA's requirements." (RCa43) The Appellate Division also found that the Board's departure from the APA's requirements constituted an "'irregularity or informality [that] tends to defeat or impair the substantial right or interest of the appellant,'" by violating ratepayers' right to have the new CTA adopted in accordance with the APA. (RCa47) (quoting N.J.S.A. 48:2-46).

The 2017 Appellate Division Decision found the Board's failure to provide a socio-economic impact statement as required by the APA to be particularly troubling. (RCa47) Specifically, the Appellate Division held:

> Compliance with the requirements provides the stakeholders with the Board's analysis and assessment of the economic impact of a proposed rule and the Board's response to a stakeholder's data, comments and arguments before a rule is adopted. Moreover, compliance provides the stakeholders with the opportunity to present evidence and address the

> Board's economic impact assessment and response to the stakeholder's data, comments and argument. In other words, the statutory requirements guarantee that Rate Counsel and the stakeholders are fully informed of the Board's position concerning a rule's economic impact....When the requirements are ignored, the Board gathers information and comment, but Rate Counsel and stakeholders are deprived of the right granted by the APA to consider and contest the Board's assessment of economic impact....The failures are of particular significance here because of the conflicting evidence presented concerning the modified CTA's potential economic impact on ratepayers.
>
> (RCa47 – RCa48).

Accordingly, the 2017 Appellate Division Decision reversed the Board's 2014 CTA Order. (RCa49)

4. Rulemaking

At its December 19, 2017 Board Agenda meeting, the Board adopted Staff's recommendation to publish a proposed rule ("First Rule Proposal") in the New Jersey Register. (RCa389) The First Rule Proposal was subsequently published in the New Jersey Register on January 16, 2018. 50 N.J.R. 281(a)(RCa394). The First Rule Proposal provided for a different CTA formula than that contained in the 2014 CTA Order that was reversed by the Appellate Division. Specifically, the First Rule Proposal allocated seventy-five percent of calculated savings to ratepayers, with twenty-five percent allocated to shareholders, as compared to the seventy-percent allocated to shareholders contained in the reversed 2014 CTA Order. (RCa397)

Rate Counsel filed comments on the First Rule Proposal on March 16, 2018. (RCa402) Among other things, Rate Counsel's comments noted that:

> a. Because the CTA calculation is a reduction to rate base, the benefit to ratepayers reflects only the time value of the benefit provided to the consolidated group. Accordingly, there was no justification to further reduce ratepayers' share by 25%.
>
> b. Despite the lack of justification for reducing ratepayers' share of benefits by 25%, Rate Counsel was still pleased to see the Board rejected Board Staff's prior recommendation to allocate 75% of calculated benefits to shareholders.
>
> c. The proposed rule failed to explain why a five year lookback period was appropriate. The proposed rule should be changed to incorporate a twenty-year lookback period, consistent with Federal tax laws allowing losses to be carried forward for twenty years.
>
> d. A proposed twenty year lookback maintains one of the Board's original objectives in establishing the RECO Methodology, which was consistency with the Internal Revenue Code.
>
> e. The Economic Impact Statement provided failed to satisfy the statutory requirements of the APA.
>
> f. In failing to satisfy the requirements of the APA, the Economic Impact Statement also violated the 2017 Appellate Division Decision.
>
> g. The Jobs Impact Statement and Housing Affordability Impact Analysis were flawed.
>
> h. The Regulatory Flexibility Statement was unclear, rendering Rate Counsel unable to offer appropriate feedback on it.
>
> (RCa402 – RCa409).

The New Jersey Large Energy Users Coalition ("NJLEUC") also filed comments on the First Rule Proposal. (RCa410)

In May 2018, approximately two months after filing comments on the First Rule Proposal, Rate Counsel learned that a second rule proposal on consolidated taxes had been published in the New Jersey Register on February 5, 2018 ("Second Rule Proposal"). 50 N.J.R. 709(a) (RCa398). Rate Counsel informed NJLEUC of the existence of the Second Rule Proposal at this time. The Second Rule Proposal changed the formula for calculating the CTA that was published in the First Rule Proposal. The Second Rule Proposal allocated seventy-five percent of calculated CTA benefits to shareholders and twenty-five percent to ratepayers. (RCa401) The Second Rule Proposal offered no explanation as to why ratepayers' share of savings was reduced from the seventy-five percent in the First Rule Proposal, down to twenty-five percent. This Second Rule Proposal was published in the New Jersey Register without providing Rate Counsel notice of the proposal, contrary to the requirements of the APA at N.J.S.A. 52:14B-4(a)(1). Accordingly, Rate Counsel and NJLEUC only learned of the existence of the Second Rule Proposal after the expiration of the comment period.

The regulated utilities and several other organizations were aware of the Second Rule Proposal's publication, and filed comments accordingly. Comments on the Second Rule Proposal were filed by Atlantic City Electric Company ("ACE"), Engineers

Labor-Employer Cooperative, New Jersey Utility Shareholders Association, JPC&L, New Jersey Laborers'-Employers' Cooperation & Education Trust, New Jersey Utilities Association ("NJUA"), New Jersey Chamber of Commerce, and the Utility & Transportation Contractors Association of New Jersey. (RCa419 – RCa437)

Upon learning of the Second Rule Proposal, Rate Counsel informed Board Staff that it believed the rulemaking to be out of compliance with the requirements of the APA. By letter dated August 21, 2018, Rate Counsel informed Board Staff that it only received notice of the First Rule Proposal, and did not receive notice of the Second Rule Proposal. (RCa439) NJLEUC sent a similar letter on August 22, 2018. (RCa442) At its August 29, 2018 Agenda meeting, and presumably in response to Rate Counsel's and NJLEUC's letters, the Board voted to re-open the comment period for further input. (RCa449) Rate Counsel filed comments on the Second Rule Proposal on November 28, 2018, along with NJLEUC and ACE on November 30, 2018. (RCa454 –RCa499) Rate Counsel's comments included the following observations:

a. The Board's failure to provide an explanation or the basis for the proposed rule deprived Rate Counsel of the opportunity to fully respond to the proposal.

b. The Second Proposed Rule constituted a "substantive change" to a proposed rule that failed to comply with the APA.

c. The Economic Impact Statement, which was a significant part of the Appellate Division Decision, was deficient and incorrect.

d. The Jobs Impact Statement was deficient.

e. The Regulatory Flexibility Statement was unclear, so interested stakeholders were not sufficiently informed of the expected impact on small businesses.

f. The Housing Affordability Impact Analysis, which claimed no impact on the cost of housing from the proposed rule, was flawed, incorrect, and inconsistent with the APA. The change in policy effectuated by the Second Proposed Rule will result in higher utility rates, which will result in higher housing costs.

g. The Board has never explained the basis for its selection of the five-year lookback period contained in the proposed rule, or how the use of a five-year lookback period satisfies the legal mandate that consolidated tax savings must be shared with a utility's ratepayers.

h. The proposed five-year lookback produces volatile results. Negative income in one or two years can easily outweigh the positive income over a five year period, resulting in no consolidated tax adjustment. The five-year lookback will therefore result in the collection of millions of dollars each year from ratepayers for the payment of hypothetical taxes.

i. The Board should utilize a twenty year lookback period instead of a five-year lookback period. A twenty-year period is consistent with the pre-Tax Cuts & Jobs Act carry-forward period, which allows losses to be carried forward for twenty years.

j. The Board never explained why it made a substantive change to the proposed regulation, decreasing ratepayers' share of calculated benefits from 75% to 25%. If the Board wishes to continue with this new allocation, it must re-publish the proposed rule to explain its basis for making this substantive change.

k. The Rockland Methodology already includes an allocation between ratepayers and shareholders. Further sharing would whittle down ratepayers' share of tax savings to such an extent that the sharing with ratepayers would become insignificant.

l. The CTA rate base deduction only compensates ratepayers for the time value of the benefit provided to the consolidated group. The formula itself results in a sharing between the utility and shareholders. An additional 75% reduction to ratepayers' share is unreasonable.

m. Transmission assets of electric utilities should continue to be included in the calculation, because transmission rates are paid for by ratepayers.

(RCa454 – RCa471)

At its Agenda meeting on January 17, 2019, the Board adopted the proposed rule without changes. (RCa500) The Board's rule response was published in the New Jersey Register on March 18, 2019. 51 N.J.R. 414(d) (RCa506). This final rule (hereafter, "CTA Rule") is the subject of the current appeal.

Argument

Point I

The CTA Rule's 75/25 Split of Benefits in Favor of Shareholders is Arbitrary, Lacks Substantial Credible Evidence in the Record to Support its Adoption, And Violates the Express Policy of the Legislature That Rates Be Just and Reasonable. (RCa398)

While judicial review of agency action is limited, an agency's discretion is not absolute. Courts will set aside an agency action if one of the following circumstances applies: (1) when the agency's action violates the enabling act's express or implied legislative policies; (2) when the record lacks substantial evidence to support the findings on which the agency action is based; and (3) when in applying the legislative policies to the facts, the agency clearly erred by reaching a conclusion that could not have reasonably been made upon a showing of the relevant factors. In re Petition for Rulemaking, 117 N.J. 311, 325 (1989).

An appellate court will reverse a promulgated regulation when there is a lack of substantial evidence in the record to support the findings on which the agency based the regulation. N.J. Soc. for Prevention of Cruelty to Animals v. N.J. Dept. of Agriculture, 196 N.J. 366, 385 (2008). While agency action is entitled to presumptive validity, "this is not a 'strong' or 'conclusive' presumption. The [Board's] determination must find

reasonable support in the evidence." In re N.J. Power & Light Co., 9 N.J., supra, at 509 (1952) (emphasis in original).

Furthermore, if a regulation is "plainly at odds with the statute, we must set it aside." In re Freshwater Wetlands Prot. Act Rules, 180 N.J. 478, 489 (2004); accord Lower Main Street Assocs. v. N.J. Housing & Mortgage Finance Agency, 114 N.J. 226, 243 (1989) ("[H]owever circumscribed the judicial function may be, its limits plainly encompass the duty to set aside agency rulemaking unauthorized by or inconsistent with the agency's enabling legislation.") Regarding judicial review of administrative regulations, "it remains the province of courts, under their traditional review powers, to determine what are the express or implied legislative policies in an enactment." In re Petition for Rulemaking, supra, 117 N.J. at 325.

While certain agency actions are entitled to deference, an agency's interpretation of a statute is not. An appellate tribunal is "in no way bound by the agency's interpretation of a statute or its determination of a strictly legal issue." Mayflower Sec. Co. v. Bureau of Sec. in Div. of Consumer Affairs of Dep't of Law & Pub. Safety, 64 N.J. 85, 93 (1973). Courts will examine the "purposes, policies, and language of the enactment" to determine the Legislature's intent. Airwork Serv. Div., Div. of Pac. Airmotive Corp. v Dir., Div. of Taxation, 97

N.J. 290, 296 (1984). Moreover, N.J.S.A. 48:2-46 authorizes the Appellate Division to review and set aside Board Orders "when it clearly appears that there was no evidence before the board to support the same reasonably or that the same was without the jurisdiction of the board."

A. The 75/25 Split of Benefits in Favor of Shareholders Lacks Any Basis in the Evidentiary Record, and is Therefore Arbitrary and Capricious. (RCa398)

In reversing the 2014 CTA Order, the 2017 Appellate Division Decision found that the Board's departure from APA requirements "constituted an 'irregularity or informality [that] tends to defeat or impair the substantial right or interest of [ratepayers].'" N.J.S.A. 48:2-46. (RCa47) The Appellate Division found that the Board violated ratepayers' right to have the new CTA policy adopted in accordance with the APA, including providing the expected economic impact of the rule and providing responses to comments and arguments. (RCa47) The Appellate Division stressed that it did "not consider these APA requirements to be insubstantial. They require more of the Board than merely making information available on a website and requesting comment." (RCa47)

Despite the Appellate Division's mandate to provide Rate Counsel and other interested parties with due process, the Board has never offered any explanation or basis for its decision to

allow shareholders to retain 75% of calculated CTA benefits. When Board Staff first proposed changes to the Rockland Methodology on June 18, 2014, including the 75/25 split, it did so without explanation. (RCa102) The 2014 CTA Order likewise lacked an explanation of why the Board was allowing shareholders to retain 75% of calculated benefits. The 2014 CTA Order simply stated that:

> The Board also FINDS that the current CTA policy shall remain in effect with the following modifications:
>
> 1. The review period for the calculation shall be for five calendar years including any complete year that is included in the test year;
>
> 2. 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;[4] and
>
> 3. Transmission assets of the EDCs would not be included in the calculation of the CTA.
>
> (RCa318)

Finally, in proposing the draft rule, the Board never provided a basis for these modifications to the Board's CTA policy, nor did it do so in its response to comments. (RCa394 – RCa401) The

[4] The CTA is actually a rate base adjustment, not a revenue requirement adjustment. 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. Rate Counsel believes that the Board's reference to a revenue requirement adjustment in this paragraph was an additional error and that the reference should have been to a rate base reduction.

Board failed to offer the slightest indication of how it arrived at a 75%/25% split in order to afford Rate Counsel and other stakeholders the opportunity to analyze and comment on the Board's reasoning.[5]

In failing to explain the basis for its proposal, the Board prejudiced both Rate Counsel's ability to adequately respond to the proposal and this court's ability to know the basis for the agency action. Indeed, a statement of the reasons for an agency's action is the minimum requirement of due process. Riverside Gen. Hosp. v. Hosp. Rate Setting Comm'n, 98 N.J. 458, 468 (1985). The lack of basic due process that occurred in the Second Rule Proposal was exactly what the Appellate Division Decision was trying to remedy when it reversed the Board's 2014 CTA Order. As the 2017 Appellate Division Decision noted:

> the statutory requirements guarantee that Rate Counsel and the stakeholders are fully informed of the Board's position concerning a rule's economic impact and the Board's response to the submitted data, comments and arguments, thus permitting Rate Counsel and the stakeholders an opportunity to present further evidence and argument.
>
> (RCa48)

[5] There is not an iota of evidence in the record to support the 75%/25% split in favor of shareholders. Indeed, the only regulated utility to comment on a possible additional sharing was ACE, and that company endorsed a 50/50 split between ratepayers and shareholders. (RCa111)

In requiring the Board conduct a rulemaking if it wished to alter its CTA policy, the Appellate Division intended for Rate Counsel and other stakeholders to be advised of the Board's reasoning, so that the parties could fully participate in the rulemaking process. This did not happen. Because the rulemaking failed to cure the defects recognized by the Appellate Division, the CTA Rule is arbitrary and capricious.

Nor did the Board explain why it believes giving 75% of calculated benefits to shareholders conforms with judicial or statutory mandates, or why such a split is reasonable. Indeed, it is not. The Board's rate base methodology that the CTA rule retains already results in a significant sharing between a utility and its ratepayers. The rate base methodology is not a dollar-for-dollar reduction to the utility's income tax expense, but rather credits ratepayers with the carrying costs on the capital they contribute to the holding company. In other words, if a utility holding company saves $1,000 in Federal income tax expense based on the income contributed by the New Jersey public utility, New Jersey ratepayers only save approximately $100 in rates from the CTA. Ratepayers still pay the utility's full Federal income tax expense in rates, even though some, if not

all, of these utility holding companies are paying $0 in taxes to the IRS.[6]

Furthermore, given how the calculation is done, the New Jersey utility receives only a portion of the overall tax benefit. As part of its comments on the Second Proposed Rule, Rate Counsel submitted evidence in the form of a spreadsheet demonstrating how significant this sharing already is, even before the additional 75% share is given to shareholders. (RCa257) For example, using Rate Counsel's proposed twenty year lookback period, without additional sharing, ACE's ratepayers would receive 26.64% of calculated tax benefits, RECO's ratepayers would receive 2.90%, and JCP&L's ratepayers would receive 14.91% of benefits. (RCa257) The remainder of the benefits not credited to New Jersey ratepayers is retained by shareholders. In other words, in the example above, ACE's shareholders would retain 73.36% of calculated benefits, RECO's shareholders would retain 97.1% of calculated benefits, and JCP&L's shareholders would retain 85.09%. This sharing exists absent the additional 75% sharing imposed by the CTA rule, the basis of which the Board has never explained.

[6] See ITEP Report, reporting that FirstEnergy, the parent company of JCP&L, had an effective tax rate of -1% in 2018, and Public Service Enterprise Group, the parent of PSE&G, had an effective tax rate of -5%. According to the ITEP Report, neither of these utility holding companies paid any Federal income taxes in 2018.

Ratepayers are paying hundreds of millions of dollars per year of Federal Income Tax Expense in rates. Most, if not all, of this money never gets paid to the IRS. The Board has never explained why giving an additional 75% of benefits to utility shareholders is a reasonable decision. Since there is no support in the record or any articulated policy supporting the 75% additional sharing with shareholders, the CTA Rule is unreasonable, arbitrary and capricious, and should be voided by this Court.

Furthermore, allowing a utility's shareholders to retain 75% of calculated benefits is arbitrary and capricious because it has no relationship to the Board's stated goal in the Second Proposed Rule. While the Second Proposed Rule acknowledges that "[t]he purpose of a CTA is to ensure that the ratepayers who pay a utility's Federal income tax expense share in the tax benefits that members of the consolidated tax filing receive," the Second Proposed Rule failed to explain how reducing ratepayers' share of benefits by 75% accomplishes this objective. (RCa399) In fact it does not, instead accomplishing the opposite of this objective by allowing shareholders to retain 75% of the calculated benefit. If ensuring a proper sharing with ratepayers is truly the Board's goal, then the 75% split in favor of

shareholders is arbitrary and capricious, as it bears no relationship to the Board's purported goal.[7]

B. In Giving 75% Of Calculated Benefits to Shareholders, the CTA Rule Requires Ratepayers to Pay Hypothetical Income Tax Expenses in Rates in Violation of Settled New Jersey Case Law and the Board's Statutory Obligation to Set Just and Reasonable Rates. (RCa398)

The Board has long recognized that it is legally mandated to share the benefits of consolidated tax savings with the ratepayers who pay a utility's Federal income taxes. (RCa61) New Jersey law prohibits the Board from setting rates that require ratepayers to pay "hypothetical expenses" of a utility. I/M/O N.J. Power & Light Co., supra, 9 N.J. at 528. 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 CTA as the method of implementing this sharing required by the courts.

[7] Alternatively, if the Board's true goal with the proposed rule is to reduce ratepayers' share of benefits, as seems to be the case with its decision to give 75% of benefits to shareholders, then the Board's CTA Rule is still reversible error. The "very process of rulemaking contemplates public notice and public disclosure of an agency's regulatory objectives." Lower Main St. Assocs, supra, 114 N.J. at 243 (citing N.J.S.A. 52:14B-4) ("When an administrative regulation disguises an aspect of the agency's true regulatory purpose, it cannot be sustained as a proper exercise of the rulemaking power.")

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 (Lambertville) 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 CTA for the State's utilities as the means of carrying out this judicial mandate. In a New Jersey Natural Gas rate case, the Board acknowledged that "[t]his policy, which required that consolidated tax savings be passed along to consumers, has been both affirmed and mandated by the courts of this state." 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.4. (RCa61) Likewise, 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. (RCa70) 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. (RCa79)

As noted above, an administrative regulation must be set aside if it is contrary to the express or implied policies of the Legislature. In re Petition for Rulemaking, supra, 117 N.J. at 325. The 75/25 additional sharing is arbitrary and capricious as it violates the Legislative mandate that utility rates must be "just and reasonable." N.J.S.A. 48:2-21(a). The Legislature delegated to the Board the authority of "general supervision and regulation of and jurisdiction and control over all public utilities…." N.J.S.A. 48:2-13(a). As part of this wide-encompassing delegation of authority, the Board has exclusive jurisdiction to fix the rates of public utilities. However, the Board's authority to set rates is not unfettered. Public utilities are permitted monopolies, with ratepayers living within a public utility's service area being required to take delivery service from that public utility and pay the rates of that utility. Accordingly, the Legislature required the rates set by the Board to be "just and reasonable." N.J.S.A. 48:2-21(b)(1). When a utility files a petition seeking a rate increase, the Board "shall have power after hearing, upon

notice, by order in writing to determine whether the increase, change or alteration is just and reasonable." N.J.S.A. 2:21(d). The burden of proof to show that an increase is "just and reasonable" is on the public utility. Id.

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, of which the CTA is a component; its expenses, including income taxes and an allowance for depreciation; and the developed rate of return. Pub. Serv. Coordinated Transp. Co., supra, 5 N.J. 196, 216 (1950); accord In re N.J. Am. Water Co., 169 N.J. 181, 188 (2001). 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." Pub. Serv. Coordinated Transp. Co., supra, 5 N.J. at 216. Our Supreme Court has opined that without such evidence, "any determination of rates must be considered arbitrary and unreasonable." Id. at 219.

By only giving ratepayers 25% of calculated benefits, without explanation or justification, the CTA Rule on its face requires ratepayers to pay hypothetical income taxes in rates, in violation of both the State Supreme Court's holding in In Re N.J. Power & Light, supra, and the Board's statutory obligation

to set "just and reasonable" utility rates. N.J.S.A. 48:2-21(a). Indeed, if ratepayers are paying hypothetical taxes in rates, those rates are not "just and reasonable" under the law, and therefore the CTA Rule mandating them to pay it is arbitrary and capricious.

A look at a recent base rate case illustrates this violation. The fully litigated 2015 JCP&L base rate case mentioned above demonstrates how the CTA Rule, which uses the same formula as used by the Board in that base rate case Order, violates these mandates. In that case, JCP&L's ratepayers were ordered to pay approximately $108 million per year in Federal income tax expense. (RCa56) Under the Board's prior CTA methodology, JCP&L's rate base would have been reduced by $511 million per year to reflect ratepayers' share of consolidated tax savings, which translates to approximately $55 million per year in revenue requirement benefit to ratepayers. (RCa55, RCa57) Instead, under the methodology adopted by the Board in that case, reducing the lookback period to five years and giving 75% of benefits to shareholders, ratepayers' share of benefits was reduced to a rate base adjustment of only $47 million, less than one tenth of the benefit ratepayers received under the former policy. (RCa55) This $47 million rate base reduction

translates into an approximate revenue requirement reduction of only approximately $5 million per year.[8] (RCa54)

In other words, ratepayers in that particular case were ordered to pay $108 million per year in Federal income tax expense, and using the same formula as found in the Board's new rule, received a CTA benefit of only $5 million per year. Meanwhile, in 2018, JCP&L's holding company, FirstEnergy, paid no tax to the IRS.[9] Given the totality of the circumstances, not only are such rates not "just and reasonable" under N.J.S.A. 48:2-21(a), but they force ratepayers to pay hypothetical taxes in rates in violation of the N.J. Supreme Court decision in In Re N.J. Power & Light, supra.

Point II

The Adoption of a Five Year Lookback Period is Arbitrary and Capricious, Has No Support in the Record, and Violates the Board's Statutory Obligation to Set Just and Reasonable Rates. (RCa398)

When Board Staff originally proposed changing the lookback period for the CTA calculation to five years, it offered no explanation for its choice of that timeframe. (RCa301) When it adopted the five year lookback period in the CTA Order, it

[8] Without the additional 75% split to shareholders, ratepayers would have received a consolidated tax benefit of $20 million per year.

[9] See ITEP Report, supra.

offered an explanation that lacked any basis in the record evidence. In that order, 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.
>
> (RCa317)

Similarly, the Board failed to offer any explanation for its adoption of a five year lookback period in the CTA Rule. (RCa394 – RCa401) There is nothing in the comments or any part of the evidentiary record filed with the Board that supports the use of a five year look-back period. Indeed, no party filing comments provided any rational basis for the use of a five year lookback period.[10]

[10] There are, however, comments in the record from even the regulated utilities endorsing the notion that the five year look-back period is totally arbitrary. New Jersey American Water Company commented that "[t]he Company accepts Staff's proposal to limit the CTA calculation to the previous 5 years, but notes that while this change does help mitigate some of the more onerous impacts of the current adjustment, this time period is no less arbitrary than that used by the current methodology…." (RCa198)

Rate Counsel supported a twenty year look-back period as more consistent with tax law and regulatory policy.[11] (RCa247, RCa467) Neither in the 2014 CTA Order nor in response to comments on the Second Proposed Rule did the Board address Rate Counsel's proposal. Nor did the Board ever provide a single evidentiary cite to support a five-year lookback period. The Board merely noted, in the CTA Order, its "belief" that "a shorter, fixed review period is necessary to return the impact of the CTA to that which was originally intended." (RCa317)

If the Board's goal was truly to follow the original intent of the CTA, then its adoption of a five-year lookback period is arbitrary and capricious, because it accomplishes the opposite of the CTA's original purpose. The intent of previous Boards in establishing the CTA can be found in many 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

[11] Under IRS regulations in effect during the generic proceeding before the Board, tax losses incurred in years prior to 1998 could be carried forward fifteen years and those incurred after 1997 could be carried forward twenty years. After that, the carry forward expired. Internal Revenue Code 26 U.S.C. 172. Since that time, the Tax Cuts and Jobs Act passed, which now allows tax losses to be carried forward indefinitely.

Service and Other Tariff Revisions Consolidated Taxes, BPU Docket Nos. GR89030335J –Phase II, GR90080786J, Decision and Order, (November 26, 1991), p.5 (RCa62) (The CTA was necessary to pass along to ratepayers their fair share of savings which arise from the filing of a consolidated tax return.) See also 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) (RCa70) ("Ratepayers who produce the income that provides the tax benefits should share in those benefits"); 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) (RCa81) ("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.")

In fact, the adoption of a five year lookback deprives ratepayers of their fair share of consolidated tax savings. 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 CTA. (RCa246) 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. (RCa246) In requiring ratepayers to pay these hypothetical taxes, the five-year lookback period fails to "closely reflect the current economic state of the utility at the time the CTA is applied," as claimed by the Board in the 2014 CTA Order. (RCa317) The adoption of the five year lookback period is therefore arbitrary and capricious.

In fact, Rate Counsel submitted evidence in our comments on the rulemaking demonstrating exactly how the use of a five year lookback would force ratepayers to pay hypothetical income taxes. Given the latest data available throughout this proceeding, Rate Counsel calculated the estimated CTAs that would result for the major utilities using several different lookback periods. (RCa478) Rate Counsel submitted a spreadsheet showing the resulting CTAs using a five-year period, fifteen year period, and twenty year period. (RCa478) The use of a five year lookback period resulted in a $0 CTA for five of the seven gas and electric companies, including ACE, JCP&L, PSE&G, South Jersey Gas, and Elizabethtown Gas. (RCa478) In contrast,

selecting a fifteen or twenty year lookback period maintained the required CTA for all utilities. (RCa478) The Board never addressed Rate Counsel's evidence in its response document.

In the CTA Order, the Board acknowledges that "New Jersey regulated utilities, as part of holding companies, are required to reduce rates as a result of a CTA applied during base rate cases to reflect certain tax savings realized by the holding company." (RCa318) As noted above, this legal requirement dates back to at least 1952, when the State Supreme Court ruled that utilities cannot charge ratepayers hypothetical income taxes in rates. In re N.J. Power & Light Co., supra, 9 N.J. at 528. The record evidence shows that the use of a five year lookback period would result in no CTA for most of the largest utilities, despite ratepayers paying hundreds of millions of dollars per year in hypothetical income taxes in rates. (RCa478) Accordingly, the five year lookback period adopted in the CTA rule is ultra vires, as it violates both State Supreme Court precedent and the Board's statutory obligation to set "just and reasonable" utility rates. N.J.S.A. 48:2-21(a).

Point III

In its Proposal and Adoption of the CTA Rule, the Board Failed to Comply with the Administrative Procedure Act by Depriving Interested Parties of Notice of a Rate Increase and of How The Rule Would Impact State Economics, Housing Affordability, Jobs, and Small Businesses. This Lack of Notice Renders the Rule Arbitrary and Capricious. (RCa398)

A. The Board Did Not Provide the Necessary Economic Impact Statement for Rulemaking as Directed by the Appellate Division in 2017 and as Required by N.J.S.A. 52:14B-4(a)(2). (RCa400)

In the 2017 Appellate Division Decision, the Court specifically admonished the Board in that it "failed to comply with the APA's requirements that [the Board] publish 'a description of the expected socio-economic impact of the rule' N.J.S.A. 52:14B-4(a)(2)." (RCa47) In its reversal of the Board's decision, the Court made clear that the Board's actions concerning the CTA should have been executed through a formal rulemaking and one of the main factors in its decision was the notable absence of a statement regarding the CTA's economic impact. (RCa47) With regard to conducting an analysis of the "socio-economic impact" the Court stated: "[w]e do not consider these APA requirements to be insubstantial…compliance provides the stakeholders with the opportunity to present evidence and

address the Board's economic impact assessment."[12] (RCa47 – RCa48). The Appellate Division suggested that the absence of an economic impact analysis alone could constitute a due process violation when it stated:

> the statutory requirements guarantee that Rate Counsel and the stakeholders are fully informed of the Board's position concerning a rule's economic impact and the Board's response to the submitted data…thus permitting Rate Counsel and the stakeholders an opportunity to present further evidence and argument. When the requirements are ignored, the Board gathers information and comment but Rate Counsel and the stakeholders are deprived of the right granted by the APA to consider and contest the Board's assessment of economic impact and responses to the submissions prior to the adoption of a rule.
>
> In our view the Board's failure to comply with the requirements deprived Rate Counsel of substantial rights and interests under the APA: the right to obtain the Board's assessment of the economic impact and of the proposed modified CTA…The failures are of particular significance here because of the conflicting evidence presented concerning the modified CTA's potential economic impact on ratepayers.
>
> (RCa48), emphasis added.

Additionally, the purpose of providing these impact statements is "to give those affected by the proposed rule an opportunity to participate in the rule-making process not just as a matter

[12] In the same paragraph, the Court emphasized that the Board also failed to "prepare and distribute a report 'summarizing the content of the submissions and providing the [[Board's]] response to the data, views, comments and arguments contained in the submissions.' N.J.S.A. 52:14B-4(a)(4)." (RCa47). It was in reference to both failures that the Court stated: "[w]e do not consider these APA requirements to be insubstantial." (RCa47).

of fairness but also as a means of informing regulators of possibly unanticipated dimensions of a contemplated rule." In re Protest of Costal Permit Program, 354 N.J. Super 293, 365 (App. Div. 2002) (quoting Federal Pac Elec. Co. v. N.J. Dep't of Envtl. Prot., 334 N.J. Super 323, 340-41 (2000) and In re Adoption of Regulations Governing Volatile Organic Substances in Consumer Prods., 239 N.J. Super 407, 411 (App. Div. 1990)).

However, the Board ignored the Court's explicit instructions in the 2017 Appellate Division Decision to provide an "assessment" of economic impact. It also failed to perform many of the other analyses required pursuant to the APA at N.J.S.A. 52:14B-4(a)(2). In fact, the required statements provided by the Board contain only conclusory statements that are devoid of any evidence to demonstrate that a substantive analysis or even an assessment was performed.

The Board's Economic Impact statement provides in full:

> Economic Impact
>
> There may be an economic impact to utility rate payers and utilities as a result of this proposed amendment. The rule requires that utilities share with ratepayers a portion of any tax savings earned through a utility's consolidated tax filing. The vast majority of states have abolished the CTA. The amendment also provides applicable utilities with a five-year look back period, a share allocation of the tax savings, and the elimination of transmission income from the CTA calculation.

50 N.J.R. 709(a). (RCa400)

Only the first sentence of this statement actually touches on the potential economic impact of the rule. However, it is completely devoid of any meaningful analysis or information stating only that "[t]here may be an economic impact to utility rate payers." (RCa400) The remaining sentences do not relate to any economic analysis and certainly do not leave the public with an understanding of the rule's economic impact. This statement fails to provide the "Board's analysis and assessment of [the] economic impact" as required by the 2017 Appellate Division Decision and the APA. (RCa47).

In fact, the Board's Economic Impact statement is so vague that it obscures the plain fact that ratepayers will experience an increase in rates as a result of the CTA Rule. Any ratepayer reading the rule proposal would not have any reason to believe that the rule is directly associated with a bill increase since the Economic Impact statement provides only that there "may" be some unspecified impact on ratepayers. (RCa400) Rate Counsel's filed comments in response to the CTA Rule proposal cited actual numbers from JCP&L's 2015 base rate case decision on the CTA where the Board adopted the same method as that proposed in the CTA Rule, which resulted in an additional $50 million per year rate increase to ratepayers. (RCa462 – RCa463). An increase of $50 million is a substantial increase for ratepayers and this

could be compounded two or three times for a single family if they pay multiple public utility bills for gas, electric, and water. In addition to omitting the fact that the CTA Rule will result in a bill increase, the Economic Impact statement also does not provide an approximation of how much the typical residential, commercial, or industrial ratepayer's bill could increase and it does not provide an explanation of the factors which could result in a smaller or larger CTA increase to ratepayers. The Board's Economic Impact statement does not suggest that any type of economic impact study, assessment, or analysis was performed by the Board in connection with the CTA Rule proposal.

In response to Rate Counsel's comments on the Economic Impact statement the Board responded that there is "a potential for a modest economic impact on ratepayers" but, again, the Board left ratepayers to guess the size and likelihood of any rate increase or decrease. 51 N.J.R. 414(d). (RCa509 – RCa510) Moreover, the Board did not amend its Economic Impact statement to provide further supporting information in response to Rate Counsel's comments. (RCa509 – RCa510) Since the Board failed to provide an Economic Impact statement that conforms with the requirements of the APA and the 2017 Appellate Division Decision, the CTA Rule should be voided by the Court.

B. The Board Failed to Provide an Accurate Housing Affordability Analysis as Required by N.J.S.A. 52:14B-4(a)(2) and N.J.S.A. 52:14B-4.1b. (RCa400)

Pursuant to N.J.S.A. 52:14B-4(a)(2) and N.J.S.A. 52:14B-4.1b, the Board is required to provide a housing affordability impact statement which includes "[a] description of the estimated increase or decreases in the average cost of housing which will be affected by the regulation." The Board provided in full:

> Housing Affordability Impact Analysis
>
> The proposed amendment will have no impact on the affordability of housing in New Jersey and will not evoke a change in the average costs associated with housing because the proposed amendment pertains to CTA calculations.
>
> 50 N.J.R. 709(a). (RCa400)

This statement does not account for the inextricable link between the cost of utilities and housing affordability. This link has been recognized by the U.S. Department Housing and Urban Development ("HUD") and the U.S. Census Bureau, through their inclusion of utility costs as a component of housing costs when examining the percentage of income that is spent on housing

in various regions of the country.[13] In its 2017 whitepaper which presents the 2015 study, HUD states that:

> Utility costs are an important component of housing costs, which also includes rent or mortgage payments; garbage, trash, water and sewage costs; real estate taxes and other housing-related fees. Accurate estimation of housing costs is crucial to monitoring trends in affordable housing supply over time.[14]

The fact that the Board does not appear to recognize that utility costs will necessarily impact housing affordability is myopic and hides from plain view the true economic impact of the CTA rule. It is also inconsistent with the APA, which seeks to provide notice to the public of true impacts the regulation will have on housing affordability.

In its rule comments, Rate Counsel noted that the Housing Affordability Impact Analysis is flawed and therefore constitutes a violation of the APA. (RCa464 – RCa465) The Board responded that it is satisfied with its analysis and that Rate Counsel did not provide support for its position. 51 N.J.R. 414(a), See Comment #19. (RCa510) However, the Board has the burden to provide the analysis of how its CTA Rule will impact housing affordability and it is not Rate Counsel's burden

[13] Utility Cost Estimation Model Development and Decisions for 2015 American Housing Survey and Beyond, at https://www.huduser.gov/portal/sites/default/files/pdf/American-Housing-Survey.pdf

[14] Id.

to provide such information. By ignoring the fact that utility costs are a component of overall housing costs, the Board is taking a constricted view of its statutory obligation that is inconsistent with that obligation.

The Board must be aware that housing costs include the cost of utilities. The CTA Rule will affect utility rates, which in turn affect the cost of housing. In fact, because the CTA Rule applies to electric, gas, and water public utilities, one family can see rates for not just one, but for multiple utilities, go up. The interrelationship between the cost of utilities and housing should have been reflected in the Housing Affordability Impact Analysis, but was notably absent. By ignoring the CTA's impact on housing affordability, the Board acted arbitrarily and capriciously, and failed to comply with the requirements of the APA.

C. The Board Failed to Provide an Accurate and Complete Regulatory Flexibility Analysis and Jobs Impact Statement as Required by N.J.S.A. 52:14B-4(a)(2) and N.J.S.A. 52:14B-19. (RCa400)

Pursuant to N.J.S.A. 52:14B-4(a)(2) and N.J.S.A. 52:14B-19, agencies must provide a regulatory flexibility analysis as part of a rule proposal. The applicable statute provides:

> Each regulatory flexibility analysis shall contain… (a) A description of the types and an estimate of the number of small businesses to which the proposed rule will apply; (b) A description of the reporting,

> record-keeping and other compliance requirements…; (c) An estimate of the initial capital costs and an estimate of the annual cost of complying with the rule, with an indication of any likely variation in the costs for small businesses of different types and of differing sizes; and (d) An indication of how the rule, as proposed for adoption is designed to minimize any adverse economic impact of the proposed rule on small businesses.
>
> N.J.S.A. 52:14B-19.

In the CTA Rule proposal, the Board's analysis in this area stated in full:

> Regulatory Flexibility Statement
>
> The proposed amendment will not impose any recordkeeping, reporting, or other compliance requirements on small businesses. A small business, as defined in the New Jersey Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq., is a business that has fewer than 100 full-time employees. With regard to utilities that qualify as small businesses under the Act, this amendment simply provides clarity to an existing statutory right that may be exercised by utilities voluntarily and, as such, will not impose any requirements on small businesses.
>
> 50 N.J.R. 709(a). (RCa400)

Although the Board addressed the recordkeeping issue in its statement, it ignored subparts (a), (c) and (d) of N.J.S.A. 52:14B-19 since it did not address which businesses would be impacted, the impact of the rule on annual costs for small businesses, or how the Board planned to "minimize any adverse economic impact" on small businesses. In ignoring these statutory requirements, the Board failed to provide small business owners with both meaningful notice that utility rates

will increase, and how the Board intended to mitigate the impact of these increases on small business owners. Had they been aware of such information, small business owners may have provided comments to the Board on the proposed rule. The Board's lack of disclosure in violation of the APA deprived small business owners from knowing the impact on them and deciding whether to comment accordingly.

Moreover, Rate Counsel's comments noted that the Regulatory Flexibility Statement was unclear when it states that the rule "provides clarity to an existing statutory right that may be exercised by utilities voluntarily…" No further explanation was provided after Rate Counsel raised this question in its Rule Comments. 51 N.J.R. 414(d), See Comment #18. (RCa510) The Board responded that no new record keeping standards were imposed and that "[a]s described in the notice of proposal's Summary, these amendments encompass relatively modest adjustment to the scope of a consolidated tax adjustment analysis." (RCa510) However, the Board's response to Rate Counsel's comments did not provide a meaningful response as required by the New Jersey case law. Animal Prot. League of N.J. v. N.J. Dep't. of Envtl. Prot., 423 N.J. Super. 549, 572 (App. Div. 2011) and In re Adoption of Rules Concerning Conduct of Judges, 244 N.J. Super. 683, 687 (App. Div. 1990). While the Board

states that there may be a "relatively modest adjustment" it does not plainly state that this adjustment will be an increase to small businesses' utility bills and it does not provide any statistics or supporting information to support that claim that the adjustment will be "modest."

The APA also requires that rule proposals include "a jobs impact statement which shall include an assessment of the number of jobs to be generated or lost if the proposed rule takes effect." N.J.S.A. 52:14B-4(a)(2). The Board stated that "it is not anticipated that the proposed amendment will result in creation of new jobs or the loss of existing jobs." 50 N.J.R. 709(a). In its Rule Comments, Rate Counsel responded that the "[j]obs impact statement is flawed because the rule proposal will increase utility rates, and in turn will have a negative impact on all sectors of the New Jersey economy, and may result in the loss of existing jobs." 51 N.J.R. 414(d), see Comment #18. (RCa510) The Board responded reiterating that it did "not believe that this rule will result in the direct creation or loss of jobs in New Jersey." (RCa510) However, the Board did not provide an estimation of the overall potential economic impact of the CTA Rule on ratepayers, small businesses, or on New Jersey workers.

The deficient Jobs Impact statement is related to the deficiencies in the Regulatory Flexibility Statement since increased utility costs for businesses, especially small businesses, could impact expenses and therefore could produce the loss of jobs in small or large businesses.

Without notice of utility bill increases in any of the aforementioned four impact statements (economic, housing affordability, Regulatory Flexibility or Jobs), the Board has not complied with the requirements under the APA and business owners who may have commented on the rule were deprived of notice of a bill increase. Because the CTA Rule proposal and adoption violated the APA, it constitutes an arbitrary and capricious act by the Board and should be rendered void.

D. The Board Failed to Respond to Rate Counsel's Rule Comments Therefore Depriving Rate Counsel and Other Interested Parties of a Meaningful Role in the Rule Adoption Process in Violation of the APA (Not Raised Below). (RCa506)

In the rule adoption process, the Appellate Division has stated that "[p]ublic comments should be 'given a meaningful role.'" Animal Prot. League of N.J., supra, 423 N.J. Super. at 572 (quoting In re Adoption of Rules Concerning Conduct of Judges, supra, 244 N.J. Super. at 687 (App. Div. 1990)). The APA provides that: "[t]he agency shall consider fully all written and oral submissions respecting the proposed rule [and]

provid[e] the agency's response to the data, views and arguments contained in the submissions." N.J.S.A. 52:14B-4(a)(3)-(4). Additionally, as noted supra, courts will set aside agency action where the record lacks substantial evidence to support the agency findings or where the agency clearly erred by reaching a conclusion that could not have reasonably been made. In re Petition for Rulemaking, supra, 117 N.J. at 325.

Board rulemakings have been remanded by the Appellate Division in the recent past due to failures to respond to stakeholders' input. In 2017, the Appellate Division remanded a rulemaking to the Board to "amplify its responses" in a decision concerning the Board's rulemaking on the "One-Call Damage Prevention System" and found that:

> In our view, the responses the BPU provided to the appellants' comments when the subject regulation was pending readoption neither fully addressed appellant's comments nor explained why [the rule] warranted readoption without any change. Thus, it is not clear from the agency's responses whether it fully considered appellants' comments, as statutorily required under the APA…The responses provided raises [sic] the question whether appellants' comments were given the consideration required by the APA, which is significant because, under the APA, any rule not adopted in substantial compliance with the Act is invalid.
>
> In Re Readoption of N.J.A.C. 14:2, 2017 N.J. Super. Unpub. LEXIS 2095, Docket No. A-3913-14T2, p.13-14 (Aug. 18, 2017). (RCa522)

Additionally that Court stated: "'[t]he grounds upon which an administrative order must be judged are those upon which the record discloses that the action was based' and not upon an after-the-fact explanation of the administrative agency's decision." (RCa521) (quoting In re Petition of Elizabethtown Water Co., 107 N.J. 440, 460 (1987)).

In the instant matter, the Board did not fully address Rate Counsel's comments nor did it indicate that it fully considered these points. More importantly, the Board did not provide explanation or support in the record for why it chose certain parameters for the CTA Rule. Rate Counsel details below the Board's specific responses to Rule Comments where it was either non-responsive or its response was without support. In failing to provide substantive and fully-reasoned responses, the Board violated the APA and acted arbitrarily and capriciously.

1. The Board Did Not Fully Consider Rate Counsel's Comments Regarding the Five-Year Lookback Period in violation of the APA (Not Raised Below).

With regard to the five-year lookback period, the Board summarized Rate Counsel's comments as follows:

> The CTA formula proposed in the draft rule has a five-year lookback period, which is too short, will lead to volatile results, and does not provide an accurate reflection of the actual taxes paid over time…The rule fails to explain how the use of the five-year lookback satisfies the mandate of In re Revision in Rates Filed by New Jersey Power & Light Company, Increasing its

> Rates for Electric Service, 9 N.J. 498, 528 (1952) (a utility 'is entitled to an allowance for actual taxes and not for higher taxes that it would pay if it filed on a different basis'). The proposed five-year lookback is, therefore, arbitrary and it should be changed to a 20-year period.
>
> 51 N.J.R. 414(d), see comment 27. (RCa511)

The BPU responded in full:

> As discussed in Response to Comment 7, the Board determined that the open-ended lookback period that dated back to the Rockland Order was unfair and unsustainable and that a five-year lookback period would be the best policy. The commenter improperly suggest that the Board is bound to adhere to the Federal Internal Revenue Service (IRS) time period when, in fact, the Board has broad discretion in its policy decision and is not governed by the policies of the IRS.
>
> (RCa511)

There are multiple deficiencies in this response. First, the response to Comment 7 is a reiteration of the procedural history of the CTA and does not contain a substantive explanation of why the Board chose a five-year lookback period. Second, the Board does not actually address the twenty-year lookback period that Rate Counsel recommends, it only states that an "open-ended look back period" is "unfair and unsustainable." This sentence misstates Rate Counsel's comment and it does not respond to Rate Counsel's recommendation of a twenty-year look-back period. Additionally, there is no support in the record for the Board's use of a five-year lookback period, so the Board cannot and does not reference the record to

support its position for a five-year period. The Board's response only states that the "five year lookback period would be the best policy" but, again, it does not provide any substantive analysis or legal argument of why the five-year period is "the best" nor does it provide any reasoning as to why five years is better than twenty years, or any other time period. (RCa511)

Moreover, the Board mischaracterized Rate Counsel's comment when it stated that "[t]he commenter improperly suggests that the Board is bound to adhere to the Federal Internal Revenue Service (IRS) time period." (RCa511) Rate Counsel did not argue that the Board is bound by IRS time periods. Rate Counsel's comments provided three main arguments to support a twenty-year lookback: (1)the twenty-year lookback was consistent with the pre-Tax Cuts and Jobs Act carry-forward period, (2)the twenty-year period maintained one of the Board's original objectives when it established the Rockland methodology, and (3)twenty years would smooth out the effect of outlier tax years. (RCa467) By mischaracterizing Rate Counsel's three main arguments in favor of a twenty-year lookback, the Board did not adequately respond to the legal arguments in the Comments provided by Rate Counsel.

Furthermore, the Board entirely ignored the substantive analysis attached to Rate Counsel's comments that illustrated that a five-year lookback period would result in $0 CTAs for five of seven utilities. (RCa478) The Board never provided a response to Rate Counsel's analysis. The Board also failed to explain how the use of a five year lookback period complied with the Supreme Court's prohibition on payment of hypothetical taxes in In Re N.J. Power & Light Co., supra, 9 N.J. at 528, in light of Rate Counsel's analysis. Accordingly, the Board's failure to respond to Rate Counsel's comments on the five-year lookback period renders the rule in violation of the APA and arbitrary and capricious. Animal Protection League of New Jersey, supra, 423 N.J. Super. at 572 and In re Adoption of Rules Concerning Conduct of Judges, supra, 244 N.J. Super. at 687.

2. The Board Did Not Fully Consider Rate Counsel's Comments Regarding the Inequitable CTA Allocation of 75% to Shareholders and 25% to Ratepayers in Violation of the APA (Not Raised Below).

The Board's responses to Rate Counsel's rule comments do not meet the standards in the APA since N.J.S.A. 52:14B-4(a)(3)-(4)requires the agency to "consider fully" and provide a "response to the data, views, comments and arguments." The Board did not respond substantively to Rate Counsel's argument that the imbalanced 75%/25% ratio is inequitable to ratepayers. The Board's dismissive responses demonstrate that Rate Counsel's

comments were not "given a meaningful role" in the Board's decision. Animal Protection League of New Jersey, supra, 423 N.J. Super. at 572 and In re Adoption of Rules Concerning Conduct of Judges, 244 supra, N.J. Super. at 687.

In its comments, Rate Counsel set forth substantive and legal arguments for why the 75%/25% allocation benefitting shareholders is inequitable for ratepayers. Rate Counsel contended that the allocation in the proposed CTA Rule did not comport with the NJ Supreme Court decision I/M/O N.J. Power & Light Co., supra, 9 N.J. at 498 which prohibited New Jersey ratepayers from paying hypothetical taxes given the sharp reduction or elimination of the sharing with ratepayers under the Board's recommended ratio. (RCa468) Additionally, Rate Counsel noted that the 75%/25% sharing mechanism is not equitable since part of the income tax benefit is already allocated to the utility even before the 75%/25% sharing mechanism is applied, therefore the benefit that actually reaches ratepayers will be in essence a sharing of a sharing. (RCa469 – RCa470) Rate Counsel also highlighted that ratepayers are paying 100% of *pro forma* income tax expense on their utility bills even though in many cases those amounts are not actually paid to the IRS. (RCa469)

In response to Rate Counsel's comments on the sharing ratio, the Board stated:

> The Board is aware that the CTA deduction from rate base is a method of sharing the benefit with customers. After affording appropriate notice and engaging in extensive stakeholder proceedings, the Board has made a policy determination that using the current method of deducting the CTA from rate base along with an allocation of sharing between a utility and ratepayers, using a five-year look back period and excluding income associated with a utility's transmission assets produces [sic], is a fair method of sharing the consolidated tax savings. See also, the Response to Comment 7.
>
> 51 N.J.R. 414(d), responses to comments 35, 36, 37 and 38. (RCa514)

This does not respond to Rate Counsel's comments nor does it explain how the Board reached the 75%/25% ratio. Rate Counsel's comments raised the issue that the 75%/25% ratio is an inequitable sharing and therefore begs a response which would provide some explanation as to why the Board may believe it is not inequitable. Instead, the Board provided a conclusory statement that the ratio is a "fair method of sharing." (RCa514) The Board only states that it has made a "policy determination" without providing legal or factual support for the decision. (RCa514) It did not explain how it determined that ratepayers should only be entitled to 25% of the CTA instead of other possibilities such as 50% or 100%.

In summary, the Board's responses to Rate Counsel's comments regarding the five-year lookback period and the inequitable sharing ratio do not comport with the standards established by New Jersey case law and the APA. Therefore Rate Counsel was deprived of substantial rights under the APA, rendering the CTA Rule arbitrary and capricious. Accordingly, this Court should void the CTA Rule.

Conclusion

For the all of the reasons stated above, the Board's regulation pertaining to consolidated taxes, N.J.A.C. 14:1-5.12(a)(11), should be rendered void by this Court.

Respectfully submitted,

STEFANIE A. BRAND
DIRECTOR, DIVISION OF RATE COUNSEL

By: _____
Christine M. Juarez
Assistant Deputy Rate Counsel