REDACTED VERSION

I/M/O THE BOARD'S REVIEW OF THE APPLICABILITY AND CALCULATION OF A CONSOLIDATED TAX ADJUSTMENT
BPU Dkt. No. EO12121072

Division of Rate Counsel Comments
August 18, 2014

I. INTRODUCTION

In this proceeding, the Board of Public Utilities ("BPU" or the "Board") is examining the appropriate method of calculating a Consolidated Tax Adjustment ("CTA") to a utility's rate base. This adjustment addresses the fact that, while ratepayers pay utilities for their federal income tax liability based on the utility's income, very often the utilities do not then pay that amount to the Internal Revenue Service ("IRS"). Instead, if the utility's parent corporation elects to file its federal income taxes for all of its subsidiaries as a consolidated group, the utility's earnings are used to offset losses by other subsidiaries, thus reducing the overall tax liability for the consolidated group. This process is permitted by both utility and tax law, but New Jersey's Supreme Court has ruled that if ratepayers are paying the utility as if it is paying full taxes on its income, the utility must share with ratepayers the savings that result from filing on a consolidated basis. The question in this proceeding is how that sharing should be calculated.

The Board established a formula in 1991 that it has followed consistently since then. In response to concerns regarding the current formula, the Board Secretary issued a letter, dated June 18, 2014 seeking written comments on a Staff straw proposal ("Straw Proposal") to change the Board's current CTA policy. Specifically, the Straw Proposal proposed that:

(1) the calculation of tax savings would look back only 5 years from the beginning of the test year,

(2) the savings allocation method would allow 75% of the calculated savings to be retained by shareholders and 25% of the calculated savings would be allocated to ratepayers, and

(3) the transmission share of the CTA would be retained by shareholders.

Unfortunately the proposed Straw Proposal effectively eliminates the Consolidated Tax Adjustment for most companies. As set forth below, it results in ratepayers paying "hypothetical" taxes that do not reflect the actual tax liability of the utilities, and thus it does not lead to the setting of rates that are just and reasonable. Moreover, the distinctions made to achieve the proposed formula are arbitrary and capricious. There is no factual basis in the record to establish a look-back period of only five years or a "sharing" that gives the utility the overwhelming majority of the pie. The Straw Proposal should therefore be rejected.

However, the Division of Rate Counsel ("Rate Counsel") does acknowledge that some adjustment of the CTA calculation may be appropriate. The current methodology has at times led to very significant adjustments that the Board may wish to correct. While the Board is not free to arbitrarily select inputs to the calculation in order to practically eliminate the CTA, as is the case with the Straw Proposal, Rate Counsel does set forth below some criteria that may be used to calculate a modified CTA. These criteria have a rational basis and result in a fair sharing of the benefits of consolidated taxes between ratepayers and shareholders.

II. DISCUSSION

A. It is Settled Law in New Jersey That Income Tax Savings Derived From the Filing of A Consolidated Tax Return Must Be Shared With The Utility Ratepayers Who Pay Such Income Tax Expense In Rates.

It is well-established law in New Jersey that the savings associated with a utility's participation in a consolidated tax group must be shared with the utility's customers. I/M/O the Revision in Rates Filed by New Jersey Power & Light Company, Increasing Its Rates For Electric Service, 9 N.J. 498 (1952). 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.

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

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

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

This language has long been relied upon by the Board in establishing consolidated tax adjustments for the State's utilities. For example, in discussing a CTA in an Atlantic City Electric base rate proceeding, the Board reasoned that:

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

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

Similarly, 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. 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 dated April 20, 2004, at p. 62.

The CTA likewise represents sound ratemaking policy. The tax sharing arrangements of consolidated group members are generally governed by Tax Sharing Agreements ("Agreements") among the members of the consolidated group. Pursuant to these Agreements, subsidiaries with positive taxable income pay the amount of their stand-alone tax liability to the parent company. The parent company then pays the amount of taxes due by the consolidated group to the IRS. Any excess funds are then allocated by the parent company to the members of the consolidated income tax group with tax losses, resulting in a contractual means to have the regulated and profitable subsidiaries subsidize unregulated and unprofitable ventures.

Because utilities are usually assured of positive income, these procedures ordinarily transfer the excess amounts collected from ratepayers for income tax expense from the utility to the affiliates that generated the income tax losses, effectively resulting in a subsidization of the unregulated affiliates by New Jersey ratepayers. The CTA provides some compensation to ratepayers for this subsidization, and is a regulatory mechanism necessary for the Board to meet its statutory obligation to set just and reasonable rates. Without a CTA, ratepayers would be paying for fictitious expenses that the holding company would retain as excess profits, which would be unreasonable and contrary to the Board's statutory mandate to set just and reasonable rates.

B. The Board Is Required By Statute To Set Rates That Are Just and Reasonable. The Straw Proposal Does Not Comport With This Statutory Obligation and Established Case Law, and Will Result In Unreasonable Rates.

While the Board of Public Utilities' has broad discretion to set utility rates, the Board's ratemaking power is not limitless. I/M/O Pub. Serv. Coordinated Transp. Co. For An Approval of An Increase in the Rates of Fare, 5 N.J. 196, 214 (1950). Our State

Supreme Court has found that in order for the Legislature's delegation of ratemaking power "to be valid under our Constitution it is essential that adequate standards be prescribed by the Legislature and adhered to by its agent, in this instance the Board." Pub. Serv. Coordinated Transp. Co., supra, 5 N.J. at 214. Those standards are found in N.J.S.A. 48:2-21(b), in which the Legislature has limited the Board to fixing rates that are "just and reasonable."

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

The Straw Proposal contained in Board Staff's Notice of Opportunity to Provide Additional Information dated June 18, 2014 proposes a CTA methodology that would result in either a zero or negligible CTA for most New Jersey utilities that file consolidated tax returns. Because New Jersey ratepayers will continue to pay fictitious income tax expenses in rates while receiving little or no CTA benefit, the Straw Proposal fails to meet the Board's statutory obligation to set just and reasonable rates. I/M/O the Revision in Rates Filed by New Jersey Power & Light Company, supra, 9 N.J. at 528.

There are three electric utilities, three gas utilities, and one combined gas/electric utility in New Jersey. If all seven of those utilities currently had pending base rate cases, five of the seven – Public Service Electric & Gas Company, Atlantic City Electric Company, Jersey Central Power & Light Company, South Jersey Gas Company, and Elizabethtown Gas Company - would not be subject to a consolidated tax adjustment under the Straw Proposal.[1] Our State Supreme Court has ruled that the tax benefits flowing from the filing of a consolidated tax return have to be shared with ratepayers, as 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." I/M/O the Revision in Rates Filed by New Jersey Power & Light Company, supra, 9 N.J. at 528. Given this precedent, a Straw Proposal resulting in no consolidated tax adjustment for five of the seven New Jersey gas and electric utilities cannot be viewed as "just and reasonable" and is not consistent with the Board's statutory mandate.

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

[1] Only Rockland Electric Company and New Jersey Natural Gas Company would receive a CTA under the Straw Proposal. While the regulated water companies would receive CTAs under the Straw Proposal, with the exception of Aqua New Jersey, the benefits to ratepayers would be minimal with the application of the proposed 75/25 split in favor of shareholders.

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

These holding companies have paid little or no taxes (or have received refunds) while New Jersey ratepayers have continued to pay federal income tax expenses in rates to the utility affiliate <u>as if they were paying taxes</u>. In their most recent rate cases before the Board, ACE requested approximately $37.375 million in federal income tax expense from ratepayers, JCP&L requested approximately $79.59 million, and South Jersey Gas requested approximately $43.087 million. While they were (or will be) permitted to recover income tax expenses, regardless of what they actually pay to the IRS, their rates will currently reflect a CTA to recognize in part the contribution ratepayers are making to the reduction in the consolidated group's tax liability. However, if the Straw Proposal methodology is adopted, <u>each of these utilities would receive a CTA adjustment of $0</u>.

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

C. Staff's "Straw" Proposal Is Arbitrary And Should Not Be Adopted.

1. The Proposed Five Year Look Back Period Is Arbitrary And Does Not Give An Accurate Picture Of The Utility's Actual Tax Experience.

Staff's selection of a 5 year look back period is arbitrary. There is nothing in the record to support Staff's proposal to use a 5 year time frame for the calculation of a consolidated tax adjustment. There is no logic or reasoned analysis to support the use of a 5 year period in any of the filed comments in this proceeding. There is no connection to tax law or regulatory policy.

The record does show, however, that the Staff proposal is contrary to New Jersey law. As shown on the attached schedule the five year look back period results in no CTA for five of the seven gas and electric utilities presented. As noted above, it is settled law in New Jersey that utility consumers are entitled to have reflected in the calculation of utility rates the savings that result from the utility's participation in a consolidated tax group. In re Lambertville, supra, 153 N.J. Super. at 28. Staff's proposed 5 year look back period does not do that.

Furthermore, the proposed five year look back period produces volatile results and does not give an accurate picture of the actual taxes paid over time by the holding company[2]. Using a five year look back period, negative net income of one or two years can easily outweigh the positive income of the prior years resulting in no consolidated tax adjustment. The five year look back period thus provides a distorted picture of the true economic activity of the utility and the holding company and results in the collection of millions of dollars each year from ratepayers for the payment of these hypothetical taxes.

[2] For example, the CTAs (without any further benefit sharing) for both RECO and Aqua New Jersey would be much greater using a five year period than either a 15 or 20 year period. See attached chart.

The five year look back period thus results in an inaccurate measurement of consolidated tax benefits and is unfair to ratepayers.

If the Board decides to revise its current methodology for calculating CTAs, Rate Counsel recommends that the Board utilize a longer time period that produces a more accurate picture of a company's negative and positive net income with the resulting more accurate picture of the amount of taxes actually paid. Attached hereto is a summary that shows the impact of using a 15 or 20 year period as opposed to the current methodology or the Staff Straw.

Rate Counsel recommends a twenty year look back period. This period is consistent with federal tax laws which allow losses to be carried forward for 20 years. 26 U.S.C. § 172 (2014). As explained by utility witness James I. Warren in his testimony for JCP&L, "under tax law, tax losses incurred in years prior to 1998 can be carried forward 15 years and those incurred after 1997 can be carried forward 20 years. After that, they expire."[3] Mr. Warren argued in that case and others that if a CTA is applied, it should follow the methodology formerly used in Texas where "affiliate tax losses only remained in the calculation for the duration of the carryforward period."[4] Mr. Warren noted: "Even under the Board's fundamentally flawed policy, it makes much more sense to follow the former Texas procedure in this regard and eliminate a fictional loss from the calculation when it would have expired."[5] The twenty year look back period recommended by Rate Counsel is consistent with Mr. Warren's testimony and has a basis in tax law and in regulatory policy.

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[3] Rebuttal Testimony of James I. Warren, BPU Docket No. ER12111052, page 22, included as part of the "Supplemental Documents" attached to JCP&L's Sept. 4, 2013 filing in this proceeding.
[4] Id. See also, e.g., Direct Testimony of James I. Warren, page 35, I/M/O Petition of N.J. American Water Co. For Approval of Increased Tariff Rates, BPU Docket No. WR11070460.
[5] Id. page 23.

Rate Counsel's proposed twenty year look back period also maintains one of the Board's original objectives in establishing the RECO methodology:

> Further, the rate base approach recommended by Staff properly compensates ratepayers for the time value of money that is essentially lent cost-free to its affiliates in the form of tax advantages used currently and takes into account the fact that loss affiliates could utilize their net operating loss on a stand-alone-basis under the carry back and carry forward provisions of the Internal Revenue Code.

I/M/O The Verified Petition of Jersey Cent. Power & Light For Review & Approval Of An Increase In & Adjustments To Its Unbundled Rates, BPU Docket Nos. ER02080506 et. al., Board Order dated May 17, 2004.

For these reasons, the twenty year look back period has a sound basis in law and will produce less volatile results. It should be adopted in lieu of the five year period included in the Straw proposal.

2. The Proposal To Give 75% Of The Utility's Allocated Consolidated Tax Benefit to Shareholders is Arbitrary and Deprives Ratepayers of Their Fair Share of the Tax Advantage Enjoyed by the Consolidated Group and Financed with Ratepayer Funds.

The proposed allocation of some of the utility's CTA to shareholders has been characterized as a "sharing" of the benefit between ratepayers and shareholders.[6] In reality, the CTA calculation itself includes an allocation between ratepayers and shareholders and no further sharing is "required." Staff's proposal to give only 25% of the calculated CTA to ratepayers is not a fair allocation of the tax benefit, because it ignores the fact that the CTA calculation already gives New Jersey ratepayers only an allocated share of the consolidated tax benefit. Ratepayers do not get the entire tax benefit, only a share based on the positive net income of the utility. There is nothing in

[6] See, e.g., Atlantic City Electric's Comments filed in this proceeding on May 3, 2013, page 29 recommending a 50%/50% sharing allocation.

the record in this proceeding to suggest that a further reduction in the ratepayers share by 75 percent is reasonable.

Under the BPU's current methodology, the consolidated income tax benefit is allocated among all companies that had cumulative taxable income from 1991 to the present, based on each entity's share of the aggregated positive taxable income. All companies with cumulative positive taxable income receive a portion of the tax benefit, based on each company's share of cumulative taxable income. For example, if the New Jersey utility was responsible for 10% of the cumulative positive taxable income since 1991, then the New Jersey utility would be allocated 10% of the consolidated tax benefit. Under the current BPU methodology, the remaining 90% would be allocated either to non-regulated entities in New Jersey or to companies (both regulated and non-regulated) in other states. Attached hereto is a summary that sets forth the percentage allocated to each regulated New Jersey utility of the consolidated tax benefit.

Staff proposes to further reduce by 75% the allocated share of the tax benefit allowed ratepayers. Under Staff's proposal, the corporate parent would end up retaining the overwhelming majority of the tax benefit. Using the rate base methodology, shareholders get all of the loss benefit allocated to the unregulated affiliates and all of the benefit that should go to the regulated affiliates in jurisdictions without a CTA. Thus for example, using the numbers provided in this proceeding, Rate Counsel calculated a JCP&L tax benefit allocation of 14.91%.[7] That means of the entire FirstEnergy consolidated tax benefit, JCP&L customers were allocated only 14.91%. The remainder goes to FirstEnergy and its shareholders. Atlantic City Electric's allocation is 26.64%. PHI's shareholders get the remaining 73.36%.

[7] A listing of New Jersey utility allocation percentages is attached.

The Board's proposal would further drastically reduce even these moderate adjustments. It is important to recognize that the Board is not recommending that 25% of the entire CTA benefit be allocated to ratepayers, but rather that ratepayers receive only 25% of the benefit that they would receive under the current methodology. Thus, while JCP&L ratepayers would receive 14.91% of the CTA allocation under the current methodology, the Board's proposal to implement a 75%/25% split would reduce ratepayers' share from 14.91% to 3.73%. Shareholders would retain the remainder.

Moreover, the proposed 75/25 sharing mechanism ignores the fact that the CTA is a rate base deduction that compensates ratepayers only for the time value of the benefit provided to the consolidated group. Ratepayers do not get any of the direct benefit of lower income tax expense. Given the methodology used by the BPU for determining consolidated tax adjustments, utility base rates include the full income tax expense based on the utility's level of revenues and expenses found by the Board to be reasonable. Ratepayers are paying 100% of this *pro forma* income tax expense even though in many cases these amounts are not being paid to the IRS. Because the consolidated tax adjustment is a rate base adjustment and not a direct expense reduction, the benefit to ratepayers reflects only the time value of the benefit provided to the consolidated group. As noted by the Board in the 1993 JCP&L base rate case adopting the base rate methodology:

> The rate base approach properly compensates ratepayers for the time value of money that is essentially lent cost-free to the holding company in the form of tax advantages used currently and is consistent with our recent Atlantic Electric decision.[8]

[8] 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, Decision and Order (June 15, 1993).

Thus, ratepayers actually get only a small percentage of the benefit of the consolidated tax adjustment.[9] By allocating only one quarter of the benefit of the consolidated tax adjustment to ratepayers, the Straw Proposal exacerbates this imbalance. It is far from fair and far removed from what the Board has established as a reasonable policy.

In sum, the rate base method essentially treats the tax benefits derived by the holding company as cost free capital contributed by ratepayers. By providing a rate base adjustment, ratepayers are credited with the carrying costs of those contributions, prospectively, reflecting the present value benefits of being able to use the tax losses sooner rather than later (or never) because of the utility's income. This method already represents a sharing approach since only the carrying costs are credited to ratepayers, while the contributions or savings themselves are retained by the holding company. Further "sharing" is thus unreasonable and unfair to ratepayers.

However, if the Board is determined to reduce ratepayers' share of the consolidated tax benefit, ratepayers should receive at least half of the calculated benefit. It is ratepayers who are paying millions of dollars in tax expense collected by the utility each year which is not going to the IRS but is being passed on to an unregulated affiliate. To allow a greater portion of the benefit to go to shareholders is inequitable and arbitrary and should not be adopted. At the very least, if a further sharing is to be considered, it should be an equal 50/50 allocation.

3. Transmission Assets Of The Utility Should Continue To Be Included In The Calculation Of The CTA.

Transmission is a regulated service. Transmission rates are regulated by FERC and paid by New Jersey ratepayers. FERC regulates in a totally different way than the

[9] Attached hereto is a summary that shows the revenue requirements that would be associated with the rate base adjustments, using a sample capital structure and debt and equity rates.

BPU and, unfortunately, FERC formula rates do not include a consolidated tax adjustment. Thus, if transmission assets are excluded from the Board's consolidated tax calculation, ratepayers will never receive tax benefits accrued through the use of ratepayer funds. Ratepayers are entitled to share in the benefits of the consolidated tax filing. If transmission assets are removed from the calculation, then regulated rates are subsidizing unregulated and unprofitable ventures with no benefit to New Jersey ratepayers. Rate Counsel recommends that the Board continue to include transmission assets in the consolidated tax adjustment.

D. The Board Must Make Any "Material Changes" To Its Current CTA Policy Through A Rulemaking Process.

The CTA calculation affects at least eleven regulated utilities in every prospective rate case, implicates numerous issues of public policy, and involves a variety of stakeholders and unsettled factual issues. If the Board wishes to make "material changes" to its current CTA policy, it must institute an agency rulemaking pursuant to the provisions of the Administrative Procedure Act ("APA"). Metromedia, Inc. v. Div. of Taxation, 97 N.J. 313, 331-32 (1984). As the Supreme Court has stated, agencies "should act through rulemaking procedures when the action is intended to have a 'widespread, continuing, and prospective effect,' deals with policy issues, materially changes existing laws, or when the action will benefit from rulemaking's flexible fact-finding procedures." I/M/O The Provision of Basic Generation Service For the Period Beginning June 1, 2008, 205 N.J. 339, 349-50 (2011) (quoting Metromedia, supra, 97 N.J. at 329-31 (1984)). Courts apply the following multi-factor analysis in determining whether an agency action is considered an administrative rule implicating the rulemaking requirements of the APA:

> (1) the determination has wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group;
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> (2) the determination is intended to be applied generally and uniformly to all similarly situated persons;
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> (3) it is designed to apply only to future cases;
>
> (4) it prescribes a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authority;
>
> (5) it reflects an administrative policy that (i) was not previously expressed in any official agency adjudication or rule, or (ii) constitutes a material change from a past agency position on the identical subject matter; and
>
> (6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy.

Metromedia, supra, 97 N.J. at 331-32.

Not all six of the Metromedia factors are necessary for an agency action to constitute rulemaking, and the factors should be weighed, not tabulated. I/M/O the Provision of Basic Generation Service, supra, 205 N.J. at 350; accord I/M/O Request For Solid Waste Utility Customer Lists, 106 N.J. 508, 518 (1987).

Here, there is little doubt that the majority of Metromedia factors weigh in favor of changes to the CTA formula being done via rulemaking. If the Straw Proposal is adopted, nearly all of the Metromedia factors are present and there can be little argument that a rulemaking is required. It should be noted, however, that if the Board adopts Rate Counsel's recommended CTA position, it may be able to do so via Board Order without the need for a rulemaking, because under the fifth Metromedia factor Rate Counsel's

CTA recommendations do not constitute a "material change from a past agency position on the identical subject matter." Metromedia, supra, 97 N.J. at 331-32; see also In re Att'y Gen.'s "Directive on Exit Polling: Media & Non Partisan Pub. Interest Groups", 402 N.J. Super. 118, 136-37 (App. Div. 2008), aff'd in part, modified in part on other grounds, 200 N.J. 283 (2009) (finding no implication of rulemaking requirements because agency directive did not materially change a past Attorney General position, even though other Metromedia factors were present). Rate Counsel's position maintains every aspect of the Board's current CTA policy with one exception: there would now be a reasonable twenty year look back period for tax benefits, linked to the IRS tax loss carry forward period, whereas under the Board's current policy the look back period was tied to a specific year, namely 1991. All other aspects of the CTA calculation would remain the same as current Board policy if Rate Counsel's recommendations are adopted. Rate Counsel posits that there would be no "material change" that warrants a rulemaking procedure

On the other hand, if the Board wishes to explore the possibilities of materially changing the look back period, of having further CTA benefit sharing, or removing the transmission share from the CTA calculation, then the Board must initiate a rulemaking because combined these constitute "material changes" under the fifth Metromedia factor. These proposed, material modifications are beyond the scope of the Board's current CTA policy. The qualitative analysis under Metromedia mandates that changes to the Board's current CTA policy must be done by way of a rulemaking when one considers how many of the other Metromedia factors apply.

Regarding the first Metromedia factor, all three electric utilities, all three gas utilities, the one combined gas/electric utility, as well as three of the four biggest water companies in New Jersey receive consolidated tax adjustments. Changes in the CTA calculation therefore would affect a very large segment of the regulated community, as well as a large segment of New Jersey ratepayers. See I/M/O The Provision of Basic Generation Service, supra, 205 N.J. at 350-51 (noting the implication of the first Metromedia factor because a large segment of the generic public will be affected in its ratepaying capacity). The second Metromedia factor also applies, as the Board's CTA policy has always uniformly applied to all utilities that file consolidated tax returns.

Any changes the Board makes to its existing CTA policy will only apply in future rate cases, giving support to the third Metromedia factor. This is true because CTA adjustments are made during base rate proceedings, and base rates are only set prospectively. Unless specifically authorized by the Legislature, the Board is prohibited from engaging in retroactive ratemaking. I/M/O Elizabethtown Water Co., supra, 107 N.J. 440 (1987).

Factor four clearly leans in favor of a rulemaking. CTAs are not addressed in legislation, so there is no statutory direction on how the tax benefits from consolidated tax filings should be passed on to ratepayers in base rate cases. Factor six also applies, since by announcing a uniform CTA policy applicable to all regulated utilities that file consolidated tax returns, the Board intends to implement a general policy decision.

In summary, while the Board may be able to avoid a rulemaking by adopting Rate Counsel's proposed modification, a rulemaking will definitely be required for any of the changes of the nature being contemplated by the Board's Straw Proposal.

III. CONCLUSION

For the reasons discussed above, Rate Counsel recommends that the Straw Proposal be rejected. The Straw Proposal as currently proposed by Board Staff fails to meet the Board's statutory mandate to set "just and reasonable" rates, as well as long established law that the tax benefits derived from the filing of consolidated tax returns be shared with the ratepayers who pay such income taxes in rates. If the Board chooses to change its current CTA policy, it should only be modified to allow a twenty year look back period for purposes of calculating tax savings. The consolidated tax savings associated with transmission should be included in the calculation of the CTA, and no further sharing of the CTA benefit with shareholders, other than that embedded in the CTA calculation, should be allowed. If the Board is determined to reduce ratepayers' share of the consolidated tax benefit, the Board should adopt a sharing that gives ratepayers at least a 50% share of the benefit, as there is no rational basis in the record to do otherwise.

SUMMARY OF CTA ADJUSTMENTS

Rate Base Adjustments - Reflects Current Sharing Methodology

	5 Years	15 Years	20 Years	Since 1991	% of Tax Benefit Allocated To Utility (20 Yrs.)
Atlantic City Electric	$0	$84,949,821	$168,834,450	$214,074,243	26.64%
RECO	$15,847,477	$7,959,191	$8,549,175	$8,240,137	2.90%
JCP&L	$0	$287,093,108	$433,593,208	$457,340,796	14.91%
PSE&G (Total)	$0	$31,595,481	$66,842,707	$78,594,917	47.67%
South Jersey Gas	$0	$9,161,320	$14,707,040	$15,823,390	59.58%
Elizabethtown Gas Co.	$0	$34,565,629	$42,934,836	$45,895,733	10.55%
New Jersey Natural Gas	$9,980,319	$20,572,909	$23,002,203	$24,005,688	56.14%
Aqua	$14,546,104	$3,166,841	$4,262,222	$4,468,160	8.00%
New Jersey American	$113,763,398	$188,027,335	$183,571,240	$181,956,792	25.56%
United Water	$37,103,240	$120,176,297	$94,611,731	$90,516,401	34.57%
Atlantic City Swerage	$142,828	$351,194	$721,035	$1,512,021	100.00%

Estimated Revenue Requirement Impact (Assuming 50% debt at 6.0%, 50% equity at 9.75% and 40.85% tax rate.)

	5 Years	15 Years	20 Years	Since 1991
Atlantic City Electric	$0	$9,549,853	$18,979,960	$24,065,708
RECO	$1,781,535	$894,753	$961,078	$926,336
JCP&L	$0	$32,274,312	$48,743,499	$51,413,145
PSE&G (Total)	$0	$3,551,887	$7,514,295	$8,835,450
South Jersey Gas	$0	$1,029,893	$1,653,330	$1,778,827
Elizabethtown Gas Co.	$0	$3,885,784	$4,826,630	$5,159,487
New Jersey Natural Gas	$1,121,963	$2,312,757	$2,585,852	$2,698,661
Aqua	$1,635,238	$356,009	$479,149	$502,300
New Jersey American	$12,789,006	$21,137,578	$20,636,634	$20,455,142
United Water	$4,171,056	$13,509,928	$10,636,022	$10,175,635
Atlantic City Swerage	$16,056	$39,480	$81,057	$169,978