Morgan, Lewis & Bockius LLP
89 Headquarters Plaza North
Suite 1453
Morristown, NJ 07960
Fax: 877-432-9652
www.morganlewis.com

Morgan Lewis
COUNSELORS AT LAW
A Pennsylvania Limited Liability Partnership

Gregory Eisenstark
973.993.3134
geisenstark@MorganLewis.com

August 18, 2014

Via Email and Overnight Delivery

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

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

Dear Secretary Izzo:

Please accept this submission on behalf of Jersey Central Power & Light Company ("JCP&L" or "Company") in response to the Board of Public Utilities' ("Board" or "BPU") June 18, 2014 "Notice of Opportunity to Provide Additional Information" in the above-referenced matter ("June 18 Notice"), which concerns the Board's policy on consolidated tax adjustments ("CTA") in the context of setting a utility's rates. JCP&L is pleased to provide the comments as requested in the June 18 Notice.

I. Introduction

In the June 18 Notice, Board Staff outlined the following proposed modifications to the "current CTA policy[1]":

[1] JCP&L notes that the Board has never issued an Order, policy statement, or other written document that clearly sets forth its "current CTA policy." Rather, the "policy" has been developed on an *ad hoc* basis in several Board decisions over a number of years. Moreover, as demonstrated in the record of the pending JCP&L base rate case, in its application of even this *ad hoc* "policy" the Board has never addressed many of the myriad issues that arise in attempts to apply that "policy" to the particular facts of a given utility's situation.

> Staff proposes that the current CTA policy remain in effect except as amended by the following:
>
> 1. The revised time period for the calculation of the savings would look back 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 the company and 25% of the calculated savings to be allocated to the ratepayers; and
>
> 3. Transmission assets of the EDCs would not be included in the calculation of the CTA.[2]
>
> [referred to hereinafter as "Staff's Straw Proposal"]

JCP&L applauds Board Staff for proposing modifications to the CTA calculation methodology that represent a move in the right direction. As JCP&L has demonstrated in the record of its pending base rate case[3], the Board's current CTA methodology is fundamentally flawed, violates federal tax laws, and its application would result in confiscatory rates for JCP&L and likely for other utilities as well. As such, Staff's Straw Proposal, which would lessen the magnitude of the CTA for JCP&L (and likely for other utilities), is clearly a positive development.

In response to those who may argue that Staff's Straw Proposal "goes too far", JCP&L offers the following observations. First, the proposed modification of the "look back period" to five years (as compared to the current calculation that begins in 1991 and continues indefinitely) attempts to make the CTA methodology better comport with the federal tax laws (see discussion below in Section III), and also provides a reasonable basis for tax planning purposes. Second, the proposal that 25% of the calculated amount would be allocated to ratepayers must be

---

[2] June 18 Notice, at p. 1.

[3] *In the Matter of the Verified Petition of Jersey Central Power & Light Company For Review and Approval of Increases in and Other Adjustments to Its Rates and Charges For Electric Service*, *et al.*, BPU Docket No. ER12111052, OAL Docket No. PUC 16310-2012N.

Morgan Lewis
COUNSELORS AT LAW
A Pennsylvania Limited Liability Partnership

compared to the current policy wherein Board Staff usually recommends that 50% of the calculated amount be allocated to customers. As such, the proposed 25% sharing level is a mid-point between the usual Board Staff litigation position (50%) and the normal utility litigation position (zero).

However, Staff's Straw Proposal does not address the fundamental legal and policy flaws inherent in the application of *any* CTA. Moreover, the proposal addresses some, but not all, of the inherent flaws in the current calculation methodology. Therefore, while JCP&L appreciates Board Staff's efforts, the Company nonetheless urges the Board to: (1) completely eliminate the imposition of a CTA (either immediately or through a "phase-out period" as discussed below); or (2) in the alternative, build upon Staff's Straw Proposal with additional modifications that address the other flaws in the current CTA calculation methodology.

II. The Board Should Eliminate the CTA

1. There is No Legal Requirement that the Board Impute a CTA in Approving a Utility's Rates.

JCP&L's fundamental position continues to be that the Board should completely eliminate the imposition of a CTA in utility rate-setting. It is important to emphasize that there is no legal mandate in New Jersey that requires the Board to implement a CTA during base rate cases or otherwise in the rate-setting process. Title 48 of the New Jersey Statutes, the Title that governs the Board and utility ratemaking, contains nothing that requires a CTA. Similarly, the Board's regulations make no mention of a CTA, let alone require one. While there have been court decisions that affirmed the Board's ability to reflect some impact from a consolidated tax filing in an individual rate case, none of those decisions require the Board to do so in every case.

Moreover, while the issue of a CTA has existed in New Jersey since at least the early 1950s, the Board itself has not systematically implemented CTAs in each and every utility base rate case, nor has the Board employed a single, consistent methodology. Notably, during most of the 1980s, the Board did not employ any CTAs in utility rate setting, based at least in part on several draft Internal Revenue Service ("IRS") rulings which held that the imposition of CTAs would result in a violation of tax normalization rules. The Board only started its current CTA policy in the early 1990s, following an IRS statement and memorandum that concluded that a CTA may not, depending on how structured, violate the normalization rules. If, as some parties have argued, the Board is legally required to implement a CTA in every base rate case, the Board would not have been able to issue final decisions in rate cases during the 1980s without a CTA. And, for that matter, the Board would not have been able to approve numerous rate case settlements from the early 1990s through the present where there is no stated recognition of a CTA at all.

Finally, New Jersey courts give the Board extremely wide latitude with respect to utility ratemaking issues. *See, e.g., In re Public Service Elec. and Gas Company's Rate Unbundling*, 167 N.J. 377, 384 (2001)(ruling that "[t]he proceedings and decisions in this matter involve rate making by the BPU, 'to which the Legislature has delegated its rate-making power, [and which] is vested with broad discretion in the exercise of that authority'" (internal citations omitted); *Deptford Tp. v. Woodbury Terrace Sewerage Corp.*, 54 N.J. 418, 424 (1969)(holding that New Jersey courts have consistently held that the Legislature in Title 48 intended to delegate the widest range of regulatory power over public utilities to the Board). Consequently, if the Board were to determine that a CTA is no longer an appropriate ratemaking mechanism, it is highly likely that the New Jersey courts would defer to the Board's expertise, were such a determination

challenged on appeal. *See Petition of Public Service Elec. and Gas Co.*, 304 N.J. Super. 247, 265 (App. Div. 1997)(holding that "[t]he Board is not required to employ any particular mode of computing rates, but it must reach a result that is supportable: It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.").

In sum, the argument that the Board "must" implement a CTA as a matter of law is clearly erroneous and should not deter the Board from completely eliminating a CTA, as a matter of policy, in the instant proceeding.

Given all of the conceptual, legal, and regulatory issues with CTAs, it is not surprising that the vast majority of regulatory jurisdictions in the United States do not impose them. As of 2012, only three state utility commissions other than New Jersey imposed CTAs: Pennsylvania, West Virginia, and Texas. In 2013, Texas enacted legislation that prevents its public utility commission from imposing a CTA, reducing the number of other jurisdictions that impose a CTA to just two. Thus, there are now 50 utility regulatory jurisdictions (including FERC, the District of Columbia, and the New Orleans City Council) that do <u>not</u> impose CTAs.[4] It is apparent that the vast majority of utility regulatory jurisdictions have recognized that CTAs are not based on sound regulatory and economic principles, and the time has come for New Jersey to come to the same conclusion.

[4] Moreover, among the three states that impose some form of CTA, New Jersey is the only regulatory jurisdiction in the United States to utilize a rate base methodology that calculates a CTA based on cumulative tax losses of affiliates from 1991 until, apparently, the end of time.

2. If the Board Does Not Eliminate the CTA Immediately, it Should Consider a Five-Year Phase Out of the CTA

For all the reasons that JCP&L has established in its submittals in this proceeding, as well as in the record of its pending base rate case, the Board should eliminate the CTA immediately (*i.e.*, for any utility with a currently pending base rate case and in all subsequent base rate cases). However, should the Board determine that it would be more appropriate to eliminate the CTA more gradually, it should consider a five-year phase out. Under this approach, the Board would immediately implement the revised CTA calculation methodology it adopts in this proceeding in any currently pending base rate cases or in any base rate cases that conclude within five years of the date of the final Order in this matter. With respect to any base rate cases that conclude more than five years from the date of the final Order in this case, there would be no CTA applied.

III. If the Board Determines to Modify the CTA Methodology, It Should Make <u>Other Changes in Addition to Those Proposed by Board Staff.</u>

As alluded to in the introductory section of these comments, Staff's Straw Proposal, while a step in the right direction, does not address other flaws in the Board's current methodology for calculating a CTA. As JCP&L has established in record evidence in its pending base rate case, the Board's so-called "Rockland" methodology suffers from six broad instances in which it may violate the federal tax laws:

1. Failure to observe the tax law with regard to the treatment of tax losses;

2. Failure to incorporate the economic consequences of net operating loss carryforwards ("NOLCs");

3. Consideration of tax results even in years that could not impact current year tax losses;

4. Freezing forever tax benefits provided by companies that are no longer part of the consolidated tax group;

5. Failure to incorporate the impact of JCP&L's transition from a BPU-regulated, vertically-integrated electric company (including generation, transmission and distribution) to the regulation by the BPU of only its distribution operations;

6. Failure to eliminate tax losses of other regulated group members in the CTA calculation.[5]

Certain of these inconsistencies with the tax years would be mitigated, in part, by elements of Staff's Straw Proposal. For example, issues 1, 3 and 4 would be mitigated to some extent by the proposed 5-year look-back period. Issue 5 would be largely mitigated by the combination of the 5-year look-back period and the removal of transmission revenues from the CTA calculation. However, issue 2 (failure to incorporate the economic consequences of NOLCs) would not be mitigated by Staff's Straw Proposal to the extent that the NOLCs are comprised of tax losses of unregulated affiliates. In addition, Staff's Straw Proposal does not address issue 6 (failure to eliminate tax losses of other regulated group members in the CTA calculation) at all.

Accordingly, should the Board determine to modify the CTA methodology (either in lieu of eliminating a CTA immediately or during a five-year phase out period), the Board should amplify Staff's Straw Proposal by:

[5] These issues are discussed in greater detail in the Direct Testimony and Rebuttal Testimony of James I. Warren, filed on behalf of JCP&L in BPU Docket No. ER12111052. JCP&L previously filed a copy of Mr. Warren's direct and rebuttal testimony in the instant docket as attachments to its September 4, 2013 comments in this proceeding.

1. Ruling that any element of the methodology that is inconsistent with the federal tax laws will be eliminated;

2. Excluding the impact of all NOLCs of unregulated affiliates;

3. Eliminating entities that are no longer part of the consolidated tax group from the calculation; and

4. Eliminating tax losses of other regulated utility group members from the calculation.

CONCLUSION

For all the foregoing reasons, JCP&L respectfully requests that the Board completely eliminate the imposition of a CTA (either immediately or through a five-year phase-out period). In the alternative, the Board should adopt a modified version of Board Staff's Straw Proposal to further reduce the inherent flaws in the CTA methodology, as discussed herein above. Regardless of which of these alternatives the Board selects, it should also declare that the new policy will be implemented for all currently pending and future utility base rate cases.

Respectfully submitted,

/s/ Gregory Eisenstark
Gregory Eisenstark

c: Stefanie Brand, Director, Division of Rate Counsel
Babette Tenzer, DAG
Jerome May, Director, Division of Energy
Tricia Caliguire, Chief Counsel
Mark Beyer, Chief Economist
(all via email)