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May 5, 2022

VIA ELECTRONIC DELIVERY
Hon. Patricia Caliguire, ALJ
Quakerbridge Plaza, Building 9
P.O. Box 049
Trenton, N.J. 08625

Re: I/M/O the Petition of N.J. American Water Co. Inc. for Approval of Increased Tariff Rates & Charges For Water & Wastewater Service & Other Tariff Modifications
BPU Docket No. WR22010019
OAL Docket No. PUC 00808-22

Dear ALJ Caliguire:

Please accept for filing this letter brief in lieu of a more formal brief from the Division of Rate Counsel ("Rate Counsel") in the above referenced matter. Copies of this letter brief are being filed with each person on the service list by electronic mail. No paper copies will follow.[1] Thank you very much for your attention to this matter.

Procedural History & Statement of Facts

New Jersey American Water Company ("New Jersey American" or "Company") filed the present rate case on January 14, 2022. New Jersey American filed a proposed consolidated tax adjustment ("CTA") as part of its rate case filing. The Company's proposed CTA is calculated

[1] A hard copy of this filing will be mailed to ALJ Caliguire.

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using a five year lookback period, with rate base being reduced by 100% of the calculated CTA. The Company's CTA position is based on its interpretation of the Appellate Division decision in I/M/O the Adopted Amendment to N.J.A.C. 14:1-5.12 (Tariff Filings or Petitions Which Propose Increases in Charges to Customers), 2021 WL 2303075 (June 7, 2021) ("Second Appellate Division Decision") and its interpretation of N.J.A.C. 14:1-5.12. The Company believes that the Second Appellate Division Decision upheld the five year lookback period but directed that 100% of the CTA go to customers. Testimony of John S. Tomac, p. 14.[2]

During the discovery process in the present rate case, Rate Counsel requested twenty years of data related to the annual taxable income or losses for each affiliated regulated utility, New Jersey American's annual taxable income or loss, the annual taxable income or loss for each unregulated affiliate, as well as several other pieces of information. RCR-A-71, Company Brief, Exhibit C. The purpose of this request is to allow Rate Counsel to calculate its own position on consolidated taxes. Without this information – which Rate Counsel seeks but New Jersey American now refuses to provide – Rate Counsel will be unable to formulate its own position on the appropriate CTA for New Jersey American. New Jersey American objected to Rate Counsel's discovery request based on an inaccurate assessment of the law and subsequently sought guidance from ALJ Caliguire on this matter.

A CTA can be easily explained. When regulated utility rates are set, an allowance is made for the utility's Federal income tax liability. Ratepayers thus pay in rates the utility's full federal income tax obligation. However, the taxes collected from ratepayers are for the most part never paid to the IRS. When utilities are subsidiaries of large holding companies, they provide those taxes over to their parent corporation, which then files a consolidated tax return for all of

[2] Mr. Tomac is not an attorney, and his legal opinion on this issue should not be considered by this Court.

its subsidiaries. When it does so, it uses the utility's positive taxable income to offset losses from other subsidiaries and thus reduces the overall tax liability of the consolidated income tax group, thus funding its riskier or less profitable ventures with captive ratepayer funds. The result in some instances is that ratepayers are paying tens of millions of dollars in rates to cover their utility's taxes, while the holding companies are paying no federal income tax or are getting refunds.

Since the 1950's our courts have said that it is impermissible for these utilities to recover "hypothetical" tax expenses that are not then used to pay taxes. I/M/O the Revision in Rates Filed by New Jersey Power & Light Co., Increasing its Rates for Electric Service, 9 N.J. 498 (1952). The Appellate Division has found that the utilities must share with ratepayers the benefits that the consolidated income tax group receives by filing a consolidated tax return. In re Lambertville, 153 N.J. Super. 24, 28 (App. Div. 1977), rev'd in part on other grounds, 79 N.J. 449 (1979). The CTA, at issue before Your Honor, is the mechanism used by the Board of Public Utilities ("BPU"), albeit with different formulas, since the 1950's to provide that shared benefit to ratepayers.

The current CTA has been the subject of proceedings before the BPU and/or the Appellate Division since 2013. Initially, the BPU changed the CTA formula through a Board Order. Rate Counsel appealed this Order, and the Appellate Division subsequently ruled that changes to the CTA must be done through rulemaking. I/M/O the Board's Review of the Applicability & Calculation of a Consolidated Tax Adjustment, 2017 WL 4105226 (Sept. 18, 2017) ("First Appellate Division Decision"). In subsequent years, the BPU conducted a rulemaking, using the same formula as that contained in their ill-fated prior Board Order. This rulemaking was the subject of a second appeal by Rate Counsel, resulting in the Appellate

Division overturning the BPU's rule in 2021. See Second Appellate Division Decision. The Appellate Division remanded the rule back to the Board again for further consideration. Since that second decision in 2021, the BPU has conducted an informal process to get input from stakeholders on a new CTA rule as part of its general review of Chapter One of its regulations. The new rule would call for a five year lookback period with 100% of the calculated CTA going to ratepayers. While the BPU has sought this informal input, it has not yet formally proposed a new CTA rule for comment. The proposed CTA rule, even if adopted, does not preclude Rate Counsel's discovery in this matter.

Argument

New Jersey American Water Should Be Ordered to Respond to RCR-A-50 and RCR-A-71 and Provide Sufficient Data for Rate Counsel to Calculate its CTA Position.

At this point, it unclear what a formally proposed CTA rule will look like. The matter of the BPU's position on consolidated taxes is hardly settled. The Appellate Division's remand to the BPU has been ongoing for approximately one year now. It is Rate Counsel's position that the Second Appellate Division Decision threw out the rule, and remanded the entire issue back to the BPU. As noted above, there is currently an ongoing informal process to get stakeholder input into what a proposed rule should look like. The informal draft rule does use a five year lookback period, but that could change based on stakeholder input and/or other consideration by the BPU. Given the current state of flux of a new rule, Rate Counsel is free in this case to take any position it wants on a CTA for New Jersey American. But in order to do this, Rate Counsel needs access in discovery to New Jersey American's relevant information.

New Jersey's discovery rules "are to be construed liberally in favor of broad pretrial discovery." Payton v. N.J. Tpk. Auth., 148 N.J. 524, 535 (1997), citing Jenkins v. Rainner, 69

N.J. 50, 56 (1976); accord In re Liquidation of Integrity Ins. Co., 165 N.J. 75, 82 (2000). "Our court system has long been committed to the view that essential justice is better achieved when there has been full disclosure so that the parties are conversant with all the available facts." Jenkins, supra. If information is relevant to subject matter of the pending litigation, it is subject to discovery. Rule 4:10-2(a) specifically states that "parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action…." see Payton, supra. To determine whether materials are discoverable, "their potential relevance is the initial inquiry." In re Liquidation of Integrity Ins. Co., supra, 165 N.J. at 82. "Relevant" evidence is not defined in the discovery rules. However, it is defined in the evidence rules as "evidence having a tendency in reason to prove or disprove any fact of consequence to the determination of the action." N.J.R.E. 401.

The Company attempts to argue that it should be exempt from the broad scope of discovery because somehow Rate Counsel's requests will not lead to admissible evidence. This is a narrow reading of the law and an attempt to evade the clear mandate of our courts and the BPU that an appropriate CTA must be applied. As explained more fully below, Rate Counsel, even under the proposed rule, is free to argue for a CTA other than the one proposed by the Company. The Company, nor ultimately even this Court must adopt Rate Counsel's position, but Rate Counsel is permitted to make its arguments. To do so, it must have access to the requested information. To deny access is to deny Rate Counsel its ability to put forth its arguments on one component of the Company's overall base rate.

Applying the law to the facts in this current discovery dispute, it is clear that twenty years of information should be provided by New Jersey American to all of the parties. First, New Jersey American is the party with the burden of proof, and must demonstrate that the proposed

rates are just and reasonable. The proper CTA is one component of New Jersey American's proposed rates. For this reason alone, all ratemaking information including CTA information is relevant to New Jersey American's proposed rates. Ratemaking information such as that used to calculate a proposed CTA is relevant because it can "prove or disprove any fact of consequence to the determination of the action," specifically, which calculated CTA would equate to just and reasonable rates for New Jersey American. N.J.R.E. 401.

CTA information is also relevant to the determination of a base rate case because of case law on the subject. Our State Supreme Court has held that ratepayers must be charged only actual tax expense, and cannot be required to pay hypothetical taxes in rates. In re N.J. Power & Light Co., supra, 9 N.J. at 528 (1952) ("the Utility is allowed a deduction from gross income for *actual* operating expenses only…and not for hypothetical expenses which did not and foreseeably will not occur." (emphasis in original)). The CTA is the mechanism chosen by the BPU to carry out the State Supreme Court's directive against payment of hypothetical income taxes. Thus, in order to comply with the direction of the State Supreme Court, parties to a base rate case must have access to a utility's tax information in order to ensure that the CTA is set at a level that ensures that ratepayers are not paying hypothetical income taxes. This is yet another reason why Rate Counsel should be provided with the tax information it seeks.

Rate Counsel is seeking specific, relevant information on twenty years of annual taxable income and taxable losses from the Company for the specific reason of calculating a proposed CTA. The information Rate Counsel seeks is clearly relevant to helping the ALJ and the Board determine a proper CTA for New Jersey American. As of now, there is no CTA regulation in effect, so Rate Counsel is free to take any position on CTA that is supportable by record

evidence. Rate Counsel may not have this evidence in hand and New Jersey American should be ordered to provide it. If not, Rate Counsel's ability to take relevant positions may be stymied.

The current state of the CTA rule is in flux. The Board has twice issued a proposed rule and twice it has been struck down by the Appellate Division. The Board has now informally proposed a new rule, which will at some point be formally proposed and adopted. The final form of that rule is unknown by any party to this process. While that process is ongoing, Rate Counsel should be able to take any position on CTA that it so chooses to take. Yet in denying this relevant CTA discovery to Rate Counsel, New Jersey American appears to be asserting that Rate Counsel cannot take a position on CTA in this case that is contrary to current Board policy. This is a curious assertion, because many utilities, New Jersey American among them, take positions in rate cases that are contrary to BPU policy all of the time. Three examples of this are incentive compensation expenses, the deferred taxes component of cash working capital, and rate case expenses.

For decades, the BPU's policy on recovery of incentive compensation has been that such expenses are unrecoverable, or occasionally, that only those expenses that are not tied to financial performance of the utility are recoverable. Yet in the present case, New Jersey American seeks recovery of 100% of incentive compensation expenses. Likewise, on the issue of deferred taxes for cash working capital, New Jersey American included deferred tax expense in the lead-lag calculation with a zero expense day lag, which is contrary to Board policy. Many utilities also seek recovery of 100% of rate case expenses, contrary to Board policy, although New Jersey American has not done so in this case. These are all examples of positions introduced by utility petitioners, including New Jersey American itself in the present case, which differ from current Board policy. There is no valid reason why Rate Counsel cannot do the same

with the CTA, in hopes of convincing the Board to adopt Rate Counsel's position as a result of the evidence set forth.

Finally, even if the current rule is ultimately adopted as drafted (or the Company is correct that some portion of the prior rule is currently valid), it does not preclude Rate Counsel's discovery. N.J.A.C. 14:1-5.12 is not a policy declaration of the Board; it is merely a filing requirement. The Company reads much into the rule, but at the end of the day, the rule merely provides that "petitions for the purpose of making effective or making revisions, changes or alterations of existing tariffs which prose to increase any rate . . . [shall conform with Board filing requirements] . . .and in addition, shall contain the following information and financial statements which shall be prepared in accordance with the applicable Uniform System of Accounts," followed by a list of items required in a base rate petition. Number 11 on the list is the CTA requirement, which requires that when a CTA is applicable, the "company shall include in its petition a consolidated tax adjustment (CTA) calculation." That rule does provide that "the review period for the CTA calculation shall be for five consecutive tax years," but that provision is included in the section concerning filing requirements.

Filing requirements also include a comparative balance sheet, a comparative income statement, a balance sheet at the most recent date available, a statement of the amount of revenue derived in the calendar year preceding the filing, and a pro forma income statement reflecting operating income at present and proposed rates. The Company does not, and cannot, assert that Rate Counsel cannot seek information beyond the basic filing requirements in order to properly evaluate this case. The Board's CTA policy is unclear, but at best can be stated as an intent to ensure that some CTA calculation is included in any base rate petition. The Company has in fact met that burden. Nothing in the filing requirement, or any other rule, precludes Rate Counsel

from making arguments about what does or does not constitute an appropriate rate. Indeed, as noted above, the Company itself does not consider itself bound by Board policy in its arguments over what constitutes an appropriate base rate.

In the end, no decision about what CTA to apply is currently before the Court. The only issue before the Court is whether Rate Counsel is permitted to make arguments about what it believes is an appropriate CTA; it is. Rate Counsel must be free to make its arguments regarding what will constitute an appropriate base rate, while the Company (and any other party to the proceeding) may make its arguments regarding an appropriate base rate. Not surprisingly, the parties disagree about what should be included in base rates and how those calculations are made. That is not problematic in the least. The parties must, however, be afforded the appropriate data so that they are not precluded from making their arguments. Limiting one party's ability to make arguments will result in a decision that does not properly consider all aspects of all the issues. This is problematic. For this reason, the Company should be ordered to respond to RCR-A-50 and RCR-A-71.

Conclusion

For all of the reasons stated above, Your Honor should issue an order directing New Jersey American to fully answer discovery questions RCR-A-50 and RCR-A-71.

Respectfully submitted,

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DIRECTOR, RATE COUNSEL

By: *Christine Juarez*
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C: Service List