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July 31, 2023

Via Electronic Mail

Hon. Sherri L. Golden, Secretary
New Jersey Board of Public Utilities
44 South Clinton Avenue, 1st Floor
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Board.secretary@bpu.nj.gov

Re: In the Matter of an Audit of the Affiliated Transactions Between Jersey Central Power & Light Company, FirstEnergy Corp. and its Affiliates Pursuant to N.J.S.A. 48:3-49, 48:3-55, 48:3-56, 48:3-58 & N.J.A.C 14:4-3.7(e) and (f) BPU Docket No. EA20110733

Dear Secretary Golden:

Please accept for filing in the above-referenced matter the New Jersey Division of Rate Counsel's ("Rate Counsel") comments regarding the above-referenced audit of Jersey Central Power & Light Company ("JCP&L" or "the Company") that was submitted to the New Jersey Board of Public Utilities ("the Board") on February 7, 2023, and that was accepted for filing purposes only Board at the Board April 12, 2023 agenda meeting.

Consistent with the Order issues by the Board in connection with I/M/O the New Jersey Board of Public Utilities' Response to the COVID-19 Pandemic for a Temporary Waiver of Requirements for Certain Non-Essential Obligations, BPU Docket No. EO20030254, dated

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March 19, 2020, these comments are electronically filed with the Board Secretary and with JCP&L. No paper copies will follow.

I. Background

Regular management audits of the State's regulated utilities are required pursuant to N.J.S.A. 48:2-16.4 to assist the Board in determining if the management practices, functions, operating procedures, and other internal workings of regulated utilities under its jurisdiction are efficient and cost-effective. Moreover, the Electric Discount and Energy Competition Act of 1999 ("EDECA") requires regular audits of utility transactions with affiliates and the competitive business segments of electric and gas utilities under the Board's jurisdiction for compliance with the Board's affiliate standards. See N.J.A.C. 14:4-3.1 et seq. To those ends, the Board retained an independent consulting firm, The Liberty Consulting Group from Lebanon, Pennsylvania ("Liberty"), to conduct a management audit and an affiliate transactions audit, concurrently, on JCP&L, its competitive business segments, and related corporate affiliates with which JCP&L transacts.

Liberty conducted its audit in two phases. The auditor did not specifically state the period of time covered in its audit, but it appears, at least for the affiliate transaction-related inquiries, that Liberty reviewed transactions from 2012 through 2021. Liberty prepared and submitted to the Board its final reports (collectively referred to hereinafter as the "Audit Report") on February 7, 2023, which were accepted by the Board for filing purposes only at the Board's April 12, 2023 meeting. At that time, a redacted version of the Audit Report was released to the public. Rate Counsel did not receive the unredacted version of the Audit Report Phase One and Phase Two until May 1, 2023. Initially, the Board set a due date of June 30, 2023, for the

submission of comments on the Audit Report Phase One and Phase Two. In accordance with the letter issued by the Board's Secretary on May 31, 2023, however, the due date for comments was extended to July 31, 2023.

Liberty's Audit Reports were bifurcated into two separate but not totally unrelated examinations or "Phases." Phase One was an expedited audit of a focused set of topics designated by the Board that constitutes the "Utility Operations" component of the audit.

Liberty's Phase One Audit Report addressed the following topics:

- Operations Organization
- System Planning and Load Management
- Asset Management
- Vegetation Management
- Contractors
- Reliability Programs and Smart Grid Activities
- Cyber Security and System Vulnerability
- System Resiliency and Restoration
- Customer Service
- Financial Risks and Consequences of Parent and Affiliate Operations
- External Affairs – The "DOJ Investigation"¹
- External Affairs Organization

Liberty submitted a 283-page report, excluding the 23-page Executive Summary, on Phase One topics. In its Phase One Audit Report, Liberty identified 91 conclusions and rendered 26 recommendations. Liberty stated that it had completed its Phase One audit field work by September 1, 2021.

¹ Refers to the criminal investigation and charges by the U.S. Department of Justice ("DOJ") whereby FirstEnergy Corp. conspired with public officials, among other individuals and entities, to pay millions of dollars to public officials in exchange for specific official action for the company's benefit.

Phase Two comprised all remaining functions of a comprehensive management audit and an audit of affiliated transactions that were not addressed in Phase One. The following topics were addressed in Phase Two:

- Organization and Executive Management
- Governance
- Finance and Cash Management
- Planning and Budgeting
- Staffing
- Compensation and Benefits
- Accounting and Property Records
- Controls, SOX, Auditing and Listing Requirements
- Affiliate Relationships and Cost Allocation
- Cost Deferrals
- EDECA
- Human Resources Organization
- Corporate Services
- Information Technology
- Insurance and Risk Management
- Legal Services
- Physical Security
- Records and Information Management
- Supply Chain
- Surface and Air Fleet Management
- Power Supply and Market Conditions
- MGP Remediation
- Non-Rate-Related Revenues
- Recommendations Made in Previous Examinations

Liberty's Phase Two Audit Report consists of 557 pages, excluding the 36-page Executive Summary, and includes the auditors' 270 conclusions and 73 recommendations. The auditors' field work for Phase Two was completed by March 31, 2022.

Liberty offered no specific recommendations on the following focus topics:

- Phase One: Operations Organization
- Phase One: System Planning and Load Management
- Phase Two: Cost Deferrals

- Phase Two: Corporate Services
- Phase Two: Physical Security
- Phase Two: Records and Information Management
- Phase Two: Non-Rate-Related Revenues
- Phase Two: Recommendations Made in Previous Examinations

For each of the remaining focus topics Liberty rendered one or more recommendations.

II. Comments

Rate Counsel appreciates the apparent depth and thoroughness of Liberty's audit. That said, prior to the submission of these comments, Rate Counsel was not given an opportunity to provide input on the auditors' preliminary findings. Nevertheless, it is clear that the audit was an enormous undertaking for Liberty involving dozens of personnel, countless documents, and numerous interviews both on behalf of the auditors and on behalf of JCP&L. While most of the auditors' recommendations appear to be well supported by their findings and conclusions, the lack of direct involvement in the audit process makes Rate Counsel unable to corroborate each of the auditors' conclusions and recommendations. That said, Rate Counsel will utilize this comment opportunity to highlight for the Board certain prevalent "themes" that permeate throughout the Audit Reports. Those recurring themes are:

1. that FirstEnergy inhibited the flow of information requested by Liberty which precluded Liberty from completing a thorough review of several important focus topics, and
2. JCP&L's subsidiary relationship with its corporate parent, FirstEnergy, has been adverse to JCP&L and to JCP&L's New Jersey customers.

These recurring themes call attention to significant impacts that have resulted from circumstances occurring during the audit period that adversely affected JCP&L's operations in New Jersey and the rates paid by JCP&L's New Jersey customers. The Audit Report identifies

many instances where Liberty was unable to complete its assigned task. Therefore, Rate Counsel urges the Board to consider Liberty's work, particularly that on FirstEnergy's criminal-related activities, the beginning of the inquiry – not the end. Much more information must be obtained from JCP&L and from its parent, FirstEnergy, to determine the extent to which the activities surrounding the DOJ investigation negatively impacted JCP&L and JCP&L's customers.

Rate Counsel does not oppose the ninety-nine (99) recommendations that are contained in the Audit Reports. Rate Counsel respectfully offers the following additional comments and recommendations for the Board's consideration and action. Throughout the comments that follow, Rate Counsel's specific recommendations for Board action are highlighted and italicized.

A. Phase One, Chapter V: Vegetation Management and Chapter VII: Reliability Programs and Smart Grid

The Board approved JCP&L's Reliability Plus Infrastructure Investment Program ("IIP") on May 8, 2019.² The approved IIP included funds for the removal of overhanging limbs in "Zone 2" for several identified circuits. In total, JCP&L's spending for distribution and sub-transmission circuit vegetation management was \$27.8 million in 2019 and \$28.1 million in 2020. Liberty auditors found that JCP&L's Central Region's tree related SAIFI and CAIDI had improved somewhat by year end 2020, but the Northern Region's SAIFI and CAIDI had worsened. Given these somewhat offsetting results, Liberty concluded: "Management has expended significant effort and expense on enhanced vegetation management practices, including the overhang removal work associated with the 2019-2020 program, but reliability

² In the Matter of the Verified Petition of Jersey Central Power and Light Company for Approval of an Infrastructure Investment Program ("JCP&L Reliability Plus Order"), Docket No. EO18070728. (May 8, 2019)

results from those efforts remain unclear.”³ Moreover, in Phase One, Chapter VII, Liberty found that JCP&L’s overall SAIFI and CAIDI reliability performance have not markedly improved since 2017. (Audit, Phase One, pages 114-115.) As a result, Liberty recommended that JCP&L:

- 1) “Demonstrate that enhanced Zone 2 vegetation work conducted as part of the IIP Reliability Plus was as effective in reducing SAIFI and CAIDI as predicted...”⁴ and 2) “Expedite analyzes to validate that sub-transmission improvement projects planned for 2022-2026 adequately improve SAIFI and CAIDI performance.”⁵

In approving JCP&L’s IIP in 2019, the Board made clear that the prudence and ultimate recoverability of costs incurred under the program will be addressed in JCP&L’s next base rate case. “These costs will be subject to review in the next base rate case, which the Company has committed to filing no later than five years after the Board’s approval of the Program’s start date.”⁶ Liberty found the impact on CAIDI and SAIFI performance resulting from the IIP initiative involving 277 distribution feeders “surprisingly unclear.”⁷ Thus, the data reviewed in Liberty’s audit do not establish prudence in JCP&L’s IIP expenditures associated with the removal of overhanging limbs in Zone 2 for the 277 distribution feeders.

B. Phase One, Chapter XI: Financial Risks and Consequences of Parent and Affiliate Operations

Liberty’s findings in Chapter XI are very disturbing. The Board’s approval of FirstEnergy’s acquisition of GPU and in particular JCP&L, was premised on the promise of

³ Audit Reports, Phase One, p. 76.

⁴ *Id.*, p. 77.

⁵ *Id.*, p.117.

⁶ JCP&L Reliability Plus Order, p. 12.

⁷ Audit Reports, Phase One, p.77.

tangible benefits to JCP&L and to New Jersey ratepayers, including lower capital costs.⁸ Liberty's recent audit found just the opposite to be true. In late 2020, FirstEnergy and JCP&L endured two credit downgrades by Standard & Poor ("S&P"). JCP&L's credit rating fell to BB, but Liberty found that JCP&L's own financial metrics and the S&P business and financial risk evaluations for JCP&L indicate a rating higher by three notches, at BBB.⁹ Liberty also found that the higher risk perceived by S&P resulting in the downgrades arose at the FirstEnergy level; JCP&L did not cause them.¹⁰ Rather, JCP&L's credit downgrades resulted from its corporate linkage to FirstEnergy's credit risks, not from JCP&L's utility business and financial risks as an operating company.¹¹

Shortly after the S&P credit downgrades, between November 11 and November 17, 2020, FirstEnergy's violation of the anti-corruption covenant constituted a default event of the FirstEnergy Revolving Credit Facility, which effectively choked off much of JCP&L's liquidity. This event precluded JCP&L's access to the Revolving Credit Facility and, additionally, threatened JCP&L's ability to borrow under the Money Pool.¹²

In late 2021, the combined FirstEnergy Revolving Credit Facility, of which JCP&L had been a part, was separated into six separate five-year facilities. Thereafter, JCP&L established its own separate \$500 million NJ Utility Credit Facility with Mizuho Bank as the administrative agent. After this development, S&P upgraded JCP&L credit rating one notch to BB+.¹³ But the damage to New Jersey ratepayers resulting from the credit downgrades and liquidity squeeze had

⁸ I/M/O the Verified Petition of First Energy and Jersey Central Power and Light Company., et al., BPU Docket Number EM00110870 (October 9, 2001) ("Merger Order")

⁹ Audit Reports, Phase One, p. 218.

¹⁰ Audit Reports, Phase One, p. 205.

¹¹ Ibid.

¹² Audit Reports, Phase One, pp. 206-207.

¹³ Ibid.

already been done. JCP&L's capital costs increased and continue to remain higher than they should because of FirstEnergy's perceived credit risks by the ratings agency. These higher credit costs unnecessarily result in higher rates paid by JCP&L customers.

Liberty found that JCP&L's credit ratings have been tied too closely to those of FirstEnergy, which has proved a "detriment" to JCP&L.¹⁴ That same detriment carries over to JCP&L's customers in the form of higher rates. Liberty further found the obvious, that JCP&L (and the other FirstEnergy operating companies) did not have sufficient insulation from FirstEnergy; not even enough to reach S&P's lowest level of insulation.¹⁵ Consequently, Liberty recommended that JCP&L create a lasting and enforceable ring-fencing provision sufficient to meet S&P's fourth, or maximum level of insulation. This, Liberty claims, will result in a JCP&L credit rating being established on its own financial characteristics and metrics, with no negative influence from FirstEnergy. Liberty also recommended that FirstEnergy's corporate structure be modified to give JCP&L full governance and operational control over its financing facilities.¹⁶ .

Liberty's recommendations in this regard are as necessary as they are obvious. However Rate Counsel believes these recommendations are too vague. Liberty contends that JCP&L's existing ring-fencing provisions do not represent best practices and do not adequately protect JCP&L's financial status and New Jersey customers. Liberty also provided references to other utilities that have effective ring-fencing provisions, specifically Oncor Energy in Texas and Baltimore Gas and Electric in Maryland.¹⁷ Given this knowledge of ring-fencing provisions that have proved effective for other utilities, Rate Counsel believes Liberty should have

¹⁴ Audit Reports, Phase One, p. 218.

¹⁵ Audit Reports, Phase One, p. 224

¹⁶ Audit Reports, Phase One, pp.228-229; and Phase Two, Final Report, Conclusion #6, pp. 35-36.

¹⁷ Audit Reports, Phase One, Executive Summary ("ES"), p. ES 18.

recommended specific insulation measures for JCP&L to take, with the approval of the Board, to free itself and New Jersey ratepayers from the detrimental effects of FirstEnergy's weakened credit worthiness. *Therefore, the Board should return this chapter of the audit report back to Liberty and request that Liberty recommend specific measures that JCP&L should undertake, subject to Board approval, to provide effective ring-fencing for itself and New Jersey ratepayers.*

C. Phase One, Chapter XII: External Affairs – The “DOJ Investigation”

By now, the conduct and activities on the part of FirstEnergy that led to the DOJ investigation have been well-documented in numerous court pleadings and in public news accounts. Therefore, there is no need for Rate Counsel to recite that history here. However, the aftermath and fallout from the DOJ investigation must be addressed by the Board. It is Rate Counsel's understanding that, to date, FirstEnergy has agreed to pay \$230 million to settle the DOJ's claims (not subject to rate recovery from JCP&L customers and those of the other operating companies),¹⁸ and an additional \$3.9 million in penalties agreed to in a related FERC audit investigation. Liberty auditors stated that FirstEnergy will not seek recovery of costs associated with federal-level examinations.¹⁹ But it is Rate Counsel's understanding that employee and outside costs associated with audits by state regulators were charged to the operating companies, including JCP&L.²⁰ Liberty asserts, and Rate Counsel concurs, that that it is inappropriate to charge New Jersey customers for any costs incurred in connection with activities involving criminal charges against FirstEnergy. Yet, FirstEnergy refused to provide informative responses to the auditors' requests that sought a schedule of costs charged to JCP&L

¹⁸ Audit Reports, Phase One, p. 231.

¹⁹ Audit Reports, Phase One, p.254.

²⁰ Audit Reports, Phase One, p. 241.

for investigations.²¹ As a result, Liberty recommended that the developments in federal criminal and administrative, or other state proceedings, be “followed”²², and that a means be established to preclude the inclusion in JCP&L rates of FirstEnergy, JCP&L, and outside costs, associated with state reviews of “the implications of conduct related or similar to that encompassed by the DOJ investigation.”²³

While Rate Counsel supports these two recommendations, Rate Counsel does not believe they go far enough. FirstEnergy’s stonewalling and withholding of pertinent information during a BPU audit investigation, and withholding pertinent information from JCP&L as well, cannot – and should not – be tolerated. Liberty’s inquiries into the account for costs incurred associated with the DOJ investigation and subsequent FERC and state investigations are legitimate and germane to this audit. *The Board should compel additional data and information from FirstEnergy and from JCP&L to fully respond to inquiries that Liberty deemed unresponsive to the auditors’ requests.* Only after obtaining the information sought by Liberty will the Board begin to know precisely how much of FirstEnergy’s criminal actions, and the cover-up that occurred thereafter, have cost New Jersey customers.

D. Phase Two, Chapter IV: Finance and Cash Management

Liberty’s findings in this focus area are very similar to its findings in Phase One, Chapter XI: Financial Risks and Consequences of Parent and Affiliate Operations. Liberty’s findings included that FirstEnergy unreasonably siphoned off \$760 million of JCP&L’s equity capital from 2011 through 2013²⁴ and that JCP&L’s credit ties to FirstEnergy resulted in higher interest

²¹ Ibid.

²² Audit Reports, Phase One, ES p. 21.

²³ Ibid.

²⁴ Audit Reports, Phase Two, p. 82.

expense on JCP&L's 2013, 2015, 2019, and 2021 long-term debt issuances.²⁵ In fact, Liberty roughly estimated that JCP&L's credit ties with FirstEnergy increased the interest rate on the 2021 debt issuance by 15 to 25 basis points.²⁶ Since the 2021 debt issuance will remain outstanding for several years to come, JCP&L's ratepayers will pay unreasonably higher rates for several years to come. The same is true for all debt issuances from 2013 through 2021. Liberty concluded that JCP&L experienced a more expensive pricing spread and higher interest rates than utilities making similar issuances that were not burdened by the negative credit linkage of FirstEnergy. Further, Liberty found that FirstEnergy's extensive long-term debt and guarantees cause financial risks for JCP&L that are reflected in reduced credit ratings.²⁷ As a result, Liberty auditors echoed their previous recommendation – that ring-fencing be provided for JCP&L that will result in a JCP&L-only credit rating on a stand-alone basis, to eliminate the debt interest cost premiums like that experienced over the past decade.²⁸ Rate Counsel fully supports Liberty's recommendation that adequate ring-fencing be provided to insulate JCP&L from FirstEnergy's adverse credit risks. But even that is still not enough. Liberty persuasively concluded that interest spreads and interest rates from JCP&L's debt issuances occurring between 2013 and 2021 were unnecessarily high due to the Company's credit linkage to FirstEnergy. As a result, JCP&L's higher interest rates have and will continue to have an adverse impact on rates paid by JCP&L's customers until the affected long-term debt issuances are retired. It is unfair for JCP&L's customers to pay for FirstEnergy's adverse credit profile, especially when FirstEnergy promised the Board that its acquisition of GPU and JCP&L will result in lower, not higher, capital costs. ***Therefore, the Board should return to Liberty this***

²⁵ Audit Reports, Phase Two, p. 91.

²⁶ Audit Reports, Phase Two, p. 92.

²⁷ Audit Reports, Phase Two, pages 92 and 95.

²⁸ Audit Reports, Phase Two, p. 96.

chapter of the Audit Reports and direct Liberty to prepare analyses like that prepared for JCP&L's 2021 debt issuance to quantify the impact that the higher interest rates had and continue to have on customer rates through the remaining lives of those issuances so that JCP&L's rate can be adjusted downward accordingly.

E. Phase Two, Chapter XVI: Insurance and Risk Management

Like its findings on JCP&L's financing costs, Liberty found that the costs allocated by FirstEnergy to JCP&L for Directors and Officers ("D&O") liability insurance "include a substantial sum related to FirstEnergy risks not related to those that ownership and operation of JCP&L have produced."²⁹ Therefore, Liberty recommended that FirstEnergy and JCP&L restructure the basis for allocating D&O insurance costs to avoid charging JCP&L for costs related to FirstEnergy's liability exposures.³⁰ Yet, without providing the specific details of their calculations, Liberty auditors claimed that the restructuring of D&O insurance allocations would have resulted in a \$300,000 to \$400,000 savings to JCP&L in 2021.³¹ The fact that Liberty was able to estimate the annual savings resulting from the restructuring of the allocation of D&O insurance costs suggests that Liberty has a preferred method to restructure those costs. Thus, rather than to simply recommend that FirstEnergy and JCP&L develop their own restructuring proposal Liberty should have identified and explained its proposed method. To the extent the Board, or other parties, wish to modify Liberty's proposal, this can be accomplished later within the context of this audit. Given Liberty's extensive experience with auditing these matters, a more direct approach of recommending a restructured allocation of D&O costs by Liberty is

²⁹ Audit Reports, Phase Two, p. 456.

³⁰ Audit Report, Phase Two, p. 458.

³¹ Ibid.

likely to result in a better outcome than relying on FirstEnergy to choose a method that more closely preserves the present allocation method.

III. Rate Counsel Recommendations

To summarize, based on the forgoing discussion, Rate Counsel requests that the Board direct Liberty to do the following:

- Identify concrete ring-fencing provisions that will insulate JCP&L from risks imposed by FirstEnergy.
- Continue the analyses begun by Liberty to determine the extent to which the activities surrounding the DOJ investigation have and continue to have a negative impact on JCP&L's New Jersey customers.
- Expand the analyses begun by Liberty to quantify the increases in JCP&L's annual interest expense stemming from higher interest rates caused by JCP&L's credit linkage with FirstEnergy for the long-debt debt issued during the period 2013 through 2021.
- Specify an appropriate allocation methodology for D&O liability insurance that insulates JCP&L from liability exposure risks imposed by FirstEnergy.

Moreover, Rate Counsel is particularly concerned with Liberty's inability to complete its analyses to determine whether, and to what extent, JCP&L and its customers have borne any costs associated with the criminal activities that resulted in the DOJ's investigation and the aftermath. While FirstEnergy assured the auditors that none of the payments made to resolve the DOJ investigation at the federal level were assigned or allocated to JCP&L, no such assurances were provided for any of the other state and FERC investigations and audits that followed. Liberty states that its attempts to make those determinations were thwarted by FirstEnergy through inadequate, vague discovery responses and, in some instances, FirstEnergy's outright refusal to provide responses entirely. This is not the cooperation and transparency that FirstEnergy promised the Board when it sought approval of the acquisition of GPU and JCP&L.

The Board should not stand for FirstEnergy's stonewalling tactics that thumb their nose at the Board's audit powers over regulated utilities within its jurisdiction. Those audit powers may include "after notice and opportunity for a hearing, order[ing] the affected public utility to adopt such new or altered practices and procedures as the board shall find to be necessary to promote efficient and adequate service to meet the public convenience and necessity."³²

The issues surrounding the fallout from FirstEnergy's criminal activities are significant, not only in monetary terms, but also in terms of public perception of the Board's ability to protect New Jersey customers against abuses from monopoly service providers and their corporate parents and affiliates. Therefore, given the importance of the issue to all stakeholders, and the inability of Liberty to resolve those issues within the context of their audit, it is imperative that the Board open an investigatory docket to determine matters left unanswered in Liberty's audit relative to the DOJ investigation and the aftermath that followed. The results of the proposed investigation, to the extent they have a material impact on JCP&L's rates, can be incorporated into JCP&L's pending base rate proceeding. If the base rate proceeding is decided prior to the conclusion of the separate investigation, Rate Counsel strongly believes such rates

³² N.J.S.A 48:2-16.4. See In re Pub. Serv. Elec. & Gas Company's Rate Unbundling, 167 N.J. 377, 384-85 (2001) ("The Legislature has endowed the BPU with broad power to regulate public utilities . . . [and] considerable discretion in exercising those powers.")(quoting In re Elizabethtown Water Co., 107 N.J. 440, 449-50, (1987)).

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should be deemed provisional so that the determinations in the separate investigation can be incorporated into final rates once those determinations have been made.

Respectfully submitted,

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