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Honorable Kathleen H. Burgess
Secretary
New York Public Service Commission
Three Empire State Plaza
Albany, New York 12223

***Re: Notification Pursuant to Section 89.3 of the Commission's Regulations
of a Tax Refund from the Town of Hempstead***

Dear Secretary Burgess:

The purposes of this letter are to notify the Commission, pursuant to Section 89.3 of its regulations, of the receipt by Verizon New York Inc. ("Verizon") of a property tax refund and to propose a disposition of that portion of the refund that is allocable to Verizon's regulated, intrastate New York operations.¹

As a result of the successful litigation of property tax claims against the Town of Hempstead (the "Town"), Verizon received a final refund from the Town in the amount of \$8,397,716.85 for the 1992-2002 tax years.² For the reasons discussed below, the portion of the

¹ The Commission's regulations, 16 N.Y.C.R.R. § 89.3(c)(4), recognize that the Commission's power to decide the disposition of refunds encompasses only amounts allocable to New York, regulated intrastate operations.

² The Town issued its final refund check on December 22, 2014 and Verizon received it on or about December 23, 2014. The initial refund for the 1992-2002 tax years was addressed by the Commission in Case 12-C-0318.

refund that is allocable to regulated, intrastate New York operations, \$5,120,868.95,³ should be retained by Verizon.

Summary of Tax Litigation against the Town of Hempstead

The refund check is the result of litigation commenced by Verizon against the Town and represents the partial refund of special ad valorem levies paid during the years 1992-2002. The litigation began in 1998 and continued through 2014, when the refund check was issued.

These cases challenged the imposition by the Town and by various garbage districts within the Town of “special ad valorem levies” on Verizon’s “mass property,” that is, public utility and special franchise property. Under the Real Property Tax Law, special ad valorem levies can be imposed only upon real property that benefits from the activity that is the subject of the special ad valorem levies, in this case, garbage collection services. Verizon contended that, given the nature of its mass property in the Town, it did not benefit from the special ad valorem levies that were collected on behalf of the garbage districts within the Town. Verizon sought a refund of all levies paid for garbage services on its mass property during the years at issue, as well as an injunction against the future imposition of such levies.

Verizon Should Be Allowed to Retain the Refund

Verizon’s retention of the Town’s refund is both consistent with Commission precedent and permitted by Section 113(2) of the Public Service Law, the statutory basis for Section 89.3 of the Commission’s regulations.

³ This figure represents the use of separation factors reflected in Verizon’s 2013 Annual Report, which was filed with the Commission on May 30, 2014.

In the *New York City Refund Orders*,⁴ the Commission found that Verizon should be allowed to retain the entire tax refund addressed in those orders. Allowing Verizon to retain the intrastate portion of the Town's refund for the 1992-2002 tax years is also consistent with other Commission orders addressing tax refunds received by Verizon in recent years.⁵ In those orders,

⁴ Case 14-C-0248, Order Approving Retention of Property Tax Refunds (issued and effective January 9, 2015); Case 12-C-0268, *Petition filed by Verizon New York Inc. for Approval Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the City of New York*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective September 14, 2012); Case 11-C-0209, *Petition filed by Verizon New York Inc. for Approval Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the City of New York*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective September 16, 2011); Case 10-C-0274, *Petition filed by Verizon New York Inc. for Approval Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the City of New York*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective December 16, 2010); Case 09-C-0478, *Petition of Verizon New York Inc. for Approval of a Proposed Allocation of a Tax Refund from the City of New York*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective September 18, 2009); Case 08-C-0193, *Petition filed by Verizon New York Inc. for Approval, Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the City of New York*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective June 18, 2008); and Case 07-C-0487, *Petition filed by Verizon New York Inc. for Approval, Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the City of New York*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective August 23, 2007) (collectively, the "*New York City Refund Orders*").

⁵ Case 12-C-0318, *Petition of Verizon New York Inc. for Approval, Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the Town of Hempstead*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective October 22, 2012); Case 11-C-0479, *Petition of Verizon New York Inc. for Approval, Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the Town of North Hempstead*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective December 16, 2011); Case 08-C-0999, *Petition of Verizon New York Inc. for Approval, Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the Town of Oyster Bay*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective December 10, 2008); Case 08-C-0749, *Petition of Verizon New York Inc. for Approval, Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the City of White Plains*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective October 16, 2008); and Case 06-C-0480, *Petition filed by Verizon New York Inc. for Approval, Pursuant to Public Service Law Section 113(2), of a Proposed Allocation and Disposition of Certain Tax Refunds from the Town of Oyster Bay*, Memorandum from the Office of Accounting and Finance, approved as recommended and so ordered by the Commission (issued and effective September 21, 2006) (the "*Oyster Bay Refund Order*").

the Commission found that the retention by Verizon of the tax refunds at issue was consistent with the Commission's policy regarding tax refunds that was set forth in its April 11, 2006 Statement of Policy in the "Competition III" proceeding.⁶ In that Statement of Policy, the Commission found that companies, like Verizon, that faced "significant competitive pressures" and that were not subject to "cost-of-service based regulation," should be allowed to retain tax refunds.⁷

Verizon's retention of the refund from the Town for the 1992-2002 tax years is consistent both with the principles announced in the Statement of Policy and with the findings in the Verizon tax refund orders issued since the adoption of the Statement of Policy by the Commission. Verizon is no longer subject to cost-of-service regulation. Since its regulatory financial reports must conform to the financial reports that are filed with the Securities and Exchange Commission ("SEC"), Verizon is precluded from creating either regulatory assets or liabilities. Thus, as noted in the 2006 *Oyster Bay Refund Order*, Verizon is precluded from looking to the Commission for the deferral of tax deficiencies for later recovery in future rates.⁸ Moreover, it continues to face significant competitive pressures – Verizon's 2013 Annual Report shows that it continued to suffer significant access line losses.⁹

⁶ Case 05-C-0616, *Proceeding to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services*, Statement of Policy on Further Steps Toward Competition in the Intermodal Competition Market and Order Allowing Rate Filings (issued and effective April 11, 2006) ("Statement of Policy").

⁷ Statement of Policy at 125-26.

⁸ *Oyster Bay Refund Order* at 3.

⁹ As of December 31, 2013, Verizon had approximately 8.9 million fewer telephone lines than it did on January 1, 2000, a decline of 74%.

In addition to being consistent with recent Commission precedent, allowing Verizon to retain the refund that it received from the Town is authorized by Section 113(2) of the Public Service Law, the statutory basis for Section 89.3 of the Commission's regulations. This statute gives the Commission the power to order regulated companies that receive refunds to "pass such refunds on to [their] consumers, in the manner and to the extent determined just and reasonable" by the Commission.

Section 113(2) was enacted to address the handling of tax and other refunds under traditional rate-of-return regulation. In a 1976 decision, *Niagara Mohawk Power Corp. v. PSC*, 54 A.D.2d 255 (3d Dep't 1976), the Appellate Division had determined that the Commission could not order a regulated company to flow through such refunds outside of a fully litigated rate case. As the Commission's legislative memorandum in support of the bill that enacted Section 113(2) makes clear, the bill was intended to "overturn" the Appellate Division's decision that the Commission did not have the power to order a flow through of tax refunds.¹⁰ In that memorandum, the Commission noted that, in order to encourage a regulated company to "claim all tax benefits to which it may be entitled so as to keep rates to consumers at the lowest reasonable level," it had adopted a policy of allowing regulated companies to defer tax deficiencies, for later reflection in customer rates. Since the Commission's tax deficiency policy allowed regulated companies to obtain rate recovery of upward changes from the level of taxes that had previously been reflected in rates, a reversal of the Appellate Division decision by the

¹⁰ 1977 McKinney's Session Laws of New York, Volume 2, pp. 2362-363.

proposed legislation would ensure “evenhanded” treatment of tax refunds and tax deficiency assessments.¹¹

As a result of the Verizon Incentive Plan adopted in Case 00-C-1945, Verizon moved to Generally Accepted Accounting Principles (“GAAP”) in order to bring its regulatory accounting into conformance with accounting used for SEC purposes. Given this fact and that cost-of-service regulation is no longer relevant to Verizon because it operates in a highly competitive industry, Verizon cannot look to the Commission for the recovery of possible tax deficiencies, through higher rates on customers.¹² Thus, the “evenhanded” treatment of tax refunds and deficiencies that the Commission sought through the enactment of the Section 113(2) of the Public Service Law is ensured by allowing Verizon to retain the refund that it received from the Town. Since Verizon cannot look to the Commission to recover future tax deficiencies through increased rates, it should not be required to pass through the benefits of tax refunds to its customers.

¹¹ *Id.* In the traditional rate-of-return regulation that prevailed in the years after the enactment of Section 113(2), the Commission adopted a policy that allowed regulated companies to retain some portion of refunds, generally 10% to 25%, with the remainder, after the deduction of the costs of litigating the refund, passed on to ratepayers. *See, e.g.,* Cases 92-E-0875 and 92-M-0605, Opinion and Order Determining Revenue Requirement and Rate Design and Approving Allocation of Certain Tax Refunds, Opinion No. 93-7 (issued and effective March 29, 1993), 1993 N.Y. PUC LEXIS 9, at *49-55.

¹² In addition, allowing Verizon to retain the refund would provide Verizon with some relief from the poor financial results that it has experienced in New York. As reported in its Annual Report to the Commission for Calendar Year 2013, Verizon’s rate of return was negative 6.43%. Given this, there would be no basis, even under traditional rate-of-return regulation, to find that passing on any portion of the Town’s refund to customers would meet the just and reasonable standard of Section 113(2).

Conclusion

For all of the foregoing reasons, the Commission should allow Verizon to retain the regulated, intrastate portion of the Town's tax refund for the 1992-2002 tax years.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Richard C. Fipphen". The signature is written in a cursive style with a prominent initial "R".

Richard C. Fipphen