STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

I/M/O the Verified Petition of JCP&L for Review and Approval of Increases in and Other Adjustments to its Rates and Charges for Electric Service, and For Approval of Other Proposed Tariff Revisions in Connection Therewith; and for Approval of an Accelerated Reliability Enhancement Program ("2012 Base Rate Filing")	)	**OAL Docket No. PUC 16310-12N** **BPU Docket No. ER12111052**

REPLY EXCEPTIONS TO THE INITIAL DECISION ON BEHALF OF THE DIVISION OF RATE COUNSEL

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PUBLIC VERSION

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ARGUMENT

POINT I

THE 2012 MAJOR STORM COSTS ARE TOO FAR OUTSIDE THE 2011 TEST YEAR TO BE INCLUDED IN THE PENDING BASE RATE CASE.

As a preliminary matter, there is one outstanding issue that was not addressed by the ALJ in the Initial Decision, but was raised by Jersey Central Power & Light Company ("JCP&L" or "Company") in its exceptions. That issue relates to the recovery of JCP&L's 2012 major storm costs. The Parties have already agreed to the level of prudent 2012 storm costs that may be recovered by JCP&L.[1] The only issue before the Board of Public Utilities ("Board" or "BPU") is the timing of the recovery.

JCP&L argues that the Board must include JCP&L's 2012 storm costs into the base rates set in this proceeding. *JCP&L Exceptions*, p.5. JCP&L argues that "a failure to incorporate these already-spent and already-approved costs into the Company's rates at this time would have significant financial consequence for JCP&L." *Id.*, p. 6.

There is nothing in the record in this proceeding to support this contention. To the contrary, allowing deferral for future recovery of certain costs through the creation of a regulatory asset is a long-standing generally accepted Board practice. Certainly the Company has never in the past argued that this practice would result in "significant financial consequences." Indeed, the Board has consistently allowed JCP&L to defer major storm restoration costs as a regulatory asset for consideration in a future base rate case with no "significant financial consequences."

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[1] I/M/O the Board's Review of the Prudency of Costs Incurred by JCP&L in Response to Major Storm Events in 2011 and 2012, BPU Dkt. No. AX13030196 and EO13050391, Decision and Order Approving Stipulation, (March 19, 2014).

Allowing deferral for future recovery of certain costs through the creation of a regulatory asset is a long-standing generally accepted Board practice. For example, PSE&G was allowed to defer their 2011/2012 major storm related costs "for accounting purposes only and without interest" with the prudency and recoverability of these costs to be determined in PSE&G's next base rate case.[2]

Furthermore, New Jersey Division of Rate Counsel ("Rate Counsel") objects to the inclusion of these costs, incurred, as the Company acknowledged, "in late 2012 and the first part of 2013," well beyond the 2011 test year. ***Id.*** A review of BPU jurisprudence reveals a long standing and consistently applied Board policy regarding post-test year adjustments. These 2012 storm costs do not fit within the time frame established for exceptions to the test year requirement in Elizabethtown Water[3]. They should therefore not be considered in this case.

If the Board did allow recovery in this base rate proceeding of these costs that were incurred 15 months beyond the test year, the criteria established in Elizabethtown Water will be undermined to the detriment of ratepayers going forward. Erosion of this rule would likely result in all New Jersey utilities seeking the same treatment, and, if allowed, the Board will have effectively moved to a two year test year for certain costs. Accordingly, Rate Counsel urges the Board to abide by its decision in Elizabethtown Water and direct that the recovery of the 2012 Major Storm Costs will be decided in a

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[2] I/M/O the Petition of Public Service Electric and Gas Company and Atlantic City Electric Company's Request for Deferral Accounting Authority for Storm Damage Restoration Costs, BPU Docket Nos. EO11090518 and GO11090519, and I/M/O the Petition of Public Service Electric and Gas Company's Request for Deferral Accounting Authority for Storm Damage Restoration Costs, BPU Docket Nos. EO11090518 and GO11090519, Order, (December 19, 2012).

[3] I/M/O Elizabethtown Water Company, BPU Docket No. WR8504330, Order, (May 23, 1985). The Elizabethtown Water standard allows "known and measureable" changes to income and expense items for a period of nine months beyond the end of the test year and changes to rate base for a period of six months beyond the test year.

future JCP&L base rate case. As the Board has allowed deferral of these costs, the Company will be permitted to recover prudent 2012 Major Storm Costs in its next base rate case.

Moreover, the recovery of the 2012 Major Storm Costs in a base rate case, rather than a Phase II, will address concerns of "single issue ratemaking." Single issue ratemaking is a ratemaking principle that discourages review of a single issue outside the context of a rate case, in which all of the Company's costs and revenues are reviewed as a whole. The review of JCP&L's pending base rate case has been consistently based on the 2011 test year and the Board's post test year policy as established in Elizabethtown Water. Adding the 2012 Major Storm Costs into distribution rates determined by the careful balancing as of 2011 of all the factors that go into setting base rates is contrary to established ratemaking principles and could result in excessive rates being charged to JCP&L's customers.

POINT II

RATE COUNSEL'S RECOMMENDED RATE BASE OF $1,324,452,526 SHOULD BE ADOPTED.

Rate Counsel's recommended total net rate base is $1,324,452,526. *RCRB, p. 23, RJH-3RB*.[4] The unamortized 2011 storm costs (net of tax) is a rate base addition of $24,225,567 (*Schedule D, line 8)* for a total net rate base of $1,348,678,093. Judge McGill did not fully adopt Rate Counsel's recommended adjustments to JCP&L's proposed rate base. The ALJ did not accept Rate Counsel's proposed Consolidated Tax Adjustment ("CTA") despite the fact that this adjustment, adopted by Board Staff in their initial brief, was the only adjustment properly in evidence before the ALJ. Nor did Judge McGill adopt all of Rate Counsel's adjustments to the Company's proposed cash working capital ("CWC") allowance. Those issues were discussed in Rate Counsel's Exceptions to the Initial Decision and will not be repeated in these Reply Exceptions. In this section the focus will be on responding to the Company's Exceptions to the Initial Decision and commenting on Staff's recently provided CTA calculation.

A. Materials and Supplies ("M&S")

JCP&L in the Exceptions to the Initial Decision, urges the Board to reject the ALJ's recommendation that the M&S inventory balance should be based on a 13-month average. *JCP&L Exceptions,* p. 17. JCP&L argues that the use of a 13-month average is

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[4] In this brief Rate Counsel refers to the Initial Decision as *ID*, Rate Counsel's Initial Brief and Reply Brief as *RCIB*; *RCRB*, Petitioner's Initial Brief and Reply Brief as *PIB*; *PRB*, Board Staff's Initial Brief as *SIB*, Gerdau Initial and Reply Briefs at *GIB, GRB*.

"contrary to long-standing Board precedent, ignores the principle of matching rate base amounts, and is otherwise arbitrary and unsupported." *Id.*

The Company's argument that this adjustment does not comply with long-standing BPU precedent is wrong. As pointed out at the evidentiary hearings and in briefs, it has long been Board policy to use a thirteen month average M&S balance due to the volatility of M&S balances. In 1984 the Board reasoned:

> The issue of whether to use a test year-end balance or a thirteen month average in establishing a value for materials and supplies has arisen repeatedly in the context of rate cases for utilities in the State. The Board is in agreement with the use of a thirteen month average as recommended by the ALJ. As stated in our previous Order, the use of an average balance "more accurately reflects the level needed to provide service in the future by normalizing seasonal fluctuations." The Board is convinced that its position on this issue should be consistently applied to all utilities on a uniform basis and, therefore, indicates that it shall be Board policy for the future that the thirteen month average balance be employed in valuing materials and supplies unless particular circumstances can be shown to warrant a specific departure from this policy.[5]

JCP&L offers no reason to change this long standing precedent, it only denies its existence. But, as noted by Rate Counsel witness, Robert Henkes at the evidentiary hearing, JCP&L's actual test year M&S balances certainly exhibit the "seasonal fluctuations" relied on by the Board in establishing the use of the 13 month average M&S balance. As noted by Mr. Henkes:

> Contrary to the rather stable nature of the company's other rate base components, the company's M&S balance is quite volatile during the year. This is shown on the table of page 19 of my direct testimony which shows that the company's test year M&S balance ranged from 11.9 million to 17.1 million during the year.
> This table also shows that if the test year had ended in July instead of June 2012, the M&S balance would have been 11.9 million instead of the June 2012 balance of 16.7 million. It has, therefore been well-established and

[5] I/M/O the Atlantic City Electric Company Increasing Its Rates for Electric Service, BPU Docket No. 8310-883, Decision and Order, (August 17, 1984), p.3 (internal citation omitted).

> longstanding Board policy to reflect a 13-month M&S balance for ratemaking purposes. *T62:L4-17* (October 7, 2013).

For this reason, Mr. Henkes appropriately reflected a 13-month average M&S balance. The ALJ found that Rate Counsel's proposed use of the 13 month average to determine M&S "is more representative as the balance for materials and supplies." *ID,* p. 8. Judge McGill found that Rate Counsel's proposed M&S balance of $14,821,243 "is reasonable and should be approved." *Id.* Board Staff supported this adjustment. As the ALJ's finding is supported by the record and Board precedent, it should be adopted.

B. Cash Working Capital ("CWC")

1. Lead Days for Federal Income Tax Payments

JCP&L took exception to the ALJ's recommendation that the Board adopt Rate Counsel's recommended use of four equal quarterly tax payments in the calculation of JCP&L's CWC allowance. JCP&L argues that the CWC allowance for estimated federal income taxes should be based on actual payments, not Rate Counsel's proposed use of equal payments. The Company argues that the use of quarterly tax payments violates the matching principle and test year concept "if only one element of the lead/lag study is set apart to be calculated on a hypothetical basis." *JCP&L Exceptions*, page 51.

Rate Counsel has not suggested that the income tax payments be included in the lead/lag study "on a hypothetical basis." Rate Counsel has recommended that these payments should be normalized and should not reflect unusual seasonal events. As acknowledged by Company witness Jeffrey L. Adams, JCP&L does not adjust other revenues and expenses to reflect seasonal fluctuations. As Mr. Adams testified:

> Q. Isn't it true that there is a seasonality in the Company's revenues and to a certain extent a seasonality in the Company's expenses?
> A. That's true.
> Q. Do you reflect any seasonality in your calculation of revenue lag days and expense lead days?
> A. No we do not. We use an annual. *T124:L14-22* (October 10, 2013).

Thus, it is not true that "only one element" in the lead/lag study is "calculated on a hypothetical basis." Revenues and expenses are calculated using annual amounts, not adjusted for seasonality. Thus, Rate Counsel's recommended use of four equal quarterly payments is fully consistent with JCP&L's treatment of other items in the lead/lag study.

Indeed, as testified to by Rate Counsel witness David Peterson, in ratemaking, we seek to normalize abnormal events that occurred during the test period. Mr. Peterson noted that the December 15 tax refund which skewed the lead/lag calculation was "a very unusual event, caused by expenses incurred or costs incurred associated with Hurricane Irene and the freak snowstorm in October of that year." *T140:L4-9* (October 10, 2013). Mr. Peterson continued that, as stated in his direct testimony, there were a number of reasons to use a uniform accrual assumption in calculating the federal income tax expense lead:

> but probably the most compelling reason is what you see right here, a very abnormal stream of payments and receipts in this case, and one of the fundamental principles in historic test year rate making is – I think Mr. Adams agreed, is to normalize abnormal events, and that is nothing more than what I am proposing here, is to normalize what was abnormal during the 2011 test year. *T140:L12-20* (October 10, 2013).

Board Staff agreed with Rate Counsel that the proper normalizing adjustment is to assume equal estimated tax payments, which the IRS permits under its income annualization options. *SIB*, p. 43.

ALJ McGill recognized the "gross distortions" in JCP&L's quarterly tax payments and found that Rate Counsel's recommended use of equal payments "is reasonable and should be approved." The effect of this adjustment is to reduce JCP&L's CWC allowance by approximately $10.5 million. As the ALJ's finding is reasonable and fully supported by the record, it should be adopted.

2. Deferred Income Tax

JCP&L also took exception to the ALJ's finding that deferred income taxes are not properly included in the lead/lag study. Citing long standing Board precedent Judge McGill found "that Rate Counsel's adjustment eliminating deferred taxes from the allowance for cash working capital is reasonable and should be approved." *ID,* p. 11.

In language that is not entirely clear, JCP&L argues that "Rate Counsel witness' simplistic analysis ignored entirely the investor-supplied capital that is used to benefit customers as a direct result of the way deferred taxes are reflected in the ratemaking process." *JCP&L Exceptions,* p. 52. The Company then argues that "given the absence of meaningful analysis of this issue in prior BPU decision," the Board should re-visit this policy and adopt the Company's position. *JCP&L Exceptions,* p.54.

Despite the "robust analysis" provided by the Company in this proceeding, the "simplistic" fact remains that the deferred taxes used to fund rate base are contributed by ratepayers, not investors. As testified to by Rate Counsel witness Peterson:

> Just as with the depreciation expense, there is no continuing cash payment required from the Company or from investors for deferred taxes. Because no periodic cash outlay is required, no investment in working capital is required. What makes it even more problematic to include deferred taxes in a lead/lag analysis is that investor supplied capital was never involved in the Company's deferred tax balance. Deferred taxes have been collected from ratepayers, without being paid to the US Treasury by the utility. It is perverse to conclude that deferred tax expenses create a cash

working capital requirement since no investor funds were ever expended for them. *RC-152,* p.15.

Based on that fact, and long standing BPU precedent, the ALJ has properly determined that deferred taxes should not be included in the CWC allowance. His determination should be adopted.

C. Consolidated Tax Adjustment

As discussed at length in Rate Counsel's Exceptions to the Initial Decision, it is Rate Counsel's position that the application of any new CTA policy must not be applied retroactively. The Board's revised policy is intended to be applied to all utilities in future base rate cases, after testimony and evidentiary hearings. JCP&L's revised CTA should be subject to the same level of scrutiny.

At the time JCP&L filed this base rate case, the Board's "Rockland methodology" was the CTA methodology used for all utilities filing base rate cases in that time period. Not only was the test year in this matter concluded well before the BPU determined to modify its CTA calculation, the case was fully tried and the record created before any policy changes were made public. There is absolutely no legitimate reason to apply a different rule for JCP&L than applied to other companies whose rate cases were litigated or settled between 2011 and 2014. JCP&L is not entitled to special treatment caused only by the repeated delays in this proceeding.

Based on the Board's December 12, 2014 Consolidated Tax Order [6] and the January 21, 2015 Order extending the time for the filing of exceptions, Board Staff, on January 30, 2015, circulated "a revised CTA calculation for review and comment."[7]

Board Staff's calculation incorporated the Board's recently proposed modifications to the long standing Rockland methodology to calculate the CTA. That is, Staff used a shortened look back period (2011 – 2007), imposed a "sharing" allocation of 25%, and removed transmission allocation from the calculation. The CTA calculated by Staff was a rate base deduction of $47,127,737. Staff then calculated a revenue requirement reduction of $5,359,252.

Rate Counsel addressed at length our objections to the Board's adoption of Board Staff's "straw" proposal and will not repeat those comments here. Our comments in this brief shall focus on the two major flaws to the Board's methodology made evident by Staff's proposed CTA. First the five year look back period is too short and does not provide a balanced view of the long term benefits associated with the filing of a consolidated return. As is evident from the Company's response to RCR-CIT-14[8], JCP&L's taxable income (loss) fluctuates radically from year to year. With this truncated look back period, one year's income, either positive or negative, can dominate the CTA calculation.

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[6] In the Matter of the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment, BPU Docket No. EO12121072, Order of Clarification Modifying the Board's Current Consolidated Tax Adjustment Policy, (December 12, 2014). This Order has been appealed by Rate Counsel. ("Dec. 14, 2014 CTA Order")

[7] Letter from Jerome May, Director, Energy Division, dated January 30, 2015.

[8] Rate Counsel recognizes that this document was not admitted into evidence in the base rate proceeding but requests that this document be entered into evidence pursuant to the Board's decision to re-open the record to allow the Staff CTA calculation. (A copy of this **confidential** document is attached as Attachment A to these Reply Exceptions for the Board's convenience).

For example, JCP&L's taxable income in 2007 was [**Begin Confidential** **End Confidential**] JCP&L's taxable income in 2006. (RCR-CIT-14 attachment 2 confidential) Conversely, JCP&L's taxable income in 2010 was [**Begin Confidential** **End Confidential**] while in 2011 there was [**Begin Confidential** **End Confidential**]. Thus, if the CTA calculation is done using the five years from 2006 to 2010, the resulting CTA (using the Board's new methodology) would be [**Begin Confidential** **End Confidential**.] Thus, a [**Begin Confidential** **End Confidential**] swing in the CTA results from merely a one year change in the look back period.

If the calculation is done using the five years from 2008 to 2012, the resulting CTA is [**Begin Confidential** **End Confidential**.] This would violate long standing New Jersey Supreme Court precedent and long standing Board policy that ratepayers are entitled to a share in tax savings generated by a consolidated tax filing. Thus, by limiting the look-back period to an arbitrary five years, the Board is introducing a level of volatility to the process that is contrary to the process of normalization, which seeks to treat current and future utility customers equitably by allowing customers to share in the tax benefits associated with filing a consolidated return. Normalization has the effect of leveling customer rates over time. A longer period, tied to IRS loss carry-forward period, would reduce this volatility and result in a more reasonable CTA adjustment.

The 25 /75% "sharing" mechanism is also misguided. The Board's rate base methodology does not refund to ratepayers the amount of excess federal tax paid by JCP&L ratepayers to FirstEnergy. In this base rate case, JCP&L's allowance for income

tax expense, as calculated by Rate Counsel witness Robert Henkes was $119,823,116. *RCRB*, *Sch. RJH-16R*. In 2011, JCP&L reported [**Begin Confidential** **End Confidential**] in federal income taxes.[9] The consolidated group paid [**Begin Confidential** **End Confidential**] in 2011 but [**Begin Confidential** **End Confidential**].[10] Thus, the $5 million "sharing" of the benefit calculated by Board Staff is almost insignificant when one looks at the disparity between what ratepayers paid JCP&L for taxes (over $119.0 million), what JCP&L reported [**Begin Confidential** **End Confidential**] and what the consolidated group paid to the IRS [**Begin Confidential** **End Confidential**].

Nor does the Board's rate base methodology share with ratepayers the consolidated tax savings. These savings are passed on to the FirstEnergy affiliates that suffered losses. The rate base adjustment only provides ratepayers with carrying costs on the share of the consolidated tax savings resulting from JCP&L's participation in the consolidated group. Regardless of the methodology used to calculate the rate base deduction, only between 15% and 19% of the overall adjustment is allocated to JCP&L.[11] Therefore, the rate base methodology already represents a significant sharing between ratepayers and shareholders. By reducing that sharing by an additional 75%, the amount "shared" with ratepayers is minimal and unbalanced.

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[9] JCP&L's response to Board Staff's request for additional information in I/M/O the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment, BPU Docket No. EO12121072, dated September 4, 2013. Page 9, Question n. Rate Counsel recognizes that this document was not admitted into evidence in the base rate proceeding but requests that this document be entered into evidence pursuant to the Board's decision to re-open the record to allow the Staff CTA calculation. (A copy of this **confidential** document, without the attachments, is attached as Attachment B to these Reply Exceptions for the Board's convenience).

[10] Id. Page 5, Question f.

[11] Staff's calculation results in a 17% allocation, Rate Counsel's recommended CTA is a 18.7% allocation. This difference is due to income/losses used in the calculation of the CTA.

According to the FirstEnergy tax sharing agreement, JCP&L calculates the amount of federal income tax it would pay on a stand-alone basis. This amount is then paid to FirstEnergy. FirstEnergy then pays to the IRS the amount of the federal income tax liability owed by the consolidated group. Any excess funds are then allocated by FirstEnergy 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. These procedures transfer the excess amounts collected from JCP&L's ratepayers for income tax expense from the utility to the FirstEnergy affiliates that generated the income tax losses, effectively resulting in a subsidization of the unregulated affiliates by New Jersey ratepayers. The rate base methodology that is used in New Jersey partially compensates ratepayers for this subsidization, by crediting ratepayers with carrying costs on these funds. The rate base methodology does not award to ratepayers the amount of consolidated tax saving, it merely allocates to ratepayers a carrying charge for the amount of savings effectively "loaned" by ratepayers to the parent company and its unregulated affiliates. Thus, by further reducing the amount credited to ratepayers for this loan, the Board is increasing the imbalance caused by this subsidization. In other words, ratepayers are not even being fairly compensated for the carrying costs of this very lucrative loan they have made to the Company.

The Board should certainly reject the ALJ's decision to make no adjustment for consolidated income tax until a Phase II proceeding. JCP&L ratepayers deserve the too long delayed rate relief established during the evidentiary hearings. Rates set without a CTA are not just and reasonable under the New Jersey Supreme Court's decision in

I/M/O the Revision in Rates Filed by New Jersey Power & Light Company, 9 N.J. 498 (1952) (the 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.)

The BPU should also not apply its revised CTA retroactively. JCP&L should be held to the Board practices and policies in effect at the time this rate case was filed and litigated. The Company should not be allowed to benefit from the excessive delays encountered in reaching an initial decision in this case. To allow JCP&L to continue to collect excessive rates would be unfair to JCP&L's ratepayers who have been denied just and reasonable rates for many years. The Board should establish JCP&L's new rates based on the 2011 test year and the credible evidence in the record. That evidence includes Rate Counsel's recommended rate base reduction of $511.66 million and revenue reduction of $35 million. *RC-13,* Sch. ACC-1.

If the Board utilizes the "Generic Proceeding Methodology" proposed by Board Staff on January 30, 2015, rates set using this calculation should be set subject to refund depending on the final determination of Rate Counsel's appeal of the Dec. 14, 2014 CTA Order. By doing so, if the revised calculation is upheld on appeal, there will be no prejudice to the Company. If, however, Rate Counsel's appeal is successful, JCP&L ratepayers would be able to obtain the full sharing of CTA to which they are entitled.

D. Excess Cost of Removal

The ALJ properly rejected JCP&L's proposal to remove the $107.2 million excess cost of removal reserve from accumulated depreciation. *ID*, p. 20. In Exceptions to the Initial Decision, JCP&L argues that the ALJ "appears to have misunderstood the uncontested facts." *JCP&L Exceptions,* p. 18. JCP&L urges the Board to reject the

ALJ's recommendations and instead, at a minimum, use the average balance which is "at least consistent with Judge McGill's recommendations for the treatment of the 2011 Major Storm cost deferred balance and also with how the Board often handles amortization of regulatory assets/liabilities for ratemaking purposes*." JCP&L Exceptions, p.19-20*.

What JCP&L apparently forgets, and the ALJ did not, was that, unlike the 2011 storm cost deferral, the "$107.2 million in the net excess cost of removal reserve are ratepayer supplied funds." *ID,* p. 20. As noted by Rate Counsel witness Henkes at the evidentiary hearing:

> The $107 million excess cost of removal reserve balance represents ratepayer supplied funds that should be treated as a rate base deduction similar to the rate base treatment of the company's regular depreciation reserve which also represents ratepayer supplied funds. It would be extremely unfair to the ratepayers to force them to pay the company its overall rate of return on a part of the rate base that actually has been funded by ratepayers. *T61:L1-9* (October 7, 2013).

Moreover, Rate Counsel's recommendation is entirely consistent with the treatment ordered by the BPU in the Company's prior rate case. The excess cost of removal reserve balance has forever been a part of the Company's accumulated depreciation reserve balance which is always treated as a rate base deduction. This is for good reason because the ratepayers have funded the accumulated depreciation reserve balance, including the excess cost of removal reserves. Therefore, it should be crystal clear that the ratepayers ***should*** receive the "customer benefit" of receiving a return on these reserves.[12] Thus, while JCP&L makes it sound as if this customer benefit is a

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[12] Treating these reserves as a rate base deduction in essence is the same as providing the ratepayers with a rate of return on these reserves in the sense that they don't have to pay the Company its overall rate of return on these balances, so they are "saving" themselves the rate of return requirement which is the same as saying that they are getting the return.

windfall for the ratepayers, this is not true at all. This is something that *should* accrue to the ratepayers in accordance with generally accepted financial theory and consistent with prior Board precedent. The Company should not be allowed to deprive ratepayers of the appropriate return on these ratepayer supplied funds during the period that these funds are finally being returned to ratepayers.

Board Staff agrees with Rate Counsel that the full excess depreciation reserve, including the negative net salvage amount, should be treated as a rate base deduction. *SIB*, p. 32-33. Judge McGill properly rejected the Company's proposal to add $107.2 million to rate base to reflect the removal of that amount from the accumulated depreciation reserve, which reduces rate base. Judge McGill found that the net excess cost of removal reserve was funded by ratepayers and therefore "it is appropriate" for ratepayers to receive the benefit. *ID,* p. 20. As his finding on this issue is consistent with the record and Board precedent, it should be adopted.

E. Customer Refunds

In his Initial Decision, the ALJ found that "customer refunds are ratepayer-supplied funds" and accordingly the Judge supported Rate Counsel's recommendation that JCP&L's rate base should be reduced by $314,000 in customer refunds. *ID,* p. 21. JCP&L objected to this finding, arguing that there is neither regulatory nor legal precedent for this adjustment. The Company acknowledges that "certain" customer-supplied funds are properly subtracted from rate base but argues that the "individual amounts that comprise the overall level of customer refunds" are not related to an appropriate level of rate base.

The Company has failed to provide any support for its contention that only "certain" ratepayer supplied funds are deducted from rate base. The Company has not cited a single BPU Order allowing investor recovery on ratepayer supplied funds. The fact that the "customer refunds" account contains ratepayer funds rather than investor supplied funds is really all the justification needed.

Board Staff agrees with Rate Counsel's customer refund rate base adjustment. *SIB*, p. 2. The ALJ's finding on this issue is appropriate and supported by the record. It should be adopted.

F. Unamortized Net Losses on Reacquired Debt (Net of Tax)

JCP&L has proposed an amortization of the net loss on reacquired debt of $1.773 million and an addition to rate base of $17.920 million. The Company did not object to the ALJ's reduction in the amortization expense to $1.397 million to reflect only the distribution portion of the unamortized debt. JCP&L takes exception however to the ALJ's recommendation in support of Rate Counsel's position that the rate base addition be adjusted to reflect the offsetting effect of the associated accumulated deferred income tax balance. JCP&L argues that this was not done in JCP&L's previous base rate case so it should not be done in this case, "a fact that Rate Counsel witness Mr. Henkes admitted to in his testimony." *JCP&L Exceptions* p. 22. As noted by Mr. Henkes in his Initial Testimony:

> Even if something "slipped through the cracks" in the prior base rate case, this does not mean that therefore the same error should be reflected in the current case. Two wrongs do not make a right. The fact is that the Company only incurs a carrying cost on the net-of-tax loss on reacquired debt balance and it would be wrong to allow them a return on the gross

balance while completely ignoring the offsetting accumulated deferred income tax balance as a rate base deduction. *RC-145,* p.16.

.

Board Staff agreed with Rate Counsel's adjustments and recommended rate base and expense adjustments of ($9.570 million). *SIB*, p.71. As noted by Board Staff:

> While Staff acknowledges the Company has consistently treated unamortized net gains and losses on reacquired debt as a separate rate base and operating income issue consistent with the Board-approved methodology over the past thirty years, Staff recommends the approach offered by Rate Counsel to incorporate deferred tax benefit. Staff, therefore, recommends rate base and expense adjustments of ($9.570 million) and ($0.376 million) to rate base and expense, respectively. *SIB*, p. 71.

Judge McGill adopted Rate Counsel's position finding that deferred taxes are normally recognized as a reduction to rate base. As carefully detailed by Judge McGill in his Initial Decision:

> Deferred income taxes are normally recognized as a reduction to rate base, and the Company confirmed the existence of an associated accumulated deferred income tax balance. Under the circumstances, the Company's proposed adjustment should be modified to reflect deferred tax benefits. Therefore, I **FIND** that Rate Counsel's position reducing the amortization expense to $1.397 million and the adjustment to rate base to $8.351 million is reasonable and should be approved. *ID*, p. 22.

This finding is appropriate and supported by the record. It should be adopted**.**

G. Conclusion

In sum, Rate Counsel's recommended total net rate base is $1,324,452,526. *RCRB,* p. 23; *RJH-3RB*. The unamortized 2011 storm costs (net of tax) is a rate base addition of $24,225,567 (*Schedule D, line 8).* Rate Counsel respectfully requests that the Board adopt Rate Counsel's recommended rate base, including 2011 Major Storm Costs, of $1,348,678,093.

POINT III

THE APPROPRIATE PRO FORMA OPERATING INCOME AMOUNTS TO $215,208,689 WHICH IS $47,473,771 MORE THAN JCP&L'S' PROPOSED UPDATED AND REVISED PRO FORMA OPERATING INCOME OF $167,734,919.

Following are Rate Counsel's comments on the Exceptions to the Initial Decision filed by JCP&L on operating income.

A. Pro Forma Revenue Adjustments

The Company in its Exceptions to the Initial Decision argues that Judge McGill "misconstrued relevant Board precedent" in his support of Rate Counsel's use of the number of customers at June 30, 2012 in the weather – normalized revenue calculation. *JCP&L Exceptions*, p. 22. JCP&L argues that the calculation should be based on the average number of customers during the 2011 test year. JCP&L claims that "the use of the June 30, 2012 date for the customer count would result in a temporal mismatch between revenue/expenses (based on calendar year 2011) and the number of customers". *JCP&L Exceptions* p. 23. JCP&L argues that what "Judge McGill failed to consider is the fact that, in the 2002 case, the Company's rate base and revenue/expenses were all based on a 2002 test year." *Id.*

The Company is wrong. Judge McGill did properly consider that fact and then decided that Rate Counsel's use of the actual number of customers at June 30, 2012 more closely matched Board precedent than the Company's proposed use of the average number of customers in 2011. Judge McGill noted:

> In JCP&L's 2002 base rate case, the Company used the year-end plant-in-service balance and annualized its depreciation expense based on year end plant. In response, Rate Counsel proposed an adjustment based on the test year-end number of customers. In that case, the Board approved Rate

> Counsel's adjustment to match the test year-end number of customers with test year-end rate base and annualized depreciation expense.
>
> This case differs in that the Company adjusted rate base and depreciation expense to the levels at June 30, 2012, which is six months beyond the end of the test year, as opposed to the test year end level. Under the circumstances, there is a greater timing difference between rate base and depreciation adjusted to June 30, 2012, and all other expenses. Nonetheless, on balance, Rate Counsel's proposed adjustment is more similar to Board precedent than the Company's position. Therefore, I find that Rate Counsel's proposed adjustment increasing pro forma revenues by $823,138 is reasonable and should be approved. *ID*, p. 35.

Staff agrees with Rate Counsel "that the number of customers as of June 30, 2012 should be reflected in the revenue normalization adjustment, and that operating revenue should be increased by $0.824 million." *SIB,* p. 85. The ALJ's determination is therefore supported by the record and Board precedent. It should be adopted.

B. Rate Case Expenses

Again in Exceptions to the Initial Decision, JCP&L argues that the Board's policy requiring 50/50 sharing of rate case expenses should not apply in those cases where the Board has had to order the utility to come in for a rate case. JCP&L argues that as shareholders do not benefit, they should not have to pay rate case expense.

Rate Counsel discussed this issue at length in our Initial Brief and that argument will not be repeated here. *RCIB*, pp. 87-90. What bears repeating is not whether the Company was directed by the Board to file a base rate case but why the Company was directed to come in for a base rate case. The Company had to be directed to come in for a base rate case due to justified concerns that the Company has been significantly over-earning for the past several years. As noted in Rate Counsel's Initial Brief, during 2009-2011, JCP&L paid out 170 percent of its earnings as dividends to its parent FirstEnergy.

RCIB, p.89. Certainly shareholders benefitted from these payments. To charge customers full rate case expenses because the Company was over-earning and therefore declined to file a rate case voluntarily would defy logic.

Board Staff agreed with Rate Counsel's recommended adjustments, that is, 50/50 sharing of rate case expenses amortized over a six year period. This reduces the Company's annual rate case expense amount of $802,025 by $534,684 for a total recommended annual rate case expense amount of $267,342. *SIB,* p. 65

Judge McGill noted that the Company's 2002 base rate filing was also not voluntary but had been mandated during the restructuring. *ID,* p. 37. The Judge also noted that the 2002 case was also filed ten years beyond the Company's previous base rate case in 1991. In the 2002 case the Board ordered a 50/50 sharing of rate case expense amortized over four years. Thus the ALJ found that an annual rate case expense of $401,013 representing a 50/50 sharing of rate case expense and a four year amortization was reasonable. The ALJ further directed the Company to file an update to its actual rate case expense in this proceeding with its replies to exceptions for the Board's consideration.

C. Cost to Achieve Merger Savings

JCP&L complains that ALJ McGill "has applied an unrealistic standard regarding the specificity to which a utility must identify expenses incurred to meet its burden of proof." *JCP&L Exceptions*, p.25. JCP&L claims that "no utility, in any base rate case, has ever been required to document each and every expense down to the level of individual invoices or item-by-item description." *Id.*

Rate Counsel agrees it would be unduly burdensome to require a utility to provide an invoice for each individual component of a $14.5 million cost to achieve merger savings claim. On the other hand, it is unreasonable for the Company to assume that it is entitled to recover $14.5 million in deferred expenses without thoroughly documenting those expenses. At a minimum the Company must be required to show the time period over which the costs were incurred, by whom and for what. It is the Company that has the burden of proof and in this instance, the Company did not meet that burden.

As noted by Judge McGill:

> The main difficulty with respect to this proposed adjustment to recover costs totaling $14.5 million is that the Company has said nothing more specific than that the costs to achieve "are related to materials, outside services and employee separation necessary to produce the synergy savings." As noted by Rate Counsel, the Company has failed to provide necessary information regarding exactly what costs are included in this amount, when the costs were incurred and by whom. In the absence of this information, a determination cannot be made that the proposed recovery of these costs is reasonable. Under the circumstances, I **FIND** that the Company has failed to establish that the requested recovery of these costs is reasonable. It follows that the proposed adjustment should not be approved. *ID*, p.40.

As the ALJ correctly found that JCP&L had failed to meet its burden of proof on this issue, his disallowance of these costs should be adopted.

D. Net Salvage and Cost of Removal

JCP&L argues that because it "has submitted substantial, unrebutted evidence supporting the $4.8 million of net salvage/cost of removal expense, the Board should approve that level of expense in its final decision." *JCP&L Exceptions*, pp. 27-28.E. In fact, JCP&L provided, in addition to a two year average, a three year average (2010 through 2012) and test year expenses of $6.5 million. The Company claims this "upward

trend" supports the use of a two year average net salvage amount. Rate Counsel, Board Staff, and the ALJ disagreed.

Rate Counsel proposed the continued use of a five year average net salvage amount. As explained by Rate Counsel witness Henkes at the evidentiary hearing:

> the impact of an increasing trend in the net salvage and cost of removal costs will also be captured in a rolling five-year historical average, . . . five years takes a little longer, but it will always be reflected in the average because it's on a rolling basis.
>
> In addition, a two year average is not a long enough time span to derive a reliable normalized net cost level. I also see no other reasons why the five-year historic average established by the Board for JCP&L in its last base rate case should now be abandoned. It has been Board policy to use a rolling historic average of five years or more in all cases known to me regarding a utility's normalized net salvage and cost of removal cost level. *T64:L8-23 (October 7, 2013)*

Judge McGill recognized that, in the past, the Board has approved a five-year average "based upon the view that it more closely aligns the amount recovered in base rates with the historical expense level." *ID*, p. 41. Judge McGill reasoned that the "five-year average from 2007 to 2011 reflects actual historical experience during that period without distortion by a shorter term aberration." *Id*. The ALJ accordingly found that Rate Counsel's recommended adjustment using the five year historical average "is reasonable and should be approved." *ID,* p. 41. As the ALJ's finding on this issue is supported by the record and consistent with Board policy, it should be adopted.

E. Major Storm Costs – Amortization of Deferred Operation and Maintenance ("O&M") Expenses

JCP&L takes exceptions to the ALJ's recommendation that the Board allow the Company to recover its deferred storm damage costs over a six year period. JCP&L

argues that three years is consistent with the deferred storm cost amortization in the Company's last base rate case and that the Board allowed ACE to recover its deferred costs over a three year period. The concern expressed by Rate Counsel was that, unlike ACE who has been in for at least three base rate cases over the past decade, JCP&L has not. As explained by Mr. Henkes at the evidentiary hearing:

> It is my recommendation that these costs be amortized over a six-year period rather than the company's proposed three-year amortization period in order to mitigate a potential significant ratepayer risk as explained by the following:
>
> The company's proposed annual amortization amount for the 2011 deferred storm based on a three-year amortization period is almost $30 million per year. If the rates in this case stay in effect for a period longer than three years which is highly likely because the rate effective period of the company's most recent two base rate cases has been ten years in both cases. But if the rates were to stay in effect for longer than three years, then the ratepayer runs the risk of the company over recovering its storm damage cost to the tune of $30 million a year and that is a real risk.
>
> And I am proposing to mitigate that ratepayer risk by recommending a longer amortization period and that is why I recommend a six year amortization period. *T73:L24 – T74:L18* (October 7, 2013).

Judge McGill agreed that the deferred storm costs should be recovered over six years. *ID*, p.43. The Judge reasoned:

> An amortization of three years is too short in that it would create a risk of substantial over recovery if the new rates remained in effect for a longer period. In view of the fact that the rates from each of the Company's last two rate cases remained in effect for ten years, the risk of an over recovery is very real. *Id.*

Accordingly, Judge McGill found that the recovery of the deferred storm costs related to the 2011 major storms should be recovered over a six year amortization period. This finding should be adopted.

F. Vegetation Management Expenses

JCP&L claims that the test year level of vegetation management expense was "abnormally low" and proposed a normalization adjustment which increased vegetation management expense from $9.34 million to $14.45 million. *JCP&L Exceptions*, p. 30. JCP&L argues that 2011 tree trimming expense should be "normalized" based on deferred O&M spending due to the 2011 major storms and the corridor widening program which increased capital spending with a "corresponding reduction in operations and maintenance (O&M) spending." *PIB*, p. 97.

This assertion was refuted by Rate Counsel witness Mr. Henkes at the evidentiary hearing during cross examination.

> Q. Do you agree that JCP&L's service territory experienced unusual weather last in 2011?
>
> A. Yes.
>
> Q. In fact, Hurricane Irene impacted the service territory from the end of August through a good part of the month of September. Would you agree with that?
>
> A. Yes. And I addressed that in my surrebuttal testimony. It goes to the argument of the company where they say that the test year is understated, that the test year tree trimming costs are understated because a deferral of 416 miles of tree trimming activity from the last quarter of 2011 to the first quarter of 2012.
>
> At the same time the company is pointing out in its rebuttal testimony that there was a deferral of tree trimming activities from 2009 and 2010 into 2011.
>
> *T93:L24-T94:L14* (October 7, 2013).
>
> Q. Do you agree in 2010 the company's corridor widening initiative was in full swing, again resulting in an unusual reduction in the level of tree trimming O&M expense for 2010 and that would be the $5.3 million number that you have listed in your chart?
>
> A Can you repeat that please?

> Q. Do you agree in 2010 the company's corridor widening initiative which resulted in an unusual reduction in the level of tree trimming O&M expense was on-going in 2010?
>
> A Well, I am aware that there was a program that is called a corridor widening program. I am not convinced that you can claim, therefore, there was unusual reduction in test year costs. I am aware also that, as the company has admitted, there were a number of tree trimming activities in 2009 and 2010 that were transferred into 2011.
>
> *T95:L20 - 96:L14* (October 7, 2013).
>
> Q. And do you agree in 2012, the company again experienced what we might refer to as unusual weather in fall of 2012, specifically Superstorm Sandy?
>
> A. Well, what I understand is that – and again I address this in my surrebuttal testimony, but even though the tree trimming activities in the last quarter of 2011 were moved or they were carried over to the first quarter of 2012, that did not keep the company from completely finishing up its tree trimming program in 2012, it's regular tree trimming program. So 2012 includes all of the activities associated with the regular tree trimming program, as well as the extra tree trimming activities from what was transferred from the last quarter in 2011. And I look at the actual expenses, . . . , and its $10.9 million. So that to me is telling. It's certainly not $14.4 million. And was there activity in 2012, at the end of 2012 due to storm damage, yes. I have not heard the company saying that therefore a certain level of tree trimming activity was moved into 2013.
>
> *T97:L4-24* (October 7, 2013).

As can be seen from Mr. Henkes' testimony, tree trimming expenses vary significantly from year to year and are strongly influenced by factors such as the weather and financial condition of the Company. The actual 2011 test year amount of $9.3 million is very much in line with the five year average (2007-2011) expense level of $8.7 million and the 6-year average (2007-2012) of $9.1 million., *RC-145*, p.36.

The ALJ properly rejected JCP&L's $5.1 million "normalization" adjustment.

> The company's argument is persuasive that unusual events impacted its tree trimming expense during the 2011 test year. Nonetheless, the fact remains that unusual events impacted the last three years of the five-year period from 2007 – 2011 suggesting that the estimated expense is not very firm under any circumstances. Further, the Company's budgeted annual

> expense of $14,449,113 is higher than any year during the period from 2007 to 2012 and considerably higher than the six-year average of $9.1 million.
>
> The proposed adjustment cannot be considered a known and measurable change. The Company's figure of $14,449,113 is nothing more than a budgeted figure. Under the circumstances, I **FIND** that the Company's proposed adjustment is unreasonable and should not be approved. *ID,* p.45.

The ALJ's finding in this regard is reasonable and fully supported by the record. It should be adopted.

G. Production Related Regulatory Asset Amortization

JCP&L proposed that the Board shorten the amortization period for two regulatory assets no longer owned by the Company, Oyster Creek and TMI-1. JCP&L argue "[t]here is no rational basis to have amortizations of regulatory assets related to plants the utility no longer owns continue past the mid-way point of the twenty-first century." *JCP&L Exceptions*, p. 33.

Rate Counsel witness Henkes recommended the continuation of the current amortization period. Mr. Henkes noted in his testimony that there was no compelling reason in this case to change the amortization period that was deemed to be appropriate in all of the Company's prior rate cases since 1989. *RC-14*5, p. 51. Oyster Creek and TMI-1 were sold in 2000 and 1999, respectively. Therefore, even in its last (2002) base rate case, JCP&L no longer owned these production facilities. Yet, despite this fact, in that prior case, the Board found it appropriate to continue the existing amortization period. *RC-145*, p. 51.

In that base rate case, JCP&L made a similar proposal to accelerate the amortization of certain production related regulatory assets. In rejecting JCP&L's proposal, the Board found:

> consistent with the positions of Staff and the RPA, an alteration of the amortization of these assets as proposed by the Company is inappropriate. The Board agrees that without re-evaluating the issues previously decided by the Board in the prior proceedings where these amortization periods were approved, the delicate balance struck between the competing interests of ratepayers and shareholders might be upset.

I/M/O the Verified Petition of Jersey Central Power & Light Company for Review and Approval of an Increase in and Adjustments to its Unbundled Rates and Charges for Electric Service, and for Approval of Other Proposed Tariff Revisions in Connection Therewith, et al., BPU Docket No. ER02080506, *et al.,* Order, (May 17, 2004), p.61.

Judge McGill found that because there had been no changes related to this issue and, as the Board had rejected a similar proposal in the Company's 2002 base rate case, "the proposed adjustment is unreasonable and should not be approved." *ID,* p.46 His ruling should be adopted.

H. Account 935 – Maintenance of General Plant Expense Normalization.

FERC Account 935 is listed under the Administrative & General ("A&G") category for "Maintenance of General Plant." JCP&L argues that the Board should reject the ALJ's recommended use of a five-year average for Account 935 as proposed by Rate Counsel. The Company argues that for this account, the Board should allow the 2011 test year total amount of $2.74 million. *JCP&L Exceptions*, p. 34. JCP&L argues that because account 935 is a subset of both A&G and overall O&M expense for an electric distribution utility, it is inappropriate to single it out for "normalization" while ignoring the overall level of distribution O&M for the relevant time period. *Id*. The Company

claims to have "conclusively demonstrated" that the overall level of 2011 distribution O&M was actually lower in 2012.

This claim was refuted by Rate Counsel witness Mr. Henkes in his surrebuttal testimony.

> Q. Could we turn now to Ms. Pittavino's rebuttal testimony? And do you have any comments on Ms. Pittavino's testimony regarding Account 935 maintenance expense adjustment?
>
> A. Yeah. Well, she disagrees with my proposed adjustment and instead in her rebuttal testimony and as we started to discuss with her this morning, she presents an analysis of the company's overall distribution O&M expenses which concludes that the overall 2011 distribution O&M expenses are lower than the overall distribution O&M expenses in 2012.
>
> With all due respect to Ms. Pittavino, her analysis is – is misleading to say it mildly. And she compares apples to oranges and uses inconsistent financial data. One part of her analysis is based on distribution only data and the other part of her analysis is based on total company data which includes a lot of other non-distribution related elements. And no matter what she stated this afternoon or this morning trying to explain why, it still doesn't change the fact that she is combining total company data with distribution-only data.
>
> . . .
>
> And if you correct for that and put the entire analysis on the basis of distribution –only data, then again it shows that the test year – the 2011 test year overall distribution O&M expenses were substantially higher than the 2012 distribution O&M expenses. And so that means that when you properly correct it, her analysis very much supports my proposed Account 935 adjustment.

T67:L5 – T68:L14 (October 7, 2013).

ALJ McGill found:

> Rate Counsel's arguments in support of the proposed adjustment are persuasive. The test year level of expense of $2.74 million was substantially higher that the average of $1.47 million for the four-year period from 2007-2010. With respect to the Company's argument that the data from 2007 was stale, the expense for that year was substantially the same as 2009, which was higher that both 2008 and 2009. In fact, the 2011 test year expense of $2.74 million more than doubled the level of 1.27 million in 2012. Those circumstances indicate that the test year amount for this expense was abnormally high. The Company's argument

> that the overall level of distribution O&M expense was lower in 2011 than in 2012 is unpersuasive, because it is based on a mix of distribution only and total Company data. Under the circumstances, I **FIND** that Rate Counsel's proposed adjustment reducing Account 935 expense by $1,018,802 is reasonable and should be approved. *ID* p. 47.

The ALJ's finding on this issue is fully supported by the record and should be adopted.

I. Incentive Compensation and Supplemental Executive Retirement Plan ("SERP")

JCP&L takes exception to the ALJ's disallowance of $5,740,957 in incentive compensation expense. The Company also takes exception to the disallowance of $408,576 in SERP expense. The Company acknowledges that Judge McGill's recommendations on these issues "are generally consistent with the Board's decision in the Company prior base rate case" but complains that Rate Counsel's position "merely demonstrated a rigid, antiquated view of compensation structures and ratemaking policy." *JCP&L Exceptions*, p. 37. The Company claims "the fundamental nature of corporate compensation structures has changed significantly over the last twenty years." *JCP&L Exceptions*, p. 35.

Rate Counsel recommended that JCP&L's claimed incentive compensation expense be disallowed because incentive compensation is a totally discretionary expense tied to the financial performance of FirstEnergy. Rate Counsel's position in this proceeding is based on an analysis of the specific incentive compensation programs for which the Company is seeking recovery from ratepayers. Rate Counsel's analysis showed that FirstEnergy shareholders must achieve a certain level of earnings per share before any incentive compensation award is given. *RC-145*, p. 38. Simply, it is Rate Counsel's position that if the Company decides to offer "at risk" compensation packages

based on the financial performance of FirstEnergy, then FirstEnergy shareholders should pay the cost. In addition, Rate Counsel recommended the disallowance of all SERP expense. SERP costs relate to supplemental retirement benefits for key executives that are over and above the normal retirement programs provided by FirstEnergy for its employees. JCP&L ratepayers are already paying for the regular retirement benefits of these top executives and should not be forced to also fund these additional SERP perks. If the Company wants to provide additional retirement benefits to these key employees, then shareholders rather than ratepayers should fund these additional benefits. *RC-145*, pp. 37-43, *RCIB*, pp. 97-104. Board Staff agreed with Rate Counsel's position.

Judge McGill, after carefully reviewing the arguments of the parties and long standing Board policy, adjusted Rate Counsel's proposed incentive compensation disallowance to reflect "the portion of the incentive compensation that is part of JCP&L's collective bargaining agreements with its unions." *ID*, p. 50. The ALJ then found that with that adjustment Rate Counsel's incentive compensation adjustment "is reasonable and should be approved. " *Id.* The ALJ further found Rate Counsel and Staff's proposal to disallow SERP expense "persuasive" and found "that Rate Counsel's adjustment eliminating SERP expense and reducing pro forma operating expenses by $408,576 is reasonable and should be approved." *ID*, p. 51. As the ALJ's findings are supported by the record and consistent with Board policy, they should be adopted.

J. Miscellaneous O&M Expense Adjustments.

JCP&L takes exception to Judge's McGill's recommended disallowance of the Company's "Celebrate Success" expenses of $5,707; service award expenses of $37,875 and "civic memberships of "25, 295. *JCP&L Exceptions*, p.

38. JCP&L claims that cost recovery from ratepayers is appropriate for the "Celebrate Success" program expenses, service award expenses, and civic membership costs.

Celebrate Success

The Company claims that the "Celebrate Success" awards are "modest gifts" given to employees for "noteworthy contributions in situations where the employee does not receive overtime compensation." *JCP&L Exceptions,* p. 38. Rate Counsel argued that what "noteworthy contribution" would qualify for one of these gifts has not been specified by the Company. Indeed, Rate Counsel is unable to come up with anything in the record in this proceeding to identify what type of "contribution" would qualify, who is eligible for an award and when such awards are given. The Company did not provide one example of an instance where an employee received such an award. There is nothing in the record in this proceeding to support recovery from ratepayers for "modest gifts" given to employees for "noteworthy contributions."

Service Awards

The Company next claims that the service award expense of $37,875 "provides local management a means for recognizing service anniversaries." *JCP&L Exceptions*, p. 38. The Company claims that these awards "assist in keeping employees engaged and promote recognition for longevity within the FirstEnergy organization…" *Id.* Rate counsel recommended that these costs be disallowed as again, the Company has failed to provide even the most basic information about these awards. Who is eligible to receive and when remains

unanswered. A portion of this amount is not incurred directly by JCP&L but is allocated from the service company. The Company fails to explain how longevity of service company employees is directly related to the provision of safe adequate and proper service in New Jersey. Rate Counsel would argue that it is not.

In recommending disallowance of the Celebrate success expenses and the service awards expense, Judge McGill reasoned:

> These expenses include items such as parties, outings and gifts which should not be borne by ratepayers, and petitioner has not provided a breakdown to identify items that might appropriately be recovered through rates. Under the circumstances, these items should not be included in pro forma operating expense. *ID*, p. 52.

Civic Membership Expense

The Company has also included civic membership expenses of $25,295 to a number of civic organizations such as chambers of commerce, mayor associations, area associations, Jersey Shore partnership association and economic development associations. The Company claims this contribution to civic organizations creates "a forum to promote communication between the Company and the municipalities it serves." *JCP&L Exceptions,* p. 39. Rate Counsel argued that the promotion of communication is not adequate justification to support the inclusion of these costs in rates. The Company has failed to explain what local organizations are favored with these "memberships" and which are not. Certainly these costs are discretionary and the discontinuation of this practice would have no impact on the Company's provision of safe and adequate service.

Judge McGill found Rate Counsel's arguments "persuasive." He noted that the Company had not demonstrated that it could not establish "channels of

communication" without paying membership fees. It follows that this item should not be included in pro forma operating revenues. Judge McGill concluded that Rate Counsel's proposed disallowance of $79,258 was reasonable and should be approved. *ID,* p. 53. As the ALJ's findings on these issues are fully supported in the record and are consistent with Board policy, they should be adopted.

POINT IV

ALJ CORRECTLY DETERMINED PENSION EXPENSE FOR RATE MAKING PURPOSES BASED UPON THE "PRELIMINARY PENSION EXPENSE" METHOD; REJECTING THE EXPENSE ANOMALY RESULTING FROM THE COMPANY'S ONE-TIME PENSION EXPENSE ACCOUNTING CHANGE.

FirstEnergy unilaterally changed its accounting methodology in 2011 creating an aberration in pension expense. The Company now seeks Board approval of the resulting calculations as an ongoing pension expense. ALJ McGill correctly questioned the results of that change in methodology, noting "the risk that the test year results will be too high or too low and not representative of the conditions that will exist while the new rates are in effect;" if the Company's position is adopted. *ID*, p. 56. In adopting the "preliminary pension expense" method of calculating pension expense, the ALJ understood the necessity of having a stable measurement of pension expense for purposes of setting rates, as reflected in his Initial Decision.

The Company asserted its authority to change the accounting method for computing pension expense and in its Petition requested that the Board accept this new method for ratemaking purposes. Rate Counsel established that the change of accounting method in 2011 was an option on the part of FirstEnergy and not required by any regulatory agency or Financial Accounting Standard. Company Witness Wagner confirmed there was no requirement to change methodology in 2011. *T31:L8-20*. (October 16, 2013).

Rate Counsel's witness, Dr. Mitchell Serota, a Fellow of the Society of Actuaries, demonstrated that the change of accounting method produced artificially high expenses for 2011 and for 2012. *RC–158*, RCR-Pen-2, Attachment 4. The pension and OPEB

expenses for these two years were not at all comparable to previous expense calculations because the change in accounting method amplified the volatility of actuarial gains and losses by immediately recognizing them, rather than smoothing them over, in what previously had been about a ten-year period. The effect of the change in accounting methods was an increased expense on the order of $500 million per year for FirstEnergy. *T58-62* (October 16, 2013). The Company's portion of this expense is estimated to be 5.36% of this amount. *T65:L8-20* (October 16, 2013). Nevertheless, the Company wants the Board to accept the artificially high expenses as indicative of its ongoing pension and OPEB expenses, for ratemaking purposes.

Rate Counsel's witness, Dr. Serota, asserted that other New Jersey utilities have their pension expense computed at the beginning of the year and do not wait to recognize actuarial gains and losses until the end of the fiscal year in question, as FirstEnergy now does. *T69-70:L20-1* (October 16, 2013). As such, the resulting pension and OPEB expenses of the other utilities incorporate a standard methodology that dampens the volatility of the equity and bond markets.

The Company argues, in its exceptions, that the pension expense approved by ALJ McGill "does not even compensate the Company for its annual pension/OPEB service costs". *JCPL Exceptions*, p. 46. However, the "preliminary pension expense," as calculated by the Company's own actuary AON Hewitt and adopted by Rate Counsel witness Dr. Serota as the basis for his pension expense testimony, absolutely incorporates the service costs as a component. This fact was acknowledged by the Company's own witness, Mr. Wagner, who stated under cross examination that the Company relies upon AON Hewitt in determining actuarial present value of benefits, which includes service

costs, as determined by the Company's own actuary, AON Hewitt. *T22-23:L16-19* (October 16, 2013).

The whole purpose of utilizing the preliminary pension expense methodology is to isolate the volatility of actuarial gains and losses and remove them from the calculation of the expense. Gains and losses over time, if the actuarial assumptions were reasonable in the first place, tend to net to zero. All other components of pension expense, as enumerated in Mr. Wagner's testimony, have not changed at all. ALJ McGill was correct to limit the pension expense to the "preliminary pension expense" because the calculations under the new methodology artificially increased the pension expense by $500 million for FirstEnergy for two years in a row and the Company's portion would then be kept in the utility's rates until the next rate case.

The alternative computations offered by the Company in its exceptions represent an effort at "compromise" ratemaking by smoothing the pension expense in an unrecognized, alternative method. *JCPL Exceptions*, pp. 45-46. The compromise offered by the Company, after the close of the hearing, has not been subjected to cross examination or reasoned analysis as to its effect. The Company's calculations discard the highest and lowest values and then average expenses over a five-year period, which produces a result higher than that produced by the evidence and adopted by the ALJ. If the Company wished to argue a recognized, accounting based, method, the Financial Accounting Standards Board offers acceptable methods for smoothing in Accounting Standard Codification ("ASC") 715-30-35-24. (The Accounting Standard Codification is the basis for Generally Accepted Accounting Practice, "GAAP.") However, the Company, through its exceptions, to the ALJ Initial Decision, is asking the Board to

create a unique smoothing technique which does not comply with the ASC and thus is not consistent with GAAP. In 2011 First Energy changed its accounting methodology for the sake of "transparency," but now asks the Board to create a new method of calculation that will be more opaque, as it was not subjected to analysis and review prior to its adoption. As noted by the ALJ, for ratemaking purposes the Company "had a perfectly good method prior to the implementation of the accounting change for 2011." *ID*, p. 56.

ALJ McGill correctly understood that the issue was how to recognize actuarial gains and losses in establishing an appropriate rate base requirement for pension expense. Changing the accounting methodology, as the Company did in 2011, caused the pension expense to increase by $500 million in 2011 and 2012, relative to the pension expenses recognized in earlier years. The preliminary pension expense method used by First Energy's own actuary for the Company and as adopted by the ALJ, eliminates the artificial surge in expense.

ALJ McGill was correct in adopting the preliminary pension expense method and this is borne out by observing the actual results. Because of the long pendency of this matter, the results are no longer a theoretical exercise. Rate Counsel witness Dr. Serota predicted a "significant actuarial gain" for 2013 which would reduce pension expense. *T59-61:L24-17* (October 16, 2013). A review of the 2013 First Energy Annual Report (a public document, although not part of the record) demonstrates that the mark-to-market adjustment for pensions for 2011, 2012 and 2013 were $729 million, $735 million and ($267) million respectively.[13] That demonstrates that there was over a $1 billion swing

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13 http://investors.firstenergycorp.com/Cache/22976207.PDF?Y=&o=PDF&D=&fid=22976207&T=&osid=9&iid=4056944, p. 84 (Rate Counsel would ask the Board to take Judicial Notice of this public document, making it part of the record in this proceeding.)

in actuarial gains, a swing so significant that it converted what was once a pension *expense*, into a pension *income* item, for the Company's accounting purposes.

The Board should adopt ALJ McGill's finding that the preliminary pension expense method of determining pension expense is appropriate and is a "stable means to estimate pension and OPEB expenses." The ALJ correctly rejected the Company's "compromise" argument as an untested alternative method, which is not recognized as an approved method to accurately account for pension expense. Experience and the ability to review actual pension expense and actuarial results demonstrate the accuracy of the pension expense methodology as supported by the testimony of Rate Counsel's witness, Dr. Serota, and the Company's own actuary, AON Hewitt. The ALJ's findings on this issue should therefore be adopted.

POINT V

JCP&L HAS NOT PRESENTED CREDIBLE EVIDENCE TO SUPPORT ITS CAPITAL STRUCTURE OR RETURN OF EQUITY OF 11% OR PROVIDES PERSUASIVE ARGUMENTS AGAINST THE ALJ'S RECOMMENDATION FOR RING FENCING MEASURES.

As set forth below, JCP&L has not presented any credible evidence to refute the findings of the ALJ regarding the capital structure, the embedded cost of debt, and the need for a ring-fencing study. Furthermore, JCP&L's proffered return on equity figure is far in excess of that supported by sufficient credible market cost of equity evidence in the record.

A. Capital Structure.

The ALJ found Rate Counsel's arguments to be persuasive and recommends a capital structure of 50% equity and 50% debt. *ID*, p 33. JCP&L argues that the Board should adopt its claimed "actual" capital structure of 53.8% equity and 46.2% debt. *JCP&L Exceptions*, pp. 8-10. However, JCP&L's proffered capital structure is based on the improper and impermissible inclusion of $1.8 billion of goodwill and a post-test year debt issuance. *RC-111*, pp. 16-21. The goodwill is a non-cash accounting write-up to it equity balance stemming from a merger, unrelated to JCP&L's utility operations and supports no utility assets.

JCP&L's claimed actual capital structure of 53.8% equity and 46.2% debt includes goodwill, in violation the express prohibitions contained in the JCP&L/FirstEnergy Merger Order. The JCP&L/FirstEnergy Merger Order prohibited

cost recovery of goodwill from JCP&L's ratepayers.[14] Here, the inclusion of goodwill (as equity) would operate to provide JCP&L's shareholders with an inflated rate of return, all else equal. *RC-111*, p. 27.

Additionally, contrary to JCP&L's assertions, the $500 million debt issue of August 2013 is beyond the test year and, therefore, the ALJ properly did not include it the recommended capital structure. *ID*, p. 33. JCP&L did not present any compelling argument to include the post-test year debt issuance in its capital structure.

B. Embedded Cost of Debt Rate.

The ALJ recommends a debt rate of 6.26%. *ID*, p. 34. Rate Counsel concurs with the ALJ's cost of debt rate finding. JCP&L also concurs that the debt rate should be 6.265%, if a 50% equity/50% debt capital structure is approved. *JCP&L Exceptions*, p. 10.

C. Return on Equity.

JCP&L's argument in support of its proposed 11.0% return on equity ("ROE") is based on little more than its claim that "an equity allowance of 11.0% would begin to restore the investment community's confidence in the Company's ongoing financial health and enable JCP&L to access needed capital on reasonable terms." *JCP&L Exceptions*, p. 6. The Board should not reward the actions of JCP&L's parent, FirstEnergy, with an enhanced return on equity award as a means of addressing its financial need. Absent the inclusion of goodwill in its capital structure, JCP&L would appear to be inadequately capitalized. Furthermore, JCP&L's financial position was weakened by cash payments to its parent in recent years. As discussed below, the

[14] I/M/O the Joint Petition of FirstEnergy Corp. and Jersey Central Power and Light Company, d/b/a GPU Energy, For Approval of a Change In Ownership and Acquisition of Control of a New Jersey Public Utility and Other Relief, BPU Dkt. No. EM00110870, Order of Approval, (October 9, 2001), p.22.

negative effects of JCP&L's affiliation with FirstEnergy may be addressed by proscriptive ring-fencing measures rather than enhanced returns to its investors.

Moreover, the Company has done very well financially since its last base rate case in 2005 at its currently authorized ROE of 9.75% and no credit rating agency report has stated that JCP&L's currently authorized ROE is too low.

Additionally, contrary to JCP&L's argument, the generally accepted Discounted Cash Flow analyses presented in this case by witnesses for Rate Counsel and Gerdau support a lower return on equity than the 11.0% advocated by JCP&L and 9.75% recommended by the ALJ. *RCIB*, pp. 37-55; *RC-111*; *Gerdau-1*.

Finally, JCP&L exaggerates the effect of the modest increase in Treasury bond rates that occurred during the pendency of this case. *JCP&L Exceptions*, pp. 12-13. RC witness Kahal presented updated schedules at hearing which showed the modest increases in dividend yields and long term interest rates. *T94:L5-T95:L14* (October 4, 2013). However, as Mr. Kahal noted, the increases (as compared to the data in his filed direct testimony) were quite small and while they caused slight changes in his DCF and CAPM figures, the updated information did not affect his ultimate recommendation: an ROE of 9.25%. *T94:L5-T95:L14* (October 4, 2013). Finally, JCP&L cannot and should not be granted a risk or credit rating related increase in its authorized ROE because doing so would be rewarding it for poor financial management and affiliate risk, and it would violate the merger settlement which included a clear provision insulating utility ratepayers from the unregulated risk. *RC-111*, pp.18-19, 27-28.

D. Ring-Fencing Study.

JCP&L, on a stand-alone basis, has a favorable business risk profile, as Rate Counsel witness Matthew Kahal testified, based on his review of rating agency reports. *RC-111*, pp. 25-28. Rate Counsel agrees that the Company's credit ratings are lower than they should be (e.g., lower than those of other New Jersey electric utilities) but this is due to FirstEnergy management decisions and its corporate risk profile. *RC-111*, pp. 27-28. JCP&L fails to note the ample support in the record which shows that its less-than-optimum financial situation is the result of the actions of its parent, FirstEnergy. Two credit rating agencies concurred that JCP&L's affiliation with FE impairs its credit rating. *RC-111*, p. 27. The Board should adopt the ALJ's ring-fencing study recommendation as a means to improve the credit quality of JCP&L. *ID*, pp. 90-91. JCP&L contests the need for such a study, but presents no persuasive reason for opposing it. This is the same recommendation as previously set forth in the most recent management audit. *T71:L9-T73:L7* (October 4, 2013). For example, the Company complains about the cost of the study, but provides no cost estimate. The ALJ's recommendation for this feasibility study is a modest first step to properly address affiliate risk and should be adopted by the Board.

POINT VI

THE CYCLE OF JCP&L'S POOR PERFORMANCE SHOULD BE STOPPED AND THE COMPANY SHOULD BE REQUIRED TO IMPROVE ITS RELIABILITY PERFORMANCE OR FACE SPECIFIC FINANCIAL CONSEQUENCES.

A. The Record Is Replete With Evidence To Show That JCP&L Has A History Of Poor Performance.

In spite of the record evidence in this case, the Company argues that no testimony or any other evidence was introduced to support Rate Counsel's position that JCP&L's customers suffer from the Company's poor reliability performance. JCP&L's Exception stated: "With no basis to follow Rate Counsel's urging the ALJ 'acknowledged JCP&L's poor performance with respect to reliability (id.)'" *JCP&L Exceptions,* p. 68. The Company's position appears to be based on the incorrect assumption that the testimony of Rate Counsel's witness Mr. Peter Lanzalotta did not address the Company's 2002-2006 performance on which the Board's reliability standards are based. *JCP&L Exceptions*, p. 69. The Company failed to note Mr. Lanzalotta's direct testimony which stated:

> … the benchmark standards and minimum reliability levels for JCP&L, which exclude major event performance, have increasingly become a non-issue in part because they are so far out of touch with the Company's actual performance. Reliability benchmark standards should reflect either more recent historical performance, at a minimum, or they should reflect a reliability target sought after by the Board, rather than just a level of historical performance. (emphasis added) *RC-87*, p. 24.

In addition, the Company ignores substantial credible evidence in the record from other sources such as previous Board Orders, Board Staff reports and the live testimony of almost one hundred JCP&L customers who appeared and spoke at a public hearing to complain about JCP&L's poor reliability performance. The Company chose to ignore the

irrefutable evidence in the record such as the Special Reliability Master's conclusion after the audit of the Morristown Underground explosion in 2011:

> The [Special Reliability Master's] report was critical of JCP&L's performance with respect to preventive and corrective maintenance procedures on its underground network system …
>
> The report found that, while the plan, design and construction of the Network are sound, JCP&L had not followed its own procedures for undertaking preventive maintenance; that JCP&L failed to appropriately prioritize corrective maintenance measures; and that the Company was deficient with respect record keeping regarding corrective maintenance issues. The report also indicated that the Company needed to improve communications with local officials. I/M/O the Petition of Rate Counsel Requesting a Board Order Directing Jersey Central Power & Light Company to File a Base Rate Case Petition and Establishing a Test Year of 2010, Order BPU Docket No. EO11090528 (July 31, 2012), p. 12 (emphasis added).

Board Staff's Report after Hurricane Irene also expressed concerns about JCP&L's operations and procedures:

> While Staff's Hurricane Irene Report found that certain practices of all the electric utilities need to be reexamined, it specified that JCP&L was deficient in its storm restoration process, and that the Company's planning and preparation in the areas of communications, estimating outage restoration, supplemental crew mobilization and mitigation of tree related damages particularly required review. In the Matter of The Boards' Review of the New Jersey's Utility Response to Hurricane Irene, Docket No. EO11090543 (December 15, 2011) (emphasis added), *See* also *RC-61* and *RC-62*.

In addition to evidence in the record in the form of Board Orders and Board Staff Reports that go back as far as the 1990s showing JCP&L's long history of poor performance, the record contains the testimony of 86 JCP&L customers that attended the

JCP&L Base Rate Case Public Hearings to express their service quality concerns to the ALJ.

Mr. Michael Ship's and Mr. John Merz's testimonies are representative of many of the JCP&L's customers concerns:

> I have lived on Aston Road in Morris Township for a little under two years. During that time my power has gone out over a dozen times not in terms of minutes but typically hours and often days. I have had to throw out the food in my refrigerator and freezer twice during that time; it's like living in the Third World. I don't know what kind of electric service this is but it's not, "services" doesn't belong in the name at all, frankly. Testimony of Michael Ship Gaston Road in Morris Township, Public Hearing dated April 16, 2013, pp. 35-36, Line 25 and 1-8.

> As my wife had said before, every time it rains, every time we get a storm of anything, especially when it comes out of the southeast in the summertime, or out of the north northwest in the wintertime, we know that we're going to have a power failure. I'm tired of my tub being filled with water for five days just to make sure that I have something to flush with. I mean it's ridiculous. Testimony of John Merz, Public Hearing dated April 8, 2013, p. 29, Lines 6-13.

Many of the concerns expressed by the customers attending the Public Hearings were from customers that consistently suffered from blackouts in a small geographic area, what Mr. Lanzalotta referred to as "pockets of poor reliability."

> … in the past five years we have had so many power outages, and I don't understand how our little area could have them but people who are across the street don't have as many blackouts, and when they do have blackouts their lights come on faster and I am still sitting in the dark, no heat, no worry, but I'm supposed to respect what JCP&L is doing for me. Testimony of Ms. Wanda Smith, Public Hearing dated April 24, 2013, p. 93, Lines 8-15

Indeed, the testimony that the ALJ heard during the public hearings caused him to note, "It is noteworthy that at the public hearings, customers and public officials seemed to be more concerned about service problems than the proposed rate increase." *ID*, p. 6.

To address these customers' concerns, Mr. Lanzolatta recommended and the ALJ adopted Rate Counsel's recommendation that JCP&L be required to report the customers experiencing multiple interruptions ("CEMI"). By recording and reporting to the Board CEMI, the regulator will be able to see reliability problems that may be too localized for the Annual System Reliability Report to capture. The Company argues that the base rate case is not the appropriate venue to address these issues, however as Mr. Lanzalotta testified, other generic proceedings may not fully address the issues specific to JCP&L:

> I am aware of the Board's recent initiative addressing poorest performing feeders. The approach of identifying poorest performing feeders, however, does not necessarily address smaller pockets of poor reliability performance on the system. I feel there's a need for the metric such as CEMI, C-E-M-I, refers to customers experiencing multiple interruptions, which provides information about the existence of pockets of customers smaller than entire distribution feeders that have been experiencing poor performance. *T22:L19 to T23:L4* (October 2, 2013).

As can be seen, the record is replete with documents as well as live testimony of JCP&L's poor service reliability. The Company's attempt to discount the voices of all the customers expressing legitimate reliability concerns is especially troubling. The ALJ attended all of the public hearings and heard for himself the suffering of these customers. Electric service is not a luxury but a lifeline service that customers rely on a daily basis. If legitimate concerns expressed at public hearings are not "evidence" that the ALJ and the Board should consider, then purpose of holding public hearings is undermined if not rendered meaningless.

The fundamental problem is JCP&L's limited view of what level of service the Company is required to provide. In the Company's view, if a New Jersey electric utility meets the Board's minimum reliability standards, it does not have to remedying on-going persistent reliability problems that unquestionably exist in its territory or suffer any consequences for failing to do so. The Board must reject such an interpretation of the law.

If a Company had poor reliability during 2002-2006, the benchmark for that utility under the Board's regulation is much lower than a system that performed in the first quartile performance during these periods. Applying only the Board regulations will never provide an incentive to improve poor performance. More needs to be done immediately. There are pockets of customers that have suffered outages on a frequent periodic basis for years. Aggregate CAIDI and SAIFI numbers system wide does not capture these long suffering customers. These customers cannot wait for another generic or a formal rulemaking proceeding as the Company suggests. *JCP&L Exceptions,* p. 72. Although Rate Counsel does not oppose generic proceedings to investigate statewide policies that will improve all New Jersey's electric utility performance, the concerns expressed by Rate Counsel in this proceeding are unique to JCP&L and a present problems that require immediate solutions.

B. The ALJ Was Correct To Conclude That A More Aggressive Tree Trimming Standard Beyond The Existing JCP&L Policy To Cut Vegetation 15 Feet Away From Distribution Lines Should Be Implemented.

The Company takes exception to the ALJ's conclusion that vegetation overhangs, even if cut to 15 feet away from the distribution lines may still pose a threat to the distribution system:

> Rate Counsel's point is well taken that branches and foliage above the conductors, even if fifteen or more feet away, will sometimes break and fall onto the wires. This is an area where the Company could expand its tree trimming to prevent outages. *ID*, p.110.

In response, the Company argues that the 15 foot clearance on all sides of the conductor "struck a balance" between reliability benefits and costs to customers among other things. *JCP&L Exceptions,* p. 74. However, Rate Counsel argues that cutting vegetation more aggressively than what JCP&L is proposing does not necessarily mean that rates need to increase for ratepayers. As discussed more fully in Rate Counsel's initial brief, JCP&L imposed cost saving measures in the past that have had a detrimental effect on JCP&L's service and reliability. *RCIB*, pp. 29-32. As Mr. Lanzalotta testified, four years of low cost tree trimmed per mile along with miles of vegetation management deferred, had a dramatic negative impact on JCP&L's SAIDI (System Average Interruption Duration Index) that includes major event. *RC-87,* pp. 31-32. In other words, the Company did not spend money collected from ratepayers through rates to do proper vegetation management and maintenance of the system. As discussed fully in Rate Counsel's Initial Brief, during the same time JCP&L was limiting its spending on vegetation management, JCP&L was giving its parent FirstEnergy a generous dividend**.** *RCIB*, p. 31; *JC-6*, Sched. PMA-3; T74:L2-17 (October 4, 2013). Over 70 percent of JCP&L's profits during 2009 to 2011 were paid out in dividends to its parent company FirstEnergy instead of reinvesting its profits in its New Jersey electric distribution utility to fund programs to maintain its vegetation management.

To be clear, Rate Counsel always encourages utilities to work efficiently so that the costs are kept at a minimum while reliability is improved. However, in JCP&L's case, the cost cutting may have negatively impacted reliability. Instead of focusing on

cost saving measures and giving its parent FirstEnergy generous dividends, JCP&L should have spent the money it collects from ratepayers to implement full canopy removal over at least the most critical backbone portions of the distribution circuits as recommended by Rate Counsel expert witness Mr. Lanzalotta. *JC-6*, Sched. PMA-3; T74:L2-17 (October 4, 2013); *RC-87*, p. 35. For the foregoing reasons, Rate Counsel respectfully request that JCP&L's exceptions be rejected and the Board adopt Rate Counsel's reliability recommendations in its entirety.

POINT VII

RATE COUNSEL'S PROPOSED SPREAD OF ITS RECOMMENDED RATE REDUCTION AMONG RATE CLASSES IS FAIR AND REASONABLE.

A. Judge McGill Was Correct In Deciding That Distribution Systems Must Be Designed And Built To Meet Non-Coincident Peak Demands In Rejecting Con Edison Developments Tariff Modification Request.

Con Edison Development ("ConEd") filed three exceptions to ALJ McGill's Initial Decision seeking tariff revisions as it relates to distribution services it receives from JCP&L under Rate Schedules GP and GT for its four solar projects located within JCP&L's service territory. First, ConEd takes exception to ALJ McGill's finding that "Adequate consideration has not been given to [ConEd's] use of JCP&L's distribution system to deliver the electric power generated by the facilities." *ConEd Exceptions*, p. 3.) ConEd explains its exception by claiming "…Con Edison Development already compensated JCP&L for use of its distribution system when it originally paid for the interconnection facilities and equipment upgrades to deliver the generated solar power into the electric grid." *ConEd Exceptions*, p 3. ConEd referenced the direct testimony of its witness's, Mr. Wemple. ConEd requires power from JCP&L only during Off-Peak Hours and the fringes of On-peak Hours. *ConEd Exceptions*, pp. 3-4.

ALJ McGill clearly and correctly rejected Mr. Wemple's assertion in this regard. (ID, page 81.) The evidence from the record demonstrated that the solar projects did indeed register maximum demands from the Company within 75 minutes of JCP&L's coincident peak on July 18, 2012. *JC-8 Rebuttal*, p. 5. Equally important, ALJ McGill correctly observed that distribution systems must be designed and built to meet non-

coincident peak demands not coincident demands. *ID*, p. 81. ConEd's first exception is both factually incorrect and irrelevant in adequate system design.

ConEd's second filed exception rejects ALJ McGill's finding that ConEd's request for relief is "grossly excessive". ConEd attempts to support its exception by arguing "….the relief requested is appropriate and necessary to end unfair and discriminatory treatment…" *ConEd Exceptions*, p. 5. Having determined that the solar projects use JCP&L distribution facilities On-Peak, it would be unfair and discriminatory to relieve the solar projects from paying any demand charge. To relieve the solar projects of all demand charges would lead to inter-class and intra-class subsidies, in that JCP&L's other customers will pay for system costs rightfully charged to the solar projects.

ConEd also filed an exception to the ALJ's finding that relief may be appropriate in a future proceeding. Given Con Edison Development's claim that most of its energy requirements from JCP&L are in the fringe On-Peak and Off-Peak hours, ALJ McGill opined that an adjustment in the definition of On-Peak hours "may be warranted after further analysis in a future proceeding." *ID*, p. 81. A review of the definition of On-Peak hours was not an issue before the court nor was there evidence in the record supporting any review. Consequently, there is no basis for a review and finding at this time. Such a finding will have to be supported by convincing evidence in any future proceeding that addresses that issue.

ConEd's case is far from "compelling" *ConEd Exceptions*, p. 2. The evidence clearly refutes ConEd's claims, demonstrating that it does indeed use JCP&L's distribution system. The Board should deny ConEd's exceptions and adopt ALJ McGill's Initial Decision as it relates to demand charges to be paid by the solar projects.

B. Judge McGill Was Correct Regarding The Allocation Of Administrative And General ("A&G") Costs Which Is Supported By The Record And By The Principle Of Gradualism.

Gerdau fails to fully present Rate Counsel's A&G expense allocation position as it relates to Gerdau in this matter. Gerdau, in its Exceptions, notes Rate Counsel's agreement with Gerdau that JCP&L's traditional method for allocating A&G expenses results in an excessive cost responsibility being allocated to Gerdau. *Gerdau Exceptions*, p. 9. However, Gerdau fails to complete Rate Counsel's position which recognizes some balance to that argument. Rate Counsel's witness Mr. Peterson testified: "In this instance, an A&G allocation method that is predominately based on Gerdau's limited investment in distribution plant (essentially meter investment only) may not recognize all of the resource requirements that JCP&L devoted to serving Gerdau's account." *RC-153*, p. 4.) Thus, while JCP&L's method allocates too much A&G expense to Gerdau, Gerdau's proposed method allocates too few. This dichotomy was discussed by ALJ McGill in the Initial Decision; "None of the parties is genuinely persuasive…Rate Counsel's position come closest to a fair result." *ID*, p. 73.

The fact is that any allocation procedure that results in fewer A&G costs being allocated to Gerdau will support a greater-than-average percentage rate reduction for Gerdau in this proceeding. For that reason, both Rate Counsel and, ultimately ALJ McGill, agreed that Gerdau should receive a greater-than-average percentage rate reduction at this time. If the Board adopts the ALJ's Initial Decision on this point, Gerdau will receive a percentage rate reduction that is 1.3 times greater than the overall percentage reduction found reasonable by ALJ McGill. For Gerdau to receive a larger-than-average rate reduction necessarily means that one or more classes will receive a

smaller-than-average rate reduction. In this respect, the ALJ has introduced the concept of gradualism into the spread of the revenue decrease among rate classes. This gradualism concept is a Board-required consideration as noted by ALJ McGill. *ID*, p. 61. ALJ McGill's Initial Decision regarding the allocation of A&G costs to Gerdau is supported by both, the record and by the principle of gradualism.

POINT VIII

THE PROPOSED ACCELERATED RELIABILITY ENHANCEMENT PROGRAM SHOULD BE REJECTED. INVESTMENTS IN RELIABILITY PROJECTS SHOULD BE TREATED NO DIFFERENTLY FROM OTHER INVESTMENTS THAT ARE NECESSARY TO PROVIDE SAFE AND ADEQUATE UTILITY SERVICE, AND SHOULD BE RECOVERED ONLY THROUGH A GENERAL BASE RATE CASE.

JCP&L takes objection to the ALJ's finding that the proposed AREP mechanism is unreasonable and should not be approved. In the exceptions to the Initial Decision, the Company reacts first to Judge McGill's suggestion that a "more clearly defined proposal may be appropriate for consideration in another proceeding." *JCP&L Exceptions,* p. 79. JCP&L argues that a base rate case is the appropriate time for the Board to review and consider a program like AREP. *Id.*

Looking at the ALJ's comment in context is necessary

> Under traditional ratemaking, the Board uses historical costs adjusted for known and measurable changes. The Board has adopted various adjustment clauses as exceptions to the traditional approach but only for specific reasons under clearly defined circumstances. Here, the cost recovery mechanism is very specific, but the details of the AREP rider are ill-defined. *ID,* p. 88-89

Thus the ALJ recognized that these costs could not be approved under traditional rate making practices as the costs were future costs, not "known and measurable." The ALJ recognized that the Board has approved clauses as an exception to this rule but only for very clearly defined, specific purposes. JCP&L's proposal cannot meet that standard. JCP&L has proposed no specific budget for the AREP projects, nor has the Company identified any specific programs that would be included in the AREP. Rather, JCP&L

proposes to work "collaboratively" with BPU staff to develop the "specific projects and time frame for the AREP."

JCP&L argues that this "collaborative process" is the reason that the Company did not provide specific tasks or budgets in its AREP proposal. Judge McGill found this process "inappropriately shifts management responsibility from the Company to Staff." *ID*, p. 89. Accordingly, the ALJ found that the AREP proposal "is unreasonable and should not be approved." *ID*, p.89. This finding is reasonable and based on the record in this proceeding. It should be adopted.

Attachment A

Confidential Document

Attachment B

Confidential Document