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April 15, 2013

<u>Via Electronic Mail and U.S. Regular Mail</u>
Kristi Izzo, Secretary
New Jersey Board of Public Utilities
44 South Clinton Avenue, 9th Floor
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Re: In the Matter of the Petition of Public Service Electric and Gas Company for Approval of a Solar Loan III Program and an Associated Cost Recovery Mechanism and for Changes in the Tariff for Electric Service, B.P.U.N.J. No. 15 Electric Pursuant to <u>N.J.S.A</u>. 48:2-21 and <u>N.J.S.A</u>. 48:2-21.1
BPU Docket No.: EO12080726

Dear Secretary Izzo:

Enclosed please find an original and ten copies of the Position Paper submitted on behalf of the New Jersey Division of Rate Counsel in connection with the above-captioned matter. Copies of the position paper are being provided to all parties by electronic mail and hard copies will be provided upon request to our office.

We are enclosing one additional copy of the comments. <u>Please stamp and date the extra copy as "filed" and return it to our courier.</u>

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Thank you for your consideration and assistance.

Very truly yours,

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encl.

SHS
Hon. Joseph L. Fiordaliso, Commissioner (via hand delivery)
cc: Service list (via electronic and regular mail)

In the Matter of the Petition of Public Service Electric and Gas Company for Approval of A Solar Loan III Program and an Associated Cost Recovery Mechanism and for Changes In the Tariff for Electric Service B.P.U.N.J. No.15 Electric Pursuant BPU Docket No.: EO12080726

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BEFORE THE STATE OF NEW JERSEY

BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE PETITION OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY FOR APPROVAL OF A SOLAR LOAN III PROGRAM AND ASSOCIATED COST RECOVERY MECHANISM AND FOR CHANGES IN THE TARIFF FOR ELECTRIC SERVICE, B.P.U.N.J. No. 15 ELECTRIC PURSUANT TO N.J.S.A. 48:2-21 AND N.J.S.A. 48:2-21.1	)	**BPU DOCKET NO. EO12080726**

POSITION PAPER OF THE NEW JERSEY DIVISION OF RATE COUNSEL

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PRELIMINARY STATEMENT

In the present Petition before the New Jersey Board of Public Utilities ("BPU" or "Board"), Petitioner Public Service Electric and Gas Company ("PSE&G" or "Company") is seeking approval for a proposed "Solar Loan III" ("SLIII"). Under its previously approved Solar Loan I (SLI) and Solar Loan II (SLII) programs, the Company was authorized to provide approximately $250 million in loans to support the development of approximately 81 Megawatts (MW) of solar generation on its customers' premises. The Company is now requesting authorization for a further $193 million in loans to its customers to support development of 97.5 MW of solar capacity.

The Company's SLIII Petition should be rejected because it fails to satisfy two key requirements recently established by the Board for solar loan programs. Under the Board's May 23, 2013 Order establishing criteria for utility-supported solar programs, a solar loan program, among other requirements, (1) must incorporate a competitive process that will "provide for the lowest achievable cost within the market segments," and (2) must assure that solar developers, and not ratepayers, will be responsible for all administrative costs associated the program. I/M/O the Review of Utility Supported Solar Programs, BPU Dkt. No. EO11050311V, Order at 27, par. k & q (May 23, 2012) ("2012 Utility Solar Extension Order"). The SLIII program fails to meet either requirement. While PSE&G has proposed what it refers to as "solicitation" process, this process does not apply to all of the proposed program segments, and more important, is proposed to be conducted "in house" with no independent solicitation manager or oversight by the Board. This is not sufficient to assure a fully competitive process especially in light of recent allegations, albeit unproven, of failures to appropriately manage ratepayer-funded solar programs. With regard to administrative costs, the Company's SLIII proposal requires ratepayers to "backstop" any costs not covered by the program's proposed fixed fee structure for loan recipients.

SLIII is a voluntary program, which is not needed to meet New Jersey's goals for solar-generated energy. The two requirements discussed above were established by the Board to assure that solar loan programs are consistent with this State's long-term goal of reliance on competitive markets, rather than rebates and other direct financial incentives, to achieve the State's renewable energy goals. Since the proposed SLIII program does not meet those requirements the Petition should be dismissed. If PSE&G wishes to pursue a loan program, it should be directed to file a proposal that complies with the Board's directives.

An additional reason to reject the SLIII proposal is that it is not necessary to meet the State's goals for solar powered electric generation. New Jersey's solar energy goals and compliance with the same are expressed through Renewable Portfolio Standards ("RPS") as annual quantities of solar renewable energy certificates ("SRECs") (i.e., tradable certificates representing the value inherent in the source of solar-generated energy). In New Jersey, there is currently an oversupply of SRECs –there are more SRECs available than are needed to meet the RPS solar generation obligations of electric generation service providers—and this oversupply is expected to continue over at least the next couple of years and possibly much longer. The oversupply has resulted in lower SREC prices and raised concerns regarding the viability of the solar industry in New Jersey. Adding 97.5 MW of additional capacity, as proposed by PSE&G, could intensify the oversupply and further destabilize the SREC market; it may also disrupt the measures to stabilize the market that were recently enacted in the Solar Energy Act ("SEA") in July 2012, P.L. 2012, c. 24. While the Board has determined to allow solar loan programs, such programs should be allowed only if they comply with the specific requirements established by the Board to assure that they are consistent with reliance on competition.

The proposed SLIII program also has other serious flaws. These should be addressed in any future filing by PSE&G.

SLIII would impose a large and unpredictable financial burden on the State's residential and business ratepayers. Since the rate impacts of the program are based in part on projections of the amounts PSE&G can receive by selling the electric output and SRECs produced by the solar facilities, the rate impacts of the program are uncertain. PSE&G estimates that this program will require the collection of over $126 million from its electric ratepayers over a 15-year period, and, as explained below, Rate Counsel believes this amount is understated.

One reasons for this is PSE&G's proposal to earn a return on its investment equal to the weighted average cost of capital ("WACC") used to set rates in its last base rate case, including a 10.3 percent return on equity. The WACC approved in PSE&G's last base rate case is dated, and excessive relative to current market conditions. Further, the Company's proposal would add another "pass through" rate recovery mechanism to an already excessive number of such mechanisms. In addition to improperly transferring risks from shareholders to ratepayers, the proliferation of such mechanisms makes it difficult or impossible to assure that ratepayers are not paying twice for costs already reflected in base rates or other clauses. The Company's proposed rate of return gives no weight to the fact that the clause-type recovery mechanism proposed by PSE&G program poses substantially less risk than recovery of costs through base rates. In fact, the proposed ratepayer "backstopping" of all costs and the proposed concurrent cost recovery make the SLIII program virtually risk free for the Company. Any re-filed petition should include a reasonable rate of return, including an ROE no higher than 9.75%. In addition, any re-filed petition should include limits on ratepayer exposure, including a NPV rate cap.

In summary, the proposed SLIII program fails to meet key requirements established by the Board to assure its consistency with the State's policy of reliance on competitive markets to meet its renewable energy goals. This program is not needed to meet solar RPS goals, and therefore should not be entertained unless and until PSE&G files a Petition in compliance with the Board's requirements. In order to meet those requirements, any re-filing should include an independently-monitored program that is designed in a manner consistent with the competitive solicitation framework envisioned by the Board and a cost recovery mechanism that assures ratepayers will not pay any administrative costs. Further, any re-fling should include a reasonable rate of return, and other safeguards against unreasonably high rates, and should allocate no more that 8 percent of the program's capacity to the residential segment, and should eliminate the "landfills/brownfields."

STATEMENT OF FACTS AND PROCEDURAL HISTORY

On April 16, 2008 the Board approved a Stipulation providing for the implementation of PSE&G's SLI program. Under the approved Stipulation, the Company was authorized to provide approximately $105 million in loans over a two-year period to support the installation of 30 megawatts (MW) solar photovoltaic electric generation systems on its customers' premises. The loans were provided across four customer segments: (1) Residential, (2) Commercial and Industrial, (3) Multi-Family/Affordable Housing, and (4) Municipal/Not-For-Profit. The loans were repayable to PSE&G in either cash or SRECs, at the borrower's election. SRECs used for loan repayment were valued at the higher of a measure of market value ("Market Value") or an established minimum guaranteed value or "Floor Price" of $475. The loans are repaid over a period of 10 years for consumer loans and 15 years for other loans. I/M/O the Petition of Public Service Electric and Gas Company for Approval of a Solar Energy Program and an Associated Cost Recovery Mechanism, BPU Dkt. No. EO07040278, Decision and Order at 4-5, 10-14, 16 (April 16, 2008) ("SLI Order").

PSE&G recovers the costs of the SLI program through a rate "pass-through" charge known as the Solar Program Recovery Charge ("SPRC") which is filed and trued up annually. PSE&G's cost recovery includes Amortization Expense, equal to the amounts credited to loans, and 50% of the Company's administrative costs of the program, up to an annual administrative cost recovery cap of $1 million in any year. The company earns a return on Net Investment, which includes unamortized loan amounts, at a WACC including the 9.75 percent return on equity used to establish rates in the Company's 2002 electric base rate base rate case, BPU Docket No. ER02050303. Revenue requirements are offset by (1) net proceeds from the sale of SRECs used for loan repayment, and (2) any cash loan repayments. The Amortization Expense charged to ratepayers includes the full value attributable to the SRECs, and is offset by only the net proceeds received by PSE&G from the sale of SRECs; thus, in the event the Floor Price is higher than such net proceed the differential is paid by ratepayers. SLI Order at 15.

On March 31, 2009, supplemented on April 13, 2009, PSE&G filed a Petition with the Board pursuant to Section 13 of the Regional Greenhouse Initiative Law, P.L. 2007, c. 340 ("the RGGI Law"), N.J.S.A. 48:3-98.1, seeking approval for an extension of the SLI program, known as the SLII program. On November 10, 2009 the Board approved a Stipulation providing for the implementation of the SLII program. I/M/O Petition of Public Service Electric and Gas Company for Approval of a Solar Loan II Program and an Associated Cost Recovery Mechanism, BPU Docket No. EO09030429 (Nov. 10, 2009) ("SLII Order"). Under the approved Stipulation, the Company was authorized to provide approximately $143 million in loans over a two-year period to support the installation of 51 MW of solar generation on its customers' premises. Loans were provided across four customer segments: (1) Residential, (2) Non-Residential projects up to 150 kilowatts ("kW"), and (3) Non-Residential projects larger than 150 kW and up to 500 kW. SLII Order at 4. SLII was later modified to include a fourth "Very Large Non-Residential" segment for projects greater than 500kW up to 2 MW. I/M/O Petition of Public Service Electric and Gas Company for Approval of a Solar Loan II Program and an Associate Cost Recovery Mechanism, BPU Dkt. No. EO09030249, Decision and Order Approving Program Changes at 6 (June 22, 2010). As under the SLI program, loans issued under the SLII program are payable in cash or SRECs, which are valued for purposes of loan repayment as the higher of a market value or a ratepayer-supported Floor Price. For this program, however, the Floor Prices were set on a schedule that varied from $330 to $450 per SREC, depending on program segment and time period. SLII Order at 5.

The Company recovers the cost of the SLII program through a component of its Regional Greenhouse Gas Initiative Recovery Charge ("RRC"). The cost recovery mechanism is similar to the SPRC, except that (1) PSE&G recovers 100% of its administrative costs for SLII, up to annual and total program caps specified in the Stipulation, and (2) the Company earns a return on Net Investment at a WACC that includes a return on equity of 10.0 percent. Solar Loan II Order at 6-9.

On August 1, 2012, PSE&G filed a Petition (the "Petition") with the Board pursuant to Section 13 of the RGGI Law requesting approval of its proposed Solar Loan III Program. As attachments to the Petition, PSE&G filed the direct testimony of Messrs. Joseph A. Forline and Stephen Swetz, and Ms. Donna M. Powell.

By letter dated August 31, 2012, Board Staff advised PSE&G that for this petition it was amending the minimum filing requirements in Appendix A of the May 12, 2008 Board Order in BPU Docket No. EO08030164 to waive any deficiencies that may be present in PSE&G's filing without precluding subsequent request for any information, and the petition was deemed administratively complete. Therefore, the Board's 180-day review period set by the RGGI Law commenced on August 1, 2012, with an expiration date of January 28, 2013.

The Company is seeking authorization to provide loans of up $193 million over a three-year period by providing loans to support the development of 97.5 MW of solar capacity on its customers' premises. *P-1*, par. 3. Of the 97.5 MW, the Company is proposing to allocate 9.75 MW to a Residential segment; 14.625 MW to a "Small Non-Res" segment for projects up to 150 kW on non-residential premises; 68.125 MW to a "Large Non-Res" segment for non-residential projects larger that 150 kW and up to 2 MW; and 5 MW to a "Landfills/brownfields" segment. *P-3*, p. 12-13 & Schedule JAF-SLIII-2, p. 1, 2.

The SLIII program includes a number of changes from the SLII program including "market-based" methodology for determining the Floor Price, and increased loan application and borrower's administrative fees and a new SREC processing fee, intended to offset administrative costs. *P-1*, par. 7. The Company is seeking to earn a return on Net Investment at the same WACC that was used to set rates in the Company's last base rate case, BPU Docket No. GR09050422, including a 10.3 percent return on equity. *P-1*, par. 9; *P-4*, p. 3.

By Order dated September 13, 2012, the Board decided to retain the matter and designated Commissioner Joseph L. Fiordaliso, as the presiding officer, with authority to rule on all motions and modify schedules and necessary. Commissioner Fiordaliso adopted a procedural schedule by Order dated October 4, 2012.

Between September 19, and October 26, 2012, motions to intervene in this proceeding were filed by the Solar Energy Industries Association ("SEIA"), New Jersey Solar Energy Coalition ("NJSEC"), KDC Solar LLC ("KDC Solar"), and Mid-Atlantic Solar Energy Industries association ("MSEIA").

Public hearings were held on November 27 and 29, and December 4, 2012, in New Brunswick, Hackensack, and in Mount Holly, New Jersey, respectively.

At a settlement conference on November 27, 2012 and in e-mail correspondence on November 28 and 29, 2012, PSE&G, Rate Counsel and Board Staff, agreed to certain changes in the procedural schedule.

By Order dated December 3, 2012, Commissioner Fiordaliso granted the KDC Solar motion to intervene. The motions of SEIA, NJSEC, and MSEIA were granted subject to the condition that these entities submit updated membership list to the Board and PSE&G. By that same Order, Commissioner Fiordaliso approved the agreed amendments to the procedural schedule contingent upon the Board's approval of a stipulation to extend the 180-day RGGI review period. By Order dated January 4, 2013, Commissioner Fiordaliso, adopted a further modified procedural schedule, also conditioned upon Board approval of the stipulation to extend the 180-day RGGI review period.

By Order dated January 23, 2013 the Board, in accordance with a December 11, 2012 Stipulation among Rate Counsel, Staff and the Company, extended the 180-day RGGI review period to to April 1, 2013.

In accordance with Commissioner Fiordaliso's January 4, 2013 procedural Order, January 11, 2012, Rate Counsel filed the direct testimony Ms. Andrea C. Crane and David E. Dismukes, Ph.D. On February 6, 2013 PSE&G filed the rebuttal testimony of Messrs. Jorge L. Cardenas, Terrance J. Moran, Paul R. Moul and Stephen Swetz. On that date SEIA also filed the rebuttal testimony of Ms. Katie Bolcar Rever.

On February 12, 2013, Rate Counsel filed a motion in limine to strike the testimony of Company witnesses Jorge Cardenas, and Paul R. Moul or, in the alternative, to extend the discovery period and allow written surrebuttal. PSE&G filed its opposition to Rate Counsel's motion on February 13, 2013.

In order to resolve the motion and pursuant to discussions among the parties regarding an extension of time to permit the filing of surrebuttal testimony and limited discovery, a proposed revised schedule developed by several parties was circulated without objection. By Order dated February 21, 2013 Commissioner Fiordaliso adopted the revised schedule, dependent on the adoption of a further extension of the 180-day RGGI review period

In accordance with Commissioner Fiordaliso's Feburary 21, 2013 procedural Order, on March 1, 2013, Rate Counsel filed the surrebuttal testimonies of Ms. Andrea C. Crane, Mr. Mathew I. Kahal, and David E. Dismukes, Ph.D.

By Board Order dated March 20, 2013, the Board approved a stipulation executed on March 6, 2012, by PSE&G, Rate Counsel, and Board Staff agreeing to a further extension of the 180-day RGGI review period to May 1, 2013.

On April 1, 2013 PSE&G, Board Staff and Rate Counsel., SEIA and MSEIA entered into a Stipulation agreeing to the cancellation of the evidentiary hearings that were scheduled in this matter for April 1 and 2, 2013 and settling the contents of the record. Commissioner Fiordaliso adopted that stipulation by Order dated April 1, 2013.

ARGUMENT

I. THE SOLAR LOAN III PROPOSAL SHOULD BE DISMISSED BECAUSE IT FAILS TO COMPLY WITH CRUCIAL REQUIREMENTS ESTABLISHED BY THE BOARD TO ASSURE THAT SUCH PROGRAMS COMPLY WITH STATE POLICIES FAVORING RELIANCE ON COMPETITIVE MARKETS TO MEET THE STATE'S SOLAR ENERGY GOALS.

New Jersey and Board Policy

Over a period of many years, it has been the policy of this State to move toward reliance on competitive market mechanisms to meet the State's renewable energy and solar energy goals at the lowest possible cost. As detailed below, the Board issued its 2012 Utility Solar Extension Order with this objective in mind.

In 1999, with the enactment of the Electric Discount and Energy Competition, Act, ("EDECA"), P.L.1999, c. 24 (1999), the Board was directed to adopt its RPS, which required electric power suppliers and basic generation service ("BGS") providers to procure specified percentages of their energy supply from renewable sources, including solar. L. 1999, c. 24, sec. 38(d). EDECA also contemplated that the Board could, in consultation with the New Jersey Department of Environmental Protection, establish a renewable energy trading program to facilitate compliance with the RPS. Id. The Board has since issued regulations requiring electric power suppliers and BGS providers to comply with the solar RPS by producing or buying SRECs, or in the event of a shortfall, by paying a Solar Alternative Compliance Payment ("SACP"). An SREC is a tradable certificate representing the environmental attributes of one megawatt-hour of solar electric generation. See 2011 EMP, Glossary and Definitions, definition of "Solar Renewable Energy Certificate (SREC)." Under this design, a shortage in the supply of SRECs needed to meet the RPS should result in increased SREC prices, thus encouraging the development of new solar facilities, and conversely, an over-supply should lower prices, thus slowing development. See Id. p. 92.

While the Board initially relied on a combination of SREC prices and other incentives to encourage the solar development needed to meet the RPS, the Board recognized the need to reduce reliance on costly rebates and increase reliance on market-based incentive mechanisms. Accordingly, the Board opened the Solar Transition Proceeding to investigate "more efficient and sustainable means" than rebates to provide incentives for solar development. I/M/O the Renewable Energy Portfolio Standard—Alternative Compliance Payments and Solar Alternative Compliance Payments, BPU Dkt. No. EO06100744, Decision and Order at 2 (Dec. 6, 2007) ("2007 Solar Transition Order"). As noted by Rate Counsel witness Dr. Dismukes, the result of this proceeding was the 2007 Solar Transition Order, which took a number of actions, including establishing a qualification life for solar projects, increasing the trading life of SRECs, increasing the SACP, and establishing an eight-year SACP schedule, all of which were intended to enhance the viability of the solar market by increasing regulatory certainty. Id. at 39-42. See *RC-3*, p. 7-8. In addition to these measures, the Board found that "an additional mechanism or mechanisms will be necessary for the market to achieve levels of growth sufficient to meet RPS requirement at an acceptable cost," and therefore convened further proceedings to consider such mechanisms. 2007 Solar Transition Order at 44. Those further proceedings culminated in a Board Order directing each of the electric distribution companies ("EDCs") to establish long-term contracting plans. I/M/O the Renewable Energy Portfolio Standard, BPU Dkt, No. EO06100744 (Aug. 7, 2008) ("2008 Utility Solar Order"). The Board directed three of the EDCs, Atlantic City Electric Company ("ACE"), Jersey Central Power & Light Company ("JCP&L") and Rockland Electric Company ("Rockland"), to develop programs to purchase SRECs from solar developers under

10- to 15-year contracts, based on a competitive procurement process. The 2008 Utility Solar Order set in motion a structured competitive procurement process, whereby non-utility solar developers submitted bids to supply SRECs under long-term contracts, with contracts awarded to the lowest-price bidders after review by an independent Solicitation Manager and approval by the Board. I/M/O Atlantic City Electric Company Renewable Energy Portfolio Standard and I/M/O Verified Petition of Jersey Central Power & Light Co., BPU Dkt. Nos. EO08100875 & EO08090840, Order at 6-7 (Mar. 27, 2009) (March 2009 ACE-JCP&L SREC Financing Order);[1] I/M/O the Verified Petition of Rockland Electric Company Concerning a Proposal for an SREC-Based Financing Program, BPU Dkt. No. EO09020097, Order at 6 (July 31, 2009)("Rockland SREC Financing Order").This process both provided a level playing field for the non-utility solar developers that submitted bids, and served the interest of ratepayers by selecting bids on a least-cost basis. *RC-3*, p. 8-9. PSE&G was permitted to propose an alternative approach based in the Company's existing Solar Loan program, a program in which the Company makes loans long-term loans to qualified solar photovoltaic projects in its service territory. The Company's proposal was, however, required to include modifications "sufficient to enable the loan program to support the transition to a market-based approach of delivering incentives for solar generation." 2008 Utility Solar Order at 17.

As the utilities completed their implementation of the long-term contracting and loan and programs in 2011, the Board initiated an additional stakeholder process to review possible future utility-supported solar programs to be filed with the Board under the Section 13 of the RGGI Law, N.J.S.A. 48:3-98.1. This process resulted in an Order dated May 23, 2012. I/M/O the

[1]By Order dated September 16, 2009 in these same BPU dockets the Board modified its March 27, 2009 Order to reflect a stipulated resolution of a cost recovery related issue that had been raised in an appeal by Rate Counsel.

Review of Utility Supported Solar Programs, BPU Dkt. No. EO11050311V (May 23, 2012) ("2012 Utility Solar Extension Order"). The 2012 Utility Solar Extension Order affirmed that utility-supported solar programs should follow a market-based approach. In adopting the recommendations of its Office of Clean Energy ("OCE") regarding the extensions of such programs, the Board found that "the OCE's recommendations, if properly executed, will move the RE [Renewable Energy] program closer to a market-based approach and, accordingly, reduce ratepayer subsidies as required by EDECA." Id. at 28. The Board, while permitting either loan or solicitation programs, the established a number of requirements applicable to both, including the following two:

> k. The loan or solicitation process shall be developed to provide for the lowest achievable and available cost within the market segments on a "competitive" basis that tracks the market rate and without a set floor price.
>
> * * *
>
> q. The EDC's costs for developing, implementing and managing the extended EDC SREC program including all SREC transition [sic] fees, all loan serving fees, and any fees associated with the EDC's weighted average cost of capital, and all administrative fees would be paid for by the solar developer or generation customer.

Id., p. 27. The above requirements support the Board's objective of relying on the competitive market by allocating all costs to solar developers, then allowing them to compete to provide solar generation at the lowest available cost.

Section 13 of the RGGI Law, which provides the legal authorization for the Board to consider the SLIII proposal, specifically recognizes the importance of the Board's efforts to increase reliance on market-based mechanisms:

> In determining the recovery by electric public utilities and gas public utilities of program costs for any program implemented pursuant to this section, the board may take into account ... the effect on competition for such programs, existing market barriers, …, and the availability of such programs in the marketplace.

N.J.S.A 48:3-98.1(b) (emphasis added). This provision thus explicitly allows the Board to assure that utility proposals are consistent with the basic principle of moving toward reliance on market-based mechanisms to meet the State's renewable energy goals.

The Board's efforts to emphasize market-based mechanisms are consistent with the recently-enacted SEA. SEA affirms the principle of reliance on market-based mechanisms. Starting in 2008, a number of factors led to an oversupply of SRECs and dramatic drops in SREC prices. *RC-2*, p. 17-19. The SEA attempts to "rebalance" the current excess supply conditions in the New Jersey solar markets by increasing the RPS from its prior levels through 2022, with corresponding reductions in subsequent years, thus preserving the SREC market as a means of encouraging solar development. *RC-2*, p. 19.

The 2011 EMP also reaffirms the importance of direct incentives the amounts of which are not regulated by competition. The very first "overarching goal" mentioned in the introduction to the 2011 EMP is to:

> Drive down the cost of energy for all customers – New Jersey's energy prices are among the highest in the nation. For New Jersey's economy to grow energy costs must be comparable to costs throughout the region; ideally these costs should be much closer to U.S. averages.

S-2, p. 1 (2011 EMP, p. 1). Consistent with this goal, the EMP has stressed the importance of relying on the competitive market to assure that renewable resources are delivered at the lowest possible cost, stating that "[u]ltimately, it is the competitive market rather than New Jersey's policymakers that should rationalize the amount, location and type of renewable technologies added to the resource mix to satisfy the RPS requirement." 2011 EMP, p. 87.

In summary, the above-cited requirements in the Board's 2012 Utility Solar Extension Order are necessary to assure that utility-supported solar programs are in compliance with New

Jersey solar energy policy as reflected in EDECA, the RGGI Law, the SEA and the 2011 EMP. The SLIII proposal does not comply with these requirements and should therefore be dismissed.

Lack of Proper Solicitation Process

In its Petition, PSE&G states that its SLIII proposal includes "a market-based method for determining the floor price at which to value the SRECs provided in repayment of the loans." *P-1*, par. 7. As stated in the prefiled direct testimony of Joseph A. Forline, the Company is proposing two different solicitation processes, one for non-residential loans and one for residential loans. *P*-3, p. 5-6. Neither process, however, includes the type of "price discovery" process envisioned in the Board's Order which allocates loans "on a 'competitive' basis" tracking "the market rate and without a set floor price." 2012 Utility Solar Extension Order, p. 27, par. k.

For residential loans, PSE&G is proposing a process whereby the floor prices would be administratively determined for each solicitation, subject to adjustment dependent upon the prior solicitation's participation level. PSE&G is proposing to conduct solicitations six times per year, but would reserve the right to conduct solicitations more or less frequently depending on market conditions and administrative workload. For the initial solicitation, the floor price would be set at an administratively-determined $310 per SREC for each residential segment. Prospective residential solar projects would submit applications, and qualified applicants would be selected on a first-come, first-served basis. If the applications received in a given solicitation exceeded the capacity allocated to that solicitation by more than 25%, the floor price for the next solicitation would decrease by $25. Conversely, if the applications received were for less than 75% of that solicitations' capacity block, the floor price would increase by $25 for the next solicitation. *P-3*, p. 5-6 & Schedule JAF-SLIII-2, p. 2, 4-5. As explained by Dr. Dismukes, this process does not comply with the Board Order. Residential loan applicants would not offer "a unique, individually-determined SREC floor price," and the floor price would be set initially and adjusted by the Company, rather than by evaluating competing bids. *RC-2*, p. 10-11.

For non-residential loans, PSE&G is proposing a solicitation process in which prospective borrowers would bid proposed SREC floor prices with their loan applications. Proposals within each segment would be ranked based on the SREC floor prices, bid from lowest to highest up to a cap of $310, including a $10 per SREC processing fee, until the capacity block for the segment is filled. Projects not making the cut-off would have the option of being included in the next solicitation at the same bid price. *P-3*, p. 5; *RC-2*, p. 9.

While this process has some features of a competitive process, it does not meet the Board's requirement for a process that results in market-based prices. PSE&G is proposing to conduct the solicitations "in house," with no requirement for independent oversight. As explained by Rate Counsel witness Dr. Dismukes, the Company's proposed program rules are fundamentally flawed because they "lack any meaningful appreciation for the role of independence in bidding processes of this nature."*RC-2*, p. 9. The Company's proposed program rules state that "PSE&G will manage the solicitation process directly or through a third-party vendor." *P-3*, Schedule JAF-SLIII-2, p. 1. However, PSE&G is not committing to independent third-party oversight, and, apparently, would retain overall authority over the solicitation process in any event: the program rules repeatedly refer to actions "PSE&G" will take with regard to the bidding and selection process. *P-3*, Schedule JAF-SLIII-2, p. 2-4; *RC-2*, p. 9-10.

The Board recognized the importance of independent oversight for competitive processes in its Orders approving the ACE, JCP&L and Rockland SREC financing programs mentioned above. As explained by Dr. Dismukes, these programs use an independent Solicitation Manager

("SM") to manage the solicitation process and review and make recommendations to the Board as to acceptance or rejection of specific offers. *RC-2*, p. 33. The participation of an independent Solicitation Manager is particularly important when there is a need to consider "conflicting goals, such as attempting to minimize cost but reach certain market segment aspirational goals …." *Id.* Independent oversight is a necessity to assure the integrity of the solicitation process for PSE&G, and this is "particularly important given recent allegations, albeit unproven, of failures to appropriately manage ratepayer-funded solar programs." *Id.*

The ACE, JCP&L and Rockland SREC financing programs provide guidance for the type of process that is appropriate to assure a fully competitive solicitation process. Those programs are conducted in accordance with detailed rules and protocols that were developed in settlement discussions among the parties, and in subsequent discussions among Companies, Board Staff and Rate Counsel, without the participation of prospective bidders and their representatives. Under this process, an independent SM conducted the solicitation, and then evaluated the bids and provided recommendations to the Board based on a process that included a statistical tests of the competitiveness of the bids, and a "soft cap" to providing guidance as to the price above which bids should not be accepted. 2009 ACE-JCP&L SREC Financing Order at 6-7. Rockland SREC Financing Order at 6. The bid evaluation methodologies and the "soft caps" were developed by developed by the SM with input from the companies, Board Staff and Rate Counsel but were ultimately determined and applied independently by the SM and were not disclosed to prospective bidders. Id. at 7 and attached Stipulation, par. 7 & 12.

These types of measures to assure the integrity of the solicitation process are all notably absent from PSE&G's proposal. The non-residential solicitation process is not consistent with the Board's requirement for a process that assures that ratepayer-guaranteed floor prices are as low as possible given market conditions.

Administrative Cost Recovery

The SLIII proposal also does not meet the requirement that administrative and implementation costs be paid by the solar developer or solar generation customer. 2012 Utility Solar Extension Order, p. 27, par. q. As explained by Rate Counsel witness Ms. Crane, the Company is proposing to charge a number of fees to borrowers: an Application Fee of $20 per kilowatt ("kW"), up to a maximum of $7,500, an Administration Fee equal to 4 percent of the loan, and an SREC Processing Fee of $10 per SREC. *RC-1*, p. 18. In a schedule filed with Mr. Forline's prefiled direct testimony, the Company claims that these fees will cover all but $456,271 of the Company's administrative costs. *RC-1*, p.8; P-*3*, Schedule JAF-SLIII-4. PSE&G also proposed for ratepayers to cover the administrative cost associated with selling the SRECS, estimated at $970,000. *RC-1*, p. 20.

In addition to the PSE&G's explicit proposal to require ratepayers to pay $456,271 in administrative costs, plus $970,000 in SREC disposition costs, the Company's actual proposal for recovering administrative costs may result in a much larger burden on ratepayers. As Ms. Crane explained, "[w]hile the Application Fee and the Administration Fee will, in fact, be paid by borrowers, the SREC Processing Fee will be included in the Company's revenue requirement and a substantial portion of this fee is likely to be paid by New Jersey ratepayers." *RC-1*, p. 18. In fact, ratepayers will be at risk for all administrative costs not covered by the Application Fee and Administration Fee. Ratepayers could be a risk for recovery of up to $11.5 million, plus the approximately $970,000 in SREC disposition costs. Id.

Ratepayers are put at risk because the recovery of the SREC Processing Fee of $10 per SREC is dependent on the value of the SRECs at the time they are used in repayment of the loans. Under PSE&G's proposal, the value attributed to the SRECs is the greater of a market value, determined under a methodology specified in the Petition (the "Market Price"), and the SREC Floor Price. *RC-1*, p. 19. If the Market Price is greater than the Floor Price, then the loan is credited with the Market Price less the $10 SREC Processing Fee. Id. In this scenario, the $10 per SREC fee is indirectly paid by the borrower. *RC-1*, p. 19.

However, if the Market Price is less than the Floor Price, the loan is less than the Floor Price, then the loan is credited with the Floor Price less $10, while the "SREC Floor Price Cost" is included in the Company's revenue requirements. The "SREC Floor Price Cost" is equal to the difference between the full Floor Price (without subtraction of the $10) and the Market Price. As a result ratepayers are responsible for the full difference between the Floor Price and the Market Price. *RC-1*, p. 19. In other words, since ratepayers are "backstopping" the full difference between the Market Price and the Floor Price, the $10 SREC Processing Fee will fall on ratepayers whenever the Market Price is below the Floor Price. Id.

Based on the foregoing analysis by Ms. Crane, the Petition explicitly provides for ratepayers to pay approximately $1.4 million in administrative costs and SREC disposition costs, and ratepayer's costs could be much higher. This analysis, which was undisputed in the Company's rebuttal testimony, shows that the SLIII proposal is inconsistent with the Board's requirement that "…all administrative fees would be paid for by the solar developer or solar generation customer." 2012 Utility Solar Extension Order, p. 27, par. q.

In addition, Ms. Crane noted that the Company's revenue requirement calculation, reflected in a schedule filed with Mr. Swetz's prefiled direct testimony, reflects administrative costs of $11,577,689, representing those costs not recovered through the initial Application Fee and Administration Fee, rather than the total claimed administrative costs of $20,507,689. *RC-1*, p. 21. This methodology would make it difficult to assure that ratepayers do not pay any administrative costs. If a loan program is implemented, the Company should separately identify and track <u>all</u> administrative costs, and should maintain records of such costs and their recovery completely separate from the SREC Floor Price. *RC-1*, p. 22.

<u>Conclusion</u>

The SLIII proposal does not meet two of the key requirements established by the Board for utility-sponsored solar programs: it does not "provide for the lowest achievable and available cost within the market segments on a 'competitive' basis that tracks the market rate and without a set floor price," and it provide that "…all administrative fees would be paid for by the solar developer or solar generation customer." <u>2012 Utility Solar Extension Order</u>, p. 27, par. k. and q. The SLIII proposal is voluntary, and as discussed in Point II below, it is not necessary to meet New Jersey's solar RPS requirements. The Board should accordingly dismiss the Petition and direct PSE&G to comply with the Board's requirements in any future filing. Any future filing should include the following:

- The program should include a market-based approach to determine the Floor Price for both residential and non-residential loans.
- The proposed process should at a minimum include the use of an independent solicitation manager and a significantly modified set of program rules that provide for greater clarity.
- The proposal should assure that no administrative costs will be charged to ratepayers.
- In order to assure that ratepayers are not paying any administrative costs, all administrative costs should be separately identified and tracked. In addition,

administrative costs and the recovery of such costs should be maintained completely separate from the SREC Floor Price.

II. THE PROPOSED SLIII WOULD FURTHER DESTABILIZE AN ALREADY OVERSUPPLIED SREC MARKET, IN DIRECT CONTRAVENTION OF THE MARKET STABILIZATION MEASURES REFLECTED IN THE SOLAR ENERGY ACT.

As set forth below and in testimony, the record shows that the proposed SLIII would have an adverse effect on the SREC market. The SREC market is presently oversupplied and will continue to be so at least for the next several years. See *RC-2*, pp. 22-26. Adding another 97.5 MW, as envisioned by the proposed SLIII, would result in more volatility, hindering further solar development and harming the associated environmental and other benefits of solar. This result would contravene state policy, which fosters the long-term stabilization of solar markets.

Bases of Solar Policy

EDECA initially established the Renewable Portfolio Standard ("RPS") requirements, which form the basis for solar development in the State. See N.J.S.A. 48:3-87. Subsequent legislation and Board Orders provided further guidance for the development of solar energy projects. Early on, the Board took a significant step in stabilizing the solar markets over the long term with its 2007 Solar Transition Order. The 2007 Solar Transition Order set a SREC trading life of two years and an eight-year Solar Alternative Compliance Payment ("SACP") pricing schedule. See *RC-2*, p. 14. In conjunction with the RPS, the parameters established for SREC trading lives and the Board's eight-year outlook provided a more stable framework for solar market development. *Id.*, p. 15.

Later, the Board reinforced its long-term outlook for the solar market with its 2008 Utility Solar Order. Therein, the Board directed certain EDC's to establish long-term contracting plans for solar energy, based on a competitive procurement process. Again, the 2008 Utility Solar Order embodied a long-term view of the solar market.

Recent Changes in the Solar Markets

As Dr. Dismukes testified, the solar market today is much different than the solar market in 2007. *RC-2*, pp. 17-18. Since that time, there have been marked changes in both the demand and supply sides of the solar market. Dr. Dismukes found that "demand" side of the solar market, comprised of the demand for solar energy (i.e., SRECs), has declined while the "supply" side of the market, consisting of the provision of SRECs and driven by both existing and new solar installations, has increased. *Id.*

Dr. Dismukes testified that the recent economic recession led to a significant reduction in electricity demand. *RC-2*, p. 18 and Schedule DED-4. This reduction in electricity demand, in turn, led to a significant reduction in the need for SRECs, since the solar RPS requirements are driven primarily by formulae tied to some percentage of electricity sales or generation. *Id.* Hence, the recent recession led to a decrease in the number of SRECs needed to meet RPS requirements, thereby depressing the demand side of the solar market. *Id.*

Meanwhile, a number of factors caused an increase in the supply of SRECs. Dr. Dismukes found that increases in the supply of solar panels and equipment, and decreases in the price of solar panels, led to an over-supply situation on the SREC supply side. *RC-2*, pp. 18-19.

Dr. Dismukes further testified on the ability of markets to correct for supply and demand imbalances, as it pertains to the solar market:

> Over time, these types of excess supply situations are typically corrected by either a significant reduction in supply (i.e., excess SRECs) or a significant increase in demand (i.e., the solar RPS or mandate), or in some instances, a combination of both.[2]

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[2] *RC-2*, p. 19.

Therefore, based on the economic principle of supply and demand, one could reasonably expect an oversupply of SRECs to result in lower SREC prices and vice versa. In turn, all else equal, higher SREC prices could reasonably be expected to encourage more development, while lower SREC prices could reasonably be expected to discourage development.

The Solar Energy Act ("SEA")

In response to the recent events affecting the solar market, the SEA was enacted in 2012. As set forth above, once again a long-term approach to creating a vibrant solar market was taken. In short, the SEA increased the RPS for Energy Year("EY") EY2014-2023, then reduced the RPS requirements for the post EY2023 period. Overall, the SEA increases the net New Jersey SREC requirement by some 38 percent (3.9 million SRECs) over the next 15 years. *RC-2*, p. 19 and Schedule DED-5. However, while the SEA increased the RPS requirements though EY2023, the SEA also decreased the corresponding SACP. The SACP schedule set forth in the Board's 2007 Solar Transition Order established an EY2014 SACP price of $625.[3] In contrast, the SEA sets the new EY2014 SACP level at $339, a full 45.8 percent reduction from the level set in 2007. *RC-2*, p. 20; N.J.S.A. 48:3-87(j). Furthermore, the SACP prices set by the SEA are then required to decrease at an annual average rate of approximately 2.5 percent until EY2028 where the SACP will be set at $239.[4] *Id.*; *RC-2*, p. 20.

Dr. Dismukes concluded that by significantly reducing the SACP price the SEA attempts to balance the interests of ratepayers and the solar industry. *RC-2*, pp.20-21. In all, by setting the RPS and SACP far into the future, the long-term outlook of the SEA provided a measure of stability for the solar market.

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[3] *RC-2*, p. 20.
[4] N.J.S.A. 48:3-87(j).

Dr. Dismukes referred to the current solar market conditions as the "new normal," which he defined as follows:

> This "new normal" consists of a New Jersey solar market that has relatively steady and strong solar installation rates ("build rates") with lower and more stable SREC prices.[5]

As shown by the solar market forecasts developed by Dr. Dismukes and the OCE, the solar capacity added by the proposed SLIII will upset the balance of this "new normal."

PSE&G claims that its proposed SLIII is consistent with the State's energy policy and the 2012 Utility Solar Extension Order. In its 2012 Utility Solar Extension Order, the Board directed electric utilities to expand solar programs by 180 MW. However, as Dr. Dismukes noted, the Board did not state that these programs should be continued at any cost. *RC-2*, p. 2. Moreover, as Dr. Dismukes found, "the current New Jersey solar energy market outlook suggests that the [SLIII] is unnecessary to continue solar installation development in the state" and "[solar] development is anticipated to continue, at a relatively healthy pace, for the foreseeable future." *RC-2*, p. 26

The SLIII's Adverse Effect on the Solar Market

In contrast to the efforts of the Board and the Legislature, the proposed SLIII would destabilize the solar market. The record below clearly shows that the additional SREC capacity proposed by PSE&G is not needed. Moreover, by introducing a prodigious amount of solar capacity into the market, backstopped by ratepayers, PSE&G's proposed SLIII would upset any balance achieved by the various statutes and Orders which guide solar development in the State.

The OCE forecasts that monthly build rates will continue to be significant, at between 18 MW per month to 48 MW per month, over the next five energy years. *RC-2*, p. 22 and Schedule

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[5] *RC-2*, pp. 21-22.

DED-7. This represents a strong build rate despite being lower than the recent peak high build rates of between 48 MW per month to 55 MW per month seen during the December 2011 to June 2012 time period. Id. Furthermore, the OCE projects that SREC availability will be above, if not significantly above the SEA's RPS requirements until EY2016. Id., Schedule DED-8; *RC-4*, pp. 7-8 and Schedule DED-SR-3. The OCE's revised forecast projected median SREC availability to range from a high of 230 percent of the annual SREC requirement to a low of 116 percent of the annual SREC requirement in EY2016. *RC-4*, p. 8 and Schedule DED-SR-3.

Dr. Dismukes reviewed the available information and concluded that an extension of PSE&G's current solar loan program is unnecessary. *Id.* at p. 26.

PSE&G's Criticism of the Forecasts Are Unfounded

As set forth below and in the testimony of Dr. Dismukes, PSE&G's arguments which attempt to refute the evidence that its proposed SLIII is unnecessary are without merit. Dr. Dismukes summarized PSE&G's three main arguments:[6]

> First, the Company claims that attempting to predict the New Jersey future solar build rates or future SREC prices is difficult in light of uncertainties.[7] Second, the Company claims that a review of the historic solar build rate in New Jersey suggests that the market may not be overbuilt for as long as some parties have suggested.[8] Lastly, the Company insists that Rate Counsel is "missing the point," in its definition of necessity.[9] PSE&G claims that its proposal is intended to ensure the availability of capital for the continued development of net metered projects....[10]

Each of PSE&G's arguments is addressed below.

First, contrary to PE&G's contention, uncertainty need not devalue the role of forecasting. Forecasting inherently involves uncertainty. However, Dr. Dismukes noted that

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[6] *RC-4, pp. 2-3.*
[7] *P-6*, p. 9].
[8] Id.
[9] Id. at p. 8.
[10] Id. at pp. 7-8.

PSE&G is likely overstating the extent of uncertainty surrounding the solar market forecasts. See *RC-4* (*RC-4A*), p. 3. Furthermore, PSE&G's criticisms of accuracy of the OCE's forecast is unsupported by any variance analysis or any other type of credible analysis. *RC-4*, p. 4 and RCR-P-36. Even PSE&G's own forecast, which it presented late in this proceeding, is only able to justify the inclusion of its proposed SLIII by assuming a 487 MWh, or 36.4 percent, shortfall in New Jersey solar generation supply in EY2014. See *RC-2*, p. 5. In sum, PSE&G's criticism of the solar market forecasts presented by Dr. Dismukes and the OCE are unsupported by any credible analysis and should be rejected.

Second, PSE&G's statements about the adverse effect of recent build rates, cancellations, and other factors on solar market forecasts are without merit.[11] PSE&G contends that two recent cancellations of large grid supply projects indicates "evidence" of a significant reduction in build rates beyond that incorporated within forecasts by market analysts.[12] However, Dr. Dismukes noted that the OCE already removed the cited projects from its pipeline inventory and, presumably, its projections of solar development. *RCR-4*, pp. 8-9. Furthermore, Dr. Dismukes considered the effect of the cancellations and the OCE's forecast and concluded that the cited cancellations do not constitute "evidence" of a significant reduction in build rates beyond that incorporated within the forecasts by market analysts. *Id.*

PSE&G's contentions about the scrub rate were also refuted by an analysis performed by Dr. Dismukes. *RC-4*, pp. 6-7 and Schedule DED DR-1. Dr. Dismukes performed an analysis of solar projects in the pipeline using data from monthly reports compiled by the OCE.[13] His

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[11] *Id.* at p. 12.
[12] *Id.* at p. 14.
[13] *Id.* Schedule DED-SR-1 depicts, on a capacity (kW) basis, the percentage of grid-connected and net metered capacity residing within the pipeline in any given month versus the amount of capacity which ends up actually being constructed.

analysis compared the total capacity of projects listed in the project pipeline with the capacity of those that end up being cancelled or scrubbed.[14] Dr. Dismukes's analysis showed that, historically, grid-connected projects within the pipeline were far more likely to come to fruition than net-metered projects. *RCR-4 at p. 7.* Only at the beginning of 2012 did the grid-connected solar completion rate start to decline. Id. However, although Dr. Dismukes found that the scrub rates for grid-connected projects has increased above historical averages over the past year or so, grid-connected solar projects account for less than 20 percent of solar capacity moving within the pipeline, on average, since November 2010. Id. at p. 7. Dr. Dismukes's analysis also showed that even during the substantial run up in grid-connected capacity seen in the summer of 2012, grid-connected solar energy only accounted for a portion of the total solar energy pipeline. Id. Dr. Dismukes found that the decline in the completion rate of grid-connected projects had little effect on the overall completion rate of solar energy capacity in the pipeline, which remained at a substantial 58.2 percent in October 2012. *Id.* This is due to the small percentage of grid-connected projects in the New Jersey solar market. Id.

Moreover, offsetting the recent decline in the completion rate for grid-connected solar projects is the relatively strong completion rate for net-metered solar projects. This refutes PSE&G's third contention, that its proposed SLII program is needed to support the net-metered segment. Dr. Dismukes found the completion percentage of net metered capacity has remained strong, averaging 62.5 percent since November 2010, and has ranged between a low of 54.5 percent and a high of 70.9 percent during the November 2010 through October 2012 timeframe. Id. and Schedule DED-SR-1. In sum, relatively strong net-metered completion rates and a forecast of high completion percentages going forward refute PSE&G's claims about a

[14] Id. For the purpose of his analysis, Dr. Dismukes removed all projects within the pipeline as of December 31, 2012 from calculations as it is unknown whether these projects will be built.

weakening of the solar market which would support the capacity addition proposed by its SLIII program.

III. THE SLIII PROPOSAL HAS OTHER SERIOUS FLAWS THAT SHOULD BE ADDRESSED IN ANY FUTURE FILING.

A. The Proposed Cost Recovery Mechanism Unfairly Allocates Costs and Risks From the Company's Shareholders to Ratepayers.

High Cost of Program

Based on the Company's estimates, the direct rate impact of the SLIII program over the 2013-2027 period will be approximately $126 million, or approximately $51 million on a net present value basis. *RC-2*, Schedule DED-13. As explained in Dr. Dismukes' prefiled direct testimony, the Company's rate impact estimates include estimates of proceeds from the sale of SRECs that are applied as an offset to program costs. *RC-2*, p. 26-27. The Company's estimated revenue streams from the sale of SRECs are overstated. The assumed credits from the sale of SRECs are based on an assumed SREC price of $200 over the entire program. A more realistic estimate is provided in forecasts by Bloomberg New Energy Finance ("Bloomberg"), a company providing subscription-based analysis. *RC-2*, p. 23, 28.[15] Using this more realistic estimate of SREC prices, the estimated revenue requirements are almost doubled—totaling $248 million over the 2013-2027 period, or $99 million on a net present value basis. *RC-2*, p. 28 & Schedule DED-13.

The Company's experience with the SLII program provides further reasons to question the reliability of the Company's estimated rate impacts for the proposed SLIII program. As of the

[15]PSE&G provided several solar energy market analyses, forecasts and outlooks prepared by Bloomberg in a discovery response, subject to a claim of confidentiality. *RC-2*, p. 23, *RCR-P-19*, Confidential Attachment 15. The Bloomfield SREC price forecast is quantified in the Confidential version of Dr. Dismukes' direct testimony, *RC-2A*, Confidential Schedule DED-11.

time the Stipulation for the SLII program was signed in November 2009, the Company was projecting revenue requirements of $4.7 million for 2012, and $3.6 million for 2013. SLII Order, attached Stipulation, Exhibit E1, col. 20. The Company's latest projections, provided as part of a discovery response in the Company's current RRC true-up filing, show a revenue requirement of $10.6 million based on 11 months of actual data and one month of projections for 2012, and a projected revenue requirement of $20.7 million for 2013. I/M/O the Petition of Public Service Electric and Gas Company for Approval of Changes in its Electric RGGI Recovery Charges and its Gas RGGI Recovery Charges, BPU Dkt. Nos. GR12070605 & ER12070606, Company response to Rate Counsel Discovery Request RCR-A-31, Updated Schedule SS-SL2-2, p. 2, col. 21 (Feb. 25, 2013).[16] Combined, the current projection for both years is about $23 million more than originally projected. In the S4AE evidentiary hearings that have been made part of the record in this proceeding, Company witness Mr. Swetz was asked about a similar difference between originally projected and currently projected revenue requirement for the Company's Solar 4 All program which, like SLII, relies on SREC sales as an offset to program costs. In that proceeding, Mr. Swetz acknowledged that the discrepancy was due in large part to "significant changes to the SREC prices …." *T44:L5-7* (March 21, 2013). The Company's actual experience thus confirms the significant changes in rate impacts that can occur if SREC prices differ from those assumed in the SLIII filing.

The cost of the SLIII to ratepayers may appear relatively modest based on the annual per-customer rate impacts, it is important for the Board to consider that this program would result in

[16] In accordance with paragraph 1(d) of the Stipulation regarding the contents of the record in this matter, approved by Order of Commissioner Fiordaliso on April 1, 2013, the referenced discovery response from the Company's current RGGI cost recovery proceeding, showing SLII Electric Revenue Requirements Calculation updated with actual data through November 2012, is part of the record in this proceeding.

financial commitments for some 2.2 million electric ratepayers over a 15-year period. See *RC-2*, Schedule DED-13. Even using the Company's likely understated rate impact analysis, the Company is seeking a financial commitment from its ratepayers of around a $50.7 million on a net present value basis. The Company's failure to comply with requirements established by the Board to employ market-based mechanisms to minimize costs to ratepayers is discussed in Point I above. In addition, the high cost of the proposed SLIII program reflects, in part, a cost recovery mechanism that improperly shifts risks from the Company's shareholders to ratepayers.

Conclusion

In addition to the rate of return recommendations below, and future solar loan program should be subject to a rate impact cap of $50.7 million, which is based upon the total estimated rate impact provided by the Company in this proceeding. The Company should be required to annually estimate the current and anticipated SLIII program costs based upon the most recently available market information regarding the outlook for New Jersey SREC prices. If these forecasts suggest potentially higher program rate impacts given SREC prices decreases relative to those upon which the SLIII program are based, then the Board should direct the Company to "ramp-down" the number of loans offered in this program to a level that preserves the program's originally-anticipated $50.7 million rate impact. This recommendation would not deny the Company the opportunity to earn a return on or of the prudently-incurred investments it has made in the SLIII program. It does, however, define the method by which the Company will be able sign new loans on an annual basis.

B. The Proposed Rate of Return is Excessive, and Any Future Filing Should Include a Reasonable Rate of Return Including a Return on Equity No Higher Than 9.75%.

For the reasons set forth in this Brief, the Board should reject the SLIII in its entirety; however, if the Board chooses to approve any part of the program the Board should adopt a ROE no higher than 9.75% for the calculation of the Weighted Average Cost of Capital ("WACC"). Rate Counsel Witness Ms. Andrea Crane testified that present market conditions do not warrant the same 10.3% ROE award from the Company's last base rate case which became effective in July 2010. Ms. Crane testified that a 9.75% ROE is more appropriate and consistent with the most recent equity awards by the Board in an electric utility base rate case. Ms. Crane also testified that it would be reasonable for the Board to adopt a significantly lower return on equity, than 9.75% because of the difference in investment risk between the SLIII program, which provides the Company prompt dollar-for-dollar rate recovery of its costs through the use of the RRC, and the Company's investment in traditional distribution plant recovered through base rates. *RC-1* at, p. 13-17.

The Company's rebuttal witness, Mr. Paul R. Moul, agreed with Ms. Crane, that the cost of capital had declined since the Company's last base rate case in 2010. *T48:L14-20*. (March 18, 2013) In addition, Mr. Moul testified that the proposed "tracker" program provides dollar-for-dollar cost recovery through the RRC without the risks of a base rate case. The only conclusions the Board can reach, based upon the testimony in the record, is that the Company's proposed ROE of 10.3% would result in over-recovery from ratepayers, and a ROE even lower than 9.75% would be justified because of the greatly reduced investment risk.

In selecting any ROE, the Board must balance a just and reasonable cost to ratepayers with the need for a regulated utility to earn a return that is sufficient to attract capital to finance its continued operations. In determining a just and reasonable rate of return in a base rate case the Board must assure the rates do not exceed the level required to assure the financial integrity of the regulated utility so as to maintain its credit and attract capital, and must be commensurate with returns on investments with comparable risks. See, Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of W. Va., 262 U.S. 679, 692-93 (1923). Rates set by the Board, "can never be more than the reasonable worth of the service supplied; neither can it be fixed so low as to be confiscatory." Pub. Serv. Coordinated Transport. v. State, 5 N.J. 196, 225 (1950). The SLIII program is not exposed to the same level of investment risk as investment in the distribution assets of the Company. The proposed SLIII cost recovery mechanism ensures that the Company will recover 100% of the prudently-incurred program costs. Therefore the Company's proposed 10.3% ROE, taken from the last base rate case, is both unreasonable and fails to achieve an appropriate balancing of shareholder and ratepayer interests.

Capital Costs Have Decreased

As set forth in the Company's petition and supported by its witness, Mr. Steven Swetz, the Company is proposing to utilize a weighted average cost of capital ("WACC") of 8.21% as set forth in Mr. Swetz's direct testimony, "The overall cost of capital utilized to set rates for the initial rate period of the Program will be based on the Company's most recent base rate case, BPU Docket No. GR09050422, which is 8.21% (11.8520% on a pre-tax basis), based on a return on equity of 10.3% and current tax rates." *P-4* at, p. 3. The currently authorized 10.3% ROE was the result of a settlement in the last base rate case, reflecting compromise by several parties on many different issues. *RC-1* at, p.11.

In the three years since the Company's last base rate case, Ms. Crane noted that financial market conditions have changed substantially. Ms. Crane testified that 30-year U.S. Government bonds fell from a rate of 4.23% in May 2009 to 2.88% in December 2012. Ms. Crane found a similar decline in AAA-rated corporate bonds, where the rates fell from 5.54% in May 2009 to

3.65% in December 2012. Ms. Crane also testified that dividend yields have generally declined as stock prices have increased, specifically noting that the Dow Jones Utility Index has increased significantly since the Company's last base rate case. Ms. Crane concluded her analysis of market conditions by stating that there has been an overall decline in equity returns based on the Discounted Cash Flow ("DCF") model. Ms. Crane's testimony notes that decreased borrowing costs have caused the Company's embedded cost of debt to decrease from 6.21% to 5.05% since the last base rate case. (Mr. Swetz, in his rebuttal testimony states that the Company's November 2012 embedded cost of debt was 5.3483%, which Rate Counsel accepts.) P-8 This evidence supports Ms. Crane's conclusion that the Company's overall cost of capital has declined substantially since the last base rate case. *RC-1* at, p. 12-14)

Under cross-examination, Mr. Moul agreed with Ms. Crane's testimony that the utility cost of equity has declined since the Company's last base rate case.

> Q. At page 3, line 19 of your testimony, you state that market conditions have changed since July 2010.
>
> A. Yes.
>
> Q. Does this sentence mean that you acknowledge that as a general matter the utility cost of equity has declined since July 2010?
>
> A. I agree with that. T-48:L14-20. (March 18, 2013)

Ms. Crane's testimony, coupled with Moul's admission under cross examination that the utility cost of equity has decreased since the Company's last base rate case, leaves only one conclusion from the established record; that is, the Company's proposed 10.3% ROE is too high and no longer represents a reasonable return for ratepayers to support. *RC-1* at, 14-15.

Ms. Crane's testimony that the cost of capital for utilities has decreased is supported by Mr. Kahal's testimony regarding his review of Mr. Moul's Exhibit PRM-2, the Regulatory

Research Associates ("RRA") survey of state regulator ROE awards for electric utilities in 2012. Mr. Kahal removed the vertically-integrated electric utilities from the survey, as being irrelevant to the sample since the market risk for those utilities is different. Using only those 2012 ROE awards (from the RRA survey) for delivery service electric utilities, the appropriate measure for PSE&G, the 2012 average ROE award is 9.74% or consistent with Ms. Crane's recommendation of a ROE of not more than 9.75%. *RC-5* at, p. 32-33.

Lower ROE from Minimal Investment Risk

The Company is proposing a 10.3% ROE but fails to acknowledge the significant differences between base rate recovery and cost recovery through the "tracker" program it proposes. A base rate proceeding examines investment risk on all utility investments. Costs, between rate cases, are recovered only if sales have increased or other costs have declined relative to revenues and expenses included in the previous base rate case. Since there is no "true-up" between base rate cases (as proposed in the SLIII program through the RRC) investment risk is dependant upon revenue and expenses between base rate cases. If revenues rise and expenses decrease, the Company may earn more than its authorized return and shareholders would benefit from the gain. If revenues decrease and expenses rise, the Company may not earn its authorized return and shareholders would suffer. In this way return on distribution assets through base rates is a more risky investment than through a relatively assured cost recovery mechanism, like the Company proposes in SLIII. *RC-3* at, p. 7. This risk is avoided by the Company under the proposed SLIII program. As proposed, ratepayers provide prompt full and dollar-for-dollar cost recovery through the annual true up of expenses and revenues through the RRC.

Ms. Crane testified that a significantly lower rate than 9.75% may be reasonable because the Company's proposed program provides the Company 100% of its costs through the RRC, eliminating investment risk for this program. If shareholders bear no risk of loss of their investment, the Company's cost of debt may be the appropriate return to use as cost of capital. Therefore, should the Board decide to grant the Company's request and approve any part of this program, the ROE should be reduced commensurate to the risk incurred. RC-1 at, 17-18.

The Company's witness, Mr. Moul, agreed with Ms. Crane when questioned by Board Staff under cross examination:

> Q. The proposed recovery mechanism for Solar 4 All basically guarantees the cost of its programs will be recovered from the ratepayers. Is that correct?
>
> A. Sure. It's the same as any type of tracker you have, whether it's environmental or energy efficiency trackers or bad debt expenses. I mean it's a characteristic of a tracker or a rider or clause, whatever you want to call it. *T-69:L6-14.* (March 18, 2013)

Mr. Swetz, in his rebuttal testimony, notes that the Board could disallow a cost the Company incurred if it was found to be imprudent, arguing that the Company did face some degree of investment risk. *P-8* at, p. 3. However, as acknowledged by the Company in its response to RCR-ROR-17, the Board has never disallowed a cost incurred by the Company for any of its energy efficiency or renewable energy programs for imprudence. Mr. Moul, too, under cross examination by Board Staff, admitted that he didn't know of any instance where costs for any solar program of the Company had been disallowed by the Board. *T-70:L20-22.* (March 18, 2013)

The surrebuttal testimony of Mr. Kahal specifically addresses the difference between using the ROE from a base rate case and the lower risk from a cost recovery tracker, such as is proposed in the SLIII program. Mr. Kahal states: "The issue is not whether PSE&G has *any* risk associated with these programs, but rather whether such risk is comparable to that under standard regulation, based on cost recovery in base rate cases." He concludes: "Unquestionaly, cost recovery is far more certain under the fully reconcilable cost recovery tracker proposed for the solar program." *RC-5* at, p. 8.

If the Board were to approve the SLIII program with a 10.3% ROE the Company would enjoy an incentive to invest as much as possible in these low risk high return projects. Investments in this program would be more attractive, on a risk/return basis, than investments in the distribution system recovered through base rate recovery. Importantly, the evidence clearly demonstrates that the requested 10.3% ROE exceeds by a large margin PSE&G's current cost of equity, creating a perverse incentive for the Company to inflate its investments and to move into regulated, monopoly utility service investments that more properly belong on the unregulated side of the business. This issue was demonstrated through the cross-examination of Mr. Moul with respect to the Value Line Report for PSE&G dated November 23, 2012. *T50-51:L23-5*. Mr. Moul acknowledged that the Value Line Report stated that PSE&G management was offsetting declines in non-utility profits with strong returns in regulated utility profits. When asked, Mr. Moul offered his opinion that a 10.3% ROE on the utility side of a diversified business would be attractive, stating:

> I mean, in this environment of low natural gas prices which drive the competitive electric market, the returns aren't what they used to be [for non-regulated business]. I mean that's pretty obvious. And the companies that are diversified that have both regulated and non-regulated, the regulated returns are attractive at this point in time. *T-53:L10-15*. (March 18, 2013)

To grant the Company its requested 10.3% ROE, based on an outdated base rate settlement, considering the reduced investment risk would unreasonably reward the Company's shareholders at the expense of the ratepayers.

<u>Company Argument</u>

The Company initially offered the direct testimony of Mr. Swetz in support of its proposed ROE of 10.3%. Mr. Swetz indicated that any change in the WACC authorized by the Board in a subsequent case would be reflected in the annual true-up in subsequent years. *P-4* at, p. 3. The Company, following Ms. Crane's direct testimony, filed the rebuttal testimony of a new witness, Mr. Paul R. Moul in response. Mr. Moul, in his rebuttal to Ms. Crane's direct testimony, agrees with Ms. Crane that market conditions have reduced the cost of equity since the Company's last base rate case but nevertheless argues the 10.3% ROE established July 2010 when the base rate case was settled, should continue to apply in today's very different capital market and economic environment. In addition, Mr. Moul presented discounted cash flow ("DCF"), risk premium, capital asset pricing model ("CAPM"), and comparable earnings studies in an effort to support the Company's position with respect to its requested return on equity.

Mr. Moul argues that because of the long recovery period associated with the proposed SLIII program, it is unreasonable to expect current low interest rates to be maintained during the program. In addition, Mr. Moul argues that today's rates are, by historical standards, unreasonably low. Mr. Moul concludes his primary criticism of Ms. Crane's analysis by stating, "It is indisputable that today's low interest rate cannot be representative of the average interest rates for the next twenty-five years." *P-7* at, p. 5-6. However, Mr. Moul, under cross-examination, admitted that the Company controls the timing of when to file a base rate case, which would include updating the ROE applicable to any SLIII program:

> Q. At page 5 you express concern that this proceeding could lock in a low return on equity for the solar tracker. Is that correct?
>
> A. Yes.
>
> Q. In response to RCR-A-51, you state that the solar tracker return on equity will be updated after each PSE&G rate case. Is that correct?

A. Yes

. . .

Q. So if the market cost of equity increases and PSE&G determines that its earnings are insufficient, it can file a rate case. Correct?

A. Oh, sure…

Q. But certainly if its earnings are being impacted by return on equity, it could choose to file a rate case?

A. Absolutely. I agree with you. *T48-49:L23-22*. (March 18, 2013)

Mr. Moul's unsupported speculation that the present low rate of interest may or may not increase over the 25 year anticipated life of this program is irrelevant. ROEs have increased and decreased over the past 25 years and will undoubtedly change over the next 25 years. What is undisputed is that the Company may file a base rate case at any time it feels market conditions and its own earnings position warrant an adjustment to its base rates. There is no need for the Board to continue to employ in the Solar tracker an overstated ROE that no longer reflects current market conditions based on speculation that at some unspecified future time capital costs may increase from today's levels. PSE&G will have every opportunity to address that circumstance if it comes to pass and seek whatever adjustment to its return that is warranted.

Mr. Moul in his rebuttal testimony did not directly address Ms. Crane's testimony regarding risk and the low-risk cost recovery under the SLIII program as proposed by the Company. Mr. Moul states; "The Solar Programs are not dissimilar in risk from the overall PSE&G utility business, as discussed in the Rebuttal Testimonies of Mr. Moran and Mr. Swetz." *P-7* at, p. 3) When pressed to further explain his testimony under cross-examination by Board Staff, Mr. Moul declined to offer an opinion of his own:

> Q. And can you please clarify on what basis you still support the 10.3 return requested by the company in this proceeding?
>
> A. Well, I've looked at testimony of other company witnesses that described some of the operational risks associated – I'm – you know, that's outside of my field and I need to rely on other people that are expert in that – in those matters. And based upon my reading of the testimony of the company witnesses, lead me to believe without doing my own analysis that the risks were indistinguishable. *T63:L4-14.* (March 18, 2013)

Mr. Moul's rebuttal testimony was specifically focused on the appropriate ROE to be included in the S4AE and Solar Loan III programs. *P-7* at, p. 1. Mr. Moul conducted an analysis based upon the DCF model, the Risk Premium("RP") analysis, the CAPM and the comparable Earning ("CE") methods. Based on Mr. Moul's analysis, the range of indicated returns were between 9.33% (CAPM) and 11.66% (RP). The average of all methods, according to Mr. Moul, was 10.76% and the midpoint is 10.5%. Mr. Moul testified that the Company should be granted an opportunity to earn 10.875% and that as a result, 10.3% is reasonable. *P-7* at, p. 16.

Rate Counsel presented the Surrebuttal Testimony of its witness, Matthew Kahal, in response to Mr. Moul. Mr. Kahal responded to and corrected Mr. Moul's CAPM studies by removing extraneous "adders" that are unrelated to the Company's cost of equity and that have received little or no regulatory acceptance. When Mr. Moul's studies are corrected to remove these adders Mr. Kahal demonstrates that Mr. Moul's DCF study produces a cost of equity estimate of 9.34% to 9.61%. When similar corrections to remove extraneous adders are made to the CAPM study, Mr. Kahal demonstrates that Mr. Moul's CAPM study produces a cost of equity estimate of about 8.5%. *RC-5* at, p. 7. Both results are well below Ms. Crane's recommended "no higher than 9.75%." As Mr. Kahal was submitting surrebuttal testimony he limited himself to correcting Moul's studies and using only Mr. Moul's data set, but he noted that in other electric and gas utility cases his own recent DCF estimates have ranged between 9.0% to 9.5%. *RC-5* at, p. 6, 7.

Mr. Kahal, in his surrebuttal testimony, specifically addressed the extraneous adder Mr. Moul describes as a "leverage adjustment." Mr. Moul used the leverage adjustment adder to both his DCF and CAPM studies, which ultimately work to the benefit of shareholders and at the expense of ratepayers. As Mr. Moul states; "if book values are used to compute the capital structure ratios, then an adjustment is required." *P-7* at, p. 24) As noted by Mr. Kahal, "this is a candid admission that the leverage adder is not part of the utility cost of equity, as measured by the standard DCF formula, but is included due to capital structure ratemaking practices." *RC-5* at, p. 22)

Mr. Kahal testified that both the Company and Rate Counsel accept the use of a book value capital structure for setting rates and that the capital structure is not in dispute in this case. Mr. Kahal testified that a departure from that standard would be novel:

> The standard practice (a market cost of equity coupled with a book value capital structure) is the essence of cost-based ratemaking that fully meets the capital attraction standard and has been used successfully by the BPU (and other regulatory commissions) for decades. I am also not aware of PSE&G in past cases advocating an ROE adder above its cost of equity due to the Board's use of book value capital structure. *RC-5* at, p. 22.

Mr. Moul admitted, under cross examination than a few Pennsylvania cases prior to 2007, have adopted his extraneous adder leverage adjustment. *T-57:L1-3*. Based upon the undisputed downward trend of the cost of capital overall, and analyses specific to this case, the Company's 10.3% recommendation is excessive and would unfairly overcharge customers.

<u>Conclusion</u>

It is within the Board's power to grant a reasonable ROE to the Company that balances a return sufficient to attract capital to finance its operations with a just and reasonable cost to ratepayers. Rates should not exceed that return necessary to balance these competing needs. The record and testimony in this matter upon which the Board must make its decision is that the Company's proposed ROE of 10.3%, as established in July 2010 from a 2009 rate case is too high considering current market conditions. That fact, coupled with the reduced investment risk resulting from the cost recovery proposed through a RRC, support a finding that the ROE for any part of the program the Board may approve should be no greater than 9.75%.

C. The Company's Proposed Residential Program Segments is Excessive Based on the Company's Actual Experience, and the Proposed Landfills/Brownfields Segment Pre-empts Another Proceeding Before the Board Under the SEA.

PSE&G is proposing to allocate 9.75 MW, or 10 percent of the total program capacity of 97.5 MW to the Residential segment. PSE&G stated in a discovery response that this allocation was determined based on "the actual historical experience of the Solar Loan I and II programs." *RCR-A-16.* However, according to this same discovery response, the loans to residential customers under the current SLI and SLII programs "comprise 8% of the available capacity …." Id. Based on the actual experience from the two prior solar loan programs, only 8% of the SLIII program's capacity should be allocated to residential projects.

The proposed landfill/brownfield segment should be eliminated because it would pre-empt another proceeding before the Board. The SEA directs the Board to "establish a financial incentive that is designed to supplement the SRECs generated by the facility in order to cover the additional cost of constructing and operating a solar electric power generation facility on a brownfield, on an area of historic fill or on a properly closed sanitary landfill facility." N.J.S.A.

48:3-87(t)(1). The Board has initiated a proceeding for this purpose. I/M/O the Implementation of L. 2012, c. 24, the Solar Act of 2012, BPU Dkt. Nos. EO12090032 et al., Order Initiating Proceedings at 2 (Oct. 10, 2012). The need for, proper level of, and form of financial incentives for these types of projects is properly considered in this ongoing proceeding before the Board.

Based on the above, the Company should:

- Allocate 8% of the program's capacity to the Residential segment, and
- Eliminate the Landfills/brownfields segment and re-allocate that capacity to the "Large Non-Res" segment.

CONCLUSION

For the reasons set forth above, the Board should dismiss the Company's SLIII Petition because it fails to satisfy the requirements in the Board's <u>2012 Utility Solar Extension Order</u> that solar loan programs (1) must incorporate a competitive process that will "provide for the lowest achievable cost within the market segments," and (2) must assure that solar developers, and not ratepayers, will be responsible for all administrative costs associated the program. Since this program is not needed to meet New Jersey's solar RPS, the Petition should not be entertained in the absence of full compliance with the Board's directive in the <u>2012 Utility Solar Extension Order</u>. In addition, the Board should direct that any future solar loan filing by PSE&G (1) include limits on ratepayer exposure, including provision to "ramp down" the program in the event expected rate impacts reach a pre-determined cap; (2) include a reasonable rate of return, with a return on equity no higher than 9.75%; (3) allocate capacity among program segments consistent with actual experience; and (4) not include a "landfills/brownfields" segment.

Respectfully submitted,

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