BEFORE THE STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES
OFFICE OF ADMINISTRATIVE LAW

I/M/O THE PETITION OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY'S DEFERRAL FILING INCLUDING PROPOSALS FOR CHANGES IN ITS RATES FOR ITS NON-UTILITY TRANSITION CHARGE (NTC) AND ITS SOCIETAL BENEFITS CHARGE (SBC) FOR THE POST-TRANSITION PERIOD PURSUANT TO *N.J.S.A.* 48:2-21 & 48:2-21.2	**DOCKET NO. ER02080604** **OAL DOCKET NO. PUC 7893-02**

REPLY BRIEF OF THE
NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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TABLE OF CONTENTS

Page No.

TABLE OF AUTHORITIES

INTRODUCTION

In this Reply Brief, the Division of the Ratepayer Advocate ("Ratepayer Advocate") will respond to those parts of the Initial Briefs of the other parties that require further discussion. The Initial Briefs of the parties will be cited as follows:

Public Service Electric and Gas Company Initial Brief on Deferrals	= PIB
Staff of the Board of Public Utilities Initial Brief	= SIB
Ratepayer Advocate Initial Brief	= RAIB

To the extent that our Reply Brief does not respond to arguments and allegations contained in some of the Initial Briefs, this does not signify that the Ratepayer Advocate concedes any of the positions it has taken in our Initial Brief. The Ratepayer Advocate continues to urge Your Honor and the Board of Public Utilities ("Board" or "BPU") to adopt those recommendations.

POINT I

THE "NET OF TAX" METHOD IS THE CORRECT, BOARD-APPROVED METHOD FOR CALCULATING INTEREST ON THE COMPANY'S NON-UTILITY GENERATION TRANSITION CHARGE ("NTC") AND SOCIETAL BENEFITS CHARGE ("SBC") DEFERRAL BALANCES.

As set forth in detail in the Ratepayer Advocate's Initial Brief, the "net of tax" method for calculating interest on the Company's NTC and SBC deferral balances is both correct and consistent with long-established Board policy. RAIB at 6-9 and 28-33. The Staff of the Board of Public Utilities ("Board Staff" or "Staff") notes in its Initial Brief that no party appears to be disputing that the "net of tax" method is "the appropriate treatment from the standpoint of sound regulatory practice." SIB at 142. The Staff further recommends that the interest rate be changed to the Company's actual average cost of short-term debt, or in the event the Company has no short-term debt outstanding, the rate available to the Company on temporary cash investments. SIB at 144. The Ratepayer Advocate concurs with this recommendation.

The Company's Initial Brief argues that it was authorized to use the "gross balances" method in the Board's Final Order in the Company's electric restructuring proceeding. PIB at 16, 19. The Company agrees with the Ratepayer Advocate that the Board's Order is silent as to the method to be used to calculate interest on SBC balances. However, the Company argues that the Board's silence must be construed as authorizing the "gross balances" method. PIB at 19. This argument is unfounded. To the contrary, the Board's silence should be construed as continuing the existing methodology which had been in effect for many years.

The Company also relies on a finding by the Board's auditors that the Company "complies in all material respects with the Board Orders" relating to the deferred balances. PIB at 16. However, during the hearing on the auditors' report, a member of the panel that presented the auditors' report testified that the net-of-tax issue "was not an area that was looked at as a part of the audit." T1798:L11-12. Since the auditors did not even address the issue, the Company's suggestion that the auditors approved the "gross balances" method is unfounded.

PSE&G also argues that all of its post-restructuring RAC filings have reflected the "gross balances" method. The Company's inclusion of an improper interest methodology in its filings does not establish that this methodology has been authorized by the Board. As explained in the Ratepayer Advocate's Initial Brief, the Board did not approve the Company's proposed methodology in the RAC-8 or RAC-9 proceedings. RAIB at 32. Indeed, as noted in the Ratepayer Advocate's Initial Brief, the only indication of Board policy in either proceeding is the statement in the Board's RAC-8 Order that the Company had been authorized to recover carrying costs "on the unamortized balance net of deferred taxes." RAIB at 30, quoting *I/M/O the Petition of Public Service Electric and Gas Company to Increase its Remediation Adjustment Clause*, BPU Docket No. GR00121003 (Order dated September 27, 2001), p. 1. As PSE&G points out in its Initial Brief, this statement was in the "preamble, or history section" of the RAC-8 Order. PIB at 21. Nevertheless, the Ratepayer Advocate believes that this language, coupled with the lack of any other language on this subject, in the "ordering" section or elsewhere, indicates that the Board's policy had not changed as of the time of the RAC-8 Order.

Finally, PSE&G argues that the Board's Order requiring Rockland to use the net-of-tax method does not apply to PSE&G. PIB at 22-25. The Company attempts to dismiss the Rockland

Order as a response to the “unique” circumstances involved in the Rockland restructuring proceeding. PIB at 24. As the Ratepayer Advocate acknowledged in its Initial Brief, the Board Order in the Rockland proceeding was based in part upon a provision in Rockland’s proposed “Plan for Resolution of Proceedings.” RAIB at 29. However, this was not the only basis for the Board’s decision. The Board also specifically addressed the correctness of the “net of tax” methodology, finding that it correctly reflected the costs of financing the deferred balances. RAIB at 29-30, quoting *I/M/O Rockland Electric Company’s Rate Unbundling, Stranded Cost and Restructuring Filings,* BPU Docket Nos. EO970770464 *et al.* (Order dated October 6, 2002) p. 4.

PSE&G also argues that Rockland may have agreed to the “net of tax” method as “part of the give-and-take of settlement discussions,” which, the Company states, also resulted in an interest rate equal to Rockland’s pre-tax rate of return of 13.26%. PIB at 23-24. This is a misleading characterization of the outcome of the Rockland proceeding. The Board, in its Summary Order in the Rockland proceeding, rejected the proposed 13.26% interest rate, and ruled that the interest rate should be equal to the 7-year constant-maturity treasury for the first $5 million of deferrals and the 7-year constant maturity treasury rate plus 350 basis points on all deferrals over $5 million. *I/M/O Rockland Electric Company’s Rate Unbundling, Stranded Cost and Restructuring Filings,* BPU Docket Nos. EO970770464 *et al.* (Summary Order dated July 28, 1999), p. 4. This was subsequently modified in the Board’s Final Order, to make Rockland’s SBC interest rate the same as that ordered for the other utilities, that is, a rate equal to the 7-year constant maturity treasury rate plus 60 basis points. *I/M/O Rockland Electric Company’s Rate Unbundling, Stranded Cost and Restructuring Filings,* BPU Docket Nos. EO970770464 *et al.* (Final Decision and Order dated July

22, 2002), p. 64. Thus, while Rockland negotiated a 13.26% interest rate, this rate was never approved by the Board, and therefore cannot be relied upon as a "unique" circumstance in the Rockland restructuring proceeding.

As explained above and in the Ratepayer Advocate's Initial Brief, the "net of tax" method has been established as a the proper method in Board Orders since 1993. Nothing in the Board's electric restructuring Order for PSE&G changes this longstanding Board policy.

POINT II

THE RATEPAYER ADVOCATE'S RECOMMENDATION THAT THE COMPANY BE REQUIRED TO FILE ANNUAL UPDATES ON ITS NUG COST MITIGATION EFFORTS WITH ITS FILINGS FOR ANY CHANGES IN ITS NTC RATE SHOULD BE ADOPTED.

The *Restructuring Case Final Order*[1] established an NTC charge to recover the above-market costs of the Company's purchased power agreements with non-utility generators ("NUGs"). The *Restructuring Case Final Order* also provided that "...PSE&G will be required to continue to make reasonable attempts to renegotiate, buy out or buy down its NUG contracts."[2] PSE&G claims that its NUG contract mitigation efforts resulted in $250 million of net present value ("NPV") savings and that the Ratepayer Advocate's "criticism" of its mitigation efforts is unwarranted. PIB at 32-36. However, the Company fails to address the fact that its ratepayers are still required to fund an NPV of $2.77 billion over the life of these contracts. *RA-DEF-9*, p. 15. As noted by Ratepayer Advocate witness Andrea Crane, through its mitigation efforts during the Transition Period the Company has only reduced the NPV of its NUG contracts by 9 percent. *Id.*, p. 15.

For the reasons above and in its Initial Brief, the Ratepayer Advocate recommends that Board oversight is needed in this area. RAIB at 10-12. Annual reporting will provide the Board with an opportunity to assess the Company's mitigation efforts. RAIB at 10-12. The Ratepayer Advocate respectfully submits that Your Honor and the BPU should require the Company to report on its mitigation activities annually at the time that it files its annual NTC rate charge.

1*I/M/O Public Service Electric and Gas Company's Unbundling, Stranded Costs and Restructuring Filings*, BPU Docket Nos. EO97070461-63, (Final Decision and Order dated August 24, 1999), aff'd 167 *N.J.* 377 (2001) (referred to hereinafter as the "*Restructuring Case Final Order*").

[2] *Restructuring Case Final Order*, p. 111.

POINT III

THE RATEPAYER ADVOCATE'S RECOMMENDATION TO ADJUST THE LEAC BALANCE TO REFLECT THE PROPER CALCULATION OF ACCRUED INTEREST SHOULD BE ADOPTED.

At issue is the proper calculation of the accrued interest on the Company's Levelized Energy Adjustment Clause ("LEAC") balance at August 1, 1999, which formed the basis of its starting NTC balance. *See* PIB at 43-46; RAIB at 13-15; and SIB at 164-165. The *Restructuring Case Final Order* provides that "[t]he accumulated LEAC overrecovery balance as of July 31, 1999, including accumulated interest thereon as of that date, shall be applied as a credit to the starting deferred balance for the NTC."[3] PSE&G utilized an opening LEAC over-recovery balance of $58,708,775.[4] However, Ms. Crane found that the Company did not properly include any interest on this over-recovery, contrary to the above-cited directive in the *Restructuring Case Final Order*. *RA-DEF-9*, p. 18; *PS-DEF-41*.

The Company argues that the Company's 1997 Salem Settlement provided that its then-existing LEAC rates, established in 1995, be frozen beginning January 1997, and that the clause period should be from May 5, 1995 through July 31, 1999. PIB at 44. Under the Company's proposal, the clause period would extend for a multi-year period. Board Staff supported the Company's position. SIB at 164-165. In contrast, as set forth in the Ratepayer Advocate's Initial Brief, the usual LEAC clause period is twelve months, per the Board's pertinent regulations.[5] RAIB at 13-15. *N.J.A.C.*

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[3] *Restructuring Case Final Order*, p. 117, para. 10.

4 *PS-D-1*, Sch. RCK-D-3-B, p. 2.

5 *See RA-DEF-2 (N.J.A.C.* 14:3-13.1 *et seq*.).

14:3-13.2 defines the "Applicable [LEAC] Period" as "the period or timeframe in which any adjustment clause is in effect, usually 12 months, or any other period as authorized by the Board." Here, the Board did not specifically extend PSE&G's LEAC clause period to cover a multi-year period through 1999. Thus, for PSE&G to change the period to other than 12 months unilaterally without specific Board approval would usurp the Board's regulatory authority.

Ms. Crane calculated the accrued interest on the Company's LEAC overrercovery using two discrete 12-month periods, and a partial period: the two 12-month periods ending July 31, 1999 and July 31, 1998, respectively, as well as the seven months ending July 31, 1997. *RA-DEF-9*, pp. 18-19, Sch. ACC-3; *PS-DEF-41*. Overall, Ms. Crane found that the Company owes ratepayers $4,662,000 in interest. *RA-DEF-9*, p. 19; Sch. ACC-3, footnote 2. Therefore, Ms. Crane recommended an adjustment of $4,662,000 in her beginning NTC balance calculation to reflect the proper accrual of interest, resulting in a beginning balance of $63,370,699. *RA-DEF-9*, Sch. ACC-3, p. 1 of 4 (Updated 2/28/03).

For the reasons set forth above, and in its Initial Brief and testimony of its witness, the Ratepayer Advocate respectfully submits that Your Honor and the Board should adopt the recommended adjustment to the beginning NTC balance recommended by Ms. Crane, resulting in a beginning BGS balance of $63,370,699.

POINT IV

THE RECOMMENDED ADJUSTMENT TO THE LEAC BALANCE REFLECTING THE BOARD-APPROVED PSEG HOLDINGS AFFILIATION FEE SHOULD BE ADOPTED.

At issue is the level of the PSEG Holdings Affiliation Fee credited to the LEAC balance. See PIB at 51-54, RAIB at 16-17, and SIB at 165-166. The PSEG Holdings Affiliation Fee was established as part of the PSE&G Focused Audit proceeding and set at a level of $2 million, of which a portion was allocated to PSE&G's electric distribution operations. *RA-DEF-9,* p. 19; *PS-DEF-45*.

As set forth in the Ratepayer Advocate's Initial Brief and the testimony of its witness, PSE&G improperly reduced the Board-approved PSEG Holdings Affiliation Fee attributable to its electric operations. RAIB at 16-17. From August 1999 through February 2002, PSE&G included a credit for the affiliation fee in its LEAC of $1,421,328, or $118,444 per month. *RA-DEF-9*, p. 19. Starting in March 2002, and continuing through July 2002, PSE&G reduced the affiliation fee reflected in its LEAC balance. *Id*., p. 20. Finally, no affiliation fee credit was included for Year 4 of the Transition Period. *Id*. Hence, the Ratepayer Advocate recommended an adjustment to the LEAC balance to reflect the proper credit attributable to the PSEG Holdings Affiliation Fee. RAIB at 16-17.

The Company argues that it reduced the affiliation fee credited to the LEAC in accordance with the Board's Order in the Focused Audit case. PIB at 51, 54. Board Staff supported the Company's position. SIB at 166. The Ratepayer Advocate opposes the position taken by the Company and Board Staff. While the Board's order in the Focused Audit case acknowledges that an eventual reduction of this fee may be appropriate, the Order does not explicitly state that the Company will be permitted to unilaterally reduce this fee without Board approval. *RA-DEF-9*, p. 20. Furthermore, PSE&G provided no basis for changing the fee. In response to a discovery request, PSE&G acknowledged that "[t]he Board Order in Docket No. EA92040459 [Focused Audit] established the $2 million and provides for no update based on the current capital structure of PSE&G or any other formula."[6]

Furthermore, contrary to the position of PSE&G, the Ratepayer Advocate's recommendation regarding the LEAC adjustment for the affiliation fee stands on its own, independent of the base rate case. PIB at 53. Any changes to the affiliation fee in the pending base rate case should be on a going-forward basis only.

In sum, the Company should not be permitted to unilaterally reduce the affiliation fee. For the reasons set forth above and in the Ratepayer Advocate's Initial Brief and testimony of its witnesses, the PSEG Holdings Affiliation Fee should be maintained at the level established by the Board throughout the Transition Period. An adjustment should be made to the Company's NTC deferred balance to reflect the maintenance of the fee at the Board-approved level of $2 million per year. *See RA-DEF-9*, Sch. ACC-3.

[6] *Id*.

POINT V

THE RATEPAYER ADVOCATE'S RECOMMENDATION THAT PSE&G BE REQUIRED TO DEMONSTRATE IN ITS ANNUAL NTC FILING THAT THE SALES OF ITS NUG OUTPUT WERE PRUDENT AND THAT THE COMPANY HAS TAKEN STEPS TO MAXIMIZE ITS REVENUE FROM ITS NUG OUTPUT, WITHIN ACCEPTABLE RISK PARAMETERS, SHOULD BE ADOPTED.

The Ratepayer Advocate recommends that PSE&G be required to continue to demonstrate, as part of its annual NTC filing, that the decisions made regarding the sale of NUG output were prudent and that the Company has taken steps to maximize revenue from this output within acceptable risk parameters. RAIB at 18. Board Staff concurs with the Ratepayer Advocate's recommendation. SIB at 151. PSE&G does not object to the Ratepayer Advocate's recommendation. PIB at 42. For the reasons set forth herein and in its Initial Brief and the testimony of its witness, the Ratepayer Advocate respectfully submits that Your Honor and the Board adopt the Ratepayer Advocate's recommendation.

POINT VI

THE NTC BALANCE ADJUSTMENT RECOMMENDED BY THE RATEPAYER ADVOCATE TO REFLECT THE SALE OF CERTAIN TRANSMISSION ASSETS SHOULD BE ADOPTED.

At issue is the rate treatment of the gain on the sale of certain transmission assets. *See* PIB at 46-47, RAIB at 20-21, and SIB at 157-158. As set forth in its Initial Brief, the Ratepayer Advocate recommends that the gain on the sale of the Company's transmission assets be shared with ratepayers, in the same manner as the gain on the sale of the Company's transferred generating assets. RAIB at 20-21. PSE&G is required to share any gains from the sale of its transferred generating assets with ratepayers, if the sale occurs within five years of the date of the beginning of the Transition Period, August 1, 1999.[7] Indeed, the Company agreed to share the gains from the sale of its Kearny generating station. *PS-D-9*, p. 11.

Board Staff and the Company oppose the Ratepayer Advocate's recommended adjustment. SIB at 158, PIB at 46-47. Board Staff opposes the adjustment unless the transmission assets are linked to the Kearny generating station. SIB at 158. The Company argues that there is no basis on the Restructuring Case Final Order or consistent regulatory policy to support the proposed adjustment. PIB at 47. While the Restructuring Case Final Order does not explicitly provide for the sharing of the gain on the sale of transmission assets, contrary to the Company's position, there are sound regulatory policy considerations which support the adjustment proposed by the Ratepayer Advocate. The treatment of gains from the sale of the divested transmission assets mirrors that for divested generating

7 *Restructuring Case Final Order*, p. 122, para. 23.

assets. Much like the Company's generating assets, prior to restructuring the transmission assets at issue were always included in the Company's unbundled rate base. *RA-DEF-3*, p. 40. Hence, from a ratemaking standpoint, the Ratepayer Advocate respectfully submits that the gains from the sale of the transmission assets at issue should be treated in the same manner.

For the reasons set forth above and in its Initial Brief and testimony of its witnesses, the Ratepayer Advocate respectfully urges Your Honor and the Board to accept the recommended NTC balance adjustment reflecting the gain on the sale of the transmission assets. Ms. Crane recommended a pre-tax adjustment to the NTC balance of $1,226,000, or $726,000 on an after-tax basis, for the transmission sales, plus accrued interest. *RA-DEF-9,* Sch. ACC-1.

POINT VII

THE RECOMMENDED ADJUSTMENT TO REMOVE THE COMPANY'S CLAIMED CARRYING CHARGES FOR THE SECURITIZATION DELAY SHOULD BE ADOPTED.

At issue is the inclusion of additional charges in the Company's MTC balance which the Company claims are related to the carrying charges on its unsecuritized stranded cost balance during the pendency of the appeal of the Board's Restructuring Case Final Order. PIB at 9-16, RAIB at 53-55, and SIB at 152-157. PSE&G has offset its total MTC overcollection by a cumulative $370.1 million (or approximately $328 million on a Net Present Value basis) for carrying costs associated with the delay in securitization. *RA-DEF-3*, p. 27. As set forth below and in the Ratepayer Advocate's Initial Brief and testimony of witness Robert Henkes, the Company's inclusion of carrying charges related to the delayed securitization should not be permitted. RAIB at 53-55; *RA-DEF-3*, pp. 26-31.

PSE&G argues that its proposed treatment of carrying charges is consistent with the Board's treatment of costs related to Atlantic City Electric Company's generating assets prior to divestiture. PIB at 11-13. Significantly, unlike the Board Order authorizing Atlantic City Electric Company's treatment of its non-divested assets, PSE&G's proposal to offset its MTC overcollection with securitization-related carrying charges was not authorized by the *Restructuring Case Final Order* nor any other Board Order. In contrast, the Board specifically allowed PSE&G to accrue carrying charges on its deferred balances for its NTC and SBC components during the Transition Period, and consider the carrying charges in the NTC and SBC reconciliation calculations at the end of the Transition Period.[8] Therefore, as set forth in the Ratepayer Advocate's Initial Brief, PSE&G's MTC

8 *Restructuring Case Final Order*, pp. 116-117.

overcollection must be adjusted to remove the securitization-related carrying charges.

Board Staff outlines arguments for and against the Company's proposal, but it is not clear that Staff makes a definitive recommendation on this issue. SIB at 152-157. However, Board Staff also states that Your Honor and the Board may want to consider that ratepayers are also paying a $201 million hedge premium incurred as a result of the securitization delay. *Id*.; *P-3S*, Sch. RCK-S-2. Thus, under PSE&G's recommended position, its ratepayers would not only be forced to pay for approximately $328 million in NPV carrying charges incurred during the securitization delay, but in addition would be paying for the separate $201 million hedge premium.

The Ratepayer Advocate avers that it is unjust and unreasonable to require ratepayers to pay $201 million for the hedge premium that was required because of the securitization delay and then require them also to pay the alleged carrying costs due to the securitization delay. Ratepayers cannot refuse to pay a reasonable hedge premium, but Your Honor and the Board can fairly balance the interests of ratepayers and shareholders by refusing to impose on ratepayers the additional $328 million in NPV for the utility's requested carrying charges.

If, however, Your Honor and the Board decide that securitization delay-related carrying charges are allowed, ratepayers should only pay for the carrying charges calculated at the 7-year constant maturities treasury rate as shown in the Federal Reserve Statistical Release on or closest to August 1, plus 60 basis points ("Seven-Year Rate"). *RA-DEF-3*, p. 31. Mr. Henkes found that the Company's overall rate of return was almost twice as high as the Seven-Year Rate for that period. *RA-DEF-3*, p. 30. Contrary to the Company's argument, the alternative rate proposed by the Ratepayer Advocate is neither inconsistent nor unreasonable. PIB at 15-16. Notably, the alternative

Seven-Year Rate recommended by the Ratepayer Advocate is the same as that applied to the Company's SBC and NTC balances, pursuant to the Board's Final Decision and Order.[9] *PS-D-1*, p. 19. Hence, the Seven-Year Rate is consistent with that applied to other restructuring-related balances.

Furthermore, the alternative Seven-Year Rate is eminently reasonable. PSE&G argues that its overall rate of return should be used as the interest rate for computing carrying charges, since it claims that it had to finance its stranded cost balance using both debt and equity. PIB at 11. However, the Company said that all of its deferred balances were financed based on the Company's overall capitalization, including those balances (SBC and NTC) for which the Board only authorized a carrying charge based on the Seven-Year Rate. RAIB at 55-56; *PS-DEF-100*; *RA-DEF-3*, p. 30. If the Board implicitly considered the Seven-Year Rate to be reasonable for the SBC and NTC balances, the Company cannot now suggest that the use of the Seven-Year Rate for the Company's carrying cost associated with the securitization delay is unreasonable.

For the reasons set forth above and in the Ratepayer Advocate's Initial Brief and testimony of its witnesses, the carrying charges for the securitization delay should be eliminated from the MTC balance. RAIB at 53-56. Eliminating the carrying charges from PSE&G's proposed MTC over-recovery amount of $204.1 million results in a recommended MTC over-recovery balance of $532.2 million. *RA-DEF-3,* Sch. RJH-6 (2/28/03 update). If, however, Your Honor and the Board finds that such carrying charges are permitted as an offset, the interest rate used to compute the carrying charges should be the same as that used for PSE&G's NTC and SBC balances, the Seven-Year Rate. Mr. Henkes calculated the total cumulative carrying charges amount of $174.820 million using the Seven-

9 *Restructuring Case Final Order*, pp. 116-117.

Year Rate, which is approximately $195.3 million lower than the Company's proposed cumulative carrying charge amount of $370.1 million. *RA-DEF-3*, p. 29, Sch. RJH-6A (2/28/03 update).

POINT VIII

IF A RECOVERY PERIOD LONGER THAN FOUR YEARS IS USED TO AMORTIZE UNDERRECOVERIES, THEN THE RATEPAYER ADVOCATE RECOMMENDS A TEN-YEAR RECOVERY PERIOD WITH A FIXED INTEREST RATE.

In its Initial Brief, PSE&G repeats the testimony of its witness, Morton A. Plawner, concerning the Company's proposal to securitize the year 4 BGS underrecovery. PIB at 25-31. However, as stated in the Ratepayer Advocate's Initial Brief, the issue of securitization is no longer before Your Honor since the Board recalled this issue and reserved the issue for its own decision. RAIB at 23-24. That recall was contained in the March 25, 2003 letter from the Board Secretary. Therefore, Your Honor can disregard this part of PSE&G's Initial Brief.

The Company criticizes the testimony of the Ratepayer Advocate witness, James A. Rothschild, which deals with the alternative to the Ratepayer Advocate's proposal to amortize the deferred balances underrecoveries over four years. PIB at 25-31. Mr. Rothschild testified that if Your Honor and the Board should decide to amortize the underrecoveries over a period longer than four years, then the balance should be amortized over 10 years at a fixed interest rate of the seven-year Treasury bond rate plus 60 basis points. *RA-DEF-7*, p. 9, lines 18-21. Oddly, PSE&G insists on calling this interest rate the "Rothschild rate" despite the fact that it is the rate that the Board and PSE&G currently apply to all the existing deferred balances. PIB at 28. Contrary to PSE&G's implication, there is nothing new about using this interest rate. It has been used by PSE&G, the other electric utilities, and the Board since 1999. In addition, PSE&G alleges that the interest rate should not apply because it was the result of a stipulation. PIB at 29. However, as Staff points out, the Board determined the interest rate, not the parties to the stipulation. SIB at 148, footnote 24. In fact, the parties to the stipulation had proposed a different interest rate, a seven-year A-rated utility debt rate. *Restructuring Case Final Order*, p. 41, para. 6 and p. 116, para. 6, and Stipulation, p. 6, para. 6. Therefore, PSE&G's allegation is incorrect and should be rejected.

PSE&G criticizes the use of this interest rate because the utility alleges that it has " no market validity" and does not represent the cost of utility capital or a fair rate of return." PIB at 29. Clearly, this criticism can be seen as incorrect when it is noted that two other electric utilities propose to use this same interest rate to amortize their deferred balances, Atlantic City Electric Company and JCP&L. PSE&G's criticism can therefore be rejected. It should further be noted that Staff recommends amortizing the underrecovery over 10 years using an interest rate equal to the rate on one-year treasuries plus 30 basis points, or about 1.6% for the transitional period between August 1, 2003 and the Board’s decision on securitization or amortization of the underrecoveries. SIB at 150. The Ratepayer Advocate recommends that Your Honor and the Board adopt the Staff's proposal as a reasonable alternative to our original proposal for that transitional period.

The Company's Initial Brief makes no mention of the fact that the interest rate on securitization is higher than the interest rate on the amortization approach, but instead presents what it calls a net present value analysis which it claims was able to show that securitization provides a net savings. PIB at 27-28. Mr. Rothschild showed that the interest rate on securitization is estimated to be 1.00% (100 basis points) above the 7-year treasury bond rate, a rate that is 0.4% (40 basis points) higher than the Board-determined recovery rate on the non-securitized deferred balance. RAIB at 25-26.

In addition, if the securitization occurred, then the Company would incur financing costs. PSE&G complains that Mr. Rothschild's proposal would put at risk some of its costs to securitize this underrecovery. PIB at 29. However, the only costs Mr. Rothschild stated might be disallowed were a sufficient amount of costs such that securitization, if it should be chosen by the Company and approved by the Board, would not cost ratepayers any more than if a non-securitization route to recovery were chosen. *RA-DEF-7*, p. 14. The only costs that may have to be excluded are costs that would be in excess of what the Company would incur if securitization were not done. Furthermore, Mr. Rothschild testified that if PSE&G could securitize at a cost such that securitization would cost ratepayers no more than if the deferred balances are amortized based on 60 basis points over the seven-year treasury rate, then there would be no need for PSE&G to take a write-off. RAIB at 26.

The fault in the Company's net present value approach to compute alleged savings is that the Company used its overall cost of capital as the discount rate. PIB at 27. It then applied this discount rate to a 15-year securitization and compared that to a 10-year amortization recovery. Because the discount rate is so high and because the Company chose to use a longer time period for securitization than the amortization recovery, the Company created the illusion that securitization was cheaper even though the interest rate on securitization was higher and, unlike amortization, securitization incurs a substantial financing cost. The discount rate the Company used is inappropriate. Since the cash flows being examined are cash flow savings to ratepayers and not to the Company, the proper discount rate is the discount rate of the ratepayer, not the Company. Correcting the discount rate makes the savings greater to ratepayers if the amortization method is used than if the securitization method is used - unless the Company agrees to a sufficient write-off under the securitization method.

PSE&G claims that Mr. Rothschild ". . . ignores the need to maintain the utility's capital structure and credit rating." PIB at 30. As explained in Mr. Rothschild's testimony, the deferred balance has already been financed. *RA-DEF-7*, p. 10. Once this proceeding is completed, the deferred balance will switch from an amount that continuously needs new amounts to be financed to an amount for which the Company will be receiving a positive cash flow. Therefore, whether Mr. Rothschild's position or the Company's position is selected, the Company's cash flow will improve, meaning that either proposal will result in improvement in the Company's credit quality.

The Company alleges that “Securitization is a recognized mechanism to economically recover regulatory assets in a cost-effective manner.” *Id.* This statement is an over-simplification. Securitization is a recognized mechanism to economically recover regulatory assets in a cost-effective manner when the alternative to securitization is to recover at the overall cost of capital. However, the facts surrounding the deferred balance recovery show that the alternative recovery is not the overall cost of capital, but is an interest rate equal to 60 basis points over the 7-year treasury bond rate - a fact that makes a substantial difference in the relative economics.

POINT IX

THERE IS NO BOARD-APPROVED ENERGY SAVINGS PROTOCOL FOR THE DETERMINATION OF DEMAND SIDE MANAGEMENT PROGRAM "LOST REVENUES." THEREFORE, THERE CAN BE NO RECOVERY FOR LOST REVENUES AT THIS TIME.

Despite the Company's argument that "the Board must act on and approve energy savings protocols to satisfy several regulatory requirements," the fact that the Board <u>eventually</u> will need to determine an energy savings protocol for other reasons does not answer the Ratepayer Advocate's concern that there is <u>currently</u> no Board-approved energy savings protocol. PIB at 49. Therefore, there is no reliable, known and measurable lost revenue amount that is justified to be charged to ratepayers at this time. Once the Board does approve an energy savings protocol, the deferred accounting nature of the DSM lost revenues preserves this issue for future recovery, if there is to be any. PSE&G is in no way harmed by waiting until the Board issues its decision regarding the protocols by which lost revenues may be measured.

The Board clearly indicated that it wants to approach the subject of lost revenues cautiously, and that recovery would only be through 2003. *I/M/O the Filings of the Comprehensive Resource Analysis of Energy Programs Pursuant to Section 12 of the Electric Discount and Energy Competition Act*, BPU Docket No. EX99050347, *et al* (March 9, 2001) p. 73. Significantly, the Board stated "[t]he program evaluation plans for determining energy savings must still be approved by the Board, <u>prior to eligibility</u> for collection of lost revenues for the new energy efficiency programs." *Id.*, p. 77 (emphasis added). This statement is unequivocal. PSE&G cannot recover lost revenues until the Board has issued its decision. Therefore, it is not appropriate to include lost revenue recovery in the

DSM rate that goes into effect August 2003.

POINT X

UNIVERSAL SERVICE FUND

The Ratepayer Advocate noted in its Initial Brief that the Board on March 20, 2003, approved the establishment of a permanent Universal Service Fund ("USF") to begin July 1st of this year. RAIB at 59. The Company does not include any USF costs for the period 8/01/03 - 7/31/04 in this filing. PSE&G has stated that it intends to update its estimate for USF for the period 8/01/03 - 07/31/04 to reflect the impact of this final Board Order. *Id.* The Ratepayer Advocate reserves the right to comment on the Company's program, based on the terms of the Order and the Company's update.

Board Staff agrees with Mr. Henkes' recommendation for excluding the $9,000 worth of PSE&G's internal labor and overhead costs associated with the administrative processing of the USF Program. SIB at 163. Thus, consistent with both the positions taken by the Ratepayer Advocate and Staff with regard to the USF Program, the Ratepayer Advocate recommends that Your Honor and the Board remove the $9,000 of administrative processing costs from rate consideration in this case. RAIB at 60.

In addition, the Ratepayer Advocate reiterates its position fully articulated in our Initial Brief at pages 59-61 and recommends a total USF Charge under-recovery balance as of 2/28/03, including cumulative interest of $1,286,000 which is $388,000 lower than the corresponding under-recovery balance of $1,674,000 proposed by the Company. RAIB at 61.

CONCLUSION

For the reasons set forth above, and the reasons in our Initial Brief and the testimony of our witnesses, and supported by the substantial, credible evidence in the record, the Ratepayer Advocate respectfully submits that Your Honor and the Board should adopt the recommendations contained therein.

Respectfully submitted,

SEEMA M. SINGH, ESQ.
RATEPAYER ADVOCATE

By:______________________________
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Dated: April 17, 2003

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