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**

INITIAL BRIEF OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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PROCEDURAL HISTORY

On August 28, 2002, Public Service Electric and Gas Company ("PSE&G" or "Company") filed a petition ("Deferral Filing") with the New Jersey Board of Public Utilities ("Board" or "BPU") for approval of a deferral filing, including proposals for changes in its rates for its Non-Utility Generation Transition Charge ("NTC") and its Societal Benefits Charge ("SBC") for the post-transition period pursuant to *N.J.S.A.* 48:2-21 and 48:2-21.1. This case was forwarded to the Office of Administrative Law ("OAL") on September 12, 2002, as a contested case and assigned to the Honorable Richard McGill, Administrative Law Judge ("ALJ") for evidentiary hearings and an Initial Decision.

In addition to the Company, the parties to this proceeding are the Staff of the Board ("Staff"), the New Jersey Division of the Ratepayer Advocate ("Ratepayer Advocate") and several other parties. Several entities moved to intervene in the proceeding. New Jersey Large Energy Users Coalition ("NJLEUC"), Co-Steel Raritan, Inc. ("Co-Steel")[1] and the Independent Energy Producers of New Jersey ("IEPNJ") were all granted intervenor status. Several Municipal Utility Authorities ("MUA") including: Stoney Brook Regional Sewerage Authority; the Mt. Holly MUA; Secaucus MUA; Cinnaminson Sewerage Authority; East Windsor MUA; Riverside Sewerage Authority; Evesham MUA; Willingboro MUA; Somerset Raritan Valley Sewerage; Bordentown Sewerage Authority; Morris Township; Monroe Township MUA; and Pemberton MUA were collectively granted intervenor status. Other movants were granted participant status. The participants are Rockland Electric Company ("RECO" or "Rockland") and Jersey Central Power & Light Company ("JCP&L").

A pre-hearing conference was held before Judge McGill on October 24, 2002, and a Pre-hearing Order was entered on October 25, 2002. In accordance with the schedule set forth in the Pre-hearing Order,

1After a merger, Co-Steel became Gerdau Ameristeel Perth Amboy, Inc.

discovery was propounded. Public hearings were held in Mt. Holly, New Brunswick and Hackensack on December 10, 11 and 16, 2002, respectively.

In support of its case and concurrent with its Deferral Filing, the Company filed the direct testimony and schedules of Robert C. Krueger, Jr. Mr. Krueger's revised schedules reflecting updated actual data through December 2002, were filed on January 17, 2003. On February 25, 2003, the Company filed additional revised schedules of Mr. Krueger reflecting the updated actual data through January 2003. The Company further filed the additional revised schedules of Mr. Krueger on March 13, 2002, which reflected the updated actual data through February 2003. On March 18, 2003, the Company further filed the corrected schedule RCK-D-2 of Mr. Krueger.

Staff filed an Audit Report in the within matter on January 14, 2003. Staff further filed the Direct Testimony of the Barrington-Wellesley Group, Inc., Perry L. Wheaton, Angela L. Anderson and Arthur W. Adelberg, on March 4, 2003, in support of the Audit Report.

The Ratepayer Advocate filed the Direct Testimonies of James A. Rothschild, Robert J. Henkes and Andrea C. Crane on January 15, 2003. Intervenor Co-Steel did not submit Direct Testimony, but reserved the right to submit Surrebuttal Testimony in the within matter.

On February 5, 2003, the Company filed the Rebuttal Testimonies of Mr. Krueger, Robert S. Chilton, Frederick W. Lark, Colin J. Loxley, Morton A. Plawner, and Gerald W. Schirra.

On February 21, 2003, the Ratepayer Advocate filed the Surrebuttal Testimonies of Messrs. Rothschild and Henkes, as well as Ms. Crane. Intervenor Co-Steel filed the Surrebuttal Testimony of Howard Gorman on February 21, 2003.

Evidentiary hearings were held at the OAL on March 3, 5, and 6, 2003. At the close of the evidentiary hearings a briefing schedule was set, with initial briefs due on April 3, 2003, and reply briefs due on April 17,

2003.

POINT I

THE PROPER STANDARD FOR REVIEW OF THE PROPOSED RECOVERY OF THE DEFERRED BALANCE IS WHETHER THE COMPANY MET ITS BURDEN OF PROOF THAT THE COSTS WERE "REASONABLY AND PRUDENTLY" INCURRED.

The Board has broad and sweeping powers over all aspects of public utilities subject to its jurisdiction. *See N.J.S.A.* 48:2-13; *Township of Deptford v. Woodbury Town Sewerage Corporation*, 54 *N.J.* 418 (1969); *In re Public Service Electric and Gas Company*, 35 *N.J.* 358, 371 (1961). The Board is the regulatory agency with jurisdiction and control over electric public utilities including jurisdiction to set rates. *N.J.S.A*. 48:2-21. It is established law in New Jersey that a public utility is required by statute to show that an increase in rates is just and reasonable. *Id.* The statute is clear that: "the burden of proof to show the increase, change or alteration is just and reasonable shall be upon the public utility making the same." *N.J.S.A*. 48:2-21(d). A long line of cases in New Jersey supports the premise that the burden of proving reasonableness of costs lies with the Company. *See, I/M/O the Petition of Public Service Electric and Gas Company for an Increase in Rates - Hope Creek Proceeding*, BPU Docket No. ER85121163 ("*Hope Creek Order*"), where the Board held that "[i]t is uncontroverted that Public Service had the burden of proving the reasonableness of its expenditures for Hope Creek as only reasonable costs can be included in rate base and permitted to earn a return." See also, *Public Service Coordinated Transport v. State*, 5 *N.J.* 196, 222 (1950).

Indeed, the Electric Discount and Energy Competition Act of 1999 ("EDECA") and the Final Order in PSE&G's Restructuring Case specifically state that only "reasonable and prudently incurred costs" claimed by an electric public utility to provide Basic Generation Service ("BGS")[2] may be recovered. *N.J.S.A*. 48:3-

2Customers on BGS receive their electric supply from the utility rather than being served by a Third Party Supplier.

57(e). *See also Restructuring Case Final Order,* p. 110 (as to the NUG costs).[3] The burden of proof that the deferred balance claimed by the utility is just and reasonable lies with the Company as supported by the above-cited precedent.

In evaluating whether the Company met its burden that it acted reasonably and prudently during the Transition Period, the Board must evaluate the managerial conduct in light of the circumstances, information and options in existence at the time when management decisions were made. Quoting a New York Public Service Commission ruling, the Board has stated that:

> The Company's conduct should be judged by asking whether the conduct was reasonable at the time, under the circumstances considered that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people could have performed the tasks that confronted the Company.

In the Matter of the Petition of Public Service Electric and Gas Company for an Increase in Rates and In the Matter of the Petition of Public Service Electric and Gas Company for an Increase in Rates – Hope Creek Proceeding, BPU Docket No. ER85121163, OAL Docket No. PUC 0231-86 (Order dated April 6, 1987) ("*Hope Creek Order*"), pp. 65-66.

The *Hope Creek Order* also clarifies the Board's standard of review when determining prudence:

> [t]he Company, as discussed earlier in this Order, had the burden of proof with respect to the reasonableness of the costs that were expended in building the plant. In order to meet that burden with respect to the various enhancements, the Company had to show the reasons why each of the enhancements were installed and the benefits to be derived from their installation. An integral part of the benefits associated with the enhancement is a justification of the costs. *Id.,* p. 89.

Thus, it is clear that the present deferred balance prudence review must apply the standards set forth in the *Hope Creek Order* and determine whether: 1) the Company's actions during the Transition Period met the reasonable person standard given the specific circumstances at the time decisions were made; and 2) the

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3 *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"*).

Company has sufficiently shown the reasons why each deferred balance cost was incurred and the benefits that ratepayers derived by the Company's actions. Moreover, Your Honor and the Board must review whether the Company sufficiently mitigated risk. Under the *Restructuring Case Final Order,* the Board recognized the possibility of a large underrecovered deferred balance, noting that:

> N.J.S.A. 48:3-61 permits recovery by an electric public utility through a market transition charge of stranded costs related to long-term NUG contracts, provided that the utility has demonstrated the full market value of each such contract and that it has taken all reasonably available measures to mitigate the contracts' above-market costs. . . .

Restructuring Case Final Order, p. 110. The Board goes on to say that PSE&G retained the ongoing obligation to show that "it has taken all reasonably available steps to mitigate above-market NUG contract costs." *Id.*

The following discussions will show that the Company failed to fully document its efforts to mitigate above-market NUG contract costs and provide the necessary proofs that it made prudent decisions for the deferred balance. Ultimately, Your Honor and the Board must determine whether the proposed recovery of the deferred balance is in the public interest.

POINT II

IN CALCULATING THE INTEREST ON THE DEFERRED BGS BALANCE, THE TOTAL AMOUNT OF THE DEFERRAL MUST BE REDUCED TO REFLECT THE INCOME TAX BENEFIT AND THE INTEREST RATE MUST BE ADJUSTED.

The Company claims that its deferred BGS balance will be $238,279,173.[4] PSE&G's proposed deferral BGS balance does not reflect the tax savings associated with its BGS expenses, nor does it reflect the proper accrual of interest during the Transition Period. Therefore, as set forth below, the Company's deferred BGS balance should be adjusted to reflect the income tax savings associated with the underlying expenses and the proper accrual of interest.

As a result of the Stipulation and Final Order in the Company's Restructuring Case, PSE&G's revenues for BGS service during the first three years of the Transition Period matched its expenses for BGS supply. This was the result of the operation of a number of provisions in the Final Order. Pursuant to the Board's Final Order, the Company's electric generation-related assets were transferred to a separate corporate entity or "Genco."[5] Furthermore, the Final Order provided that during the first three years of the Transition Period, the Genco would provide full requirements service to PSE&G for its BGS load at rates that matched the Company's tariffed BGS rates for service:

> To ensure the reliability of service to BGS and to remove the risk of price volatility, o [sic] the regulated company during the transition to a competitive market and to further ensure that PSE&G can meet its contractual obligations to provide power under certain Off-Tariff Rate Agreements (listed in Attachment 5 to the Stipulation), the transfer to the Genco shall be accompanied by the Genco and PSE&G's [sic] entering into a BGS contract which shall be submitted for approval to the Board, whereby the Genco would provide full requirements service for energy, capacity, losses and ancillary services needed by the Company for BGS and

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[4] *PS-D-1;PS-DEF-147,* Sch. RCK-D-8 (3/13/03 update).

[5] *Restructuring Case Final Order*, p. 120.

for Off-Tariff Rate Agreements for the period that the Company will be providing BGS under the Stipulation.[6]

The Final Order went on to state that:

> The BGS contract shall provide that the consideration paid by PSE&G for such full requirements service shall be: (i) an amount computed on a monthly basis equal to the full amount charged for BGS to PSE&G's retail electric customers as set forth in paragraph 15 (less any sales and use tax and transmission); (ii) an amount computed on a monthly basis equal to PSE&G's retail delivery to Off-Tariff Rate Agreement customers, multiplied by the comparable BGS rate for such customers (less sales and use tax and transmission); and (iii) an additional charge for price stability services provided by the combustion turbine assets of Genco, payable based on the installed capacity of these assets.[7]

Therefore, during the first three years of the Transition Period, the only expenses associated with BGS deferred by the Company related to $2,150,028 in BGS auction costs in Year 3. *RA-DEF-9*, p. 9.

In Year 4, when the all-requirements contract with the Genco was no longer in force, the deferred BGS balance grew by a much larger amount. The Company claims that its total deferred BGS balance at the end of Year 4 (July 31, 2003) will be $238,279,173. *PS-D-1, PS-DEF-147*, RCK-D-8 (3/13/03 update). Ratepayer Advocate witness Ms. Andrea Crane found that the Company's claimed Year 4 ending deferred BGS balance included accrued interest, Year 3 and Year 4 BGS auction fees, and a credit of $2,688,000 relating to auction tranche fees paid by the supplier.[8] *Id.*

Ms. Crane did not recommend any adjustments to the components of the Company's deferred BGS balance. *Id.*, p. 10. However, at issue is the treatment of the tax savings attributable to the underlying expense

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[6]*Restructuring Case Final Order,* pp. 121-122, para. 21.

[7]*Id*.

8Pursuant to the Master Agreement for BGS auction supply, the supplier is required "to pay to the Company a charge per Tranche which amount will be announced prior to the auction for each Tranche comprising the Supplier's BGS Supplier Responsibility Share, in order to reimburse for the total costs of the auctions." *PS-DEF-64*, Master Agreement Article 2.2(a),(v). The tranche fees, shown as an expense offset in PSE&G's filing, are intended to cover the auction costs incurred by the Company. Accordingly, Ms. Crane found that the costs of the auction are not included in PSE&G's claim. *RA-DEF-9*, p. 10. For this reason, Ms. Crane's updates do not include $1,282,975 in auction costs incurred in February 2003, since these will be reimbursed by tranche fees.

and the proper accrual of interest during the Transition Period.

First, the deferral balance needs to be adjusted to reflect income tax savings. Ms. Crane found that when the expenses comprising the deferred BGS balance were incurred, they resulted in an expense deduction for income tax purposes, reducing the Company's tax liability. *RA-DEF-9*, p. 11. Therefore, the burden of the associated expenses on PSE&G's operating income was mitigated by the income tax savings associated with the expense deductions. Thus, the net effect of the deferral on the Company's operating income should be calculated on a net-of-tax basis. *Id.* Ms. Crane concluded that the net-of-tax deferral balance should be used as the base to which interest is accrued. *Id.* Ms. Crane's recommendation is consistent with the Board's recent ruling on the use of net-of-tax deferral balance.[9] Accordingly, Ms. Crane reduced the deferred BGS balance by $96,812,947 to reflect the tax savings, for a net-of-tax deferred balance of $140,183,251. *RA-DEF-9*, Sch. ACC-2, p. 2 (2/28/03 update).

The use of a net-of-tax deferred BGS balance would not harm the Company. Ms. Crane recognized the timing difference implicit in her tax savings calculation and appropriately provided for future recovery of the associated taxes. *Id.*, p. 11. Ms. Crane recommended that when the revenues associated with recovery of the deferred BGS balance are collected from ratepayers in the future, it will be necessary to provide for a recovery of the income taxes that will be due on those revenues. *RA-DEF-9*, p. 11. Therefore, the net-of-tax deferral will eventually be grossed-up in some manner to account for the fact that the Company will incur an income tax expense at the time that it recovers its deferred costs from ratepayers.

In his Rebuttal Testimony, PSE&G witness Robert Chilton testified that the Ratepayer Advocate's recommendation to apply interest on the net-of-tax deferred balance should be rejected. *PS-D-5*. However,

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[9] *See In the Matter of Rockland Electric Company's Rate Unbundling, Stranded Cost and Restructuring Filings,* BPU Docket Nos. EO97070464-66, (Motion for Reconsideration and/or Clarification dated October 16, 2002), pp. 2-4.

Mr. Chilton does not consider the fact that the Company has benefitted from tax savings related to the deferrals during the Transition Period, as noted by Ms. Crane in her Surrebuttal Testimony. *RA-DEF-10*, p. 4. In response to Mr. Chilton's recommendation, Ms. Crane testified that if the tax benefits are ignored and if the Board calculates interest on a pre-tax deferred balance, then PSE&G will recover more than its actual carrying costs on this deferral. *Id*. As a result, Ms. Crane concluded that PSE&G would over-recover its deferred balance if Mr. Chilton's recommendations were adopted by the Board. *Id*.

Second, the interest rate used by the Company to calculate interest on its BGS deferred balance during the Transition Period needs to be updated for 2002. The Ratepayer Advocate does not object to the use of the seven-year treasury rate plus 60 basis points used in the Company's filing. However, the rate should be updated as of August 1st of each year, pursuant to the *Restructuring Case Final Order*.[10] Ms. Crane found that the Company originally did not update this rate for the August 1, 2002 seven-year treasury rate.[11] *RA-DEF-9*, pp. 11-12. Instead, Ms. Crane found that PSE&G continued to use the Year 3 rate (August 1, 2001 seven-year treasury rate plus 60 basis points) of 5.40 percent to accrue interest on its Year 4 BGS deferred balance. *Id*. p. 12. Therefore, Ms. Crane appropriately adjusted the accrued interest amount to reflect the use of the rate based on the August 1, 2002 seven-year treasury rate plus sixty basis points, or 4.64 percent. *Id*., Sch. ACC-1.

Ms. Crane computed the resulting deferred BGS balance, reflecting her recommendations. The pre-tax BGS deferral of $236,996,198 equates to $140,183,251 on an after-tax basis. *RA–DEF-9*, ACC-2 (2/28/03 update). The interest accrued during the Transition Period amounts to $3,296,382, for a total deferral with interest of $143,479,633. *Id.*, Sch. ACC-1 (2/28/03 update).

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[10] *Restructuring Case Final Order*, p. 116, para. 6 and p. 117, para. 9.

11 The August 1, 2002 interest rate was used by the Company for Year 4 in its 3/13/03 update. *PS-DEF-147*.

POINT III

IN THE ABSENCE OF SIGNIFICANT NUG COST MITIGATION, THE COMPANY SHOULD BE REQUIRED TO FILE ANNUAL UPDATES ON ITS NUG COST MITIGATION EFFORTS CONCURRENT WITH ITS FILINGS FOR ANY CHANGES IN ITS NTC RATE.

The *Restructuring Case Final Order* established an NTC charge to recover the above-market costs of the Company's purchased power agreements with non-utility generators ("NUGs"). In its filing, the Company estimates that by July 31, 2003, its NTC costs during the Transition Period will be over-collected by $101,025,000.[12] In addition to recovery of its deferred NTC balance, the Company is also seeking approval to implement a new rate prospectively for its NTC, based on its projection of above-market NUG costs during the first year after the Transition Period. This rate would be effective August 1, 2003, the beginning of Year 5.

As set forth in more detail below, the Company has failed to mitigate the burden of its outstanding NUG contracts. The *Restructuring Case Final Order* provided that "...PSE&G will be required to continue to make reasonable attempts to renegotiate, buy out or buy down its NUG contracts."[13] During the Transition Period, as a result of the Company's renegotiation of its NUG contracts, the Net Present Value ("NPV") of its NUG contracts was reduced by only 9 percent. *RA-DEF-9*, p. 15. Therefore, for the reasons set forth below, the Company should be required to report on its NUG mitigation activities annually, at the time it files an update of its NTC rate.

At the beginning of the Transition Period, PSE&G had twelve NUG contracts, which provided 697.1 MW of capacity and associated energy. *RA-DEF-9*, pp. 12-13. In his direct testimony, PSE&G witness Mr.

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[12] *PS-D-1*, Sch. RCK-D-2. While the Company updated its monthly NTC deferral balance through February 2003 (3/13/03 update), it did not update its projected July 31, 2003 balance. *PS-DEF-147*.

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

Robert Krueger testified that "through aggressive mitigation efforts PSE&G has successfully renegotiated virtually all of its Non-utility (NUG) contracts." *PS-D-1,* p. 4, lines 10-11. Ratepayer Advocate witness Ms. Andrea Crane examined the Company's NUG mitigation efforts and found that "the degree of mitigation is not as great as suggested by the Company's testimony." *RA-DEF-9*, p. 14, lines 16-17. Although the Company claims that it has mitigated approximately 90 percent of its NUG contracts (based on the number of NUG contracts mitigated), it does not follow that its NUG costs were mitigated by 90 percent, as discussed below. *RA-DEF-9*, p. 15.

Ms. Crane reviewed the pre- and post-mitigation NPVs for each of the Company's mitigated contracts. Prior to mitigation, the seven mitigated NUG contracts had a net present value of $3.04 billion. *RA-DEF-9*, p. 15; *PS-DEF-8.* Ms. Crane found that the post-mitigation NPV of the same NUG contracts dropped to $2.77 billion, a reduction of less than 9 percent. *RA-DEF-9*, p. 15. While the Company claims that its mitigation efforts have saved ratepayers "in excess of $250 million NPV," it fails to address the fact that ratepayers are still required to fund an NPV of $2.77 billion over the life of these contracts. *RA-DEF-9,* p. 15. Furthermore, the Company claims that "it is not anticipated that there are any significant additional opportunities for further NUG contract mitigation." *PS-DEF-20*.

Even if one were to accept the methodology for calculating reductions in the Company's NUG costs advocated by PSE&G witness Mr. Colin Loxley in his Rebuttal Testimony, the savings negotiated by PSE&G are still relatively small. *PS-D-6,* p. 3. Mr. Loxley advocated comparing the reduction in the NUG contract costs with the above-market value of those contracts. *Id*. Mr. Loxley quantified the Company's NUG savings using that method and the result was that PSE&G's NUG savings would amount to only a 15 percent reduction in the above-market cost of its NUG contracts. *Id.*; *RA-DEF-10*, p. 6. In sum, while PSE&G might claim to have mitigated 90 percent of its NUG contracts, the degree of cost mitigation is relatively small.

In the absence of any significant cost mitigation by the Company of its NUG contract costs, the Ratepayer Advocate respectfully submits that Board oversight is needed in this area. Your Honor and the BPU should require the Company to report on mitigation activities annually at the time that it files its annual NTC rate charge. Annual reporting will provide the Board with an opportunity to assess the Company's mitigation efforts. If the Board subsequently finds that the Company is not making a good faith effort to mitigate its NUG costs, then the Board should take all lawful steps to mitigate the burden on ratepayers' rates resulting from the Company's above-market NUG contracts.

POINT IV

THE LEAC BALANCE USED BY THE COMPANY AS ITS BEGINNING NTC BALANCE SHOULD BE ADJUSTED TO REFLECT THE PROPER CALCULATION OF ACCRUED INTEREST.

The Company used its Levelized Energy Adjustment Clause ("LEAC") balance at August 1, 1999 as its starting NTC balance. In fact, PSE&G was ordered by the BPU to utilize its LEAC balance, including accumulated interest at July 31, 1999, as the starting balance for its NTC deferral. 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."[14] PSE&G utilized an opening LEAC over-recovery balance of $58,708,775.[15] However, based on her review of the Company's response to a discovery request, Ms. Crane found that in response to RAR-DEF-41, the Company has not included 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*. As discussed more fully below, Your Honor and the Board should adopt the adjustment to the Company's beginning NTC balance recommended by Ms. Crane which properly reflects the computation of interest on the LEAC balance.

Ms. Crane testified that "...PSE&G's calculated opening balance does not include any interest because on average, since the BPU issued its last order approving a LEAC rate change, the Company has been under-recovered." *RA-DEF-9*, p. 18, lines 4-6. As discussed in PSE&G witness Mr. Krueger's Rebuttal Testimony, the Company's 1997 Salem Settlement provided that its then existing LEAC rates, established in 1995, be frozen beginning January 1997. *PS-D-9*, p. 8. No other LEAC changes occurred until the *Restructuring*

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

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

Case Final Order, which transferred the overcollected LEAC balance to the NTC, effective August 1, 1999. *Id.* The Company's methodology for computing interest on its LEAC balance is contrary to the Board's pertinent regulations.[16] The LEAC methodology set forth in the Board's regulations contemplates that the usual LEAC period requires an annual true-up, not a true-up over a multi-year period.[17] Contrary to the Rebuttal Testimony of Mr. Krueger, the Board has considered a 12-month period to be the usual LEAC period, as set forth in the pertinent Board regulations. *PS-D-9*, p. 7, l. 17-19. *N.J.A.C.* 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." Hence, while the regulation permits the Board to utilize a period different from 12 months, it is clear that the <u>usual</u> LEAC period consists of 12 months. For PSE&G to change the period to other than twelve months unilaterally without specific Board approval is to usurp the Board's regulatory authority. In her Surrebuttal Testimony, Ms. Crane testified that "[t]here is no reason to deviate from that 'usual' interpretation in this case." *RA-DEF-10*, p. 2, lines 12-13.

Furthermore, the regulations provide that interest is to be calculated on a monthly basis.[18] In her direct testimony, Ms. Crane set out the methodology for computing the interest on LEAC balances:

> At the end of the LEAC year, that [monthly] interest is summed. If at the end of the LEAC year, interest is owed to the ratepayers, that interest is credited to ratepayers. If interest is owed to the utility, the utility eliminates that interest through appropriate accounting entries. *RA-DEF-9*, p. 18, lines 11-14.

Therefore, in accordance with the Board's regulations, Ms. Crane testified that interest should be examined in discrete 12-month intervals to determine whether the Company owes its ratepayers interest on its

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16 *See N.J.A.C.* 14:3-13.1 *et seq.*

17 *N.J.A.C.* 14:3-13.4 (*RA-DEF-2)*.

18 *RA-DEF-2*.

LEAC over-collections. *RA-DEF-9*, p. 18.

Using information provided by the Company in response to a discovery request, Ms. Crane recalculated the interest due for two discrete 12-month LEAC periods, the 12-months ending July 31, 1999 and July 31, 1998, as well as the seven months ending July 31, 1997. *RA-DEF-9*, pp. 18-19, Sch. ACC-3; *PS-DEF-41*. Ms. Crane found that PSE&G did not owe any interest to ratepayers for the seven months ending July 31, 1997 or for the 12-months ending July 31, 1998. *RA-DEF-9*, p. 19. However, for the twelve months ending July 31, 1999, Ms. Crane found that the Company owes ratepayers $4,662,000 in interest. *Id.*, Sch. ACC-3, footnote 2. Ms. Crane concluded that the Company's claimed beginning LEAC credit balance was understated by $4,662,000 and recommended an adjustment in her NTC balance calculation to reflect that understatement of interest due ratepayers by the Company. *Id.* For the reasons set forth above, the Ratepayer Advocate respectfully submits that Your Honor and the Board approve the adjustment to the beginning NTC balance recommended by Ms. Crane and adopt her beginning BGS balance of $63,370,699. *RA-DEF-9*, Sch. ACC-3, p. 1 of 4 (Updated 2/28/03).

POINT V

THE LEAC BALANCE MUST BE ADJUSTED TO REFLECT THE BOARD-APPROVED PSEG HOLDINGS AFFILIATION FEE.

As set forth below, PSE&G improperly reduced the Board-approved PSEG Holdings Affiliation Fee attributable to its electric operations. The LEAC balance must be adjusted to reflect the proper credit attributable to the affiliation fee, for the reasons set forth in detail below.

The PSEG Holdings Affiliation Fee was established as part of the PSE&G Focused Audit proceeding. *RA-DEF-9,* p. 19; *PS-DEF-45*. In response to a discovery request, PSE&G explained the basis for the fee: "[t]he parties to that proceeding [focused audit] agreed to implement a fee of $2 million to reflect the perceived benefits PSEG Holdings (formerly EDHI) receives from its corporate affiliation with PSEG Enterprise and PSE&G." *PS-DEF-45*. The $2 million annual fee was to be allocated between electric and gas operations, with the gas portion credited to the Levelized Gas Adjustment Clause ("LGAC") while the electric portion was previously credited to the LEAC. *RA-DEF-9*, p. 19.

From August 1999 through February 2002, PSE&G included an electric credit in its LEAC of $1,421,328, or $118,444 per month. *Id*. That changed in March 2002. In March 2002, PSE&G reflected a debit, or a charge to ratepayers, of $16,087 in its LEAC for the PSEG Holdings Affiliation Fee. *Id*. And from April 2002 through July 2002, the Company included a reduced credit of only $73,600 per month. *Id*., p. 20. Finally, no affiliation fee credit was included for Year 4 of the Transition Period. *Id*.

The Company's stated rationale for reducing the affiliation fee credit is without a basis in law. PSE&G stated that the affiliation fee reduction is appropriate, "as a result of the outstanding credit support being permanently reduced."[19] The Company's stated reason for the reduction in the affiliation fee credit contradicts

[19] *PS-DEF-100*.

its own interpretation of the Board's Order in the Focused Audit proceeding. 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."[20]

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 BPU approval. *RA-DEF-9*, p. 20. Clearly, the Company should not be permitted to unilaterally reduce the affiliation fee.

For the reasons set forth above, the PSEG Holding Affiliation Fee should be maintained at the level established by the Board throughout the Transition Period. Ms. Crane adjusted the Company's NTC deferred balance to reflect the maintenance of the fee at the Board-approved level of $2 million per year. *RA-DEF-9*, Sch. ACC-3. PSE&G's electric utility operation's share amounts to $1,421,328, or $118,444 per month.

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[20] *Id.*

POINT VI

PSE&G SHOULD 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.

The deferred NUG balance was offset by the capacity and energy revenues received as a result of selling the NUG power into the PJM markets, as provided for in the *Restructuring Case Final Order*, which stated that "[t]he Company will sell the energy and capacity from these contracts at the PJM Interchange Hourly Locational Marginal price and at wholesale within the PJM region, respectively...."[21] The *Restructuring Case Final Order* also provided that "PSE&G will be required to sell such power through alternative means if such means are available at a more beneficial market price."[22]

Citing the risks of the day-ahead market and third party sales if the NUGs failed to deliver, PSE&G chose to sell all energy produced by the NUGs in the PJM real-time market. *RA-DEF-9*, p. 21; *PS-DEF-50.* Considering the risk factors cited by PSE&G, Ms. Crane recommended that "the Company be required to continue to demonstrate, as part of the 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." *RA-DEF-9*, pp. 21-22. The Ratepayer Advocate agrees with Ms. Crane's recommendation and respectfully requests that Your Honor and the Board adopt Ms. Crane's recommendation.

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[21] *Restructuring Case Final Order*, p. 116, para. 8.

[22] *Id*., p. 111.

POINT VII

THE RATEPAYER ADVOCATE CONCURS WITH THE BOARD AUDITOR'S RECOMMENDATION THAT CARRYING COSTS ASSOCIATED WITH THE OVER-MARKET NUG BALANCES SHOULD BE DISALLOWED.

Contrary to the Rebuttal Testimony of PSE&G witness, Frederick W. Lark, the Board did not establish an "applicable standard of selling NUG output into the PJM spot market." *PS-D-7,* p. 7, l. 18-20. As discussed more fully above, pursuant to the *Restructuring Case Final Order*, PSE&G is "required to sell such [NUG] power through alternative means if such means are available at a more beneficial market price…"[23] Therefore, PSE&G was required to find the most beneficial price for its NUG output during the Transition Period.

The Audit Report discusses possible "damages for failing to pursue alternative means of selling the NUG power" *S-DEF-2*, p. IX-14. The Auditors set forth the conceptual method for estimating these "damages" where the Auditors used the difference between the value of the power in the real time PJM market and the value of the power in the forward, bilateral market by auction or otherwise. *Id*. The Auditors recognize that this differential is difficult to measure. *Id*. Therefore, the Auditors proposed an alternate method for measurement: "[a]n alternative approach would be to disallow recovery by PSE&G of carrying costs associated with the over-market NUG balances for the period in question."

Ms. Andrea Crane found that the Auditor's recommendation is reasonable and appropriate. *RA-DEF-10*, p. 5. The Ratepayer Advocate respectfully submits that PSE&G should not be permitted to recover carrying costs associated with its over-market NUG balances, in accordance with the treatment set forth by the

23 *Restructuring Case Final Order*, p. 111.

Auditors.[24]

POINT VIII

THE NTC BALANCE MUST BE ADJUSTED TO REFLECT THE GAIN ON THE SALE OF THE KEARNY GENERATING STATION AND OF CERTAIN TRANSMISSION ASSETS.

Pursuant to the Board's Final Decision and Order in the Company's Restructuring Case, certain generating facilities were transferred from the regulated utility operations to an unregulated affiliate ("Genco").[25] PSE&G is required to share any gains from the sale of the transferred assets with ratepayers, if the sale occurs within five years of the date of the beginning of the Transition Period, August 1, 1999.[26]

The Company originally proposed an NTC adjustment to return 50 percent of the pre-tax profits associated with the sale of one of the transferred assets, the Kearny Generating Station, through the NTC. *PS-D-1,* Attachment A, p. 7. The Company included an after-tax credit to the NTC of $5,101,000 relating to the sale of that facility.[27] However, Ms. Crane concluded that since this amount is on an after-tax basis, it must be grossed-up to pre-tax level upon being returned to ratepayers. *RA-DEF-9*, p. 22. Ms. Crane calculated the pre-tax amount, $8,624,000, and recommended that the pre-tax amount be included with the other pre-tax balance. *Id*., p. 23, Sch. ACC-1. In his Rebuttal Testimony, Mr. Krueger accepted this change. *PS-D-9*, p. 11.

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24 The Company has yet to quantify the adjustment (requested in a discovery request) and hence, the adjustment is not included in the adjustment dollar totals presented in this brief.

25 The Kearny sale and the transmission sale were addressed in the Direct Testimonies of Ratepayer Advocate witness Ms. Andrea Crane and Mr. Robert Henkes. *RA-DEF-9;RA-DEF-3*.

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

27 *PS-D-1*, Sch. RCK-D-4, page 1 of 3.

Ms. Crane also included an adjustment to the NTC to reflect the ratepayers' share of the gains associated with the sale of certain electric transmission properties. *Id*. Ms. Crane concluded an additional pre-tax amount of $1,226,000, or $726,000 on an after-tax basis, for those sales. *Id*., Sch. ACC-1. Ms. Crane also recommended that the NTC adjustment should also include the accrued interest associated with sales gains. *Id*., pp. 23-24.

As set forth above and in the testimony of the Ratepayer Advocate's witnesses, the NTC balance must be adjusted to reflect the ratepayers' share of the sales gains, plus interest.

POINT IX

THE UNDER-FUNDED DEFERRAL AMOUNTS SHOULD BE COLLECTED FROM RATEPAYERS AND OVER-FUNDED DEFERRAL AMOUNTS SHOULD BE RETURNED TO RATEPAYERS OVER A FOUR-YEAR PERIOD.

Ratepayer Advocate witness Andrea Crane recommends that over-funded deferral amounts should be returned to ratepayers over a four-year period and under-funded amounts collected over a four-year period. *RA-DEF-9*, p. 25. Furthermore, Ms. Crane recommends that interest accrued on the balances be computed using a fixed interest rate. *Id.* Ms. Crane's recommendation is conditioned upon the fact that the Company has not filed a securitization petition. *Id.* Adoption of Ms. Crane's recommendations would result in a total BGS/NTC under-recovery of $105,450,596 on a pre-tax basis and of $62,373,303 on an after-tax basis, yielding a total net deferred BGS/NTC underrecovered balance of $59,471,838 including interest. *RA-DEF-9*, Sch. ACC-1, line 7 (2/28/03 update), while adoption of Mr. Henkes' recommendations would result in a significant net over-recovery of the SBC. *Id.*; *RA-DEF-9,* Sch. ACC-1 (2/28/03 update)*; RA-DEF-3*. Should the Company propose to securitize the deferred BGS balance, then Your Honor and the BPU should consider additional methods for recovery of the BGS deferral, as addressed in the Direct Testimony of Mr. Rothschild.

POINT X

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.

Ratepayer Advocate witness Andrea Crane recommended that overrecovered deferral amounts should be returned to ratepayers over a four-year period and underrecovered amounts should be charged to ratepayers also over a four-year period. *RA-DEF-9*, p. 25. Therefore, this is the primary recommendation of the Ratepayer Advocate concerning the rate recovery periods. However, if Your Honor and the Board decide that the deferred balance underrecoveries should receive different ratemaking treatment than overrecoveries and that the amortization of underrecoveries should be longer than the four years recommended by the Ratepayer Advocate, then the Ratepayer Advocate recommends approval of the proposals contained in the testimony of our witness, James A. Rothschild.

Mr. Rothschild recommended that if PSE&G's Year 4 BGS underrecovery is to be charged over a period longer than four years, then the recovery period should be ten years. *RA-DEF-7, p. 4, l. 21-24.* The interest rate to be used during this ten-year recovery period is the 7-year treasury bond rate plus 60 basis points, with the rate being fixed as of the time the deferral recovery begins rather than a variable rate to be adjusted annually. As stated by Mr. Rothschild, his proposals would apply only if Your Honor and the Board decide to charge the underrecoveries over a period longer than four years.[28] *RA-DEF-7, p. 4, l. 7-13.* Mr. Rothschild's alternate proposal is to be considered against PSE&G's proposal to securitize the Year 4 BGS

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28 It should be noted that on March 13, 2003 PSE&G submitted updated schedules of Mr. Krueger that contained two separate proposals. *PS-DEF-147*. The schedules were updated for results through February 28, 2003. Schedule RCK-D-4, page 1 of 3 was presented in two formats. One proposal is the original request to amortize deferred balances over one year. PSE&G's alternate proposal is to amortize deferred balances over two years.

underrecovery.

However, Mr. Rothschild's proposal must now also be considered in light of the Board's recent decision to recall from this case the issue of securitization. In the March 25, 2003 letter from Board Secretary Kristi Izzo, the Board advised that Your Honor should determine the reasonable and prudent amount of the deferred balances including any underrecovery. The Board recalled the issue of how much of the prudently incurred deferred balances should be securitized and the issue of the appropriate transitional amortization and interest rate for such deferred balances between August 1, 2003 and the time of the Board's ultimate decision on the issue of securitization versus amortization. While Your Honor will not recommend a decision on whether or not to securitize the BGS underrecovery, if Your Honor and the Board decide that the Year 4 BGS underrecovery should be amortized at rates reflective of a period longer than four years, then the Ratepayer Advocate recommends approval of Mr. Rothschild's proposal to recover the balance at rates reflective of a ten-year recovery period.

As originally stated by Mr. Rothschild:

> I have been advised by Counsel that this proceeding is to determine what amount of the deferred balances was prudently incurred by the Company and the level of the prudently incurred deferred balances that is eligible for securitization. According to the Company's SEC filing, Public Service expects to file a subsequent Petition with the Board to determine whether securitization is appropriate and in the ratepayers' best interest. Therefore, my primary focus in this testimony will be the appropriate amortization period and interest rate that should be used to recover the under-recovered BGS deferred balance which is owed to the Company from ratepayers as an alternative cost recovery mechanism to be considered if the Board is presented with a securitization petition by the Company. Securitization data has been presented for comparison purposes only.

RA-DEF-7, p. 7, l. 15 to p. 8, l. 2.

Presumably, the Board's decision to recall the securitization issues will make the testimony of PSE&G witness, Morton A. Plawner, irrelevant. His testimony focused on critiquing Mr. Rothschild's views on

securitization of the Year 4 BGS balance. *PS-D-4, p. 1, l. 14-18.* Securitization is an issue no longer before Your Honor. However, PSE&G witness, Mr. Krueger, included in his updated schedules a recovery proposal for Year 4 BGS costs based on an estimate of the results of the Company's expected securitization filing. *Schedule RCK-D-4, page 1.* The annual recovery amount for the BGS underrecovery would be $20,356,000 as seen on that schedule. Since that is PSE&G's proposal based on a securitization estimate, Mr. Rothschild's testimony that offers an alternative to securitization would still be relevant as a response to PSE&G's proposal which is based on a hypothetical securitization.

Mr. Rothschild expressed his concern that if PSE&G files a petition for securitization, then securitization would cost ratepayers more than if the interest earned on the deferred balance were at the rate of 60 basis points in excess of the 7-year U.S. Treasury bond rate, unless the Company takes a write-off of part of the deferred balance. *RA-DEF-7, p. 5, l. 3-7.* For comparison purposes, Mr. Rothschild assumed that PSE&G's proposal would be to securitize the balance over 15 years. *Id., p. 9, l. 5.* Mr. Rothschild presented his proposals using the Company's original $248,289,000 estimate of the Year 4 BGS balance. He used this figure as a proxy for the figure that Your Honor and the Board will ultimately decide. Using that figure did not signify Mr. Rothschild's acceptance of the reasonableness of that figure. *Id., p. 5, l. 8-13.*

Part of Mr. Rothschild's concern arose from his estimate that the upfront transaction costs of securitization of this balance would cost $6 million, if the balance subject to securitization would be the after-tax amount related to the deferred BGS balance, or approximately $147 million. *Id., p. 9, l. 9-12.* The reason why securitization would be more expensive than Mr. Rothschild's ten-year proposal is that the interest rate on securitized debt is approximately 1% higher than the associated treasury bond rate including upfront transaction costs. *Id., p. 9,* lines 7-9.

As additional support for his alternative proposal for a ten-year amortization, Mr. Rothschild prepared

a graph that shows how the annual charge per kWh for the BGS underrecovery changes as the number of years for the deferred balance recovery changes. *RA-DEF-7, p. 12, Table 2.* He explained that the data in the graph show that, as the number of years used to recover the deferred balance increases, the rate of drop in the annual kWh charge is diminished. The steep part of the drop-off in the annual recovery lasts for approximately the first ten to twelve years, after which the drop-off is much more gradual. It was the more gradual drop-off that begins to occur after the first ten to twelve years that caused Mr. Rothschild to recommend a ten-year recovery as preferential to securitization. *Id., p. 13,* lines 3-8.

Mr. Rothschild calculated that, in order for the Company's proposal (based on a hypothetical securitization) to have no higher an impact on customers' rates than a ten-year recovery at 60 basis points over the 7-year treasury interest rate, it would need to take a write-off of about $10 million. *RA-DEF-7,* p. 14. Mr. Rothschild also testified that if PSE&G could securitize with financing costs lower than his estimated $6,000,000, then the write-off needed to keep ratepayers whole would be proportionately less. T1844:L10-19. Furthermore, Mr. Rothschild stated that if PSE&G could accomplish a securitization issuance such that the securitization, including financing expense, would cost ratepayers no more than if the deferred balance were charged to ratepayers based on 60 basis points in excess of the 7-year treasury rate, then there would be no need for the Company to take a write-off to converge the economics of the securitization approach with the 60 basis points over the 7-year treasury approach over ten years. *RA-DEF-8,* p. 3, lines 9-15.

In addition, Mr. Rothschild recommended that the interest rate on the BGS underrecovery should be fixed at the beginning of the recovery period. *RA-DEF-7,* p. 15, lines 6-7. Mr. Rothschild gave several reasons for this proposal. During the four-year transition period, underrecoveries had to be financed in the year that they occurred. However during the prospective period of rate recovery, the deferred balances will only be producing cash, meaning that no new financings will be required. Since the deferred balance will have already

been financed at the beginning of the recovery period, then the interest rate should be fixed at the beginning of the period.

Mr. Rothschild also described additional advantages of fixing the interest rate, such as not having to change the recovery rate annually, and making the non-securitization case more directly comparable to the securitization case because if securitization financing is used, that financing must be accomplished at a fixed rate. *Id.,* p. 10, lines 4-12. He also testified that using a variable rate of 60 basis points over the 7-year treasury rate could work to the Company's benefit at the expense of ratepayers. The low short-term interest rates that currently exist give PSE&G the opportunity to finance much of the deferred balance at short-term interest rates that are now considerably cheaper to the Company than 60 basis points in excess of the 7-year treasury rate. Therefore, PSE&G would be recovering from ratepayers a higher carrying charge on these costs than the Company was actually paying. That is an unreasonable result that should not be permitted.

The Ratepayer Advocate therefore respectfully recommends that:

- if Your Honor and the Board decide that the deferred balance underrecoveries should receive different ratemaking treatment than overrecoveries and that the amortization of underrecoveries should be longer than the four years recommended by the Ratepayer Advocate, then the underrecoveries should be amortized over ten years at an interest rate fixed at the beginning of the amortization period.
- the fixed interest rate should be 60 basis points over the then-effective 7-year treasury bond rate.

POINT XI

CARRYING CHARGES ON THE COMPANY'S SBC DEFERRAL BALANCES SHOULD BE CALCULATED USING THE "NET OF TAX" METHOD.

A. Interest Should be Calculated on Deferred SBC Balances Net of Accumulated Deferred Income Taxes, in Order to Avoid Windfall Profits to Shareholders.

The carrying charges included in the Company's SBC deferrals were calculated based upon the gross amounts of the deferred balances. This method should be rejected because it provides the Company's shareholders with windfall profits at the expense of ratepayers. Instead of the Company's method, carrying charges should be calculated on the SBC deferral balances net of associated deferred income taxes. This is known as the "net of tax" method. *RA-DEF-3,* p. 4.

Ratepayer Advocate witness Robert Henkes provided a simplified example to illustrate why the Company's "gross balances" methodology is improper. Assume that PSE&G has a deferred cost balance of $10 million, and assume further that the Company's combined federal and state tax rate is 40%, and that its financing costs are 6% annually. In this example, PSE&G has deferred $10 million of unrecovered SBC costs. However it has also been able to use the $10 million in unrecovered expenses as a tax deduction, resulting in a tax benefit of $4 million. Thus, the cash outflow that PSE&G needs to finance is only $6 million, resulting in an actual carrying charge of $360,000 annually ($6 million times 6%). PSE&G's method is to calculate carrying charges on the entire $10 million, completely ignoring the fact that PSE&G's actual cash outlay is only $6 million. PSE&G's method results in a purported $600,000 in carrying charges ($10 million times 6%), resulting in an annual windfall profit of $240,000 for the Company's shareholders. *RA-DEF-3,* pp. 5-6.

As noted in Mr. Henkes' prefiled direct testimony, JCP&L is using the "net of tax" method to calculate carrying charges on all of its deferral balances. In other words, JCP&L has applied the appropriate interest rate to its deferral balances net of associated deferred income tax benefits. *RA-DEF-3,* p. 6.

Further, the Board has recently ordered Rockland to use the "net of tax" methodology in its October 6, 2002 Order on Motion for Reconsideration and/or Clarification in the restructuring proceeding. *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) (referred to hereinafter as the "*Rockland Order of Clarification"*). Rockland had challenged a provision in the Board's Final Decision and Order in that proceeding which required Rockland to use the net-of-tax method to calculate carrying charges on its deferred BGS, NUG and Societal Benefits costs. *Id.,* pp. 1-2. The Board rejected this challenge, finding that the "net of tax" methodology had been included in Rockland's own proposed Plan for Resolution of Proceedings, and that this provision had not been modified in the Board's Summary Order in the Rockland restructuring proceeding. *Id.,* pp. 2-3.

The Board also explained that the "net-of-tax" methodology correctly reflects the actual costs of financing deferred balances:

> ... the appropriateness of the net of tax treatment reflects the fact that even though no revenue was received for the deferred costs during the Transition Period ... the deferred costs did provide a tax benefit, namely a reduction in [Rockland's] federal and state income taxes of approximately 41% of the amount of the deferred costs. This reduction accordingly reduced the amount needed to finance the deferred balance during the Transition Period.

Id., p. 4.

The Board further explained that the fact that, while the deferred taxes must eventually be paid when the deferred costs are recovered, the current tax reductions result in "a substantial reduction in the interest

that would otherwise be payable" to finance the "full deferred balance absent the tax reduction." *Id.*

The same reasons apply to PSE&G's SBC deferrals. The net-of-tax methodology properly recognizes the tax benefits associated with the deferrals and allows the Company to recover only the actual costs incurred to finance the deferrals.

The net-of-tax method is also consistent with Board Orders in prior proceedings involving the Company's Remediation Adjustment Clause ("RAC"). The Company's RAC was established as part of the Company's 1991 base rate proceeding. While most of the issues in that proceeding were stipulated, the parties were unable to reach agreement on the Company's request to establish an adjustment clause for the recovery of its manufactured gas plant ("MGP") remediation costs. This issue was therefore certified to the Board for resolution. *I/M/O the Petition of Public Service Electric and Gas Company for Approval of an Increase in Electric and Gas Rates and for Changes in the Tariffs for Electric and Gas Service,* BRC Docket No. ER91111169J (Decision and Order dated September 15, 1993). In establishing the RAC, the Board required the Company to calculate carrying charges using the net-of-tax method:

> In recognition of the fact that rates will reflect carrying cost recovery, ratepayers should receive the benefit of accumulated deferred taxes, which shall accordingly be deducted from the unamortized balance of remediation costs in determining the interest component of cost recovery.

Id., p. 18.

The continuing validity of the net-of-tax method was affirmed in the Board Order approving a stipulated resolution of the Company's RAC-8 filing:

> The Board approved the Company's RAC mechanism in Docket No. ER91111698J, in an Order dated September 15, 1993, which provides for recovery of the Company's reasonably incurred MGP costs amortized over rolling seven-year periods of actual and reasonably included MGP costs. The Board further authorized carrying costs of 6.25% on the unamortized balance, net of deferred taxes. *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). [emphasis added]

The Company has offered no testimony to dispute the correctness of the net-of-tax methodology. Indeed, during cross-examination, PSE&G rebuttal witness Robert Chilton appeared to acknowledge as a matter of principle that the tax benefits associated with the deferrals reduced the costs of the deferrals, as explained in Mr. Henkes' testimony.

> Q Would you agree that the impact of these deferrals on the Company's operating income during the transition period was mitigated by the income tax savings associated with these expense deductions for income tax purposes?
>
> A In isolation certainly that would be the case. ...

T1664:L15 - T1665:L6.

Mr. Chilton argues, however, that this methodology was changed as one of many issues in a "complex, multi-faceted settlement" which was then approved by the Board in the Company's electric restructuring proceeding. T1665:L6 - T1666:L8; *PS-D-5,* p. 7-8.

Contrary to Mr. Chilton's argument, the Company's restructuring proceeding was not resolved by a settlement in which all parties agreed to change the interest methodology. The so-called "settlement" referred to by Mr. Chilton, although entitled a "Stipulation," was actually a joint position of only one segment of the parties involved, the adoption of which was opposed by the Ratepayer Advocate and other parties. *Restructuring Case Final Order*, pp. 48-54, 60-76.

Further, nothing in either the "Stipulation" or the Board Order adopting it suggests an intent to adopt the "gross balances" methodology. The Stipulation states only that "[i]nterest at a seven-year single A debt rate (Interest Rate) will be accrued on any under- or over-recovered balances." *Id., Stipulation,* p. 6. While this language does not specify the "net-of tax" methodology, it also does not state an intent to change

the pre-existing methodology. The Board's Order is similarly silent on this issue, stating only that interest "will be accrued on any under- or over-recovered balances," and that the interest rate will be "based on seven year constant maturity treasuries as shown in the Federal Reserve Statistical Release on or closest to August 1 of each year plus sixty basis points." *Id.,* p. 116. Given the Company's long history of using the net-of-tax method, the Board's silence on this issue should not be interpreted as authorizing the Company to change to the incorrect "gross" method.

It is immaterial that it was the Company's "interpretation and understanding" that the Board had permitted the "gross balances" methodology. T1666:L9-17. That intent was not clearly stated in the "Stipulation" or the Board Order. PSE&G's unilateral "interpretation and understanding" did not provide Board authorization to change the Company's established practice of calculating interest using the "net of tax" method.

Mr. Chilton also attempts to suggest that the "gross balances" methodology was agreed to by the Ratepayer Advocate and approved by the Board for the "electric" portion of the Company's MGP costs in the RAC-8 proceeding discussed above. *PS-D-5,* p. 10. As Mr. Chilton acknowledged, this RAC-8 Stipulation, which affected only the Company's rates for natural gas service, continued the "net of tax" methodology for the "gas" portion of the Company's RAC deferrals. *PS-D-5,* p. 9; *I/M/O the Petition of Public Service Electric and Gas Company to Increase its Remediation Adjustment Clause,* BPU Docket No. GR00121003 (Order Adopting Stipulation dated September 27, 2001) (referred to hereinafter as the "*RAC-8 Order*"). Nowhere in the Stipulation, Initial Decision, or Board Order is there any indication that the Ratepayer Advocate agreed to the "gross balances" methodology, or that the Board intended to adopt it.

In any event, the *RAC-8 Order* cannot be relied upon as a precedent to support the Company methodology. The Stipulation which resolved the RAC-8 proceeding provided that the Stipulation was "being entered into exclusively for the purpose of resolving the issues in this matter," and "cannot be cited as precedent by the undersigned or any other party in any other forum other than to enforce its terms." Further, the Stipulation also includes the parties agreement that the Stipulation, "in total or by specific item, is in no way binding upon them in any other proceeding, except to enforce the terms of this Stipulation." *RAC-8 Order, attached Stipulation,* pp. 4, 5. Thus, PSE&G may not properly rely on the Stipulation, or the Board's Order approving it, as a binding precedent on the proper methodology for calculating interest on its SBC deferrals.

Finally, Mr. Chilton notes that the Company's methodology was reflected in its RAC-9 filing. *PS-D-5,* p. 10. However, the proper methodology for calculating interest has not been resolved in that proceeding. The parties have recently entered into a Stipulation in the RAC-9 proceeding which, if approved, would implement a negotiated resolution of the amount of the carrying costs for the RAC-9 period. The parties specifically agreed to have Your Honor and the Board determine the proper interest calculation methodology to be in this proceeding. *I/M/O the Petition of Public Service Electric and Gas Company to Increase its Remediation Adjustment Clause,* BPU Docket No. GR01110773 (Initial Decision dated February 20, 2003), attached *Stipulation*, pp. 2, 3. Thus, there has been no authorization for the Company's proposed methodology as a result of the RAC-9 proceeding.

In summary, the "net-of-tax" methodology properly reflects the actual costs of financing PSE&G's SBC deferrals, and is consistent with longstanding Board precedent as reflected in Orders involving PSE&G's RAC and as recently affirmed in the *Rockland Order of Clarification*. This methodology

should be adopted by Your Honor and the Board for calculating interest on the Company's deferral balances.

POINT XII

SUBJECT TO CHANGES RESULTING FROM THE COMPANY'S PENDING PETITION FOR DECLARATORY RELIEF WITH REGARD TO ITS NUCLEAR DECOMMISSIONING TRUST FUNDS, RATEPAYERS SHOULD RECEIVE A $40.434 MILLION RATE REDUCTION ASSUMING REMOVAL OF DECOMMISSIONING COSTS FROM THE SBC BEGINNING ON AUGUST 1, 2002, AND REFLECTING A 4-YEAR AMORTIZATION OF AN OVER-RECOVERY BALANCE OF $19.698 MILLION AS OF THE END OF THE TRANSITION PERIOD.

1. The Ratepayer Advocate Has Properly Used a "Placeholder" of Zero for the Nuclear Decommissioning Component of the SBC, Pending Resolution of the Company's Petition for Declaratory Judgment.

As a result of restructuring, PSE&G's nuclear generating units, including the trust funds established to provide for the costs of decommissioning the units, have been transferred to the unregulated affiliate, PSEG Power. Nevertheless, in accordance with the Board's Final Order in PSE&G's electric restructuring proceeding the SBC rate was set at the level of costs included in the SBC components as of February 9, 1999, including nuclear plant decommissioning costs. The Order further provided that the SBC rate would remain constant through the end of the Transition Period, with actual costs incurred by the Company for each component subject to deferred accounting. *Restructuring Case Final Order,* pp. 115-16. The current SBC thus reflects the February 9, 1999 funding level of $29.5 million per year for the nuclear decommissioning trust funds. *RA-DEF-3,* p. 15.

The level of ratepayers' continuing responsibility for nuclear decommissioning costs and interest in the nuclear decommissioning trust funds, if any, is being addressed in a separate proceeding before the Board in BPU Docket No. EO02080610. *I/M/O Petition of Public Service Electric and Gas Company for Declaratory Ruling Clarifying the Cost Responsibility for Nuclear Generating Asset Decommissioning Funds,* BPU Docket No. EO02080610; *PS-DEF-28,* pp. 5-17. Pending the outcome of the separate nuclear

decommissioning proceeding, Ratepayer Advocate witness Robert Henkes has assumed, as a placeholder, that no nuclear decommissioning cost will be reflected in the SBC after July 31, 2003. *RA-DEF-3,* p. 16. PSE&G has proposed instead to use the current funding level of $29.5 million per year as a placeholder. *PS-D-1,* pp. 11-12. Company witness Robert Krueger is in agreement with the Ratepayer Advocate that assuming the Board decides the decommissioning proceeding on or before August 1, 2003, the outcome of that proceeding can simply be reflected in the determination of the SBC rate in this proceeding. However, in the event of a delay in deciding the separate decommissioning proceeding, Mr. Krueger proposes that the SBC continue to reflect the current $29.5 million funding level until the nuclear decommissioning proceeding is decided. Mr. Krueger states that the reason for this proposal is to preserve the tax deductibility of the decommissioning costs, should the Board ultimately decide to continue ratepayer funding of decommissioning costs. *PS-D-9,* p. 13.

The Company's proposal to continue the current level of ratepayer funding in the event of a delay in the decommissioning docket should be rejected as unfair to ratepayers. The Company has been authorized to recover $2.94 billion in generation stranded costs, most of which is attributable to the Company's nuclear generating units. *Restructuring Case Final Order,* p. 117. [29] The nuclear generating units have been transferred to the unregulated affiliate, PSEG Power, and the affiliate's obligation to provide generation service to PSE&G on behalf of the Company's BGS customers expired on August 1, 2002. *Id.,* pp. 120-21. Under these circumstances, the Ratepayer Advocate believes that it would be entirely inappropriate for the Company to continue collecting for nuclear decommissioning costs after July 31, 2003, in the absence of a Board Order

29While the "Stipulation" and Board Order in the restructuring proceeding do not specify what portions of the Board-approved level of stranded costs relate to the Company's nuclear units, the PSE&G's Stranded Cost filing attributed approximately $3.1 billion of its proposed $3.9 billion in stranded costs to the Company's nuclear units. *Restructuring Case Final Order,* p. 11.

providing for continued ratepayer funding.

Further, if the Board does not decide before August 1, 2003 whether ratepayers should continue to pay for nuclear decommissioning costs, this will have been the result of the Company's own actions. As part of the *Restructuring Case Final Order,* the Board stated that, while it was approving the Company's proposal to continue collecting for nuclear decommissioning costs through the SBC, "we believe it necessary to place parameters on such continued funding by ratepayers and we shall do so." *Restructuring Case Final Order,* p. 104. Therefore, the Board directed the Company to submit for Board approval "a specific proposal to limit its financial responsibility for funding, and, in turn, its ratepayers' obligation to fund through the SBC the cost of decommissioning the nuclear units transferred to [PSEG Power]." *Id.*

In response to this directive, the Company submitted a letter to the Board on November 23, 1999. *PS-DEF-28,* pp. 2-4. This letter, which was provided only to the Board and not copied to the Ratepayer Advocate or any of the other parties to the Company's restructuring proceeding, did not include any proposed limitation of liability. Instead, the Company stated that it believed that "the $29.5 million annual fixed recovery of nuclear decommissioning costs included in the SBC is essential to recover the associated liability based on the 1995 site-specific study and to limit the liability of the Company's utility customers." *PS-DEF-28,* p. 4. The Company proposed that the "issue of revenue requirements associated with nuclear decommissioning can be addressed at the end of the Company's transition period." *Id.* This issue was addressed again by the Board in a July 22, 2002 procedural Order issued in connection with the Company's pending electric base rate proceeding. In that Order, the Company was directed "to file supplemental testimony in the instant proceeding setting forth a more specific proposal for limiting ratepayer funding of decommissioning costs." *I/M/O the Petition of Public Service Electric and Gas Company for Approval of Changes in its Tariff for Electric Service, Depreciation Rates and for Other Relief,* BPU Docket Nos. ER02050303 *et al.* (Order dated July

22, 2002), p. 5. The Company's petition in Docket No. EO02080610 was filed approximately one month later, on August 28, 2002. *PS-DEF-28,* p. 5.

The Board's *Restructuring Case Final Order* provided the Company with the opportunity to obtain the Board's determination as to its ratepayers' continuing responsibility for decommissioning costs well in advance of the end of the Transition Period. However, PSE&G chose to request that the Board defer its decision on this issue. Any adverse consequences, tax or otherwise, that result from this decision, should be the responsibility of the Company, not its ratepayers. The SBC rates determined in this proceeding should reflect a "zero" level of nuclear decommissioning costs, as proposed by Mr. Henkes.

2. The Company's Nuclear Decommissioning Charge Should Result in an Annual Rate Reduction of $40.434 Million, Assuming Removal of Decommissioning Costs from the SBC Beginning on August 1, 2002, and a 4-Year Amortization of an Over-Recovery Balance of $19.698 Million Calculated Using the Proper Interest Rate.

The Ratepayer Advocate recommends that the nuclear decommissioning component of the SBC be established as a credit of (0.0117) cents per kilowatt-hour, subject to any further adjustments resulting from the Board's decision in the pending separate decommissioning docket. This represents a rate decease of $40.434 million compared to the current nuclear decommissioning component of 0.0845 cents per kilowatt-hour. *RA-DEF-3,* p. 17; *RA-DEF-12, Schedule RJH-1 (2/28/03 Update).*

The recommended credit is based on a four-year amortization of an over-recovery balance as of July 31, 2003, including cumulative interest of $19.698 million. *RA-DEF-3,* p. 17; *RA-DEF-12, Schedule RJH-1 (2/28/03 Update).* This amount is $.754 million lower than the Company's proposed over-recovery balance of $20.452 million because the Ratepayer Advocate's interest calculations are based on the "net of tax" method, as discussed above. *RA-DEF-3,* p. 18; *RA-DEF-12, Schedule RJH-3 (2/28/03 Update).*

The above rate decrease should be adopted subject to any further rate adjustments, including further

rate decreases and customer refunds, that may result from the ongoing proceedings in the Board's Docket No. EO02080610.

POINT XIII

THE COMPANY'S MANUFACTURED GAS PLANT REMEDIATION ADJUSTMENT CHARGE SHOULD RESULT IN AN ANNUAL RATE INCREASE OF $11.209 MILLION, BASED UPON THE ELECTRIC PORTION OF THE RAC RECOVERY AMOUNT STIPULATED IN THE COMPANY'S RAC-9 PROCEEDING.

The amounts to be recovered through the Company's RAC for the period from August 1, 2003 through July 31, 2004, have been established by Stipulation in the Company's "RAC-9" proceeding. The Stipulation in the RAC-9 proceeding was signed by the parties on February 11, 2003, and an Initial Decision approving the Stipulation is now pending before the Board. *I/M/O the Petition of Public Service Electric and Gas Company to Increase its Remediation Adjustment Clause,* BPU Docket No. GR01110773 (Initial Decision dated February 20, 2002). In accordance with the RAC-9 Stipulation, $13.543 million in RAC recoveries were allocated to PSE&G's electric customers. *Id., Stipulation,* par. 12. This stipulated amount includes a negotiated resolution of the amount of the carrying costs included in the costs for the Company's RAC 9 period. *Id., Stipulation*, par. 1. Thus, assuming Board approval of the Stipulation, it is not necessary to address the proper interest methodology to establish the level of the RAC component of the Company's SBC for the period from August 1, 2003 through July 31, 2004.[30]

This stipulated $13.543 million electric portion of the RAC recovery amount results in a charge of 0.0319 cents per kilowatt-hour, representing a rate increase of $11.209 million compared to the Company's current RAC charge of .0055 cents per kilowatt-hour. *RA-DEF-3,* p. 23; T1728:L10-23; *RA-DEF-12, Schedule RJH-1 (2/28/03 Update).* The RAC component of the Company's SBC should be set at this recommended level.

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30 As noted above, the RAC-9 Stipulation provides that the methodology to be used to calculate the Company's gas and electric deferred RAC cost beginning with the RAC-10 period will be consistent with the interest methodology ordered in this proceeding.

POINT XIV

YOUR HONOR AND THE BOARD SHOULD NOT PERMIT THE COMPANY TO RECOVER "LOST REVENUES" FROM DEMAND SIDE MANAGEMENT ("DSM") PROGRAMS PRIOR TO A BOARD DETERMINATION OF PROPER PROTOCOLS.

A. Introduction

"Lost revenues" are the monetary amount of reduction in sales, net of corresponding reductions in a utility's variable costs, due to the implementation of energy efficiency programs. PSE&G has included $1,074,000 in Company projected "lost revenues" for the period from August 1, 2003 through July 31, 2004, and $2,800,000 for lost revenues associated with DSM[31] programs from August 2002 up to July 31, 2003. T1757:L18-25. The Company has also stated that the actual lost revenues associated with DSM programs up to August 2002 have not been reflected in the calculation; rather, they still appear in forecast numbers. T1760:L14-25. It is the position of the Ratepayer Advocate that lost revenues may not be collected until the Board has approved the protocols by which lost revenues are established.

B. The Board Has Mandated That No "Lost Revenues" Are Recoverable Until the Board Has Issued Its Decision Regarding Energy Savings Protocols

In its *March 9, 2001 Order*[32], the Board was clear that it did not undertake lightly the task of allowing recovery for DSM programs, including "lost revenue" recovery. The Board was equally clear that it was going to be the sole arbiter for determining the methodology of determining energy savings achieved by the energy efficiency programs (usually referred to as the protocols). Indeed, the Board unequivocally states in its Findings that, "[t]he program evaluation plans for determining energy savings must still be approved by the Board, prior

31 Renamed NJ Clean Energy Program

32 *I/M/O the Petition of the Filings of the Comprehensive Resource Analysis of Energy Programs Pursuant to Section 12 of the Electric Discount and Energy Competition Act of 1999*, BPU Docket No. EX99050347 (Generic) *et al.*, (Final Decision and Order March 9, 2001) (*"March 9, 2001 Order"*).

to eligibility for collection of lost revenues for the new energy efficiency programs." *Id*. at 77. (Emphasis added). The language is specific and not open to interpretation. There will be no recovery of lost revenues without Board approval of the protocols by which lost revenues will be established.

To date, the Board has not made any decision pursuant to its *March 9, 2001 Order* indicating which, if any, Company DSM programs may qualify for lost revenue recovery from ratepayers. Consequently, no decision has been made as to how any allowed "lost revenue" should be calculated, and therefore, no recovery can occur. The Company's argument that the proposed energy savings protocols to determine lost revenues is pending before the Board is irrelevant. This does not change the fact that the Board has not yet made a final determination regarding these protocols. Contrary to the Board Order, the Company wishes to collect money first and let the Board decision happen later. Ratepayers should not be made to pay ahead of time for programs that the Board may or may not approve for recovery. To do so would be to benefit the Company shareholders at the expense of ratepayers.

The Board clearly states in its *March 9, 2001 Order* how careful it intends to be with these calculations. The Order states, "[t]his need for accuracy is the reason the Board was historically unwilling to allow the recovery of lost revenues for programs that did not have verified, measured savings….[t]he Board wished to ensure that continued lost revenue recovery is based on accurate savings data." The Board also directed the continued decrease in collection of lost revenues for legacy programs "to protect ratepayers from paying too much." Ratepayer protection is also why the Board correctly insists that, "the basis for determining the collection of lost revenues for the new energy efficiency programs must still be approved by the Board." The Board did not state that protocols could be implemented and after the fact the Board would examine them. The Board wisely insists that the recovery methods (or protocols) must be approved before the ratepayers

begin to pay for alleged lost revenues. Company witness Gerald W. Schirra states that "[t]hese protocols have been filed with the Board and their approval is pending." T1764:L6-7. Filing, of course, is not equivalent to approval, and at this point neither we nor anybody else knows what or how much the Board may approve. Until this is determined, there should be no lost revenue recovery.

C. The SBC Amortization Period Should be Four Years Rather Than the One Year Suggested by the Company

The Company has proposed a one-year amortization period for its SBC over-recovery balance. The DSM over-recovery is part of the larger SBC balance. The Ratepayer Advocate rejects this proposal in favor of a more ratepayer-friendly amortization plan. A more gradual, four-year amortization will help prevent serious rate shock on August 1, 2004 when, under the Company proposal, the SBC over-recovery will be completely amortized. After the over-recovery balance is eliminated, there will no longer be a stabilizing factor that helps keep ratepayer bills from skyrocketing. *RA-DEF-4*, p. 6.

Regarding the DSM over-recovery in particular, if it were amortized over a four-year period, the DSM credit to ratepayers would amount to $9,495,000 annually. For the period from 8/1/03 – 7/31/04, the DSM Program cost is $142,435,000. Dividing the projected sales volume for the corresponding annual period results in a DSM program charge of .3356 cents/Kwh. This amount is .1379 cents/Kwh lower than the current charge of .4735 cents/Kwh, and would result in an annual rate decrease to ratepayers of $58,521,000. *Schedule RJH-1 updated for actual data 2/28/03*. As this is one of the few decreases that ratepayers are likely to see, the Ratepayer Advocate suggests that Your Honor and the Board set the amortization period at four years in order to prevent needless future rate shock.

D. Conclusion

Your Honor and the Board should reject PSE&G's estimated total DSM Program charge over-recovery balance of $29,907,000 in favor of the appropriate over-recovery calculation by the Ratepayer Advocate witness of $37,981,000. *Id.*

POINT XV

CONSUMER EDUCATION PROGRAM ("CEP") COSTS INCURRED BY PSE&G IN YEARS 2 AND 3 ARE NOT RECOVERABLE THROUGH THE SOCIETAL BENEFITS CHARGE BECAUSE THE UTILITIES HAVE FAILED TO MEET THE "REASONABLE AND PRUDENT" STANDARD FOR THESE COSTS.

1. Background of the Consumer Education Program ("CEP")

By Order dated September 22, 1998[33], the Board established a consumer education program to educate consumers on the impending changes that would result from deregulation of the electric and gas markets pursuant to EDECA. The Board was required to establish a multi-lingual electric and gas consumer education program, with the goal of educating residential, small business, and special needs consumers concerning restructuring of the electric power and gas industries. *See N.J.S.A.* 48:3-85(d).

The Board in its *May 20, 1999 Order*[34] created the Utility Education Committee ("UEC"), which represented the interests of the electric and gas utilities, and the Energy Education Council ("EEC"), which represented the interests of consumers.[35] The Board gave the UEC responsibility for developing and implementing the statewide consumer education program. The EEC was given a minor "consulting" role, but the ultimate decision-making power was left with the UEC. As noted in its *October 15, 1999 Order*[36], in its Order dated August 11, 1999, the Board retained the Center for Research & Public Policy of Hartford, Connecticut ("Center") "to advise the Board and present their research regarding the level of [consumer

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[33] *I/M/O the Energy Master Plan Phase II Proceeding to Investigate the Future Structure of the Electric Power Industry,* BPU Docket No. EX94120585Y (Order on Consumer Education dated September 22, 1998) ("*September 22, 1998 Order*").
34 *I/M/O the Matter of the Consumer Education Program on Electric Rate Discounts and Energy Competition,* BPU Docket No. EX99040242 (Order dated May 20, 1999) ("*May 20, 1999 Order*").
[35] The Ratepayer Advocate was a participating member of the EEC.
36 *I/M/O the Matter of the Consumer Education Program on Electric Rate Discounts and Energy Competition,* BPU Docket No. EX99040242 (Order dated October 15, 1999) ("*October 15, 1999 Order*").

awareness] of energy deregulation and restructuring.' The Center was required to present its findings on the effectiveness of the statewide CEP and also make recommendations for improvements to the Board.

In the *October 15, 1999 Order*, the Board adopted performance standards and benchmarks that were called "Measures of Success," which were subject to review and refinement as necessary to assess the success of the CEP. These actions were consistent with *N.J.S.A.* 48:3-85(d), which requires the Board to "promulgate standards for the recovery of consumer education program costs from customers which include reasonable measures and criteria to judge the success of the program enhancing customer understanding of retail choice." (*emphasis added*). Subsequently, the *June 23, 2000 Order*[37] established filing procedures for utilities that were planning to file for CEP cost recovery. The Board relied on its previous ruling in the restructuring proceedings, which stated that CEP costs would be recovered through the societal benefits charge ("SBC"). The CEP cost recovery filings would be accompanied by public notice and a public hearing in compliance with *N.J.S.A.* 48:2-32.2 and *N.J.S.A.* 48:2-32.4. The Board further recognized that evidentiary hearings would be needed to assess the reasonableness and prudence of the cost levels incurred to achieve the Board approved Measures of Success. *See June 23, 2000 Order* at 3.

Since the implementation of the CEP, the electric and gas utilities have been deferring costs for both the statewide and local CEP campaigns. Winning Strategies, the UEC's consultant, billed the utilities for the statewide program based on its determination as to the appropriate allocation between electric and gas utilities generally, and then, by utility, based on the utilities' number of customers. *Id.* Each utility paid for its own local campaign.

37*I/M/O the Matter of the Consumer Education Program on Electric Rate Discounts and Energy Competition,* BPU Docket No. EX99040242 (Order dated June 23, 2000) ("*June 23, 2000 Order*").

2. The Company Did Not Demonstrate Compliance With the "Reasonable and Prudent" Standard For Years 2 and 3.

Pursuant to *I/M/O the Consumer Education Program on Electric Rate Discounts and Energy Competition, I/M/O the Petition of Public Service Electric and Gas Company for Declaratory Ruling and Other Remedies*, BPU Docket Nos. EX99040242, ER00080550 (Decision and Order Approving Stipulation dated October 15, 2001), PSE&G was authorized to recover $4.705 million of Year One gas CEP costs and $7.299 million of Year One electric CEP costs, subject to reconciliation. The Company now seeks recovery of electric-allocated CEP costs for Years 2 and 3 without making the requisite showing that the costs were reasonably and prudently incurred. PSE&G asserted that its Year Two CEP costs are $6.0 million, Year Three CEP costs are $2.9 million, Year Four CEP costs are $0.1 million, plus internal labor expenses deferred related to energy restructuring training for its employees. *PS-DEF-118.* Including the Year One recovery, the Company originally claimed its total CEP costs amounted to $17.7 million through July 31, 2003. *PS-D-1*, Schedule RCK-D-2. However, the Mitchell & Titus LLP Audit Report noted that "PSE&G included in the CEP of the SBC deferred balance costs incurred by the Company for energy restructuring training and certain local advertising in the amount of $1,043,000....The Board Orders do not include any provisions for the inclusion of these costs on the deferred balances." *S-DEF-2*, p. III-18, paragraph D. Now, "[t]he Company, in its pending RAC 9 Proceeding, has included the elimination of the $1.0 million from consumer education costs as a settlement issue. This elimination was reflected in the Company's 12+0, December 31, 2002 update." *PS-D-9,* pp. 15-16. The Company currently has an open docket at the Board requesting recovery of its Year 2 CEP expenses. *PS-D-1*, p. 17.

The determination that the CEP costs are reasonable and prudently incurred does not rest on the attainment of the Measures of Success or performance standards for that particular year, or even on the recommendation of an auditor's report. Even if the Measures of Success are achieved, there must be a showing that all costs incurred were reasonable and prudent. The Board in its *June 25, 1999 Order*[38] stated that it would look to "the extent these [expenditures] represent prudently incurred expenses," and the *June 23, 2000 Board Order* stated that "[t]he reasonableness and prudence of the cost levels incurred to achieve the Board approved measures of success will need to be assessed in reviewing the SBC filings." Only then will the utilities be permitted to recover the CEP costs in a manner consistent with EDECA. Accordingly, the Company's recovery of costs is dependent on the Board's determination of prudence. This important step cannot be circumvented. Simply stated, the fact that the Measures of Success were attained does not by itself indicate that the Company's CEP expenses in achieving that target were reasonable and prudently incurred. It merely indicates that minimum benchmark levels were achieved for the performance standards established by the Board to measure the success of the CEP.

The Company may also not choose to rely on the "pre-approval" process as proof of prudence. Pursuant to the *August 9, 1999 Order*[39], the UEC (of which PSE&G was a member) filed its proposed consumer education materials to the Board and the EEC before dissemination, plus a factual presentation to the Board of the UEC's budgets and expenses for each year of the CEP prior to implementation. The "preapproval" and "presentment of budgets" by the UEC to the Board is not equivalent to an automatic finding of prudence by the Board for each utility requesting CEP recovery. The *August 9, 1999 Order*, which

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38*I/M/O the Matter of the Consumer Education Program on Electric Rate Discounts and Energy Competition,* BPU Docket No. EX99040242 (Order dated June 25, 1999) ("*June 25, 1999 Order*").

39*I/M/O the Matter of the Consumer Education Program on Electric Rate Discounts and Energy Competition,* BPU Docket No. EX99040242 (Order dated August 9, 1999) ("*August 9, 1999 Order*").

established the pre-approval procedure, gave no indication that the Board's approval of the content of the consumer education material was also an approval of the costs that would be incurred. Even if the Board approved the content of the consumer education material, the prudence of the costs of producing these materials presented by the utilities was not considered by the Board at that time. Therefore, the UEC's "presentment of budgets" to the Board cannot be considered an "automatic" finding of reasonableness and prudence for each of the utility's statewide CEP costs.

From the inception of the CEP, the Board contemplated the manner in which utilities would be able to recover reasonably incurred expenses associated with carrying out the objectives of the CEP. In the *June 25, 1999 Order*, the Board began to lay the foundation for CEP cost recovery. The Board ordered that any electric or gas public utility that had incurred expenses related to the CEP would be able to defer those expenses, to be recovered at a later date, according to a two-part test. First, the CEP expenses must meet the standards for measures of success to be developed by the Board, and, second, the CEP expenses must have been prudently incurred, a determination also to be made by the Board. *See June 25, 1999 Order* at 2.

Again in April 2002[40], the Board restated the position taken in its October 15, 1999, and June 23, 2000 Orders allowing utilities to recover their CEP costs through the SBC. The Board repeated that in order for utilities to recover CEP expenses, the utility must file with the Board and be subject to public and evidentiary hearings. The Board decided to proceed in this manner because "CEP cost recovery through the SBC will result in an increase to the SBC now or at the time the deferral ceases and recovery commences in the case of electric utilities." *See April 8, 2002 Order* at 3. After establishing that public hearings would be held regarding CEP cost recovery through the SBC, the Board reiterated its position that, "[t]he reasonableness

40*I/M/O the Consumer Education Program on Electric Rate Discounts and Energy Competition*, BPU Docket NO. EX99040242, Order of Extension, (Order dated April 8, 2002) ("*April 8, 2002 Order*").

and prudence of the cost levels incurred to achieve the Board approved measures of success will need to be assessed in reviewing the SBC filings." *Id*.

Prudence requirements are imposed on a public utility's ability to recover costs in order to encourage efficient managerial behavior.[41] According to New Jersey law and Board precedent, the utility must prove that all costs incurred were reasonable and prudent before these costs can be collected from ratepayers. *See N.J.S.A*. 48:2-2(d); *Hope Creek Order*[42].

The Board in *Hope Creek* disallowed recovery of specific costs because the company had not established that the costs were reasonably incurred. The Board noted:

> Having clearly reserved its right to scrutinize the reasonableness of the costs incurred in the construction of Hope Creek, it is important to delineate the standard employed by the Board during its review. It is uncontroverted that Public Service had the burden of proving the reasonableness of its expenditures for Hope Creek as only reasonable costs can be included in rate base and permitted to earn a return. (*citation omitted*).
> *Id*. at 65.

The Board expounded upon the criteria used to determine whether a utility's costs were prudently incurred when it stated:

> The Company's conduct should be judged by asking whether the conduct was reasonable at the time, under the circumstances considering that the Company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people could have performed the tasks that confronted the Company.
> *Id*. at 66.

The Board repeated this sentiment in its discussion of construction enhancements when it stated:

> The Company, as discussed earlier in this Order, had the burden of proof with respect to the reasonableness of the costs that were expended in building the plant. In order to meet that burden with

[41] *See El Paso Natural Gas Co. v. FPC*, 281 *F.2d* 567, 573 (5th Cir.), *cert denied*, 366 *U.S.* 912 (1960).

42 *In the Matter of the Petition of Public Service Electric and Gas Company for an Increase in Rates and In the Matter of the Petition of Public Service Electric and Gas Company for an Increase in Rates – Hope Creek Proceeding*, BPU Docket No. ER85121163, OAL Docket No. PUC 0231-86 (Order dated April 6, 1987).

> respect to the various enhancements, the Company had to show the reasons why each of the enhancements were installed and the benefits to be derived from their installation. An integral part of the benefits associated with the enhancement is a justification of the costs. The Board is not convinced that the Company has met its burden of proving that the following enhancements are both reasonable and necessary and therefore FINDS that their costs should be disallowed for ratemaking . . .
>
> *Id*. at 89.

In the *Hope Creek Order*, the Board set forth the two-part standard of review for a prudence determination. The standard provides that before a cost can be recovered in rates, each Company must: 1) show that the Company's actions meet the reasonable person standard given the specific circumstances at the time decisions were made; and 2) show the reasons why each cost was incurred and the benefit to ratepayers by the Company's actions. In effect, the prudence review determines whether the Company performed in a manner that was reasonable at the time, and allows regulators to prevent unreasonable costs from being passed on to ratepayers.

The Measures of Success were only a benchmarking tool, used to measure the level of awareness energy customers achieved through the education program. They were never intended to replace the prudence standard to which all the utilities, including PSE&G, must be held. In this proceeding, Your Honor and the Board must ascertain whether the costs expended to achieve the task were prudently incurred. In order for PSE&G to show that it prudently incurred these expenses, the Company must meet the two-part prudence test as stated in the *Hope Creek Order.*

Throughout the consumer education proceedings there has been no Board scrutiny of CEP costs. The Company presented no testimony in this proceeding demonstrating that they satisfied the *Hope Creek* prudence standard. Rather, it simply asserts monetary amounts with no explanation of the prudence or reasonableness of these amounts. The Company may not recover CEP costs until it has shown compliance with the prudence

standard. As stated previously, the utility bears the burden of proving that its costs are reasonable and prudently incurred, and in this case, the Company has failed to present any evidence in order to meet its burden.

3. Even Under The Company's Erroneous Position That Achieving Measures of Success Is Synonymous With Prudence, The Failure of the Statewide CEP to Satisfy the Measures of Success Established by the Board in Years 2 and 3 Should Preclude Cost Recovery.

Even if Your Honor and the Board were to determine that the achievement of the Measures of Success was equivalent to prudence, the fact that the statewide CEP failed to achieve its objectives for Year 2 and Year 3 should necessarily preclude the recovery of costs incurred by the Company in those two years.

The Board hired the Center to conduct research on the level of awareness of gas and electric consumers regarding energy deregulation and restructuring. In order to evaluate consumer awareness in different areas, the Center developed performance standards and benchmarks referred to as Measures of Success**.** The Year 1 Measures of Success were accepted.

The Year 1 Measures of Success adopted by the Board in its *October 15, 1999 Order*[43] focused mainly on increasing consumer awareness of deregulation and choice of alternate energy suppliers.[44] However,

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[43] *I/M/O the Consumer Education Program on Electric Rate Discounts and Energy Competition*, BPU Docket No. EX99040242 (Decision and Order dated October 15, 1999).

[44] The Year 1 Measures of Success were as follows:

A. **Awareness** - awareness of deregulation across all market segments of at least 70%. This would include the General Consumer Market (GCM), Hispanic Consumer Market (HCM), African-American Consumer Market (AACM), Small Business, Low Income, Seniors and the Disabled.
B. **Knowledge** - at least a 50% correct knowledge level of deregulation facts across the four-core markets: GCM, HCM, AACM, and Business.
C. **Selection Process Awareness** - at least a 30% "very of somewhat aware" level for the supplier selection process.
D. **Decision Making** - at least a 30% level of making a conscious decision to switch, not to switch or not to decide.
E. **Call Center Satisfaction** - at least 80% satisfaction level among consumers utilizing the NJ Energy Choice call center.
F. **Response to Recommendations** - CEP campaign officials are to respond to any recommendations made in the Center's reports which are endorsed, accepted and forwarded by the Board in memo form only.

Year 1 Measures of Success were changed in Year 2 and Year 3 to reflect later developments in the energy market.

Year 2 of the consumer education program failed to raise the awareness of gas and electric consumers of competition and the ability to switch to alternate energy suppliers, which was vital to the success of the program. The Ratepayer Advocate filed comments expressing its concerns to the Board in a letter dated January 11, 2001, which stated that the continued focus on deregulation in Year 2 was inappropriate given the high awareness levels achieved in Year 1, and recommended that the CEP should instead focus on the benefits of deregulation such as increased competition and a choice of energy suppliers. See Exhibit A attached hereto. The data compiled by the Center for Year 2 of the CEP indicated that many energy consumers were still very much in the dark about alternate suppliers and their pricing plans as well as information on the mechanics of making a switch.[45] Equally problematic was consumer ignorance of the term "price-to-compare" and how this information could be used to shop around for a new supplier.[46] Therefore, it came as no surprise when the Center revealed in its Sixth Report to the Board that the switching activities of consumers in Year 2 did not meet its benchmark target for residential markets. Switching statistics continued to show a steady decline in Year 3, as shown in the Center's Seventh Report.[47] Presumably, if more consumers were provided with information that would give them the necessary tools to research their switching options, make a decision, and

[45]The Fifth Report presented by the Center and accepted by the Board in an Order dated April 25, 2001, showed a 10% decline in the number of consumers who were very or somewhat aware of the process to follow in selecting an energy supplier. In addition, the Fifth Report also revealed that 55.4% of consumers were still waiting for more information in order to make a decision to switch to a energy supplier. *Fifth Report* at 8.

[46]The Center in its Sixth Report to the Board acknowledged the need to provide consumers with the necessary information so that they may make a switch and recommended that "consumers need to be taught by both utilities and the CEP how to find and just what their price-to-compare is. This may be a very large barrier to participation. Nearly 100% of consumers don't know what or how to find what they pay per-kilowatt hour or per-therm." See Center's *Sixth Report* at 12.

[47]The Seventh Report revealed declining levels of switching activities among consumers. For example, 96.9% of all respondents could not name or estimate the amount they pay per kilowatt hour which serves as a barrier to shopping. Approximately 60% of respondents were still not familiar with the term price-to-compare and how to use this information in making a decision to switch. Also, only 6.6% of respondents had actively shopped around for a new energy supplier. See *Seventh Report* at 8.

initiate a change in energy providers, then residential switching numbers would have increased, not decreased, in Years 2 and Year 3.

In Year 3, because of sharp increases in energy prices, the Ratepayer Advocate filed comments recommending that the statewide component of the CEP should be re-directed to address concerns related to high energy costs. See Exhibit B attached hereto (comments dated February 15, 2001). This would include providing information to consumers about the reason for high energy costs, advising consumers of ways to manage their energy usage and energy bills, and increasing awareness of financial assistance for which consumers may be eligible. Although Year 3 of the statewide CEP did include Measures of Success related to consumer awareness of energy conservation and efficiency, as well as the availability of financial assistance,[48] these Measures of Success were very general and not detailed or specific enough to be truly effective in ensuring that consumers had the necessary information to respond to high energy costs. These shortcomings became very obvious when the Center's Seventh Report to the Board revealed that the CEP fell short of Year 3 goals in the areas of awareness of conservation/efficiency and financial assistance.

In conclusion, the statistics from both Year 2 and Year 3 demonstrate that the statewide CEP failed to increase awareness among gas and electric customers in the critical areas of competition, switching to alternate energy suppliers, energy conservation and efficiency, and the availability of financial assistance to eligible consumers. The apparent foible in the statewide CEP was its continued focus on the message of deregulation in Year 2 and Year 3 when there were issues of greater concern worthy of consumers' attention. Therefore, it is improper to allow utilities to recover statewide CEP costs for Year 2 and Year 3, when the statewide CEP failed to achieve its Measures of Success in the aforementioned areas. It follows that if ratepayers did not

[48]The specific measures were general consumer awareness that: (1) "[l]ocal utilities have energy conservation and efficiency programs;" and (2) "[f]inancial assistance programs are available to help low income households pay their energy bills." See *Seventh Report* at 33.

benefit from the CEP during Year 2 and Year 3, utilities should not be permitted to recover from ratepayers costs associated with a failed program.

POINT XVI

PSE&G'S PROPOSED MTC BALANCE MUST BE ADJUSTED TO REMOVE CARRYING COSTS RELATED TO THE COMPANY'S "DELAYED" SECURITIZATION.

Pursuant to the *Restructuring Case Final Order*, MTC overcollections are to be returned to the ratepayers as a credit component of the SBC.[49] While PSE&G proposes to return its overcollected MTC balance to its ratepayers through a credit to the SBC, as set forth below and in the testimony of Ratepayer Advocate witness Robert Henkes, the Company's calculation of its MTC overcollection improperly includes an amount for accrued interest related to its delayed securitization. *RA-DEF-3*, pp. 26-31.

The Company proposes to return an MTC overcollection of $204.1 million to its ratepayers. *PS-D-1*; *RA-DEF-3,* Sch. RJH-6, RJH-6A (2/28/03 update). PSE&G proposes to refund this over-collection amount over the one-year post-Transition Period, from August 1, 2003 through July 31, 2004. *PS-D-1,* Attachment A, p. 18. However, 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. The Board's Final Decision and Order in the Restructuring Case was subject to an appeal process, culminating in the affirmation of the Board's ruling by the New Jersey Supreme Court.[50] The Company's MTC offset includes carrying charges related to the delay caused by the appellate process in securitizing $2.4 billion of its stranded costs, covering the period from January 1, 2000 through February 1, 2001. *RA-DEF-3*, pp. 27-28; *PS-DEF-65*. Mr. Henkes found that absent the offset, the total MTC overcollection due ratepayers would amount to approximately $532.2 million. *RA-DEF-3*, pp. 27-28. Sch. RJH-6 (2/28/03 update).

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49 *Restructuring Case Final Order*, p. 119, para. 14.
50 *In Re Public Service Electric & Gas Company*, 167 *N.J.* 377 (2001).

The Company'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 and, therefore, should be disallowed. The provision of the Restructuring Case Final Decision and Order cited by PSE&G – paragraph 14, page 119 – did not clearly provide for carrying costs on the stranded cost amount of $2.4 billion. *PS-DEF-124*. Furthermore, as noted by Mr. Henkes, the delay in the securitization due to the appeal process took place after that Order, which was dated August 24, 1999. *RA-DEF-3*, p. 28. Therefore, the *Restructuring Case Final Order* could not have specifically addressed the issue of carrying charges on the amount securitized. Finally, the Board has not issued any other Orders subsequent to the securitization delay which addresses the ratemaking treatment of these carrying charges.

In sum, the Board has never specifically authorized PSE&G to accrue carrying charges on any deferred securitization balance. Nor has the Board ever ruled that such carrying charges should be used as an offset in the MTC reconciliation calculations at the end of the Transition Period. In contrast, the Board specifically allowed PSE&G to accrue carrying charges on deferred balances for its NTC and SBC components during the Transition Period, and consider carrying charges in the NTC and SBC reconciliation calculations at the end of the Transition Period.[51]

Therefore, PSE&G's MTC overcollection must be adjusted to remove the securitization-related carrying charges. Eliminating the "securitization delay" related 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). The resulting MTC balance, in turn, must be returned to ratepayers through the SBC, pursuant to the *Restructuring Case Final Order*.[52]

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51 *Restructuring Case Final Order*, pp. 116-117.
52 *Id.,* p. 119, para. 14.

If, however, 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. Mr. Henkes recommended that the interest accrue at the rate for seven year constant maturities 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. The rate recommended by Mr. Henkes is the same as that applied to the Company's SBC and NTC balances, pursuant to the Board's Final Decision and Order.[53] *PS-D-1*, p. 19.

In contrast, the Company proposes to use its overall rate of return, grossed up for income taxes, to compute the carrying charges related to the delayed securitization. As noted by Mr. Henkes in his direct testimony, there is a large difference between the Company's proposed grossed up overall rate of return (14.232 percent) and the seven-year rate during that period. *RA-DEF-3*, p. 30. Mr. Henkes found that the Company's overall rate of return was almost twice as high as the seven-year rate for that period. *Id*. The seven-year rate effective from January 2000 through July 2000 was 6.71 percent, and 6.74 percent from August 2000 through January 2001. *Id*.

The Company argues that it is appropriate to use its overall rate of return because the $2.4 billion deferral balance was financed by both debt and equity. *PS-DEF-120.* However, as Mr. Henkes pointed out in his Direct Testimony, the use of debt and equity financing is not unique to the financing of the $2.4 billion stranded costs deferral balance. *RA-DEF-3*, p. 30. Mr. Henkes noted that all of the Company's cost deferral balances are presumed to be financed with a combination of debt and equity. *Id*. The Company confirmed this in its response to a discovery request: "[a]ll deferred balances are financed based on the Company's overall capitalization, that is a combination of debt, preferred and equity." *PS-DEF-120.* Mr. Henkes further noted that the Board was "obviously aware of this" when it ordered that carrying charges on all deferral balances

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

(SBC and NTC) during the Transition Period be calculated based on the seven-year rate. *RA-DEF-3*, p. 30, l. 26.

Mr. Henkes testified that the "primary reason for the large difference between the pre-tax overall rate of return of 14.232% used by PSE&G and the pre-tax constant maturity rate of approximately 6.7% is the fact that the Company's overall rate of return includes a profit element in the form of the return on equity." *RA-DEF-3*, p.30, l. 28 - p. 31, l. 2. In deciding to use the seven-year rate for deferred balances during the Transition Period, Mr. Henkes testified that "the Board must have recognized that it would not be appropriate to include a profit element in the carrying charge calculations." *Id.*, p. 31, l. 4-5.

Mr. Henkes re-calculated the carrying charge on the stranded cost balance during the delay period using the seven-year rate. *RA-DEF-3*, Sch. RJH-6. Mr. Henkes calculated the total cumulative carrying charges amount of $174.820 million using the seven-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. 31. On a net present value basis, Mr. Henkes found that the $195.3 million carrying charge differential amounts to $173.1 million. *Id*. If the Board accepts the Company's argument for including securitization-related carrying charges in the MTC reconciliation calculations, then appropriate carrying charges should amount to $174.820 million, rather than the $370.1 million proposed by PSE&G. *RA-DEF-3*, p. 29, Sch. RJH-6A(2/28/03 update).

POINT XVII

THE RATEPAYER ADVOCATE'S RECOMMENDED TOTAL SOCIAL PROGRAM CHARGE ("SPC") OVER-RECOVERY BALANCE, INCLUDING CUMULATIVE INTEREST AMOUNTS TO $20,951,000, WHICH IS $1,046,000 LOWER THAN THE CORRESPONDING OVER-RECOVERY BALANCE OF $21,997,000 PROPOSED BY THE COMPANY SHOULD BE ADOPTED BY YOUR HONOR AND THE BOARD.

The Board in its August 24, 1999 Order in PSE&G's Restructuring Case under BPU Docket Nos. EO97070461, EO97070462 and EO97070463 approved the inclusion of the Company's electric uncollectible cost in this component of the overall SBC. The Ratepayer Advocate is recommending that Your Honor and the Board allow an SPC over-recovery balance as of 07/31/03 in the amount of $20,951,000, which is $1,046,000 lower than the corresponding over-recovery balance proposed by the Company.

PSE&G has projected an uncollectible cost level of $22,500,000 for the period 8/1/03 – 7/31/04. To this annual cost level must be added the total cumulative over-recovery balance for the Company's SPC projected as of 7/31/03, which Mr. Henkes has calculated to be $20,951,000. Consistent with Mr. Henkes' recommendation that all SPC over- and under-recovery balances as of 7/31/03 be amortized over a 4-year period, the 4-year amortization of the $20,951,000 SPC over-recovery balance at 7/31/03 results in an annual SPC credit of $5,238,000. *RA-DEF-3*, Sch. RJH-1, pp. 12-13.

Based on the above recommendation, the Ratepayer Advocate is recommending that the net amount to be recovered in the SPC for the period 8/1/03 - 7/31/04 is a charge of $17,262,000. Dividing this charge by the projected sales volume for the corresponding annual period indicates a recommended SPC of 0.0411 cents/kWh. This is 0.0182 cents/kWh lower than the current SPC of .0593 cents/kWh. The corresponding rate implication is an annual rate decrease to the ratepayers of $7,658,000. *RA-DEF-3*, Sch. RJH-1 p. 13.

In sum, the Ratepayer Advocate has recommended a total SPC over-recovery balance as of 07/31/03, including cumulative interest, of $20,951,000, which is $1,046,000 lower than the corresponding over-recovery balance of $21,997,000 proposed by the Company. *RA-DEF-3,* Schedule RJH-2.

POINT XIII

THE RATEPAYER ADVOCATE'S RECOMMENDED TOTAL UNIVERSAL SERVICE FUND CHANGE ("USF") UNDER-RECOVERY BALANCE, INCLUDING CUMULATIVE INTEREST AMOUNTS TO $1,286,000, WHICH IS $388,000 LOWER THAN THE CORRESPONDING UNDER-RECOVERY BALANCE OF $21,674,000 PROPOSED BY THE COMPANY SHOULD BE ADOPTED BY YOUR HONOR AND THE BOARD.

PSE&G does not include any USF costs for the period 8/1/03 – 7/31/04 in this deferral filing. The Board on March 20, 2003, approved the establishment of a permanent USF to begin July 1st of this year. *I/M/O the Establishment of a Universal Service Fund*, Docket No. EX00020091 (Agenda dated March 20, 2003, Item 2C). The first year of the USF program will be funded with an expected $30,000,000 plus administrative and start-up costs. Implementation of the USF awaits final Board Order. PSE&G intends to update its estimate for USF costs for the period 8/1/03 – 7/31/04 to reflect the impact of this final Board Order in the above-referenced USF proceeding. In response to Ratepayer Advocate discovery request RAR-DEF-134, the Company confirmed that, as of that time, the Board had not acted on a Permanent USF and that, therefore, there were no costs associated with such a program. Mr. Henkes showed on line 1 in column 6 of Schedule RJH-1, the recommended USF cost level for the period 8/1/03 – 7/31/04 is $0. *RA-DEF-3*, Sch. RJH-1.

The Board in Docket No. EX00020091 (Order dated April 2, 2002) approved an Interim Plan for recovery of USF costs as a component of the SBC. While the Company has not included any USF costs for the period 8/1/03 –7/31/04 in this deferral filing, it has incurred costs associated with the Interim USF Program. Since the Company's USF component in the current SBC rate is set at $0, all of the Company's USF costs associated with the Interim USF Program represent under-recovered deferred USF Program costs. Mr. Henkes has determined that the appropriate cumulative under-recovered USF Program cost balance as of

7/31/03 amounts to $1,286,000. Consistent with his recommendation that all SBC over and under-recovery balances as of 7/31/03 be amortized over a 4-year period, the 4-year amortization of the $1,286,000 Interim USF under-recovery balance at 7/31/03 results in an annual USF charge of $322,000. Dividing this charge by the projected sales volume for the annual period 8/1/03 – 7/31/04, indicates a recommended USF Charge of .0008 cents/kWh (line 9). Since the current USF Charge is 0 cents/kWh, the recommended new USF Charge results in an annual rate increase to the ratepayers of $322,000. *RA-DEF-3*, p. 24; Schedule RJH-1.

PSE&G is proposing to include approximately $9,000 worth of PSE&G's internal labor and overhead costs associated with the administrative processing of the USF Program in the actual cumulative USF Charge under-recovery balance of $1,247,000 as of 2/28/03. The Company has not shown these internal labor and overhead costs to be "incremental" to the labor and overhead costs already incorporated in PSE&G's current electric base rates. In addition, these administrative processing costs have not been offset with any cost savings and system benefits from the implementation of the Interim USF Program. Thus, consistent with the positions taken by the Ratepayer Advocate with regard to such issues in the pending USF docket, the Ratepayer Advocate recommends the removal of the $9,000 of administrative processing costs for rate consideration in this case. *RA-DEF-3*, p.25; Schedule RJH-5.

Next, Mr. Henkes has made an adjustment to the Company's proposed interest calculations. PSE&G's interest calculations are based on the pre-tax USF Charge under-recovery balances, the Ratepayer Advocate's interest calculations are based on the USF Charge under-recovery balances net of associated deferred income taxes. In addition, in calculating the interest on the under-recovery balances from 3/1/03-7/31/03, PSE&G used an estimated interest rate of 5.50%, whereas the Ratepayer Advocate's interest

calculations for that period are based on the appropriate actual interest rate of 4.64%.[54] *RA-DEF-3*, p.26; Schedule RJH-5.

In sum, the Ratepayer Advocate has recommended 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. *RA-DEF-3*, Sch. RJH-5.

[54] See Footnotes (3) and (5) of Schedule RJH-5 in *RA-DEF-3* for calculations used to arrive at the Ratepayer Advocate's recommended cumulative interest amounts.

CONCLUSION

For all the reasons set forth above and in 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 following recommendations:

- PSE&G's calculation of carrying costs on its deferrals is based on the gross amounts of the deferrals,which fails to take tax benefits into account and therefore provides the Company's shareholders with windfall profits at ratepayer expense. Instead, carrying charges should be calculated on the deferral balances net of associated deferred income taxes, known as the "net of tax" method.

- The interest rate of 4.64%, which reflects the August 1, 2002 seven-year treasury rate plus 60 basis points, should be used to accrue interest for Year 4 of the Transition Period.

- As shown in Andrea Crane's Schedule ACC-2, the pre-tax BGS deferral of $236,996,198 equates to $140,183,251 on an after-tax basis. Interest accrued during the Transition Period amounts to $3,296,382 (*See RA-DEF-9,* Schedule ACC-1, p. 2 (2/28/03 update).

- The Company should be required to report on its NUG contract mitigation activities annually, at the time that it files its annual NTC rate charge. If the Board subsequently finds that the Company is not making a good faith effort to mitigate its NUG costs, then the Board should take all lawful steps to mitigate the burden on ratepayers' rates resulting from the Company's above-market NUG contracts.

- At the time that it files its annual NTC rate charge, the Company should be required to report on its efforts to maximize revenues from the sale of NUG output.

- The Company's NTC balance should be adjusted to (1) include $4,662,000 in interest owed to ratepayers on the beginning over-recovered LEAC balance and (2) maintain the PSEG Holdings Affiliation Fee at an annual level of $2 million on a total Company basis during the Transition Period, which includes an annual amount of $1,421,328 for electric operations.

- PSE&G should not be permitted to recover carrying costs associated with its over-market NUG balances, in accordance with the treatment set forth by the Board Auditors.

- The NTC balance should be adjusted to reflect the return of 50 percent of the profits from the sale of the Kearny Station ($8,624,000 on a pre-tax basis and $5,101,000 on an after-tax basis) and the sale of certain electric transmission facilities ($1,226,000 on a pre-tax basis and

$726,000 on an after-tax basis) to ratepayers, with interest in the amount of $623,586. Schedule ACC-1, line 5 (Updated 2/28/03).

- Adopting the recommendations herein would result in a total net deferred BGS/NTC balance of $105,450,596 on a pre-tax basis and of $62,373,303 on an after-tax basis, yielding a total net deferred BGS/NTC underrecovered balance of $59,471,838 including interest. *RA-DEF-9*, Sch. ACC-1, line 7 (2/28/03 update). The resulting NTC balance would amount to no less than $121,695,602, or $71,982,948 on an after-tax basis, with interest on this deferred NTC balance of $5,574,260. *RA-DEF-9*, Sch. ACC-3, p. 4 (2/28/03 update).

- Overrecovered deferral amounts should be returned to ratepayers over a four-year period and underrecovered amounts collected from ratepayers over a four-year period. Interest accrued on the balances should be computed using a fixed interest rate.

- If a recovery period longer than four years is used to amortize underrecoveries, then the amortization should be over a ten-year recovery period with a fixed interest rate at 60 basis points over the then-effective 7-year treasury bond rate.

- The level of nuclear decommissioning costs included in the Company's post-Transition Period SBC should be assumed to be zero, pending the Board's decision in the separate decommissioning docket in which the Board will address ratepayers' continuing responsibility for the costs of decommissioning the former PSE&G nuclear units, and ratepayers' continuing interests in the associated nuclear decommissioning trust funds. It would be inappropriate for the Company to continue to collect for the costs of decommissioning its divested nuclear units after August 1, 2003 in the absence of a Board Order providing for continued ratepayer funding.

- The Company's Nuclear Decommissioning Charge should be established as a credit of (0.0117) cents per kilowatt-hour, resulting in a rate decrease of $40.434 million.

- Assuming Board approval of the Stipulation in the Company's RAC-9 proceeding, the Company's Manufactured Gas Plant Remediation Adjustment Charge ("RAC") should be established at 0.0319 cents per kilowatt-hour, resulting in a rate increase of $11.209 million.

- PSE&G should not be permitted to recover "lost revenues" from DSM programs until the Board's determination of proper protocols to measure energy savings and, therefore, lost revenues.

- Reject PSE&G's estimated total DSM Program charge overrecovery balance of $29,907,000 in favor of the appropriate overrecovery calculation of $37,981,000 by the Ratepayer Advocate.

- Reject PSE&G's claim for Year 2 and Year 3 CEP costs due to the Company's failure to prove that these costs were reasonable and prudent.

- Adopt the Ratepayer Advocate's MTC overrecovery of $532.2 million and reject PSE&G's unauthorized claim to reduce the MTC overrecovery by a Net Present Value of $328 million (or a cumulative $370.1 million) for carrying charges related to an alleged "securitization delay." If Your Honor and the Board should permit some allowance for this item, the interest rate should be reduced to 60 basis points over the 7-year treasury rate, which produces carrying charges of $174.8 million.

- Approve a total Social Program Charge overrecovery balance of $20,951,000 (including cumulative interest), as of July 31, 2003, which is $1,046,000 lower than the corresponding overrecovery balance of $21,997,000 proposed by the Company.

- Approve a total USF Charge underrecovery balance of $1,286,000 (including cumulative interest), which is $388,000 lower than the $1,674,000 underrecovery balance proposed by PSE&G.

Respectfully submitted,

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RATEPAYER ADVOCATE

By:______________________________
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Dated: April 3, 2003

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