BEFORE THE
STATE OF NEW JERSEY
OFFICE OF ADMINISTRATIVE LAW

I/M/O of the Verified Petition of Rockland Electric Company for Approval of Changes in Electric Rates, Its Tariff for Electric Service, Its Depreciation Rates, and for Other Relief ("Base Rate Filing")	**BPU Docket No. ER02100724** **OAL Docket No. PUCRL 09366-02N**

REPLY BRIEF ON BEHALF OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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INTRODUCTION

As set forth more fully in the sections which follow, and in the arguments raised in the Division of the Ratepayer Advocate's ("Ratepayer Advocate") Initial Brief, as well as in the testimony of the Ratepayer Advocate's witnesses, Rockland Electric Company ("Rockland" or "the Company") proposed an unreasonably high rate of return, used a rate base figure which did not accurately reflect the actual assets utilized, understated its projected revenue, and overstated its expenses, including an unreasonably high estimate of its depreciation expense.[1] The Company's overstated claim for rate relief should be rejected. Instead, in accordance with the analyses and recommendations set forth in the testimony of the Ratepayer Advocate's witnesses, a rate decrease of approximately $5,300,000 million is due ratepayers. *R-51*, p. 9. As set forth in the Ratepayer Advocate's Initial Brief and in the sections which follow in this Reply Brief, there is overwhelming evidence in the record which supports the Ratepayer Advocate's recommended adjustments to the Company's proposed return on equity, rate base, and pro-forma revenue and expenses. Similarly, there is ample support for the Ratepayer Advocate's recommendations regarding the Company's proposal for its tariff and rate design.

Based on the analysis of Ratepayer Advocate witness James A. Rothschild, the Ratepayer Advocate is proposing a return on equity of 9.5%. Unlike the 12% return proposed by the Company, Mr. Rothschild's recommended return figure is based on the proper application of sound methodology and is consistent with interest rate trends and expected returns for electric distribution utilities. As discussed herein, in the Ratepayer Advocate's Initial Brief, and in the testimony of Mr. Rothschild, the Company bases its proposal on a flawed application of the Discounted Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") methodologies.

The Ratepayer Advocate also proposes the adoption of rate base adjustments to the Company's proposal, totaling over $23,726,000, as recommended by its witness, Robert J. Henkes.

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[1] The Initial Briefs filed in this proceeding will be referred to as follows: Rockland Electric Company - "REIB"; Ratepayer Advocate - "RAIB"; and Board Staff -" SIB".

R-51, p. 7, Sch. RJH-1. The Ratepayer Advocate recommends other adjustments which properly reflect a reasonable level of expenses and revenues associated with the provision of utility service. Ratepayer Advocate witnesses also challenged many components of the Company's claimed operating expenses, including the Company's accounting for labor operating and maintenance ("O&M") expense, labor cost increases, incentive compensation, pension expense, regulatory expense, and others. The result of the pro-forma revenue and expense changes proposed by the Ratepayer Advocate amounts to an increase of $11,683,000 in pro-forma operating income.

The recommended adjustments also include a significantly larger reduction to the Company's depreciation expense, reducing the pro-forma depreciation expense by $1.9 million versus the $522 thousand decrease proposed by Rockland. *R-36*, p. 5.

In order to equitably benefit the different classes of ratepayers, the rate decrease should be allocated to the various customer classes on an equal percentage basis, as proposed by Ratepayer Advocate witness David E. Peterson. *R-10*, p. 5. Furthermore, the Ratepayer Advocate recommends that the Company's proposed increase to the service charge be rejected. Rockland already has the highest residential monthly service charge of the four regulated New Jersey electric utilities. It is the Ratepayer Advocate's recommendation to maintain Rockland's current service charge. The Company could instead recoup any increase or decrease in class revenue responsibility that results form this proceeding by changing current energy and demand charges by a uniform percentage within each rate classification. Rockland also proposes to extend the applicability of its dishonored check charge to residential customers. The cost data presented in this proceeding supports only a $7.00 flat charge for each dishonored check and that is the Ratepayer Advocate's recommendation. Rockland's proposal to increase its reconnection charge from $7.00 to $27.00 would significantly exceed the existing electric reconnection charges approved in New Jersey. The Ratepayer Advocate recommends that the reconnection charge be raised to $15.00 instead. *R-10*, p.6.

This Reply Brief will highlight the differing approaches taken by the Company and the Ratepayer Advocate, and respond to selected issues raised in the Initial Briefs filed by the Company

and the Board of Public Utilities' Staff ("Staff"). In sum, as set forth in the sections which follow, the Ratepayer Advocate respectfully submits that its recommended adjustments and modifications to the Company's request be adopted by Your Honor and the Board.

POINT I

YOUR HONOR AND THE BOARD SHOULD ADOPT THE RATEPAYER ADVOCATE'S RECOMMENDED 9.25% RETURN ON EQUITY, WHICH IS BASED ON WELL-ESTABLISHED METHODS, RELIES ON VALID RESEARCH, AND IS CONFIRMED BY RECENT MARKET TRENDS.

Rockland argues in its Initial Brief, based on the testimony filed by Roger G. Rosenberg, that the Your Honor and the Board should maintain the 12.0% return on equity that was established nearly a decade ago for the Company's electric operation. REIB pp. 142, 144. The infirmities of Mr. Rosenberg's approach were analyzed in depth in the Ratepayer Advocate's Initial Brief, and those arguments will continue to be relied on here. This Reply Brief will focus on Rockland's specific critiques of the testimony filed by the Ratepayer Advocate witness James Rothschild, and show that Mr. Rothschild's two DCF models were calculated correctly and are consistent with long-term growth forecasts reflective of investors' expectations. Similarly, the Ratepayer Advocate will show that Mr. Rothschild properly applied the "inflation risk premium"/CAPM method, as well as the "debt risk premium"/CAPM method.

The Company, at page 142 of its Initial Brief, incorrectly concludes, "Mr. Rothschild relied almost exclusively on only one model – the simple constant-growth DCF model to produce a recommended cost of equity of 9.25%." That is an erroneous conclusion. Mr. Rothschild used more than one approach to arrive at a recommended cost of equity in this proceeding. Mr. Rothschild used two DCF approaches and several Risk Premium/CAPM methods. He exercised his professional judgment and relied on both the DCF method and the Risk Premium/CAPM method. Because his recommendation of 9.25% is conservatively high, his recommended cost of equity ends up being closer to the DCF results, but Mr. Rothschild nevertheless considered the results of the Risk Premium/CAPM as well as the DCF. RAIB pp. 7-8.

The Company continues to ignore recent market trends, arguing that Mr. Rothschild's cost of equity is 200 basis points below the cost of equity that has been allowed by regulatory agencies

across the United States over the last two years. REIB, p. 142. Mr. Rothschild addressed this issue during his oral surrebuttal.

> Q. On Page 12, Mr. Rosenberg compared the cost of equity that you recommended to the average allowed return recorded by Regulatory Research Associates. Can you respond, please?
>
> A. … RECO-49… I would like to ask his Honor and the rest of the fine people in the room to look at what is labeled page 7 of that response. It's the page that begins the individual results of the electric utility decisions. The first company reported on the page is Green Mountain Power. And what I have done in looking at these results is to focus on the allowed returns in the Northeast, because they are, from my experience, closer to the way the regulation tends to work in New Jersey.
>
> And we see, if we focus on those, the first one is Green Mountain Power Back in early 2001 at 11.25. The next one is Vermont showing up, Central Vermont Public Service at 11.0. The next one is Central Hudson at 10.30. Niagara Mohawk right below that at 10.60. We go to the next page. We get to United Illuminating, the case I testified in, 10.45. And the next one is Fitchburg Gas and Electric in Massachusetts, 10.0.
>
> So what I see in there is, with some exceptions, for the most part as Vermont shows up. Basically- well, not absolute, but basically consistent returns in the 10 range, going down to 10.0. And a trend towards lower allowed returns. And I'm also aware that starting with the Board decision in this case, in the Verizon UNI case which is not electric, telephone, the Board found a 10.0 percent cost of equity in that number and stipulations, not for decisions, has been replicated in numerous grapevines thereafter. So, I think if you look behind the numbers that you see, that the –and recognize that while my recommendation is below 10.0, it's a natural progression. It's a progression of what kind you should expect given what's happened to interest rates. And so I think this report looked at, as is appropriate to use, is a big help and supports my recommendation.

T:146-148 (2/21/03), *RECO-49*

Mr. Rothschild's above analysis of prior decisions is confined to allowed returns in the Northeastern portion of the United States and his cost of equity recommendation is consistent with what has been allowed in the region. Looking at the Northeast is especially important given the

serious problems encountered by electric companies elsewhere in the country for reasons such as the deregulation fiasco in California.

In addition, Staff also rejects Mr. Rosenberg's 12% cost of equity recommendation as unreasonable and finds that, "in terms of the end results, Mr. Rothschild's estimate is closer to what Staff believes is a reasonable range for a final rate determination." SIB, p. 46. Staff then goes on to say that "for the purpose of advising the Board in this matter, a range of 9.5 to 10 percent is reasonable and consistent with Board decisions involving two natural gas utilities." *Id.*, citing, *I/M/O Petition of Public Service Electric & Gas for Authority to Revise Its Gas Property Depreciation Rates*, BPU Docket No.GR01050297, (Order dated January 9, 2002) and *I/M/O Petition of NUI Utilities, d/b/a Elizabeth Gas Company for Approval of Increase Base Tariff Rates et al.*, BPU Docket No. GR0204050245, (Order dated November 20, 2002).

The Company makes another baseless criticism of Mr. Rothschild's use of the constant-growth DCF model, claiming that Mr. Rothschild's method has little value in today's uncertain economy, because the estimate of the future expected growth rate is "based on a growth rate that is sustained for many years into the future." REIB, p. 152. As stated in the Ratepayer Advocate's Initial Brief, and discussed below, this criticism is unfounded because the growth rate methodology employed by Mr. Rothschild in his DCF model in this proceeding specifically looks through the short term fluctuations, and results in a long-term sustainable average growth rate that is appropriate. RAIB, pp.13-14.

The Company cites the country's current economic stagnation and the downturn in the stock market as proof that investors hardly expect constant growth for electric utilities. REIB, p. 152. While the Ratepayer Advocate acknowledges that several factors have negatively impacted investor's expectations, such as corporate ethics, analyst's improprieties, and the general economic downturn, the Company erroneously turns this into a conclusion that investors are therefore not expecting constant growth. In reaching this conclusion, the Company is making an invalid comparison. Mr. Rothschild, in his analysis, determined long-term sustainable growth by

considering what investors are expecting as the sustainable future expected return on book equity in the long run. This number was determined by considering what analysts are forecasting, and what historic actual returns on book equity would be. To the extent investors believe corporate ethics are causing earnings to be overstated, then his growth rate is overstated. Thus, what the Company finds as a flaw is really a factor that makes Mr. Rothschild's recommendation conservatively high. It does NOT impact the appropriateness of using the constant growth version of the DCF method in this proceeding. RAIB pp. 12-13.

It is important for the growth rate used in the constant growth version of the DCF model to be representative of the constant growth rate for dividends, earnings, book value and the stock price. The Company argues that future growth should have been set equal to future stock price appreciation, not earnings growth. REIB, p. 153. The Company then assumes it is possible to simply look up in a book what investors expect for future stock price appreciation. The Company argues that the cost of equity could simply be determined by looking at what Value Line forecasts for stock price appreciation and then adding that number to the dividend yield. It was shown during cross-examination of Mr. Rosenberg and during Mr. Rothschild's oral surrebuttal that the Value Line stock appreciation forecast could not possibly have been consistent with what investors expect. At the evidentiary hearing, Mr. Rosenberg testified that Value Line showed CH Energy's dividend yield to be 4.4 percent and Teco Energy, Inc's to be 6.9 percent.

He then was asked:

> Q. Is it true that if you add the average annual percentage increase in price and the dividend yield for Teco Energy, Inc., you get a total Return of 22.7 percent?
>
> A. Something on that order.
>
> Q. Okay. And also if you add the dividend yield to the price appreciation for CH Energy, you get something on the order of 2 percent?
>
> A. 1.8, actually.

T70:L3-25 (2/21/03)

If investors expected the very low return on CH Energy, no one would buy the stock. Conversely, if investors believed Value Line about the stock price appreciation for Teco Energy, Inc., then Teco Energy would be the only electric company from the group that investors would purchase. Since the DCF method must be based upon a growth rate that investors expect, these Value Line five-year stock price appreciation numbers are improper for use in the DCF method.

On the other hand, the Company claims that Mr. Rothschild did not give much weight to his multi-stage DCF model. That is not an accurate description of what he did. Mr. Rothschild examined the results of his multi-stage DCF and in evaluating the result, was aware that the multi-stage DCF is highly dependent upon Value Line's estimates over the short-term. Since Value-Line has a history of being overly optimistic, Mr. Rothschild pointed out that this result could be somewhat on the high side. However, the multi-staged DCF model that he used was not much higher than the single-stage DCF model he used. Furthermore, both the single-stage and the multi-stage DCF results were considerably higher than the Risk Premium/CAPM results. Since his equity cost recommendation was much closer to the DCF results than to the Risk Premium/CAPM results, his cost of equity recommendation is conservatively high, and would still be conservatively high if the constant growth DCF was eliminated and weight was given to only the multi-stage DCF and the Risk Premium/CAPM methods.

There was much disagreement in both pre-filed testimony and on the record regarding whether a risk premium model should be implemented using the arithmetic average or a geometric average. The Company, at page 148 of its Initial Brief, discusses this issue. The Company provides three sources in support of Mr. Rosenberg's decision to use an arithmetic average. Two of those sources, Roger Ibbotson and Roger Morin, are company cost of capital witnesses, hardly independent sources. The third source is the textbook entitled "Investments" by Bodie, Kane, and Marcus. The Bodie, Kane and Marcus text that is referenced does not address what averaging method should be used to compute a risk premium, it merely addresses what approach should be used to examine the distribution of stock market performance over only a one-year time period. The

Company is attempting to use the Bodie, Kane and Marcus reference in an out-of context manner. It is an important contrast to note that while the Company relied on three sources in support of its witnesses approach to the arithmetic average, it merely ignored the numerous sources provided by Mr. Rothschild in support of the geometric average. Mr. Rothschild's sources include SEC, Value Line, various textbooks, common-sense examples, and end-result comparisons to what investors actually do. The Company cannot cavalierly dismiss the opinions of the SEC and Value Line, both cited by Mr. Rothschild as favoring the geometric mean over the arithmetic mean, without providing credible evidence of why these respected entities are wrong. RAIB, pp. 22-23.

Your Honor and the Board should endorse the use of the geometric mean to implement the risk premium model based on the numerous authoritative examples cited by the Ratepayer Advocate in it's Initial Brief.

In sum, based on the arguments presented by the Ratepayer Advocate in *R-13*, as well as this Reply Brief and the Ratepayer Advocate's Initial Brief, Your Honor and the Board should adopt a rate of return for Rockland of 9.25%.

POINT II

ROCKLAND HAS PRESENTED NOTHING WHICH SERIOUSLY REFUTES THE REASONABLENESS OF THE DEPRECIATION ADJUSTMENTS RECOMMEND BY THE RATEPAYER ADVOCATE BASED ON THE ADOPTION OF THE NET SALVAGE ALLOWANCE APPROACH.

The underlying depreciation issue in the instant case is the ratemaking treatment of net salvage. As set forth in the testimony of its depreciation witness, Mr. Michael J. Majoros, and in its Initial Brief, the Ratepayer Advocate's recommended adjustments, which are based on the adoption of Mr. Majoros' "net salvage allowance approach," are based on the Company's actual net salvage and are consistent with current accounting and regulatory practices. *R-36*; RAIB, pp. 24-31. Mr. Majoros' recommended adjustments are based on the Company's actual net salvage experience for the past five years. Mr. Majoros found that Company has only experienced $43,000 of net salvage, on average, over the five-year period ending 2001. *R-36*, p. 15, Exhibit MJM-1, Sch. III-2. In contrast, Mr. Majoros found that the Company has incorporated $897,000 of net salvage expense in its test year depreciation expense. *Id.*, Exh. MJM-1, Sch. III-2. In its testimony and Initial Brief, Rockland has presented nothing which effectively refutes the fact that its actual net salvage experience over the past five years is but a small fraction of the amount it proposes to collect for net salvage from its ratepayers. The Ratepayer Advocate respectfully submits that Rockland's ratepayers should not be burdened with an estimated expense that is so far removed from the Company's actual experience. As discussed more fully below, Rockland has not presented any convincing argument to refute that conclusion.

Notably, Board Staff supports the Ratepayer Advocate's position, with the exception of the time period used to establish the allowed average removal expense. *See* SIB, pp. 89-91. Significantly, Board Staff noted that the Company did not provide any statistical support for its level of removal costs. *Id.*, p. 90. Furthermore, Board Staff concurs with the Ratepayer Advocate "by supporting the intellectual foundation of FAS No. 143, which supports 'unbundled' depreciation rates." SIB, p. 90. However, Board Staff recommends that a ten-year time frame be used to

compute the allowed removal expense, rather than the five-year period recommended by the Ratepayer Advocate. *Id*. Thus, instead of a $43,000 annual allowance for removal costs, Board Staff recommended a $150,000 annual allowance. *Id*. Furthermore, Board Staff concurs with the Ratepayer Advocate's recommended adjustment in the Company's claimed reserve amortization. SIB, p. 91.

In contrast to the position taken by Board Staff, Rockland erroneously presents its proposed approach to net salvage as if it were the only recognized ratemaking approach for net salvage. *See* REIB, pp. 128-136. In fact, as set forth in detail in the Ratepayer Advocate's Initial Brief, in its 1996 Public Utility Depreciation Practices manual the National Association of Regulatory Utility Commissioners ("NARUC") explicitly recognizes the approach recommended by the Ratepayer Advocate. RAIB, pp. 25-26; *R-35*. While Rockland selectively quotes from one of the introductory chapters of the NARUC Manual (Chapter 2), the Company avoids the discussion of the current-period accounting approach to net salvage discussed in a later technical chapter of that manual. REIB, p. 132. The "current period accounting" approach recognized by NARUC in Chapter 11 (entitled "Estimating Salvage and Cost of Removal") of its 1996 depreciation practices manual sets forth the underlying basis for Mr. Majoros' net salvage allowance approach. There, NARUC recognized the "current period accounting" approach and provided a rationale for its use:

> Today, few utility plant categories experience positive net salvage; this means that most depreciation rates must be designed to recover more than the original cost of plant. The predominance of this circumstance is another reason why some utility commissions have switched to current-period accounting for gross salvage and, particularly, cost of removal. *R-35*, p. 158.

It is undisputed that Rockland faces the prospect of negative net salvage. Furthermore, the amount Rockland proposes to collect in current rates for net salvage is far in excess of its actual net salvage experience. Therefore, the current period accounting approach to net salvage recognized by NARUC and embodied in the net salvage allowance approach advocated by the Ratepayer Advocate should be adopted by Your Honor and the Board.

Although Rockland proffers an "intergenerational inequity" argument in support of its approach to net salvage, it fails to consider the burden that its approach places on Rockland's current ratepayers. REIB, p. 133. As Mr. Majoros noted in his Direct Testimony, under Rockland's proposed approach, today's ratepayers would pay for future inflation incorporated in the Company's proposed depreciation rates. *R-36*, p. 15. Thus, Rockland conveniently ignores the intergenerational equity problem posed by its own proposal while failing to show how future ratepayers would be harmed by the net salvage allowance proposal, whereby current ratepayers would pay for actual removal costs. If Rockland's proposal were adopted, today's ratepayers would be burdened with the cost of future inflation incorporated in Rockland's depreciation rates. That burden was quantified by Mr. Majoros, who compared the Company's actual negative net salvage experience ($43,000, on average) with the amount the Company incorporated in its proposed rates ($897,000). *R-36*, p. 15.

Rockland also gratuitously claims that an increased depreciation expense provides its current ratepayers a "benefit" in the form of a rate base reduction. REIB, p. 133. Notably, Rockland failed to quantify this "benefit." Moreover, as pointed out by Mr. Majoros, "[s]ince depreciation expense flows dollar-for-dollar into the revenue requirement, excessive depreciation expense results in an excessive revenue requirement." *R-36*, p. 4, lines 29-30. In contrast, the revenue requirement effect of a rate base reduction is a derivative of not only the Company's rate base, but the allowed rate of return as well.

In support of its position, Rockland cites a Board Order from a 1986 gas base rate case.[2] REIB, p. 133. However, as set forth by Mr. Majoros in his Direct Testimony, since that time, some important developments have taken place with respect to the accounting for asset retirement obligations (*i.e.*, removals), namely the adoption of Statement of Financial Accounting Standards Number 143 ("SFAS 143") by the Financial Accounting Standards Board ("FASB") in 2001. *R-36*,

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[2] *I/M/O New Jersey Natural Gas Company*, BPU Docket No. GR851097, (Order dated July 30, 1986). ("1986 New Jersey Natural Order").

p. 15; *See R-37* (excerpt); *RECO-57*. SFAS 143 requires affected companies to record asset retirement obligations, as indicated by a legal obligation upon the assets' retirement. *R-36*, p. 16. Rockland did not identify any SFAS 143-related asset retirement obligations for its New Jersey jurisdictional assets. *RECO-59.*

The net salvage allowance method recommend by Mr. Majoros, which uses the Company's actual negative net salvage experience as the basis for the expense, is consistent with SFAS 143, as noted by Mr. Majoros. *R-36,* p. 19. The net salvage allowance method recommended by Mr. Majoros does not require Rockland to record a retirement obligation on its books for regulatory purposes, absent a requirement to do so by SFAS 143. Instead, the net salvage allowance method accounts for removal cost using a five-year average of actual removal cost experience. As aptly noted by Mr. Majoros at hearing, the adoption of SFAS 143 changed the "regulatory paradigm," as it pertains to the treatment of net salvage. T190:L1-3. The Company's actual experience with removal costs and the adoption of SFAS 143 warrant a new look at the regulatory treatment of net salvage in New Jersey since the time the cited New Jersey Natural Gas Company case was decided, almost 17 years ago.

Furthermore, in the Initial Decision in the cited 1986 New Jersey Natural case, the ALJ noted that "[t]he Rate Counsel's witness in this respect did not have the expertise in this area [depreciation]."[3] In contrast, Mr. Majoros has extensive experience in depreciation studies and analysis. *R-36,* Appendix A. Here, there is ample reason to take a fresh look at the regulatory treatment of net salvage.

Finally, contrary to the Company's claims, Mr. Majoros did not question the Company's compliance with SFAS 143 for financial reporting purposes. REIB, p. 136. Furthermore, the Company's assertion that its compliance with SFAS 143 was confirmed by NARUC, among others, is flat wrong. *Id*. The NARUC document cited by Rockland is comments filed with the American

[3] *I/M/O New Jersey Natural Gas Company*, BPU Docket No. GR851097, OAL Docket Nos. PUC 7317-85 and PUC 4993-85, Initial Decision, dated June 20, 1986, at p. 49.

Institute of Certified Public Accountants on a proposed Statement of Position ("proposed SOP"), "Accounting for Certain Costs and Activities Related to Property, Plant and Equipment." *Id.*, *R-62.* The cited NARUC document does not even refer to Rockland. Moreover, although the comments were filed by NARUC, the document does not bind the State Commissions comprising NARUC's membership. In fact, as noted above, the Staff of the New Jersey Board of Public Utilities supports the Ratepayer Advocate's recommendations, except for the time period used to establish the Company's net salvage expense level. For the reasons set forth above and in the Ratepayer Advocate's Initial Brief, and its witnesses testimony, the recommended net salvage allowance approach and the attendant adjustments to depreciation expense, and the excess depreciation reserve amortization should be adopted by Your Honor and the Board.

POINT III

THE RATEPAYER ADVOCATE'S PROPOSED ADJUSTMENTS TO RATE BASE ARE PROPERLY BASED ON THE RECORD AND SOUND RATEMAKING POLICY.

The Ratepayer Advocate's proposed adjustments to the Company's pro forma rate base were explained in detail in the Ratepayer Advocate's Initial Brief. Sections A through R below respond to arguments in the Rockland Initial Brief and the Staff Initial Brief for each adjustment recommended by the Ratepayer Advocate.

Rockland claims that it would not have filed this rate case asking for a rate increase but for the Board's direction that a rate case filing was required. REIB, pp. 69, 78, 84, 85, 88, and 120-121. For example, regarding the Upper Saddle River project, Rockland states "[h]ad RECO not been required to file a rate case on October 1, 2002, RECO would have delayed any such filing until such time this needed investment would have been within a six month post-test year period." Additionally, Rockland argues that it should recover 100% of rate case expenses because the Board mandated to make a base rate filing. REIB, p. 121.

The real and hidden reasons Rockland did not want to file a rate case are abundantly clear at this time. After a thorough review of the Rockland filing, both the Ratepayer Advocate and Staff have shown a substantial rate reduction is appropriate and warranted. The Ratepayer Advocate recommends a reduction of $5.324 million. RAIB, p. 32. Staff recommends a rate reduction of $4.8 million. SIB, Exhibit P-2, Summary, page 1.

Apparently, Rockland feels that its is entitled to an $11.7 million premium for filing this rate case (the difference between Rockland's $6.332 million rate increase and the Ratepayer Advocate's $5.324 rate decrease). Rockland's assertion of being forced to file by the Board under cuts Rockland's credibility in this case.

In addition, the Ratepayer Advocate requests that Your Honor and the Board consider the fact that Rockland has added $25.782 million of additional plant in the last five years and is now

proposing another increase of $25.4 million. This represents, approximately, a 33% increase in plant when measured from a base of $155,000,000.

Rockland has offered no support why the first $25.872 million was needed and prudent, and as explained below, why the newest additions are justified by the so called "planning criteria." RAIB, Exhibit A, page 9. Rockland has made no showing that its "planning criteria" are necessary or prudent in so far as providing safe, adequate, and proper service. Rockland has made no showing at all why the first $25.872 million of plant additions were incurred in the first instance. All that we know is that the money was spent. There is no evidence in the record that such additions to plant were needed or that such additions were predicated on the need to provide safe, adequate, and proper service. It is clearly within the province of Your Honor and the Board to question each and every element in the rate base and make adjustments necessary to balance the interests of all parties. When making your decision, the Ratepayer Advocate urges consideration of the matters discussed above.

The Ratepayer Advocate relies upon the *Public Service Coordinated Transport v. State*, 5 *N.J.* 196 (1950) in support of its position that Rockland failed to show that the entire plant in service is used or useful in the provision of service. In *Public Service Coordinated Transport v. State*, the Supreme Court set forth the standards for determining what is an appropriate rate base:

> The determination of an adequate rate base is, as the term applies, fundamental in any rate proceeding. The rate base is the fair value of the property of the public utility that is **used and useful** in the public service . . . a case amply supported by the authorities, it was held that a 'utility is entitled to a just return upon the fair value of the property at the time of its employment for the convenience of the public, and the public to protection against unreasonable exactions' and that 'a rate based upon excessive valuation or **upon property not used or useful** in the renditions of the service subject to such regulation obviously would lay upon the individual users a burden greater than the reasonable worth of the accommodation thus supplied. . . .' (emphasis added).[4]

[4] *Public Service Coordinated Transport v. State*, *supra* at 217.

The Ratepayer Advocate notes that neither Your Honor nor the Board can accept the books of account of a public utility at face value and there must be proof in the record not only as to the amount of the various accounts, but also sufficient evidence from which the reasonableness of the accounts can be determined. See *Public Service Coordinated Transport v. State*, *supra* at 218-219. The burden of proof is upon the public utility. See *N.J.S.A.* 48:2-21(d). As discussed above, Rockland failed to make any showing on the record that the additions to plant in service from 1997 forward were necessary, useful, and otherwise required in order to provide safe, adequate, and proper service. As noted in *Public Service Coordinated Transport v. State*, *supra* at 218, Your Honor and the Board must go behind the figures shown on the books and records and determine the appropriateness of the numbers. Rockland has no proof or evidence on the record that the existing plant in service and additions thereto after 1997 were necessary or prudent. Therefore, the Ratepayer Advocate recommends that an additional $25.872 million be eliminated from the rate base and the revenue requirement be recalculated.

A. The Company Has Failed to Show That its Plant Additions Meet the Board's Standard for Inclusion in this Rate Case.

Both the Ratepayer Advocate and Staff recommend adjustments to the Company's rate base to reflect adjustments to decrease the plant in service additions proposed by Rockland. As pointed out by the Ratepayer Advocate in its Initial Brief :

- Rockland's claim that these projected post-test year plant additions can be considered known and measurable is not supported by the record or the facts now in evidence. RAIB, p. 36.

- The Company's statement that the projected post-test year plant additions are "based on known and valid historical costs" falls far short of meeting the Board's "known and measurable" standard, which requires that such projections must be "carefully quantified through proofs which manifest convincingly reliable data." See *I/M/O Elizabethtown Water Company,* Decision On Motion For Determination Of Test Year And Appropriate Time Period For Adjustments, BRC Docket No. WR8504-330, (Order dated May 23, 1985) ("*Elizabethtown Water Company Rate Case*"). *R-16,* RAIB, p. 36.

- It should also be recognized that the majority of these projected post-test year plant additions will not be verifiable with actual results by the time the record in this proceeding closes. RAIB, p. 36.

- Since the test year in this case ends April 30, 2003, six months beyond the end of the test year in this case would be October 31, 2003. Thus, in accordance with the previously referenced Board policy, rate base additions through October 31, 2003 could receive rate recognition in this case, if the Company can prove with convincingly reliable data that such post-test year plant additions will indeed be in-service at that time, and if the Company's projected costs for these post-test year plant additions can be substantiated with very reliable data. The Company has not met these standards for the great majority of its proposed post-test year plant additions. RAIB, p. 37.

Staff also recommends 100% exclusion of the of the Darlington and Upper Saddle River projects based upon the record. SIB, p. 61. Staff states:

> [t]he proposed adjustments do not reflect known and measurable changes and these two projects' cost and timetables are subject to contingencies. Anticipated price spikes have not been demonstrated, nor has the potential for short-term serious earnings erosion. Moreover, the Company has not demonstrated reliable forecasting supported in the record. Thus, its projections are not based upon 'convincingly reliable data,' as required by Board policy and precedent. SIB, p. 61.

Staff conditionally supports the inclusion of $2.4 million for the Oakland Project in the rate base provided that "the Company certifies prior to the Board's initial decision that the project will be wholly in service within post-test year guidelines." SIB, p. 51. The Ratepayer Advocate submits that Your Honor and the Board should reject that recommendation and exclude the Oakland Project in accordance with the Ratepayer Advocate's recommendation. The Ratepayer Advocate demonstrated that, based on the record, the construction portion of the Oakland project and delivery of certain equipment on Oakland is slipping, and no definitive milestone schedule is available for when the work assigned to O&R forces will actually be started and completed in Oakland. In its Initial Brief, the Ratepayer Advocate offered "[a]n additional reason for rejecting all of the proposed plant additions is that Rockland between 1997 and 2002, completed plant additions of approximately $25.872 million. Rockland has offered no evidence as to why it needs a rate increase now, when no rate increase for additions to plant in service were requested." RAIB, p. 39.

The Ratepayer Advocate also notes that Rockland continues to benefit from its current approved rates in effect prior to and after October 2002, which overcompensate Rockland at the expense of ratepayers. Those additional returns more than compensate for any costs associated with

implementation of the Oakland Project. The Ratepayer Advocate submits that Your Honor and the Board must take this fact into account in determining whether to permit the application of the 6 month rule in the first instance.

The Ratepayer Advocate notes that Rockland's attack on the Ratepayer Advocate's argument that inclusion of additional plant in service violates the integrity of the test year and matching principles is misplaced. REIB, pp. 89-92. Rockland's position that there is no additional revenues to be added because all the post test-year additions to plant in service are non-revenue producing is simply disingenuous, strains common sense, and conflicts with the evidence in the record. REIB, p. 89. Load growth, by definition, means that additional capacity is required and that additional capacity should produce additional revenues. The Darlington Study indicated that the project was predicated on additional service requirements associated with more UPS demand and other customer demand. RAIB, pp. 41-42.

Rockland's attempt to mischaracterize Mr. Henkes' position on matching should be rejected. Mr. Henkes is not arguing that specific post-test year rate base additions requires adjusting all other revenue and expense items. Rockland's reliance on *I/M/O Petition of South Jersey Gas Company For Approval Of Increased Base Tariff Rates And Charges For Gas Service And For Authority to Change Depreciation and Make Other Tariff Revisions*, BPU Docket No. 843-184 (Order dated May 10, 1985) is simply wrong.

Mr. Henkes is relying upon a prior New Jersey Natural Gas base rate case.[5] As noted in the Initial Brief of the Ratepayer Advocate, the Board established the rate making policy that if the Company proposes to reflect plant additions projected to be in service 6 months after the end of the test year, the Company should similarly bring its entire embedded accumulated depreciation reserve balance forward to that same point in time, *i.e.*, 6 months after the end of the test year. *R-41*. RAIB, p. 41. On page 8 of the 1990 Order in the New Jersey Natural Gas case, the Board states:

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[5] Final Order Adopting in Part and Modifying in Part the Initial Decision, *I/M/O the Petition of New Jersey Natural Gas Company for Approval of Increased Base Tariff Rates and Charges for Gas Service and Other Tariff Revisions*, BPU Docket No. GR89030335J (dated July 17, 1990). *R-41*.

> The Board FINDS this consistent with the principle of including in plant six months of post-test year additions. Depreciation expense should therefore be calculated in this case for this additional 6-month period, and the **accumulated reserve account should be extended out for the entire plant the additional six months**….(emphasis added).

Mr. Henkes is only recommending that same treatment in this case when he notes that the Company did not bring its entire accumulated depreciation reserve forward to September 30, 2003. Moreover, the Company did not reflect the incremental revenues from post-test year customer growth up to September 30, 2003. *R-50*.

B. Rockland Should Not Be Allowed to Include as Expenses in the Test Year Any Expenses for the Proposed Enhanced Service Reliability Program, Which Results in an Increase in Net Operating Income of $675,000.

As set forth in detail in the Ratepayer Advocate's Initial Brief, the rates now being charged and the new Ratepayer Advocate proposed rates permit a reasonable rate of return to the Company, and should already include all amounts necessary to meet the statutory obligation for safe, adequate, and proper service. The unadjusted test year rate base and expenses should already include all of the capital expenditures and operation and maintenance expenses associated with rendering safe, adequate and proper service now and in the future. The Company should not be seeking additional funds for doing what it is already required to do. The costs for further improvements in service reliability should already be factored into its proposed rate structure. RAIB, p. 42. Staff supports the Ratepayer Advocate's position and also recommends removal of these expenses from the rate base. SIB, pp. 62-64.

Rockland offers nothing more than a restatement of the parameters of the Enhanced Reliability Program and justifies this program as consistent with Board's policy of high service levels. REIB, pp. 94-99. The Company has simply failed to meet its burden of showing that all of these proposed initiatives are not otherwise covered in its obligations under *N.J.S.A.* 48:2-23, the provision of safe, adequate, and proper service.

C. Rockland Electric Plant Depreciation Reserve Should Be Adjusted to Exclude Depreciation Associated with Post-test Year Plant Additions and the Enhanced Reliability Program as Shown on Schedule RJH-6 (8+4 Update).

Rockland relies upon its arguments made in its Initial Brief which discuss post test-year in plant additions and enhanced service reliability to support its position that its plant depreciation reserve should remain unchanged. REIB, pp. 71-92, 94-99. Both the Ratepayer Advocate and Board Staff recommend adjustments to the electric plant depreciation reserve. RAIB, pp. 43-44; SIB, pp. 64-65. If Your Honor and the Board accept the positions of the Ratepayer Advocate and Board Staff, the depreciation reserve should be adjusted.

D. The Adjustments Recommended by Rockland and Staff to the Ratepayer Advocate's Lead/lag Study Cash Working Capital Recommendations Should Be Rejected.

The Ratepayer Advocate notes that Staff supports Mr. Henkes' recommendation for excluding deferred Federal income taxes and investment tax credits from the calculation of working capital. Staff supports this recommendation based upon prior Board policy and precedent. SIB, pp. 68-70. Specifically, Staff relies on *I/M/O Public Service Electric & Gas Company for an Increase in Rates*, Order dated April 6, 1987, BPU Docket No. ER85121163. In that case, the Board adopted the treatment of deferred income taxes in a lead/lag study proposed by the Ratepayer Advocate. Staff, in its Initial Brief, notes that the Board adopted that portion of the ALJ's recommendation on this issue and includes the following quote from that case:

> I FIND that deferred taxes should be excluded from the lead/lag study because they did not, at any point in time, require investor-supplied capital. It would be unreasonable and inappropriate to force ratepayer to pay a return on funds not supplied by investors. (Initial Decision at 35) SIB, pp. 69-70.

The Board affirmed this policy in BPU Docket No. GR88121321 *I/M/O Elizabethtown Gas Company for Approval of Increased Base Tariff Rates and Charges for Gas Service and Other Tariff Revisions*, Order dated February 1, 1990, where the Board found:

> The ALJ was persuaded by Staff's argument as to the proper ratemaking treatment for deferred taxes. The ALJ recommended that deferred taxes be deducted from operating revenues in the working capital allowance for purposes of this proceeding. The Board FINDS the ALJ's determination on deferred taxes to be reasonable and

> consistent with Board policy. Therefore, the Board ADOPTS the ALJ's conclusion on this issue. *Id.* at 7.

Even though both Staff and Rockland reject the Ratepayer Advocate's proposed exclusion of depreciation and amortization expenses and return on invested capital, the Ratepayer Advocate submits that Your Honor and the Board should accept Mr. Henkes' recommendations based upon the arguments set forth in the Ratepayer Advocate's Initial Brief at pages 45-49. The Ratepayer Advocate submits that the arguments are, in fact, compelling and warrant a change in policy at this time. Therefore, Your Honor and the Board should accept the lead/lag study cash working capital of $4.4 million set forth on Schedule RJH-3 (8+4 Update), *R-51*.

E. Rockland's Arguments for Inclusion of Unamortized Research and Development ("R&D") Expenses Should Be Rejected.

Rockland has shown no reason as to why Your Honor or the Board should not accept the Ratepayer Advocate's recommendation to exclude $56,000 in unamortized R&D expenses from the rate base. In fact, Staff fully supports this exclusion. Staff correctly points out in its initial brief that:

> - The RPA disagrees with the Company's proposal because, while the Board allowed rate recovery through amortization, inclusion of the unamortized expenditure balance in rate base is not anywhere provided for in that prior case's stipulation or Board Order approving that stipulation.
> - The RPA asserts that these expenditures are a result of an abandoned project that has never been, and never will be, used and useful in servicing the ratepayer.
> - Further, according to the RPA, the Board has a long-standing and well-established policy that costs associated with abandoned projects, if prudently incurred, must be shared between ratepayers and shareholders.
> - The Board has implemented this policy in the past by having the ratepayer pay for the amortization and the shareholders for the carrying costs of the unamortized balance. (R-50:24-17 to 23). SIB, pp. 73-74.

As a result, Your Honor and the Board should adopt the Ratepayer Advocate's recommendation on this issue.

F. Rockland's Arguments for Inclusion of the 1993 Management Audit Costs and the Electric System Reliability Audit Costs and an Amortization Period of 3 Years Should Be Rejected.

The Ratepayer Advocate recommended that the 1993 Management Audit costs and Electric System Reliability Audit costs be eliminated and that, for the cost that are included, the amortization period be changed from 3 years to 5 years. The arguments made by Rockland and Staff in their Initial Briefs do not change our recommendation on this matter. With respect to the 1993 Management Audit and the Electric System Reliability Audit, Rockland and Staff assert that both audit costs are proper based upon an agreement by and between Rockland and the Board's deferred balance auditors to remove them from the BGS portion of the case and include them in the rate base case. REIB, pp. 107-108, SIB, pp. 61, 62, 73.

The Ratepayer Advocate never agreed to this change, nor was it included in any of the discussions. Therefore, the Ratepayer Advocate submits that these audit costs are properly excluded as late filed adjustments for the reasons set forth in the Ratepayer Advocate's Initial Brief at pages 50-51. It is fundamentally unfair and lacks due process to have audit costs included in one case and then, by unilateral action with no opportunity to conduct discovery or cross examine on this so-called agreement, include them in another case. The change comes too late in the process and Your Honor and the Board should not permit it.

With respect to the amortization period, the Ratepayer Advocate reaffirms its position that a more appropriate period is 5 years in lieu of either proposal offered by Rockland or Staff. Therefore, Your Honor and the Board should accept the recommendations set forth on Schedule RJH-16 (8+4 Update), *R-51*.

G. Rockland's Proposed Amortization Period (3 Years) for Pension/OPENS and Staff's Proposed Amortization Period (4 Years) for Pensions/OPENS Should Be Rejected.

With respect to the amortization period, the Ratepayer Advocate reaffirms its position that a more appropriate period is 5 years in lieu of either proposal offered by Rockland and Staff. SIB, p. 73, REIB, pp. 121, 122. As stated in the Ratepayer Advocate's Initial Brief, 5 years is conservative and reasonable based upon the fact that the Company's last base rate proceeding was

more than 11 years ago. RAIB, p. 66. Therefore, Your Honor and the Board should accept the recommendations set forth on Schedule RJH-11 (8+4 Update), *R-51*.

H. Rockland's Proposed Amortization Period (3 Years) for Storm Damage Reserve and Staff's Proposed Amortization Period (4 Years) for Storm Damage Reserve and Rejection of the 6 Year Historical Average Should Be Rejected.

Neither Rockland nor the Staff demonstrate in their Initial Briefs why the 6 year period proposed by the Ratepayer Advocate is not appropriate. REIB, pp. 126-128, SIB, pp. 63, 79-80. The Ratepayer Advocate reaffirms its recommendation that, based upon its expanded storm damage analysis, an expense accrual of $170,000 is warranted. The Ratepayer Advocate submits that Your Honor and the Board have wide discretion to determine what is just and reasonable and that the Ratepayer Advocate's recommendation is just and reasonable to ratepayers.

I. Rockland's Proposed Accumulated Deferred Income Taxes ("ADIT") Balance and Staff's Proposed ADIT Balance Should Be Rejected.

Rockland merely states that it will update the ADIT balance for actual results through April 2003 for inclusion in the test year. No party is challenging the position that ADIT should be included in this case. The only disagreement is over what the appropriate amount should be. The Ratepayer Advocate notes that the difference between Staff's recommendation of $14,244,000 and the Ratepayer Advocate's recommendation of $13,673,000 results from disallowance by Staff of the Enhanced Service Reliability Program and the exclusion of only two of the three additions in post test-year plant in service. SIB, pp. 77-78. For the reasons discussed above, the Ratepayer Advocate recommends that Your Honor and the Board adopt the Ratepayer Advocate's ADIT adjustment.

Operating Income Adjustments

J. Rockland's Proposed Other Operating Revenue in Accounts 451, 454, and 454 Are Understated, and Should Be Adjusted.

The Ratepayer Advocate recommended adjustments to these accounts as set forth on Schedule RJH-9 (8+4 Update), *R-51,* in the amount of $74,000, with a net operating income increase impact of $44,000. Rockland has agreed in its Initial Brief that if the late payment charge for residential customers is adopted, an adjustment is required. The Ratepayer Advocate has

recommended an adjustment of $138,000 per RJH-4 (8+4 Update), *R-51*. Staff supports all of the Ratepayer Advocate recommendations and argues that Rockland has not offered any compelling arguments against these adjustments. SIB, pp. 78-81. As a result, Your Honor and the Board should adopt the Ratepayer Advocate's recommendation on this matter.

K. Rockland's Proposed Expenses for Incentive Compensation Under its Annual Team Incentive Plan ("ATIP") Should Be Rejected.

Rockland is seeking to increase its O&M expenses by $421,000 which represents Rockland's portion of ATIP expenses. The Ratepayer Advocate has recommended entire disallowance of this expense with a $249,000 after tax adjustment to operating income. Sch. RJH-10 (8+4 Update), *R-51*. The Ratepayer Advocate offered three reasons why this expense is not appropriate. RAIB, pp. 57-58. In addition, the Ratepayer Advocate relied upon past Board precedent in support of its position. RAIB, pp. 57-58, with citation to *I/M/O the Petition of Jersey Central Power & Light Company for Approval of Increased Base Tariff Rates and Charges for Electric Service and Other Tariff Revisions*, BRC Docket No. ER91121820J (Final Decision and Order dated June 15, 1993) (referred to hereinafter as the "*JCP&L 1993 Base Rate Order*"). Staff fully supports the Ratepayer Advocate's position on this issue and reaffirms Board precedent in this area; all incentive compensation should be eliminated as an expense in rate cases. SIB, pp. 81-84.

Additionally, the Ratepayer Advocate notes that at the top of page 114 of Rockland's Initial Brief, the Company states regarding ATIP "it should be remembered that payments are only made if goals are achieved." This is an admission that ATIP incentive compensation expenses included in the test year are not known and measurable because no one knows at this time whether the ATIP goals will ever be achieved. Likewise, if such compensation is not paid, the rates include such amounts which means the additional revenues represent additional profit to the Company and its shareholders for each year until there is a new rate case filing. This is simply wrong and unfair to ratepayers.

As a result, the Ratepayer Advocate recommends that Your Honor and the Board adopt the recommendation to exclude all ATIP expenses from this case.

L. Rockland's Proposed Pension Expense Adjustment for SFAS 87, OPEB for SFAS 106, and the Deferral Accounting Should Be Rejected.

Rockland has proposed a pension expense increase of $2,882,114 with a credit of $1,651,198 amortized over three years resulting from application of SFAS 87. REIB, pp. 115-119. Rockland also is proposing continuation of deferral accounting for pensions and other post-retirement employee benefits. REIB, pp. 117-119. Rockland used a projection of pension expenses for the 12 month period ending July 31, 2004. The Ratepayer Advocate recommended a projection of pension expenses for the 12 month period ending December 31, 2003. RAIB, p. 62. This reduces the net pension expense allocated to the Company to $2,274,000.

Staff supports the Ratepayer Advocate's recommendation as to the appropriate 12 month period and supports the Ratepayer Advocate's recommended amount for project pension expenses of $3,464,000. Specifically, Staff concludes:

> The Staff, consistent with RPA witness Henkes, does not agree with the Company's proposal to utilize an expense projection extending 15 months beyond the end of the test year. (R-50:41-17) As asserted by the RPA, Staff believes such a proposal is inconsistent with the known and measurable standards set forth in R-16, the Board Order in Elizabethtown Water Company, Docket No. WR8504330, dated 5/23/85 and as such, violates the integrity of the test year concept. Moreover, as noted by the RPA, the Company's projected pension expense will not be verifiable by the end of this proceeding since the Company's final actuary report for 2004 will not be available until the 2nd quarter of 2004. (3T:20-3 to 16: R-17).
>
> Staff believes the RPA recommendation to utilize the projected expense of $3, 464,000 for 2003 is more reasonable in this matter, since the parties should have the opportunity, prior to the conclusion of this proceeding, to verify this amount when the final actuary calculations for 2003 become available in the 2d quarter of 2003. (R-17) The net pension expense increase utilizing the 2003 amount would be $2,274,000 when applying the same adjustments made by the Company to the 2004 projected expense, prior to the over-recovery offset.

Although Staff proposes to offset the over-recovery based upon 4 years instead of the 5 years recommended by the Ratepayer Advocate or the 3 years proposed by Rockland, the Ratepayer

Advocate, for the reasons previously discussed, remains firm in its proposal to amortize the over-recovery over 5 years.

As set forth in the Ratepayer Advocate's Initial Brief, the pro forma OPEB expenses in this case should be based upon the projected SFAS 106 OPEB expenses for calendar year 2003. Therefore, the Ratepayer Advocate recommends the adjustments shown on RJH-12 (8-4 Update), *R-51.*

With respect to continuation of deferral accounting, the Ratepayer Advocate recommended elimination for the reasons set forth in its Initial Brief. RAIB, pp. 63-65. Staff concurs in the discontinuance of deferred accounting. SIB, pp. 87-88.

M. Rockland's Proposed Rate Case Expense Allocation of 100% to Ratepayers Should Be Rejected and Deferral Accounting Should Be Rejected.

Rockland's argument that 100% of the rate case expenses should be borne by the ratepayers is simply wrong and inconsistent with established Board precedent. Furthermore, Rockland's argument is disingenuous when one considers the reason offered, which is that Rockland was forced to file a rate case and, but for such direction, it would not have filed. This purported reason is pure fantasy. As noted above, the Company wants to recover approximately $11.7 million from ratepayers. The $11.7 million is the difference between their proposed rate increase and the recommended rate reduction established by the record in this case. The mere fact that Rockland is proposing such treatment casts extreme doubt on their credibility and causes one to question each and every position asserted in this case.

Staff fully supports the Ratepayer Advocate's recommendation that these costs should be shared 50/50. RAIB, pp. 66-67, SIB, pp. 94-97.

N. Rockland's Proposed Common Expense Adjustment Must Be Adjusted and the $180,000 Double Count Removed.

Rockland urges Your Honor and the Board to accept the updated common expense adjustment reflected in Rockland's 8+4 filing. The Ratepayer Advocate remains convinced that an adjustment is required for common expenses for the following reasons:

- C The support for this new common expense allocation ($400,000) consists of P-2, Schedule 23 in Rockland's 8+4 update filing. *RECO-11A*. This adjustment is late-filed and should not be considered.
- C The purpose of the 8+4 update filing is to update 7+5 filing data for another month's worth of actual test year data as applied to *existing* issues for which other parties have had adequate opportunity to conduct proper discovery, review and analysis.
- C By contrast, this adjustment represents a new adjustment, introduced at the eleventh hour, with no support in terms of explanatory testimony or supporting workpapers and source documentation.
- C There has been very little opportunity for the parties to appropriately review and analyze this issue, conduct the necessary discovery on this issue, and investigate whether other "new" issues are currently present that would have an offsetting revenue requirement impact. RAIB, pp. 67-68.

More importantly, there is a $180,000 double count that must be removed. The Company's proposed common expense allocation factor adjustment of $388,000, shown on P-2, Schedule 23 (8+4), is incorrectly calculated and, as a result, is overstated by approximately $180,000. *RECO-11A*. The Company has increased its proposed 8+4 updated pension and OPEB expenses by $119,763 and $60,605, respectively, as a result of the same common expense allocation factor adjustment reflected on P-2, Schedule 23 (8+4). Therefore, the $388,000 expense adjustment on P-2, Schedule 23 (8+4), includes this same approximate $180,000 pension and OPEB expense adjustment. Thus, the expense adjustment of $388,000 on P-2, Schedule 23 would appear to include a $180,000 double count.

Board Staff, on cross examination of Mr. Marino, raised this double count issue. T109:L14-15 (2/28/03). See Staff's Initial Brief at pages 99-101, wherein Staff recommends removal of this double count. Mr. Marino's explanation is not persuasive. T109:L18-24 (2/28/03). Looking at Account 926 (which includes Rockland's pension and OPEB expenses) on Exhibit P-2, Schedule 23 (8+4), *RECO-11A*, the line item shows a claimed expense increase for Change in Common Expense Allocations of approximately $190,000. Mr. Kane, on Exhibit P-2, Schedule 8, and Schedule 9 to his Rebuttal Testimony, increased the Company's claimed pension expenses by approximately $120,000 to account for the same Change in Common Expense Allocator and increased the OPEB expenses by approximately $61,000. *RECO-23*, p. 6, lines 5 and 17.

Rockland's explanation offered in its Initial Brief is equally unconvincing. REIB, pp. 138-140. As a result, the Ratepayer Advocate believes this is a double count and it must be removed.

As a result, the Ratepayer Advocate respectfully requests that Your Honor and the Board adopt the Ratepayer Advocate's recommendation.

O. Rockland's Proposed Inclusion of $665,000 for Merger Savings Should Be Rejected.

Rockland continues to argue that O&M expenses should be increased by $665,000 to account for merger savings resulting from the merger of O&R and Consolidated Edison, Inc. REIB, p. 123. Both the Ratepayer Advocate and Staff agree that these phantom expenses should be removed. Rockland has simply failed to meet its burden of proof on this issue. In fact, it is charitable at best to even characterize its failure as a burden of proof issue because there is no probative support in the record to justify this expense. Staff correctly points out the flaws in Rockland's analysis on merger savings when it states:

> Staff notes that increasing the cost of service for artificial costs surely does not meet the long standing "known and measurable" standard used by the Board. Mr. Marino also acknowledged that regardless of the merger, ratepayers would have realized reduced tariff rates because of the legislative mandate in EDECA. (5T:98-9 to 24) RECO's own witness testified that "The rates under the law would go down regardless of the merger. I think the Board found that the merger was an appropriate way for Rockland Electric to achieve part of those rate reductions." (5T:98-9 to 24) In addition, the Company has not quantified its merger savings to justify the adjustment in this proceeding. (5T:99-1 to 100-14) In view of the foregoing reasons, Staff also recommends rejection of the Company's proposal. SIB, p. 94.

In addition, the Ratepayer Advocate reaffirms its position, as stated in its Initial Brief, that it is equally appropriate if Your Honor accepts the phantom increase proposed by Rockland, to permit a corresponding credit to expenses in the amount of $1,995,000 to reflect the 75% share of merger savings for ratepayers. RAIB, p. 72.

P. Rockland's Proposed Inclusion of Certain Miscellaneous O&M Expenses Should Be Rejected.

Rockland continues to seek inclusion of $75,019 in certain miscellaneous O&M expenses in this case. These expenses include financial accounting services to the Company President,

restricted stock awards, additional restricted stock program, lobbying expenses and advertising expense. Rockland has simply offered no valid reasons why these costs should be borne by ratepayers. Both Staff and the Ratepayer Advocate recommend that these costs be removed. SIB, p. 99, RAIB, p. 73.[6]

Q. Rockland's Pro Forma Annualized Depreciation Expense Should Be Rejected.

Rockland proposed a pro forma annualized depreciation expense level of $5.2 million. The Ratepayer Advocate's recommendation remains unchanged at $2,961 million. *R-51,* Sch. RJH-17 (8+4 Update). Staff generally supports the recommendation of Mr. Majoros and his recommendations on net salvage value as implemented by FAS No. 143. However, Staff recommends an end of test year annualized depreciation amount of $3.971 million instead of the Ratepayer Advocate's recommended amount of $3.864 million. See SIB, Exhibit P-2, Sch. 13-14, page 5-5.

As a result, the Ratepayer Advocate asks that Your Honor and the Board adopt the recommended adjustment to decrease annualized depreciation expense with the impact on pro-forma test year net operating income of $1,271,000.

R. The Interest Synchronization Expense Adjustment Should Be Adopted.

As shown in more detail on Schedule RJH-18, (8+4 Update), *R-51*, the only reason the recommended interest synchronization income tax impact is different from the Company's proposed interest synchronization income tax impact is because of the differences in the Company's proposed and Ratepayer Advocate's recommended rate base and weighted cost of debt positions. Because of these differences, the Ratepayer Advocate's pro forma interest deduction for income tax purposes is smaller than the Company's. As can be seen from Schedule RJH-18, line 5, this results in a decrease of $325,000 in the Company's proposed pro forma test year operating income. *R-51.*

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[6] The Ratepayer Advocate notes that Schedule Exhibit P-2 Summary contained in Staff Initial Brief, line 23 fails to exclude $4,360 in advertising expense which Staff recommended in its initial brief.

POINT IV

THE COMPANY HAS FAILED TO MEET THE BURDEN OF PROVING THE REASONABLENESS OF ITS PROPOSALS FOR INCREASING ITS SERVICE CHARGES AND RECONNECTION CHARGE, AND FOR A "COST PASS-THROUGH" MECHANISM IN THE COMPANY'S DISHONORED CHECK CHARGE.

The Ratepayer Advocate's arguments in support of its rate design proposal are set forth in detail in its Initial Brief in this matter and will not be repeated in detail here. The Ratepayer Advocate wishes to address certain arguments presented by Rockland in support of its proposals to increase its monthly Customer Charges and its Reconnection Charge, and to extend its current Dishonored Check Charge to residential customers. Contrary to the arguments presented in Rockland's Initial Brief, the Company has not sustained its burden of proving the reasonableness of its proposed changes to its service charges, Reconnection Charge and Dishonored Check Charge.

A. Customer Charges.

Rockland attempted to justify its proposed monthly customer charge increase using both the original cost of service study prepared by its witness, Allen Cohen, and a revised analysis presented by Company witness William Atzl. As explained in detail in the Ratepayer Advocate's Initial Brief, both studies classify as customer-related, costs which the Board has not allowed to be included in the customer charge. RAIB, pp. 80-81. In its Initial Brief, the Company argues that Your Honor and the Board should accept the Company's analyses because the Ratepayer Advocate has not presented its own cost of service study. REIB, p. 161. This argument is baseless. Under *N.J.S.A.* 48:2-21(d), when a utility seeks any change in its rates or other tariff provisions, "the burden of proof to show that the increase, change or alteration is just and reasonable shall be upon the public utility making the same." The Ratepayer Advocate has presented evidence showing that the Company has not met its burden of proof under *N.J.S.A.* 48:2-21(d). Since the Company has not shown that its customer service costs are greater than the costs already reflected in its current rates, its proposed increases should be rejected. The Board's Staff is in agreement with this Ratepayer Advocate recommendation. SIB, p. 94.

The Ratepayer Advocate also notes that the Company's Initial Brief includes a chart which purports to show, in column (3), "Customer Costs Per Peterson Method." REIB, p. 160. To the contrary, the purported costs shown in column (3) of the chart are based on the analysis presented in Mr. Atzl's Rebuttal Testimony. *Id.* Mr. Atzl's Rebuttal Testimony presented this analysis as a calculation of cost varying directly and linearly with the number of customers. *RECO-19.* This is the standard adopted by the Board in the *JCP&L 1993 Base Rate Order*, p. 17. Mr. Atzl's analysis is not a fair representation of the Board's methodology, and it has not been endorsed by Mr. Peterson or the Ratepayer Advocate. *See* RAIB, pp. 81-82.

For the above reasons, in addition to those set forth in the Ratepayer Advocate's Initial Brief, the two cost studies presented by Rockland do not meet the Company's burden of showing the reasonableness of its proposed Customer Charge increases.

B. Reconnection Charge.

The Company has presented a similar argument in support of its proposed increase in its Reconnection Charge. The Company's current Reconnection Charge is $7 before 3:00 p.m. on weekdays and $21 after 3:00 p.m. or prior to the next working day. The Company is relying on its cost of service study in support of its proposal to increase this charge to $27 at all times. The Company asserts that Your Honor and the Board should accept the Company's cost of service study in the absence of a study presented by the Ratepayer Advocate. REIB, p. 164. This argument should be rejected. The Ratepayer Advocate presented evidence clearly demonstrating that the Company's study allocated to the Reconnection Charge many types of costs not caused by accounts for which service was disconnected and then subsequently reconnected. RAIB, pp. 85-86. Since the Company's study did not meet the Company's burden of proof under *N.J.S.A.* 48:2-21(d), the Ratepayer Advocate was under no obligation to present its own study.

In lieu of the Company's proposal, the Ratepayer Advocate has proposed to replace the Company's current charges with a single charge of $15, rather than the Company's proposed $27. RAIB, p. 86. This proposal is consistent with the tariffs of the State's other electric utilities, all of

which have a single reconnection charge, and fair to the Company given its failure to present a proper cost analysis.

C. Dishonored Check Charge.

As explained in the Ratepayer Advocate's Initial Brief, Rockland's current Dishonored Check Charge, which applies only to non-residential, non-government customers, includes a cost "pass-through" mechanism for increases in bank fees charged to Rockland for dishonored checks. Since the "pass-through" mechanism is inconsistent with the "test year" approach for determining base rates, the Ratepayer Advocate proposed that the Company instead implement a flat charge of $7.00, an amount based on the Company's average cost of processing a dishonored check. RAIB, p. 83. With this modification, the Ratepayer Advocate does not object to applying the Dishonored Check Charge to residential customers. *Id.* The Board's Staff supports this recommendation. SIB, p. 83.

The Company's Initial Brief argues that the Ratepayer Advocate's proposal "disallows the recovery of bank fees to [Rockland] that exceed $3.50, thereby denying [Rockland] full recovery of its legitimate costs as banks modify their fees." REIB, p. 164. To the contrary, the Ratepayer Advocate is not proposing any disallowance. The Ratepayer Advocate's proposed Dishonored Check Charge reflects 100% of the Company's costs of processing dishonored checks. RAIB, p. 83.

Under the Board's established policy, utility rates may reflect changes to the test year only if they are "(1) prudent and major in nature and consequence, (2) carefully quantified through proofs which (3) manifest convincingly reliable data." *Elizabethtown Water Company Rate Case Decision on Motion For Determination of Test Year and Appropriate Time Period For Adjustments*, BPU Docket No. WR8504330 (Order dated May 23, 1985), p. 2. Further, post test year expense adjustments are limited to those occurring within nine months beyond the test year. *Id.* The Company has presented no evidence even suggesting that any of its banks are contemplating increases in their dishonored check fees. In the absence of such proofs, the Company's Dishonored

Check Charge is properly based on the Company's test year expense levels, which justify a flat charge of $7.00 per dishonored check.

CONCLUSION

For all of the foregoing reasons, and the reasons set forth in it's Initial Brief, the Ratepayer Advocate respectfully requests that an Initial Decision be rendered recommending that the Board find and conclude that:

Rate of Return

- A 9.25% return on equity is the appropriate figure to be adopted for purposes of this proceeding;

Depreciation

- Mr. Majoros' net salvage allowance approach should be adopted, and the Company's test year depreciation expense and depreciation reserve excess should be adjusted accordingly;
- Rockland's test year depreciation expense should be reduced by $827,00;
- The Company's depreciation reserve excess should be increased from $11.8 million to $22.1 million, increasing the annual amortization credit from $588,000 to $1.1 million.

Overall Revenue Requirement

- The overall revenue requirement recommended by the Ratepayer Advocate which decreases the Company's annual revenues by $5,324,000 should be adopted. *R-51*, Sch. RJH-1 (8+4 Update).

Rate Base

- The rate base adjustments (decreases) recommended by the Ratepayer Advocate which total $23,726,000, resulting in a pro-forma rate base for the Company of $106,304,000, should be adopted. *R-51*, Sch. RJH-3 (8+4 Update).
- The Ratepayer Advocate's recommended Plant in Service Position adjustments (decreases) of $26,860,000, which reduce Plant in Service from $201,614,000 to $174,754,000 should be adopted. *R-51*, Sch. RJH-3, line 3, Sch. RJH-5 (8+4 Update).
- The Ratepayer Advocate's recommended adjustment of $2,161,000 in Plant Depreciation Reserve Position to reduce the Company's Pro Forma Test Year-End Reserve Balance to $65,330,000 should be adopted. *R-51*, Sch. RJH-3, Sch. RJH-6 (8+4 Update).
- The Ratepayer Advocate's recommended Lead/Lag Study Cash Working Capital adjustments to reduce the Company's Cash Working Capital Requirement to $4,387,000 should be adopted. *R-51*, Sch. RJH-3, Sch. RJH-7 (8+4 Update).

- The Ratepayer Advocate's recommended removal of unamortized R&D expenditures, BPU Audit expenditures, and Ramapo Tax deferrals from the Company's proposed rate base should be adopted. *R-51*, Sch. RJH-3 (8+4 Update).

- The Ratepayer Advocate's recommended adjustment to increase the Company's proposed Net Pension/OPEB Liability rate base balance by $143,000 to $874,000 should be adopted. *R-51*, Sch. RJH-3 (8+4 Update).

- The Ratepayer Advocate's recommended adjustment to reduce the Company's proposed storm damage reserve rate base balance by $53,000 to $111,000 should be adopted. *R-51*, Sch. RJH-3 (8+4 Update).

- The Ratepayer Advocate's recommended adjustment for Accumulated Deferred Income Tax Position of $3,272,000 to reduce the Company's Pro Forma Test Year-End ADIT balance to $13,673,000 should be adopted. *R-51*, Sch, RJH-3, Sch. RJH-8 (8+4 Update).

Overall Rate of Return

- The Ratepayer Advocate's recommended overall rate of return of 8.04%, including a return on equity of 9.25% should be adopted. *R-51*, Sch. RJH-1, Sch. RJH-2 (8+4 Update).

Operating Revenues and Expenses

- The Ratepayer Advocate's recommended pro-forma test year operating income of $11,683,000, which reflects adjustments amounting to a net $3,155,000 increase over the Company's proposed operating income of $8,528,000 should be adopted. *R-51*, Sch. RJH-1, RJH-4 (8+4 Update).

- The Ratepayer Advocate's adjustment to increase the Company's proposed Other Operating Revenues, resulting in an adjustment (increase) of $44,000 to pro forma net operating income should be adopted. *R-51*, Sch. RJH-4, Sch. RJH-9 (8+4 Update).

- The Company's proposal to include $421,000 in executive incentive compensation expense for ratemaking purposes, resulting in an adjustment (increase) of $249,000 to pro-forma net operating income should be rejected. *R-51*, Sch. RJH-4, Sch. RJH-10 (8+4 Update).

- The Ratepayer Advocate's recommended decrease of $388,000 in Pro Forma net SFAS 87 Pension expenses, resulting in an increase in Net Operating Income of $229,000 should be adopted. *R-51*, Sch. RJH-4, Sch. RJH-11 (8+4 Update).

- The Ratepayer Advocate's recommended decrease of $80,000 in Pro Forma net SFAS 106 OPEB expenses, resulting in an increase in Net Operating Income of $47,000 should be adopted. *R-51*, Sch. RJH-4, Sch. RJH-12 (8+4 Update).

- The Ratepayer Advocate's recommended adjustment (decrease) for Rate Case Expense Position of $105,000 for an impact on Net Operating Income of $62,000 should be adopted. *R-51*, Sch. RJH-4, Sch. RJH-13 (8+4 Update).

- The Ratepayer Advocate's recommended removal from test year expenses of all expenses associated with the Company's proposed Enhanced Service Reliability Program, resulting in an increase in Net Operating Income of $675,000 should be adopted. *R-51*, Sch. RJH-4 (8+4 Update).

- The Ratepayer Advocate's recommended removal from test year expenses of the Company's proposal to retain 25% of estimated Merger Savings alleged to be incorporated in the test year, resulting in an increase in Net Operating Income of $393,000 should be adopted. *R-51*, Sch. RJH-4 (8+4 Update).

- The Ratepayer Advocate's recommended adjustment to reduce Storm Damage Expense by $80,000, increasing Net Operating Income by $47,000 and decreasing Net Rate Base by $53,000 should be adopted. *R-51*, Sch. RJH-3, Sch. RJH-4, Sch. RJH-14 (8+4 Update).[7]

- The Ratepayer Advocate's recommended Miscellaneous Expense adjustments with the effect of reducing test year expenses by $75,000 and increasing test year Net Operating Income by approximately $44,000 should be adopted. *R-51*, Sch. RJH-4, Sch. RJH-15 (8+4 Update).

- The Ratepayer Advocate's recommended adjustment (decrease) for Various Amortization Expenses of $180,000, resulting in an increase of Net Operating Income of $106,000 should be adopted. *R-51*, Sch. RJH-4, Sch. RJH-16 (8+4 Update).

- The Ratepayer Advocate's recommended adjustment (decrease) to Depreciation Expense Position of $2,149,000 with an impact on Net Operating Income of $1,271,000 should be adopted. *R-51*, Sch. RJH-4, RJH-17 (8+4 Update).

- The Ratepayer Advocate's recommended adjustment for Interest Synchronization, amounting to a decrease in the Company's pro-forma test year Net Operating Income of $325,000 should be adopted. *R-51*, Sch. RJH-4, RJH-18 (8+4 Update).

- The Ratepayer Advocate's recommended removal from test year expenses of the Company's proposed Common Expense Allocation adjustment, resulting in an increase in Net Operating Income of $230,000 should be adopted. *R-51*, Sch. RJH-4 (8+4 Update).

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[7] The difference in Schedules RJH-3, line 19 (8+4 Update) and Schedule RJH-14, line 7 (8+4 Update) is due to rounding.

- The Ratepayer Advocate's recommendation to include annualized Late Payment Fee revenues in the test year, resulting in an increase in Net Operating Income of $81,000 should be adopted. *R-51*, Sch. RJH-4 (8+4 Update).

Rate Design

- The Ratepayer Advocate's proposed distribution rate decrease should be allocated proportionately to each customer class based on each class's current annual distribution service revenue.
- The Company's cost-of-service study should be rejected, and the cost allocation principles stated in the *JCP&L 1993 Base Rate Order* should be reaffirmed.
- The Company's proposed increases in its monthly customer service charges, ranging from 37.7% for residential customers to 143.3% for Primary Time-of-Use customers, are not supported by a proper analysis of customer costs, and would unduly burden those customers with the lowest electricity usage. These proposed increases should be rejected and the current service charges maintained.
- Rockland's current dishonored check charge, which includes a cost pass through for bank fees, is contrary to established ratemaking principles and unfair to customers. The dishonored check charge should be set at a flat $7.00 for both residential and non-residential customers, reflecting the Company's average costs of handling dishonored checks.
- The Company's proposed increase in its Reconnection Charge, from $7.00 before 3:00 pm on weekdays and $21.00 after hours, to $27.00 at all times, is based on an analysis that includes costs not properly attributable to reconnections. The Company's reconnection charge should be set at $15.00 at all times, consistent with the charges of two other New Jersey electric utilities.

Respectfully submitted,

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RATEPAYER ADVOCATE

By: ______________________________
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Dated: April 1, 2003

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