State of New Jersey
DIVISION OF THE RATEPAYER ADVOCATE
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April 7, 2006

<u>Via Hand Delivery</u>

Honorable Kristi Izzo, Secretary
New Jersey Board of Public Utilities
Two Gateway Center
Newark, New Jersey 07102

RE: I/M/O The Petition Of Jersey Central Power & Light Company For Authority to: (a) Issue and Sell Up to $200,000,000 Aggregate Principal Amount of Senior Notes in One or More Series and to Make, Execute, and Deliver One or More Supplemental Indentures in Connection Therewith; and (b) Issue a Like Aggregate Principal Amount of First Mortgage Bonds to Secure the Senior Notes Until the Release Date and to Make, Execute and Deliver One or More Supplemental Indentures in Connection Therewith.
BPU Docket No. EF06020085

Dear Secretary Izzo:

Please accept these comments (original and 10 copies) on behalf of the Division of the Ratepayer Advocate ("Ratepayer Advocate") filed pursuant to the request of the New Jersey Board of Public Utilities ("Board" or "BPU") for comments on the above captioned filing.

An additional copy of this filing is also enclosed. <u>Kindly stamp and date the additional copy as "filed" and return it to our courier.</u> Thank you for your consideration and attention to this matter.

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A. **Background**

On February 8, 2006, Jersey Central Power and Light Company (JCP&L or the Company) submitted a Petition to the BPU seeking authority to issue up to $200 million in notes from time to time through December 31, 2006. In connection with these planned issuances, the Company intends to execute and submit to its trustee supplemental indentures. The Company further intends to issue a like amount of New First Mortgage Bonds as a means of securing the new notes that it plans to issue. The Petition states that the New First Mortgage Bonds shall remain in effect until the Release Date. After the Release Date (as defined in the Petition) the newly issued Notes will become unsecured general obligations of the Company. JCP&L submits that this approach will help ensure that the New Notes achieve effective cost rates similar to what could be achieved through secured debt.

The Petition seeks substantial flexibility from the Board concerning the issuance of new notes. This would include flexibility with regard to the amount of such notes issued (up to $200 million), the timing of the issuances during calendar 2006, and debt term structure. With regard to the latter, the term of the notes could range from one year to 35 years. As stated in the Petition, "The Company believes that this flexibility will enable it to react effectively to various changes in market conditions." (Petition, Para.9). The Company also seeks flexibility with regard to underwriting and marketing arrangements for the new debt issues. (Petition, Para.13).

JCP&L states that the net proceeds from the issuance of the notes are to be used to redeem existing debt, pay down short-term borrowing, construction and other corporate purposes. (Petition, Para.14). The Company also seeks authority to employ net proceeds to redeem existing outstanding debt at a premium when doing so can provide a net present value savings. (Petition, Para.14-15).

B. Overview

The Ratepayer Advocate has reviewed the Company's Petition as well as responses to discovery requests propounded by the Board Staff. Based on this review, which includes a review of JCP&L's financial circumstances, we recommend granting the Petition authorizing the issuance of $200 million of Senior Notes, as well as the "mirror" First Mortgage Bonds to secure those notes. The Board approval should be granted subject to the following conditions, findings and considerations:

(1) Given JCP&L's circumstances, the entire principal amount of $200 million should be issued. Specifically, JCP&L should refinance all debt that is maturing in 2006 with net proceeds from the New Senior Debt rather than from internally generated cash (i.e., common equity). Failure to issue the debt will increase JCP&L's cost of capital unnecessarily.

(2) The Company should seek to accomplish the debt issuances at lowest reasonable cost, for the type of securities that will be issued. This encompasses both the interest rate and issuance costs. Granting of this Petition should not constitute pre-approval of or authority to recover in rates any costs. All such costs should be subject to review in JCP&L's next base rate case.

(3) Available information with the Petition and in response to discovery requests indicates that JCP&L's present balance sheet capital structure contains an excessive amount of equity. While this $200 million debt issuance is helpful, it will not solve the capital structure imbalance problem. JCP&L should seek to establish a capital structure appropriate to its circumstances in the near future.

(4) We understand JCP&L's need for flexibility with regard issuing new debt, including questions of term structure. However, at this time the market yield curve is unusually flat while long-term interest rates are quite low. Specifically, long-term debt carries an interest rate very similar to that of intermediate to short-term debt. This means that JCP&L incurs almost no cost premium from issuing very long-term debt compared to short to intermediate debt. We therefore suggest that the Company issue primarily long-term debt.

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C. Discussion

(1) JCP&L should issue in 2006 substantially all of the $200 million in new debt requested in its petition.

Information provided with the Petition and the Company's response to Staff-4 indicate debt maturities during 2006 totaling $190 million. This includes $150 million from Senior Secured Notes on May 15, 2006 and $40 million from Medium Term Notes on November 27, 2006. These maturities alone would absorb substantially all of the $200 million in new debt, leaving almost no funds available for other purposes, such as funding of construction.

The Petition itself requests authority for JCP&L to issue "up to" $200 million, but it appears to provide the Company with discretion concerning how much it actually would issue. While we do not, in general, oppose flexibility, under present circumstances, the Company should not be refunding maturing debt with its internally generated cash. Maturing debt should be funded entirely with new debt.

Exhibit B accompanying the Petition indicates that for the 12 months ending September 30, 2005, JCP&L had $407 million in cash from operations compared to $176 million in construction spending. This suggests that the Company has the potential to refinance at least a portion of its 2006 maturing debt from internally-generated cash. However, given the Company's already very expensive capital structure, it should refrain from doing so, since that would further increase its cost of capital. Moreover, capital market conditions in 2006 continue to be relatively favorable, and if JCP&L delays or reduces its debt issuance at this time, its cost of new debt could be far more expensive in the future. For these reasons, JCP&L should issue all (or substantially all) of the $200 million for which it is seeking authority in the instant Petition.

(2) JCP&L should conduct the debt issuance in a cost-effective manner, subject to review in the Company's next base rate proceeding.

The Petition provides a general description of the process for accomplishing the debt issuances, but reserves for itself considerable flexibility to accomplish the issuances. For example, the Bond Underwriter(s) and Placement Agent(s) have not yet been selected. (See Response to CE-6). JCP&L intends to employ individual negotiated underwriting agreements and direct private placements rather than a more formal competitive bid arrangement. (See response to Staff-3.)

The Ratepayer Advocate understands the potential advantages of the issuance arrangements outlined by the Company and does not oppose the flexibility sought in the Petition. However, the granting of the Petition by the Board should not constitute pre-approval of costs associated with the new debt or rate recovery. All costs associated with these new securities (including debt interest rates and issuance-related expenses) should be subject to review as part of the Company's next base rate proceeding. The Company should seek to accomplish the new debt issuances at lowest reasonable cost, for the types of securities to be issued.

(3) JCP&L should rectify its overly expensive capital structure.

As discussed in these comments, the $200 million of requested debt issuance authority will have very little effect on JCP&L's overall debt balance and current capital structure since it replaces $190 million of maturing debt. At the present time, JCP&L has a capital structure that is overly expensive and inappropriate for a low-risk, delivery service electric utility. In response to Request CE-11, JCP&L reports a fixed charge coverage ratio of 8.07 and a common equity balance of 70.0 percent (as of calendar year 2005 for interest coverage and year-end 2005 for the common equity ratio).

Given the fact that common equity is more expensive than debt, and unlike debt interest, the equity return is not tax-deductible, a 70 percent common equity ratio contributes to an excessive cost of capital. Standard & Poor's benchmarks for delivery service utilities allow common equity ratios in the 40 to 50 percent range to achieve a solid investment grade rating.[*] It is clear that the $200 million debt issuance authority requested in this Petition will do little to rectify the present capital structure problem.

In approving this Petition, the Ratepayer Advocate recommends that the Board find that JCP&L's present capital structure is overly expensive and inappropriate. While the Board can address this problem in the short run by using a hypothetical capital structure for ratemaking, the best solution is for JCP&L to restructure its balance sheet so that it achieves a capital structure that is reasonable and economical for a delivery service utility. Doing so may require the issuance of additional debt to replace the excessive amount of equity.

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[*] Standard & Poor's "Research: New Business Profile Scores Assigned for U. S. Power Companies, Financial Guidelines Revisited", June 2, 2004.

(4) The New Senior Notes to be issued should be structured with longer terms.

Paragraph 9 of the Petition seeks authority to issue the New Senior Notes with terms of from one to thirty-five years. While the Ratepayer Advocate understands the need for flexibility to adapt to changing market conditions, this range is exceedingly wide and provides little guidance concerning the type of debt (i.e., term) that the Company believes is most cost effective.

While interest rates at the present time are not at the absolutely lowest levels, they remain relatively attractive and certainly very low by historical standards. The year 2006 to date remains a favorable environment for long-term debt issues. However, this appears to be far more true for the long end of the yield curve than the shorter end. The following chart indicates Treasury security yields, by term of the security, as of March 24, 2006:

One-year:	4.76%
Five-year:	4.66%
Ten-year:	4.67%
Twenty-year:	4.87%
Thirty-year:	4.70%

(Federal Reserve, Statistical Release, March 27, 2006.)

For all practical purposes, the Treasury yield curve is flat, and the same would largely be true for the yield curve applicable to JCP&L's Senior Notes. JCP&L will save very little by going to the short end of the yield curve, and doing so may expose ratepayers to interest rate risk when these short maturity notes must be refinanced a few years later. Given current conditions in capital markets (low long-term interest rates and a "flat" yield curve), we recommend that JCP&L emphasize the use of relatively long-term debt -- at least 15 years or longer -- for its New Senior Notes.

D. Conclusion

The Ratepayer Advocate recommends granting JCP&L's Petition to issue $200 million in New Senior Notes subject to certain conditions and considerations. The Company should move quickly and issue the entire $200 million to refund all maturing debt with the new Notes. Capital market conditions remain favorable for long-term debt issuances. Given the current "flat" yield curve, the New Senior Notes should emphasize terms of at least 15 years to protect ratepayers from the risks of having to refinancing the notes in a higher interest rate environment in the near term. In addition to proceeding with this set of issuances, JCP&L should seek to restructure its balance sheet to achieve a less expensive capital structure consistent with being a low-risk delivery service utility. Finally, granting this Petition should not constitute pre-approval of any costs or authorization for rate recovery. All capital costs should be subject to review in JCP&L's next base rate proceeding.

Respectfully submitted,

SEEMA M. SINGH, ESQ.
RATEPAYER ADVOCATE

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c: Hon. Jeanne M. Fox, President
Hon. Frederick F. Butler, Commissioner
Hon. Connie O. Hughes, Commissioner
Hon. Joseph L. Fiordaliso, Commissioner
Hon. Christine V. Bator, Commissioner
Service list (via electronic mail and U.S. Regular Mail)