STATE OF NEW JERSEY
OFFICE OF ADMINISTRATIVE LAW
BEFORE HONORABLE WALTER M. BRASWELL

I/M/O THE PETITION OF	)	
PUBLIC SERVICE ELECTRIC AND GAS	)	
COMPANY FOR APPROVAL OF AN	)	
INCREASE IN ELECTRIC AND GAS	)	
RATES AND FOR CHANGES IN THE	)	
TARIFFS FOR ELECTRIC AND GAS	)	
SERVICE,	)	BPU DOCKET No. GR09050422
B.P.U. N.J. NO. 14 ELECTRIC AND B.P.U.	)	OAL DOCKET No. PUC-7559-09
N.J. NO. 14 GAS PURSUANT TO N.J.S.A.	)	
48: 2-21 AND N.J.S.A. 48: 2-21.1 AND	)	
FOR APPROVAL OF GAS WEATHER	)	
NORMALIZATION;	)	
A PENSION EXPENSE TRACKER AND	)	
FOR OTHER APPROPRIATE RELIEF	)	

DEPARTMENT OF THE PUBLIC ADVOCATE
DIVISION OF RATE COUNSEL
REPLY BRIEF

STEFANIE A. BRAND, ESQ.
ACTING PUBLIC ADVOCATE &
DIRECTOR, DIVISION OF RATE COUNSEL

DIVISION OF RATE COUNSEL
31 Clinton Street, 11th Floor
P. O. Box 46005
Newark, New Jersey 07101
Phone: 973-648-2690
Email: njratepayer@rpa.state.nj.us

FILED: April 5, 2010

TABLE OF CONTENTS

INTRODUCTION 1

ARGUMENT 2

POINT I 2
RATE COUNSEL'S RECOMMENDATIONS ON CAPITAL STRUCTURE, RETURN ON EQUITY AND INTEREST ON LONG TERM DEBT ARE REASONABLE AND SHOULD BE ADOPTED 2

A. Debt/Equity Ratio 2
B. Customer Deposits 4
C. Cost of Debt 5
D. Return on Equity 7

POINT II 10
THE BOARD AND YOUR HONOR SHOULD ADOPT AN ELECTRIC RATE BASE OF $3.5 BILLION AND A NATURAL GAS RATE BASE OF $2.2 BILLION AS RECOMMENDED BY RATE COUNSEL IN THIS PROCEEDING 10

A. Rate Base – Post Test Year Plant in Service 10
B. Rate Base – Post Test Year Capital Infrastructure Expenditures 14

POINT III 18
RATE COUNSEL'S CONSOLIDATED INCOME TAX ADJUSTMENT IS FULLY CONSISTENT WITH BOARD POLICY AND SHOULD BE ADOPTED 18

A. Rate Counsel's Proposed Consolidated Tax Adjustment is Fully Consistent With New Jersey Law. 18
B. Rate Counsel's Proposed Consolidated Tax Adjustment Is Consistent With BPU-Approved Methodology. 20
C. The Board's Consolidated Tax Adjustment Methodology Does Not Violate the Prohibition Against Retroactive Ratemaking. 22
D. The Board's Consolidated Tax Policy Does Not Breach The Division Between Regulated and Non-Regulated Operations. 24
E. PSE&G Chose To File Taxes As Part Of Enterprise Group's Consolidate Tax Group and Therefore Must Share With Ratepayers The Benefits Of Belonging To That Consolidated Tax Group. 28
F. Conclusion 29

POINT IV 31
RATE COUNSEL'S PENSION EXPENSE CALCULATION IS REASONABLE AND REJECTING THE PENSION TRACKER IS CONSISTENT WITH TRADITIONAL RATE MAKING 31

POINT V 39
PSE&G'S INCENTIVE COMPENSATION PROGRAMS SHOULD BE FUNDED BY SHAREHOLDERS WHO RECEIVE THE MOST BENEFIT FROM THESE PROGRAMS.. 39

POINT VI.. 44
THIRTY YEAR PERIOD SHOULD BE USED TO DETERMINE NORMAL WEATHER 44

POINT VII 48
PSE&G'S WEATHER NORMALIZATION CLAUSE PROPOSAL SHOULD BE REJECTED AS FILED, AND, IF SUCH A PROGRAM FOR THE COMPANY WERE APPROVED, IT SHOULD ADHERE TO THE ESTABLISHED BOARD POLICY BEING FOLLOWED BY THE OTHER GAS UTILITIES IN THE STATE. 48

POINT VIII.. 50
PSE&G HAS NOT JUSTIFIED ITS PROPOSED EXPANSION OF THE COMPANY'S CAC CLAUSE TO ENCOMPASS ROUTINE CAPITAL EXPENDITURES OR ITS REQUEST TO RECOGNIZE PROJECTED PLANT-IN-SERVICE IN RATE BASE AS OF AUGUST 31, 2010... 50

POINT IX.. 54
PSE&G'S ARGUMENTS THAT IT SHOULD NOT HAVE TO REPORT ON SPECIFIED SERVICE METRICS AND BENCHMARKS SHOULD BE IGNORED BECAUSE THEY ARE WITHOUT MERIT AND CONTRARY TO THEIR OBLIGATION TO PROVIDE ADEQUATE CONSUMER SERVICE.................... 54

A. There is no Reason to Require the Recommended Service Metrics and Benchmarks through a Rulemaking. 55
B. PSE&G's Claim that its Metric Scorecard Contains Comparable Service Metrics Proposed by Rate Counsel is Inaccurate. 57
C. PSE&G's Claims that Rate Counsel's Proposed Benchmarks are Arbitrary and Unreasonable are Without Merit. 58
D. PSE&G's Opposition to Providing the Credit Worthiness Score ("CWS") in its Tariff and to Post the Information on the Company's Website is Arbitrary, and Unreasonable and in Violation of Board Regulations. 61

POINT X.. 64
RATE COUNSEL RECOMMENDS THAT PSE&G INVEST IN IMPROVEMENTS THAT ARE COST-EFFECTIVE AND IMPROVE THE RELIABILITY OF ITS POOREST-PERFORMING ELECTRIC CIRCUITS. .. 64

POINT XI.. 66
THE ISSUES RAISED BY MEG AND NJLEUC REGARDING ALLEGED DISCRIMINATORY TREATMENT SHOULD BE ADDRESSED AS RECOMMENDED IN RATE COUNSEL'S INITIAL BRIEF................................. 66

CONCLUSION.. 70

INTRODUCTION

The Department of the Public Advocate, Division of the Rate Counsel ("Rate Counsel") Initial Brief[1] clearly identifies many of the deficiencies in Public Service Electric and Gas Company's (the "Company" or "PSE&G") case. The arguments in Company's Initial Brief do not refute the factual or policy arguments in Rate Counsel's case or Initial Brief. Therefore, as discussed in detail in the following pages and based on the record in this matter, Rate Counsel maintains its position that Company's petition as filed should be rejected, and adopt Rate Counsel's position as set forth in our in Initial and Reply Briefs.

[1] Rate Counsel's Initial Brief will be cited as "RCIB", PSE&G's Initial Brief as "PIB" and Staff's Initial Brief as "SIB". Similar abbreviations are used for other Initial Briefs.

ARGUMENT

POINT I

RATE COUNSEL'S RECOMMENDATIONS ON CAPITAL STRUCTURE, RETURN ON EQUITY AND INTEREST ON LONG TERM DEBT ARE REASONABLE AND SHOULD BE ADOPTED

The determination of the Cost of Capital and Capital Structure in this case will have a significant impact on the increases to be shouldered by rate payers for both electric and gas service delivered by PSE&G. The amount of the proposed increase related to the return on equity is $75.5 million while more than $30.0 million of the proposed increase is related to PSE&G's proposed increase in its equity ratio. *RC-149*, *RC-150*. Rate Counsel witness, Mr. Kahal, provided a reasonable, well thought out, and appropriate Capital Structure for PSE&G. Mr. Kahal recommended adjustments to PSE&G's request resulting in an overall Rate of Return of 8.06%, including a 49.73 percent equity ratio, removal of customer deposits from the Capital Structure, and a 10.0% Return on Equity. Staff in its Initial Brief agrees with Mr. Kahal on the 49.73 percent equity ratio and a 10.0% Return on Equity. A review of the record and the Initial Briefs submitted by the Parties confirms that the original positions set forth by Mr. Kahal should be adopted in this case.

A. Debt/Equity Ratio

PSE&G sought in this case to increase its percentage of equity to 51.2%. Rate Counsel witness, Mr. Kahal, proposed a more modest increase from 47.4 percent equity to 49.73 percent equity. Staff, after a lengthy discussion of the arguments of PSE&G and Mr. Kahal, supported Mr. Kahal's increase in its Initial Brief based on its balancing of the

need for a stronger balance sheet and the rate impact of accepting PSE&G's higher proposal. *SIB,* p. 62-63. Mr. Kahal clearly established that his proposed level of equity would be sufficient to satisfy the Rating Agencies and PSE&G's need and ability to access capital. His 49.73 percent equity ratio however would be less costly to ratepayers than the equity ratio proposed by the Company. Mr. Kahal's recommendation thus provides a significant strengthening to PSE&G's regulatory capital structure and is well above the electric utility industry average, while moderating the adverse rate impact on customers.

PSE&G's references the equity ratios of New Jersey Natural Gas and Idaho Power in support of their proposal, but such comparisons are misplaced. *PIB,* p. 61-62. First, each utility and each rate case must be looked at independently, and recommendations are made based on the totality of the circumstances of each case. Second, the increase recommended by Mr. Kahal for Idaho Power still maintained an equity ratio under 50.0% well below PSE&G's proposed 51.2%. Third, New Jersey Natural Gas is solely a gas distribution company not a gas and electric distribution company, which undermines the comparability of its debt/equity ratio.

It is noteworthy that on July 1, 2009 the Board in Docket No. EO09030223 gave PSE&G, with Rate Counsel's agreement, authorization and flexibility to issue new long-term debt in the amount of $1.3 billion through December 2011. Pursuant to that authority PSE&G redeemed its Preferred Stock and financed $300 million of new debt. *PIB,* p.58 and 64. Both of these financings were completed with PSE&G's currently approved equity ratio of 47.4 percent. Thus, contrary to PSE&G's claims, a lower equity ratio is not interfering with the Company's ability to access debt.

Rate Counsel's proposed component of 49.73 percent equity, a 233 basis point increase from PSE&G's last case, is an appropriate move to a stronger capital structure that is supported by Staff. Your Honor should adopt Mr. Kahal's recommended 49.73 percent equity as the appropriate equity portion of PSE&G's Debt/Equity Ratio.

B. Customer Deposits

Staff agreed with Mr. Kahal's recommendations regarding Capital Structure with the exception of the removal of Customer Deposits. Mr. Kahal urged the removal of Customer Deposits from the Capital Structure and the reflection of Customer Deposits as a rate base deduction with interest expense above the line. *RC-131,* p. 24. Mr. Kahal's testimony was based on his concern regarding the dilution of ratepayer value of Customer Deposits. The dilution problem occurs because Customer Deposits represent very low cost capital, which results in a cost savings when they are included in PSE&G's total capitalization. That capitalization supports not just rate base in this case but also the Company's investment in FERC-jurisdictional transmission. PSE&G has confirmed that it does not recognize customer deposits in the FERC transmission rates that PSE&G customers pay. *RC-148*. This means that ratepayers are denied a large portion of the savings in the cost of capital that result from customer deposits. The result is that customer deposits become a profit center for PSE&G shareholders, which is improper and inequitable. Ms. Crane and Mr. Kahal's treatment of Customer Deposits corrects this inequity, using a more accurate (and more standard) ratemaking treatment. This rationale was unrebutted by either PSE&G or Staff and Your Honor should remove Customer Deposits from PSE&G's Capital Structure.

As with Debt/Equity issue, PSE&G raises the recent New Jersey Natural Gas matter to support its arguments that Customer Deposits should be included in its capital structure. *PIB,* p. 63. However, New Jersey Natural is a gas distribution company that does not have any FERC jurisdictional transmission lines and therefore the dilution issue is not the same as with PSE&G. Rate Counsel's arguments regarding the appropriate treatment of customer deposits are fair and appropriate and should be adopted.

C. Cost of Debt

Rate Counsel proposed a Cost of Debt for PSE&G of 6.15%. On February 14, 2010, two days before the hearings on this issue, Company Witness Mark Kahrer filed his "Second Revised Supplemental Testimony – 12 & 0" in which he proposed a capital structure with a cost of debt of 6.14%. *P-7-R-3*.

Subsequently, PSE&G attempted to include the cost of a March 2, 2010 $300 million debt issuance. The inclusion of this financing, which occurred two months after the test year ended, and was not included in the record until after cost of capital had been addressed, is inappropriate and unfair. Neither Rate Counsel nor Staff had their Cost of Capital experts in attendance at the March 3, 2010 hearing, at which Mr. Kahrer attempted to update his prior testimony.

The complete "update" by Mr. Kahrer follows:

DIRECT EXAMINATION OF MARK KAHRER BY MR. HOFFMEN:

Q. Mr. Kahrer, do you have any corrections to any your testimony?

A. Corrections, no. We will have an update. Yesterday the company issued a 30 – year bond which we had done a pro forma in and discussed the last time I testified on capital structure. We had proposed at the time that there would be a 5.65 percent coupon debt that would replace the $80 million of preferred stock that we were redeeming. The transaction yesterday was a $300 million transaction

> which will take care of the preferred stock, plus maturing floating rate note that's going to mature on March 12th. The coupon on the debt, we were very pleased yesterday, with transaction actually turned out to be 5.5 percent. So it was a good transaction for the company overall. We will update the imbedded cost of debt schedules and provide those as quickly as possible to parties in the case.

T1362:4-25

Mr. Kahrer's statement quoted above is the only record evidence in support of PSE&G's proposed increase in the cost of debt. Rate Counsel has received no additional information from PSE&G since the March 3, 2010 hearing.

The Board's policy on out of period adjustments is that they must be"known and measurable". In Re Elizabethtown Water Company Rate Case, Decision on Motion for Determination of Test Year and Appropriate Time Period for Adjustments, Docket. No. WR85040330, (May 23, 1985). This standard requires that the adjustments must be:

> (1) prudent and major in nature and consequence, (2) carefully quantified through proofs which (3) manifest convincingly reliable data.

Id. at p.2

PSE&G's March 2, 2010 financing does not meet these criteria. There are proofs or data establishing the interest rate paid by PSE&G except Mr.Kahrer's statement quoted above. The amount financed is less than 25% of the total **new** long term debt authorized by the Board and thus this financing is not sufficiently major to justify including it under the Elizabethown Water standards. Except in briefs, the parties have had no opportunity to address this new and unexpected proposal. Therefore, the information should not be used to determine the Cost of Debt for PSE&G. As set forth in Rate Counsel's Initial Brief, "The parties have been given no opportunity to evaluate this new information or determine if the proposed increase is reasonable." *RCIB*, p.12. Your Honor should adopt Mr. Kahal's Cost of Debt of 6.15%.

D. Return on Equity

Mr. Kahal recommended a Return on Equity of 10.0% based on his use of a Discounted Cash Flow ("DCF") Analysis and the Capital Asset Pricing Method ("CAPM"). Both methods have been endorsed by the Board and have been used in utility regulation in New Jersey for many years. In contrast, PSE&G's witness, Dr. Vilbert, proposed a Return on Equity of 11.25%. resulting in a 12.5% increase in the cost of equity for electric distribution rates and a 15.4% increase in the cost of equity for gas distribution rates. Dr. Vilbert's recommendation of a total PSE&G Cost of Equity of 11.25% is completely unrealistic and based on a "leverage adjustment" to the DCF and CAPM that has not been accepted by any state or federal regulatory commission in the United States. As noted by Mr. Kahal at the hearings:

> I can tell you that it is not accepted by other U.S. regulatory state commissions and the FERC…. But not because it's complicated, because it's incorrect, and not because it hasn't been advocated, it's been advocated extensively and repeatedly rejected.

T489:L24-T490:L5.

Staff reviewed the testimonies of Mr. Kahal and Dr. Vilbert and supported Rate Counsel's recommended Return on Equity of 10.0% based in part on the PSE&G's reduced risk resulting from expedited recovery in a number of PSE&G's clause cases.

Rather than address the specifics of Mr. Kahal's testimony and analyses, which were set forth in great detail in his schedules, PSE&G resorts to unsupported statements and conclusions that are irrelevant, incorrect or beside the point. For example, PSE&G criticizes Mr. Kahal's reduction of his recommended Return on Equity from 10.1 to 10.0. As he fully explained, however, the reduction was not "results oriented" but based on changes in capital cost indicators over time. *T475: L18-25, T476:L1-5.* In contrast, when

Dr. Vilbert similarly reduced his recommended Return on Equity by 25 basis points, from 11.5% to 11.25% PSE&G gushed, "The consistency of Dr. Vilbert's approach throughout this proceeding speaks to the integrity of his methods and results." *PIB,* p.69.

PSE&G also argues that Mr. Kahal's selection of proxy companies for the DCF analysis is arbitrary, "results driven" and inconsistent with his analysis in other recent cases. *PIB,* p. 65. However, as set forth at great length in his testimony, Mr. Kahal selects his proxy groups in each case and looks at the various components of his analyses in each case. Mr. Kahal used both a gas proxy group and an electric proxy group. He selected the proxies in this case based on a number of reasonable criteria, which are fully set forth in his Direct Testimony. *RC-31,* p.30-43. This is the appropriate way to do both the DCF and CAPM and it is the appropriate way to determine Return on Equity for each company. It is far from arbitrary. In fact, PSE&G argues that the proxies should be the same in each case, or else they are "inconsistent" and then reverses itself on the next page to argue that Mr. Kahal did not appropriately tailor his selection of proxies to reflect the level of growth, risk and size of a company like PSE&G. It thus appears that it is PSE&G's analysis that is inconsistent and results oriented.

Notably, the unadjusted proxy group results of Mr. Kahal and Dr. Vilbert are nearly identical (with the one anomaly of "Electric Group Simple"). *RC-33, Sch. MIK-2.* The one substantive difference is Dr. Vilbert's leverage adjustment. *T487:L21-25.* The illogic of Dr. Vilbert's after-tax weighted average cost of capital ("ATWACC") method was discussed in Staff's Initial Brief and is on the record in this proceeding. As noted by Mr. Kahal at the hearing, the ATWACC adjustment made by Dr. Vilbert forces the conclusion that PSE&G is **riskier** than the proxy companies, when no evidence has been

offered that this is the case. *T489:L9-17.* Further, the ATWACC method is based on an "apples to oranges" comparison of market versus book capital structure. This means that the adjustment will be positive (increased ROE) whenever the proxy company market to book ratios exceed 1.0. Thus, anything that increases stock prices – reduced risk, better earnings, lower market interest rates, etc. – must mean, as a matter of the mechanics of the method, that PSE&G's cost of equity goes up. *T489:L1-8.* This is totally perverse because it means that as the stock recovers, we must increase the ROE award and customer rates.

Staff echoed these concerns, "Staff is of the decided opinion that the ATWACC adjustment should be rejected for consideration in this proceeding as constituting an artificial and unjustified escalator in the cost of equity determination." *SIB,* p. 67. Nothing in PSE&G's Initial Brief has rehabilitated Dr. Vilbert's recommendation and Rate Counsel relies on all of its arguments on this issue as well as Staff's in the Initial Brief.

For all of the reasons set forth in the testimony of Mr. Kahal, and the briefs of Staff and Rate Counsel, Your Honor should adopt Rate Counsel's positions and set an overall Rate of Return of 8.06% reflecting adjustments to PSE&G's proposed Capital Structure that remove Customer Deposits, allow 49.73% equity, interest on long term debt of 6.15%, and a 10.0% Return on Equity.

POINT II

THE BOARD AND YOUR HONOR SHOULD ADOPT AN ELECTRIC RATE BASE OF $3.5 BILLION AND A NATURAL GAS RATE BASE OF $2.2 BILLION AS RECOMMENDED BY RATE COUNSEL IN THIS PROCEEDING.

A. Rate Base – Post Test Year Plant in Service

PSE&G argues that base rates in this proceeding should be established based on the "uncontested" plant in service balance as of February 28, 2010. *PIB,* p. 3. PSE&G's claim that the plant in service balance as of February 28, 2010 "is uncontested" is not accurate and should be rejected.

PSE&G's inclusion of post-test year plant in service is very much contested. Any lack of response to Mr. Kahrer's schedules is not a reflection of agreement but is based on the fact that PSE&G has failed to provide Board Staff and Rate Counsel with sufficient information on which to base any determination of whether the proposed post-test year plant additions should be included in PSE&G's rate base. In his rebuttal testimony, Mr. Kahrer provides a schedule which contains the Balance at December 31, 2009 (12 months actual) and a projected Balance at February 28, 2010. The total support for this schedule in Mr. Kahrer's rebuttal testimony, is: "Schedule MGK-5 R-3 summarizes the electric and gas rate bases, . . ." *P-7-R-3*, p.5. At the hearing, Mr. Kahrer once again updated this schedule "for actual plant in service through January 31, 2010" and promised to provide monthly updates (although the February 28, 2010 balance has not yet been provided.) *T1369:L2-15*. Apparently, PSE&G believes that it can repeatedly change rate base amounts and have these repeated "uncontested" updates

reflected in base rates. This position is not consistent with well established rate making principles nor is it compliant with New Jersey law.

The BPU has established that post test year plant additions to rate base will be allowed "for a period of six months beyond the test year, provided there is a clear likelihood that such proposed rate base additions shall be in service by the end of said six month period, that such rate base additions are major in nature and consequence, and that such additions be substantiated with very reliable data . . . . " Elizabethtown Water Company Rate Case Decision on Motion For Determination of Test Year and Appropriate Time Period For Adjustments, Docket No. WR8504330 (May 23, 1985). PSE&G has provided none of this required information, the Company has merely updated Mr. Kahrer's gross plant numbers for the month of January. This is not sufficient evidence to allow this additional claimed plant into rate base. The Company has not provided the necessary "very reliable data" regarding exactly which plant additions are included in these numbers, whether the plant additions are major in consequence, or when the plant additions will be in service. Thus, PSE&G's claim for the inclusion of post test year additions to plant do not meet the Elizabethtown Water Company standard for inclusion in the Company's rate base.

Indeed, New Jersey courts have long recognized that the determination of rate base is "fundamental in any rate proceeding." I/M/O Public Service Coordinated Transport, 5 N.J. 196, 217 (1950). A utility's rate base is the fair value of the public utility's property "that is used and useful in the public service." Id. The Supreme Court in Public Service Coordinated Transport reasoned that a utility's stockholders are entitled to a return on the fair value of the utility's property but cautioned that ratepayers should

"not be laden with unreasonable or extortionate rates in order that dividends may be provided for the utility's stockholders." Id. The Court recognized that the BPU has discretion in the determination of a utility's rates and found that the allowed rate base "should reflect the reasonable judgment of the Board." Id. The Court warned however that BPU cannot "arrive at a fair value based solely upon a utility's books of account." Id. The Board has a "duty to go behind the figures shown by the companies' books and get at realities . . ." Id. The Court concluded:

> It must be emphasized that rate making is not an adversary proceeding in which the applying party needs only to present a prima facial case in order to be entitled to relief. There must be proof in the record not only as to amount of the various accounts but also sufficient evidence from which the reasonableness of the accounts can be determined. Indeed, R.S. 48:2-21(d) specifically provides that "The burden of proof to show that the increase change or alteration [in rates] is just and reasonable shall be upon the public utility making the same." Lacking such evidence, any determination of rates must be considered arbitrary and unreasonable.

Id. at 219.

Thus, as discussed in Rate Counsel's initial brief, PSE&G has failed to provide any quantitative support for its claim beyond a schedule provided to the parties on the next to last day of hearings with numbers purporting to be actual January updates. Neither Rate Counsel nor any other party has had the opportunity to "get behind these numbers." There has been no prudency review and no review to determine if the claimed plant additions are revenue producing. Board Staff agrees that these post test year plant additions do not meet the Elizabethtown Water Company standard, reasoning that PSE&G "has not provided any evidence that the post-test year additions were 'prudent and major in nature and consequence.'" *SIB* p. 22.

PSE&G also argues that its post-test year additions should be included in rate base because Rate Counsel consultants did not make any recommendations to disallow

recovery and that even Ms. Crane "has approved recovery of PSE&G's plant-in-service through December 31, 2009." *PIB,* p. 15. Of course, Ms. Crane does not "approve recovery" for PSE&G's plant in service, Ms. Crane's role is to incorporate the recommendations of Rate Counsel's other expert witnesses into her revenue requirement calculation. Even so, the date cited is the end of the test year, and Ms. Crane's inclusion of plant-in-service up to that date in no way supports PSE&G's claim for post-test year additions.

PSE&G claims that because Rate Counsel's consultants have not recommended adjustments to the test year plant in service "[t]here is simply no basis to disallow recovery of the returns of and on PSE&G's continued capital expenditures as of February 28, 2010. *PIB*, p. 15. This argument defies logic. First, it was not possible for Rate Counsel to fully review the Company's post-test year additions since the Company only provided January 2010 plant balances immediately prior to the penultimate hearing and to date, has not provided actual balances for February 2010.

Second, the burden is not on Rate Counsel to find a basis to disallow recovery of PSE&G's proposed plant in service. The burden is on PSE&G to "to establish by competent evidence that the items . . . are properly includable in rate base." Public Service Coordinated Transport, 5 N.J. at 220. The Company has failed to provide the necessary competent evidence and therefore has failed meet its burden. The Company has also failed to establish that its post-test year additions meet the criteria established in the Elizabethtown Water Company case. The additions are not major, but the normal spending by the company in January and February. They have not been carefully

quantified through proofs and data, and they are not even fully known, as PSE&G has provided an update schedule for January actuals but nothing for February.

Accordingly, Your Honor and the Board should utilize the actual December 31, 2009 utility plant in service balances as set out in Schedule ACC-3E (brief) and Schedule ACC-3G (brief) attached to our Initial Brief in Exhibit A.

B. Rate Base – Post Test Year Capital Infrastructure Expenditures

In its initial brief, the Company fails to present a convincing argument to support its position that capital additions included in the Capital Infrastructure Investment Program ("CIIP") that were placed in service after the test year should be included in its rate base. *PIB*, p. 16-20. As set forth in Rate Counsel's initial brief and the testimony of its witness, Ms. Crane, using the same cut-off date for CIIP capital additions as that used for PSE&G's other capital additions is consistent with the terms of the stipulation approved by the Board in the CIIP proceeding. *RIB,* p. 25-26.

PSE&G's arguments miss several important points, all of which were addressed in the stipulation approved by the Board that resolved PSE&G's CIIP proceeding (the "CIIP Stipulation"): Those points are: (1) extending the cut-off date for CIIP projects will not allow the parties to conduct a proper prudency review; (2) the instant base rate case will be re-opened in the future to add CIIP projects to rate base; and (3) until rolled into the Company's rate base, PSE&G would still recover the revenue requirement associated with the completed CIIP projects through the operation of the CAC clause. *RC-85*, CIIP Stipulation, p. 8. Although PSE&G cites language from the CIIP Stipulation which states that completed CIIP projects will be rolled into base rates at the "conclusion" of the company's next base rate case, PSE&G ignores the importance of the

CIIP Stipulation language which provides that only those CIIP projects that are "deemed to be reasonable and prudent" will be rolled into base rates at that time. *Id*. at 8. The pertinent language of the CIIP Stipulation reads as follows:

> The Parties further stipulate that during the Company's base rate case . . . the net capitalized amounts for the Qualifying Projects <u>that are deemed to be reasonable and prudent</u>, will be rolled into the Company's rate base and the associated revenue requirements will be recovered through base rates. … Any Qualifying Project expenditures and CACs not included in base rates at the conclusion of the required base rate case will be included in the recalculation of CACs based on the methodology set forth in Appendix B. *RC-85,*CIIP Stipulation, p. 8 [<u>Emphasis added.]</u>

Contrary to PSE&G's argument, it is unrealistic to assume that all CIIP projects placed in service "during" the instant base rate case through its "conclusion" will be rolled into the Company's rate base without a review for "prudency and reasonableness." As a practical matter, only the CIIP projects placed in service as of the close of the test year, December 31, 2009, were reviewed for prudency and reasonableness, as provided for by the CIIP Stipulation. The Company did not even provide actual CIIP additions for the months of January and February 2010. In fact, actual capital additions through December 31, 2009 were only provided to Ms. Crane a few days before she submitted her updated recommendations based on the Company's 12+0 update. Therefore, Rate Counsel, a party to the CIIP Stipulation, did not have the opportunity to conduct meaningful discovery on the post-test year capital additions or conduct any thorough review of the Company's claimed post-test year CIIP additions. *T1610*, *T1616*. Absent a review by the parties, CIIP projects placed in service after the close of the test year cannot be deemed to be reasonable and prudent at this time. Therefore, post-test year CIIP projects should not be included in the Company's rate base. CIIP projects placed in service after

the close of the test year will face a "prudency and reasonableness" review in a subsequent phase two proceeding. *RC-85*, CIIP Stipulation, p. 8.

Furthermore, as also noted by Board Staff, PSE&G has not shown that the Company will be financially harmed by using the test year cut-off date. *SIB,* p.at 22. Until completed CIIP projects are rolled into the Company's rate base, pursuant to the terms of the CIIP Stipulation, PSE&G will earn and recover the associated revenue requirement through the operation of the CAC clause. *RC-85*, CIIP Stipulation, p. 8. Therefore, since the CAC clause provides for contemporaneous recovery of the revenue requirement associated with the completed CIIP projects - computed using the Company's allowed rate of return, PSE&G cannot now claim that it will suffer any financial harm if the post-test year in-service CIIP projects are not moved into its rate base at this time.

PSE&G finally argues that if the expansion of the CAC is not granted, Your Honor and the Board should recognize the level of plant investment as of August 31, 2010. *PIB*, p. 20. This represents eight months of post-test year plant. PSE&G's rationale for this proposed adjustment is addressed in only a few sentences in the brief, but includes a "decline in usage in both gas and electric distribution businesses"; and "no enhanced revenue on the horizon;" and a bare allegation that a "[f]ailure to recognize these real costs will guarantee that the Company will not have a fair opportunity to earn its authorized rate of return." *Id.* PSE&G projects in a schedule attached to Mr. Kahrer's testimony that this post-test year plant results in an electric rate request increase of approximately $13 million and a gas request increase of approximately $4.6 million. *Id.*

PSE&G makes no attempt to justify eight months of post-test year additions under the criteria established by the Board in the Elizabethtown Water case discussed above. The requested plant is not known and measurable or extraordinary, it simply appears to represent what PSE&G expects to spend until August. Essentially, PSE&G is seeking to recover its costs eight months beyond the test year in order to avoid the potential of having to file another rate case. However, projected rate increases of $17.6 million, less than 7% of the rate request in the pending case, are hardly significant enough to warrant such a dramatic change from the requirement that filings be based on actual numbers not projections. As PSE&G has failed to demonstrate that these costs are known and measurable or that an expansion of the test-year is justified under the criteria established by the Board, the request should be denied.

For all of the above reasons, and those set forth in its initial brief and the testimony of its witnesses, Rate Counsel respectfully submits that Ms. Crane's proposed adjustment to eliminate post-test year CIIP capital additions is reasonable and should be adopted. *RCIB,* p. 25-26; *RC-131*, p. 12 and p. 15-19; *RC-132, Schedule ACC-5E.*

POINT III

RATE COUNSEL'S CONSOLIDATED INCOME TAX ADJUSTMENT IS FULLY CONSISTENT WITH BOARD POLICY AND SHOULD BE ADOPTED.

PSE&G is seeking to have the Company's revenue requirement calculated as if PSE&G filed its federal income taxes on a stand-alone basis. However, as fully established in the record of this proceeding, PSE&G does not file its taxes on a stand-alone basis but rather files as a part of a consolidated group. The filing of a consolidated return allows the group to take advantage of tax losses experienced by other member companies who file as part of the same consolidated tax group. For PSE&G, the result is an effective tax rate that is lower than it otherwise would be had PSE&G filed its taxes on a stand-alone basis. Having reaped the savings that resulted from filing consolidated taxes, PSE&G now seeks to keep them, even though New Jersey law and Board policy have long held that ratepayers are entitled to share in that tax benefit. The methodology proposed by the Company would provide PSE&G with excess recovery for its income taxes, and allow the Company to funnel these excess funds to its parent, PSEG Enterprise Group ("Enterprise Group"). PSE&G proposal should be rejected and the long-standing requirement that consolidated tax savings be shared with ratepayers should be upheld.

A. Rate Counsel's Proposed Consolidated Tax Adjustment is Fully Consistent With New Jersey Law.

PSE&G claims that New Jersey law does not permit the consolidated tax adjustment proposed by Rate Counsel in this proceeding. PSE&G argues that as its tax liability is unchanged by consolidation, that PSE&G derives no benefit from losses suffered by its non-regulated affiliates and that the non-regulated affiliates derive no

benefit from PSE&G's taxable income. The Company concludes that as the proposed adjustment would reduce rate base without any reduction in operating expenses "such an approach is contrary to fundamental ratemaking principles and would produce confiscatory rates." *PIB, p. 24.*

In support of this assertion, PSE&G relies on a partial quote from a New Jersey Supreme Court decision, I/M/O New Jersey Power and Light Company, 9 N.J. 498 (1952). In fact, the cited decision fully supports Rate Counsel's consolidated tax adjustment. In New Jersey Power, the utility objected to the Board of Public Utility Commissioners' disallowance of 50% of the utility's claimed tax savings. The Board based its disallowance "on the ground that 'it seems equitable to allocate 50 per cent of such savings to customers.'" Id. at 528. The Supreme Court held that the utility was not entitled to collect in rates "hypothetical" income tax expenses not paid to the taxing authority and concluded that allowing the utility even 50% of the difference between actual and hypothetical taxes was in error. Id. Thus, as recognized by Board Staff, as a matter of law, ratepayers cannot be charged a "phantom" tax which is paid to Enterprise Group rather than to the IRS. *SIB, p. 11*

PSE&G's confusion seems to stem from the payment it makes to Enterprise Group pursuant to its tax sharing agreement. This argument has previously been rejected by New Jersey Courts. *See,* In re Lambertville Water Company, 153 N.J. Super. 24, 28 (App. Div. 1977), In re Toms River Water Company, 158 N.J. Super. 57, 58 (App. Div. 1978) "Actual taxes" are paid to the IRS, not to Enterprise Group. Pursuant to the tax sharing agreement, the amount of PSE&G's payment to the Enterprise Group that exceeds PSE&G's "actual taxes" is distributed, to the tax loss affiliates. PSE&G's claim

that "Enterprise receives no benefit from the utility's contribution of taxable income to the consolidated return" (*PIB,* p.26) ignores the excess tax liability payment made to PSE&G that is used by Enterprise Group to subsidize affiliate losses. It also ignores the very real benefit provided by the existence of the utility's taxable income. When a consolidated return is filed, tax losses have no value unless they can be used to offset taxable income. Thus, the taxable income of PSE&G and other companies with positive taxable income is reduced as a result of the tax losses, thus providing a further benefit to the Enterprise Group. Thus, under New Jersey law, when PSE&G pays lower taxes as a result of the consolidated filing, that savings must be shared with ratepayers. To charge ratepayers for higher taxes as if PSE&G filed independently would be the type of "hypothetical" tax that the Supreme Court found was impermissible.

B. Rate Counsel's Proposed Consolidated Tax Adjustment Is Consistent With BPU-Approved Methodology.

The Board has previously reviewed and rejected PSE&G's "methodological issues," and should do so again in this proceeding. Rate Counsel's position is fully set forth in its testimony and Initial Brief. PSE&G has provided the Board with nothing new, and has provided no legal basis to support its contention that the consolidated tax calculation used by the Board is inappropriate or that PSE&G should not be held to the same consolidated tax adjustment calculation that the Board has consistently used in setting revenue requirements for the state's utilities.

As recognized by Board Staff, the specific methodology that should be used to calculate the consolidated tax adjustment has already been clearly established by the

Board. *SIB,* p. 15. This is the very methodology used by Ms. Crane in this proceeding. As noted by Board Staff:

> Staff has examined Ms. Crane's consolidated tax savings adjustment and has determined that it is in fact calculated using the methodology approved by the Board in the 2004 Rockland Order and is consistent with Board policy. Staff recommends that the calculation and methodology used by Rate Counsel be adopted in this proceeding.

SIB, p. 9.

PSE&G, selectively citing to arguments advanced by Rate Counsel in previous cases, apparently believes that it is exempt from the Board's consolidated tax adjustment. However, the arguments of counsel are not determinative of Board policy. The cases cited by PSE&G were settled, and thus the Board Orders approving those settlements do not set out the Board's position on the issues raised by PSE&G. However, in other litigated cases the Board has clearly set forth the formula to be applied to share consolidated tax savings with ratepayers. *RC 118*. PSE&G must be held to the same well established consolidated tax adjustment as the other state utilities. PSE&G has offered no valid reason to treat PSE&G differently.

PSE&G claims in discussing an unsubstantiated $320 million payment to the IRS that "Ms. Crane inexplicably failed to account for these tax payments in her computations." *PIB,* p. 42. Ms. Crane did not address this issue because PSE&G never mentioned these payments until the filing of so-called supplemental testimony one week before hearings. There is no mention of this $320 million in PSE&G's initial filing, nor is this amount mentioned in any other piece of evidence in this proceeding, including Mr. Kruger's rebuttal testimony. What is unexplained is why PSE&G did not disclose this $320 million payment until the parties were in the midst of hearings in this proceeding.

Even if PSE&G had disclosed this payment earlier, as discussed at length in Rate Counsel's initial brief and in Staff's brief, it would be premature to make any adjustment to the proposed consolidated tax adjustment at this time based on that payment. *RCIB* p. 40-41. *SIB,* p. 17-18. The $320 million deposit was made "to defray interest costs," and is fully refundable with interest if PSE&G succeeds in its dispute with the IRS. *T1566:L1-13*. If PSE&G does not succeed, then amended tax forms should be filed and would be taken into consideration in the next base rate case filed by PSE&G. Indeed, PSE&G testified at the hearing that it has not yet received a statutory notice of deficiency from the IRS. *T1314:L16-20*. Thus, it is premature at this point to reflect this deposit as reduction to the consolidated tax adjustment. Once this issue is finally resolved, any necessary adjustment can then be made.

C. The Board's Consolidated Tax Adjustment Methodology Does Not Violate the Prohibition Against Retroactive Ratemaking.

The Company claims that Rate Counsel's proposed consolidated tax adjustment violates the prohibition against retroactive ratemaking. PSE&G argues that the proposed consolidated tax adjustment is an attempt to adjust "a utility's prospective rates to offset lawful revenues collected during a prior period." *PIB,* p. 23. This argument misconstrues both the concept of retroactive ratemaking and the Board's long-standing methodology for calculating a consolidated tax adjustment.

Retroactive ratemaking occurs when "a utility is permitted to recover an additional charge for past losses, or when a utility is required to refund revenues collected pursuant to then lawfully established rates." I/M/O Elizabeth Water Company, 107 N.J. 440, 448 (1987). Rate Counsel's recommended consolidated tax adjustment in this

proceeding is not an attempt to "reach back to 1991 to collect alleged tax saving." *PIB,* p. 22. Rather, Rate Counsel witness Andrea Crane has adjusted PSE&G's rate base, prospectively, to account for the value of consolidated tax savings realized by PSE&G and its parent Enterprise Group as the result of its consolidated tax filings. Ms. Crane has not attempted to recoup past losses or refund excess utility profits to consumers with this consolidated tax savings adjustment. Rather, the proposed consolidated tax adjustment is a vehicle for recognizing today's value of obtaining what amounted to "free capital" for the Enterprise Group.

In determining rates, Your Honor and the Board must consider whether a utility has an opportunity to earn a reasonable rate of return on its invested capital after accounting for the Company's reasonable and necessary operating expenses. Federal income tax expense may be recovered as a utility operating expense. But, this Board has decided that, in approving income tax expense to be recovered through rates, the Board will allot to ratepayers their fair share of tax benefits conferred as a result of the utility being consolidated with the parent company's affiliated group. *RC-16* (*ACE Consolidated Tax Board Order*). The Board's prior Orders on this issue require a calculation of the benefit realized and an adjustment to account for this benefit and have expressly recognized that this computation is not retroactive ratemaking. As the Board stated in the ACE Consolidated Tax Board Order:

> The rate base method endorsed in this proceeding by Staff and Rate Counsel essentially treats the tax benefits derived by the holding company as cost free capital contributed by ratepayers. By providing a rate base adjustment, ratepayers are credited with the carrying costs of those contributions, prospectively, reflecting the present value benefits of being able to use the tax losses sooner rather than later or never because of [Atlantic's] income. We concur with the ALJ that this does not represent retroactive ratemaking.

RC-116, p. 6.

Thus, in order to calculate the benefit to ratepayers, the Board has directed that affiliate tax losses since 1991 be considered. *Id.* Ms. Crane's adjustment in this proceeding properly accounted for this benefit through the Board's long standing consolidated tax adjustment rate base methodology.

Further, PSE&G ignores the reality that the ratemaking process inherently contains a retroactive element. The Board uses historic information to establish costs going forward. This is most obvious in the use of test year revenues and expenses. For example, the Board will raise utility rates if it finds that the utility has been under earning in the past. But this is not an attempt to surcharge ratepayers for those past Company losses. Rather, it is consistent with the nature of ratemaking to consider past costs in an attempt to project the level of costs that the Company may incur in the future. Certainly the Company would not consider this "retroactive ratemaking." Similarly, the use of prior years' tax information in the Board's chosen consolidated tax adjustment methodology does not constitute a violation of the prohibition against retroactive ratemaking.

D. The Board's Consolidated Tax Policy Does Not Breach The Division Between Regulated and Non-Regulated Operations.

PSE&G next argues that the Board's consolidated tax adjustment "improperly breaches the separation of regulated and unregulated operations." *PIB,* p. 28. PSE&G claims that the costs incurred by the unregulated affiliates are not borne by PSE&G ratepayers and argues that ratepayers do not assume the risk associated with the unregulated businesses. PSE&G then claims that the consolidated tax adjustment is an impermissible attempt to regulate the unregulated affiliates of Enterprise Group.

First, as recognized by the Board in the 2004 Atlantic City Electric proceeding, the "wall of separation between the utility and non-utility side has been breached" not by the Board's consolidated tax adjustment but by the utility's agreement to join the consolidated tax return in the first place. *RC-116*, p. 6. PSE&G chose to enter into the consolidated tax filing with its parent. *RC-131, RCR-A-67,* p. 2 (Tax Allocation Agreement Between Public Service Enterprise Group Incorporated and Public Service Electric and Gas Company). According to the Tax Allocation Agreement, PSE&G calculates its tax liability on a stand –alone basis and pays the amount of this liability to Enterprise Group. Enterprise Group then pays excess funds back to members of the consolidated group with tax losses, thereby transferring utility ratepayer funds, collected as income tax expense, to unregulated affiliates that generate income tax losses. In fact, PSE&G has acknowledged that from 1993 to 2007, the cumulative amounts paid by PSE&G to Enterprise Group exceeded the cumulative taxes paid to the IRS by Enterprise Group. *RC-131,* p. 31*, App, C, response to S-PREV-91*. By crediting ratepayers with carrying costs on these funds, the consolidated tax adjustment adopted by the BPU partially compensates ratepayers for this subsidization.

PSE&G claims that the non-jurisdictional entities have on their own produced taxable income and therefore "Enterprise received no benefit from the utility's contribution of taxable income to the consolidated return." *PIB*, p. 26 This argument, that assumes that tax losses are first used by the unregulated affiliates, has already been considered and rejected by the Board:

> JCP&L believes that a consolidated tax savings adjustment is not appropriate in this case because over the time in question, offsetting the tax losses by the positive income of only unregulated companies could have produced tax savings. . . . The Board

> believes that Staff correctly points out that allocating all of the savings to the unregulated affiliated, as proposed by JCP&L in this proceeding, would be as arbitrary and unfair as it would be to allocate the entire savings to the regulated companies.

RC-117, p. 46 (*JCP&L Consolidated Tax Board Order.*)

Moreover, it is not correct to say that PSE&G ratepayers "do not assume any of the risk related to the unregulated businesses." *PIB,* p. 28. In fact, PSE&G admitted at the hearings that because Enterprise Group files a consolidated tax return, the IRS will hold all members of the consolidated group individually responsible for the entire annual tax liability of the group. Indeed, any one member of the group could be held accountable for payment of the entire amount of taxes due. *T1275:L10-18*. Thus, the consolidated tax filing is certainly not risk free to PSE&G's ratepayers.

PSE&G next argues that a consolidated tax adjustment would violate the cost responsibility principle, which "dictates that the party that incurs a cost is entitled to the associated tax benefit." *PIB,* p. 28. In a related argument, PSE&G claims that the consolidated tax adjustment is an impermissible attempt on the part of the Board to regulate the non-regulated entities. *PIB,* p. 30.

In making these arguments, PSE&G appears to be under the misconception that the Board's consolidated tax adjustment is an attempt to review or to regulate the transactions of the utility's unregulated entities. This is simply wrong. The Board's consolidated tax adjustment is made in recognition of the fact that the consolidated filing has a direct impact on the regulated entity. That impact is lower taxes. What the Board is doing with this adjustment is not attempting to regulate the unregulated entities but rather the Board is ensuring that PSE&G "receives the use of the actual tax dollars saved,

while ratepayers are not put in the position of providing the utility with a return on these dollars." *RC-118*, p. 64.

As explained by Ms. Crane at the hearing during PSE&G's cross:

> Q. Let's suppose that . . . Enterprise had a subsidiary that did nothing but lobbying.
>
> A. Okay.
>
> Q. Had all expenses lobbying and, therefore, was a loss company because it had no revenues and expenses. Now, what would you do … in your consolidated income tax adjustment with that subsidiary, would that be considered in your adjustment or would that not be considered?
>
> A. Oh, it definitely would be considered as long as it was part of the consolidated income tax group, as long as it was part of the tax sharing agreement, as long as ratepayer dollars were going to the parent company to then be used by the parent to reimburse the lobbying company for its tax losses, absolutely. That company would be included in my consolidated tax adjustment.
>
> We are not addressing at all the transactions that occur within any company, regulated or unregulated other than the utility. That's not, that doesn't happen in consolidated income tax adjustment. All we are doing is saying we're providing dollars that are not going to the IRS, how should those dollars be treated for ratemaking purposes.
>
> Q. But what causes the loss in the lobbying expense? It was an expense. Is that correct?
>
> A. Doesn't matter, . . . , because we are not regulating that. We are not looking at the transactions that occur in any other subsidiary. All we are doing is we are saying we the utility or you the utility are impacted by the fact that you're part of this group and you have a tax sharing agreement. Ratepayer dollars are being given to the parent that are not going to the IRS. What are we going to do with those dollars. That is what we're doing. We are not . . . trying to get behind the transactions of the unregulated subsidiary . . . . Our hands are off those transactions. All we're doing is saying what is the impact to the utility for filing consolidated tax returns.

T1710:L17 – T1712:L14

Thus, in making this consolidated tax adjustment, the Board is not attempting to regulate unregulated affiliates. By making a consolidated tax adjustment to rate base, the Board is simply recognizing the impact the consolidated tax filing has on the regulated entity and sharing the benefit of this arrangement with the utility's ratepayers.

E. PSE&G Chose To File Taxes As Part Of Enterprise Group's Consolidate Tax Group and Therefore Must Share With Ratepayers The Benefits Of Belonging To That Consolidated Tax Group.

PSE&G claims that it should not be bound by the Board's long standing policy on consolidated taxes as PSE&G has "reasonably relied" on Rate Counsel's prior testimony on the consolidated tax adjustment calculation. *PIB*, p. 50. PSE&G therefore argues that it should be given the opportunity to restructure its operations in order "to eliminate the issue." *PIB,* p. 51. PSE&G further argues that the proposed consolidated tax adjustment would reduce the economic benefit to shareholders from lease investments made by PSEG Resources and from investments in renewable energy equipment, thereby discouraging further investment in these businesses. *PIB,* p. 50-57.

It is not credible that Enterprise Group's entire investment strategy is based on Mr. Henkes' testimony in prior PSE&G base rate cases. This is a very sophisticated company that was no doubt aware of the Board's Orders on this issue. For them to claim that they did not realize the same policy would apply to them is not credible. For them to ask to be excused from sharing tax savings with ratepayers as a result of their claimed ignorance is unsupportable. If, as claimed, the consolidated tax adjustment will threaten "financial ruin for the unregulated leasing business" it would have been unreasonable for a company as sophisticated as PSE&G to assume that its liability would be based on Rate

Counsel testimony from a prior rate case and not the Board Orders specifically addressing the issue. *PIB,* p. 54

A prudent utility would have made a financial assessment prior to filing this case. In making that assessment, a prudent utility would have considered the consolidated tax adjustment that would also be imposed under the Board's current policy. In making that assessment, a prudent utility would have weighed the risk of such an adjustment against the benefits of filing with the IRS as a consolidated entity. The prudent utility presumably decided that the benefits of the consolidated tax filing out-weighed the potential cost of a consolidated tax adjustment. The Board's consolidated tax adjustment is a rational way to share the tax benefits associated with the consolidated tax filing with the utility's ratepayers. If PSE&G decides that it does not want to be subject to a consolidated tax adjustment, PSE&G has the option of leaving the consolidated tax group prior to its next base rate case.

F. Conclusion

PSE&G has claimed in this case federal income tax expense of $111.519 million for electric operations and $67.815 million for gas operations, calculated on a stand alone basis. PSE&G files its taxes as part of Enterprise Group's consolidated income tax filing pursuant to a tax sharing agreement. To share with ratepayers the benefits of this tax sharing agreement, Rate Counsel witness Andrea Crane has calculated a rate base Consolidated Tax Adjustment, fully consistent with BPU precedent, of $281.935 million for PSE&G's electric utility and of $38.360 million for PSE&G's gas utility. This Consolidated Tax Adjustment results in a revenue requirement adjustment of approximately $38.7 million for electric operations and or $6.4 million for gas

operations. Rate Counsel's consolidated income tax adjustment is fully consistent with BPU policy and should be adopted.

POINT IV

RATE COUNSEL'S PENSION EXPENSE CALCULATION IS REASONABLE AND REJECTING THE PENSION TRACKER IS CONSISTENT WITH TRADITIONAL RATE MAKING.

By intention, design, accident or ignorance PSE&G continues to misstate or misunderstand the testimony of Rate Counsel Witness Mitchell Serota and his valuation of a reasonable amount of pension expense for ratemaking purposes. Mr. Serota's testimony quantified the excessive risk that PSE&G's pension investment portfolio contained as the Pension Benefit Obligation neared 100%, and disallowed a reasonable amount of that pension expense that represents the risk that should not be borne by ratepayers. In its Initial Brief, PSE&G failed to address the Riskiness of its Pension Committee's actions or provide any evidence to support PSE&G's pension expense claims. Simply put, PSE&G has failed to sustain its burden of proof to justify its requested pension expense.

PSE&G's essential argument is that whatever pension expense it incurred should be passed through to ratepayers. If the Company's investment decisions resulted in a higher risk and a greater loss in the current recession, the ratepayers should bear the full cost of the risk the Company chose to take on. Rate Counsel's essential argument is that if the Company's Pension Investment Committee chose to take on riskier investments, even after its Pension Benefit Obligation was almost fully funded, the loss that resulted when that risk led to record losses must be shared by shareholders. This is particularly true when the Company chose to take on risk that was not prudent. Rate Counsel maintains that its position, and its adjustments to PSE&G's pension expense, are not only

fair, but necessary to ensure that the Company pursues an investment strategy that incorporates an appropriate level of risk for its pension expenses.

In arguing the reasonableness of the pension expense it seeks, PSE&G offered the testimony of Mark Kahrer and Joe McDonald. (*P7*: p.1-2; *P7RB*: p. 2; *P7RB*: p. 6; *P12RB*: p. 2; *P12RB*: p. 1) Mr. McDonald, PSE&G's Actuary, testified under questioning by both Rate Counsel and Your Honor that: "To be very clear, I think the heart of my testimony that I went through this morning was not defending any decisions made by the company. It was clarifying the actuary cost implications had a different decision been made." *T603:L11-15.* When asked, again, to specifically confirm that he was not defending the decisions made by PSE&G with respect to the pension fund investments, Mr. McDonald replied, "Correct." *T619:L6*. Mr. Kahrer, PSE&G's only other pension witness, is not an Actuary nor did he testify as an expert on the investment decisions addressed by Mr.Serota.

On the other hand, Mr. Serota testified at length regarding his calculation of the reasonable cost of the excessive risk associated with the investment decisions made by PSE&G. Rate Counsel's adjustment for pension expense is a mathematical calculation reflecting the lost value of the "riskier" assets experienced in the 2008 financial market meltdown. It is a measurement of the amount of loss associated with the riskier assets, above the rate of return or discount rate for "low risk" investments as established by PSE&G. *T713:L1-21; RC 52, p. 6-7*

PSE&G attempts to undercut Mr. Serota's analysis by adopting an "everyone did it" defense of its investment risk decisions. However, PSE&G introduced no evidence regarding the funding status of the pension plans of "everyone" and without evidence of

that funding status there can be no valid comparison between PSE&G's pension plans and any other plan. Notwithstanding the lack of evidence, PSE&G still attempts to use them, stating "PSE&G's pension portfolio strategy as of 2008 was consistent with, and more conservative then [sic], the investment strategy adopted by many similarly situated companies." *PIB,* p. 105. PSE&G ignores the fact its pension fund was almost 100% funded and instead argues prudence with respect to its asset mix. Investments may be prudent, in a general sense, but they may still be too risky, particularly if investment goals are almost 100% achieved. Therefore, whether any or all pension funds were invested in the same stocks as PSE&G is irrelevant to whether or not PSE&G's investments were too risky considering the almost fully funded status of its Pension Plans. *T694:L3-7.* The concept of looking at risk, as a plan's fully funded levels are reached is endorsed by Mr. McDonald's firm, Hewitt Associates, who recommend that as investors get closer and closer to their funding goals they start reducing risk. *RC-44,* p. 2

The full picture of PSE&G's investment strategies is an appropriate subject for review by the parties and Your Honor. The full picture can only be examined if risk is examined. As Mr. Serota stated,

> [T]o accept the level of pension expense requested by PSE&G would retroactively validate a perverse incentive. When they have gambled and succeeded, there was no rate reduction. Now that they have lost they are asking the ratepayer to recoup their losses.

T691:L18-23

Ratepayers should not be subject to such one sided incentives.

PSE&G did not offer evidence to refute Mr. Serota's testimony that PSE&G pursued an excessively risky investment strategy or his calculations of the losses attributable to that strategy. Instead, the Company mischaracterizes and falsely restates Mr. Serota's testimony as calling for pension plan assets to be "transferred entirely into "risk free" investments" *PIB*, p. 98, 102, 105, 110 and that he expected them to have "the extraordinary prescience to divest itself of all equity investments on the eve of the market decline." *PIB*, p. 104, 114-115 PSE&G also suggests that Mr. Serota's Supplemental Testimony reflects a change in position after his initial testimony was "jettisoned." In reality, Mr. Serota's Supplemental Testimony was based on discovery that was not provided by PSE&G until January 2010 that revealed the risky investment strategy that contributed to the Company's staggering losses.

The record is clear that Mr. Serota accounted for some level of risk in the Company's investments and did not expect a risk-free portfolio. When PSE&G asked Mr. Serota on cross-examination; "[Y]our recommendation is for the BPU to assume that the company converted to 100 percent – 100 percent of its investment portfolio to … [a] bond portfolio," *T728-729:L.24-2.* Mr. Serota replied: "I don't think I recommended that." *T729:L4*. … "I was asked to calculate the amount of risk. Instead of looking at it qualitatively and saying it was risky, to look about it quantitatively and to evaluate how much risk was actually in the portfolio at that time." *T729:L14-18*; *T711-712:L23-13; T714:L. 4-5*; and, *T716:L19-22*

Despite this, PSE&G argues that Mr. Serota's analysis "ignores the logical consequences of his assumption that PSE&G's entire investment portfolio was converted to low risk bond investments as of January 1, 2008." *PIB,* p. 113. The purported

consequences are that the investment portfolio gain in 2009 would not have materialized if PSE&G only held bonds in 2008, and that the expected rate of return would thus have been 5.50% instead of 8.50%. Even if Mr. Serota had advocated for total divestment of risk, the alleged consequences are inaccurate. If PSE&G had been 100% in low risk securities on January 1, 2008 there would have been no losses to its Pension Plan to discuss in this case. Similarly, the 2009 return that PSE&G claims it would have lost was in fact illusory because it was ultimately wiped out as part of the over $1 billon loss experienced by the Pension Plan in 2008. If there had been no losses in 2008, the Pension Plan would have still been better funded than it was after the recovery of approximately 40% in 2009. The illusory 3% lower return on the $1 billion loss is $30 million, presumably even PSE&G would have preferred this loss to the $1 billion loss suffered by its Pension Plan.

The record is also clear that Mr. Serota was not expecting PSE&G's Pension Investment Committee to be psychic, but simply to follow sound investment strategy. PSE&G argues that "Mr. Serota's suggestion that PSEG should have "immunized" its portfolio at the under-funded level of 96.8% on a PBO basis is inconsistent with the actual investment practices of the vast majority of pension plan sponsors." *PIB,* p. 109. This statement mischaracterizes Mr. Serota's testimony and then argues that his false position is without merit. As Mr. Serota testified, "For one thing I never said that they should sell all of their stocks and buy bonds immediately." *T690:L12-14.*

Instead, Mr. Serota's recommendations are consistent with the recommendations of Mr. McDonald's firm, Hewitt Associates. Hewitt Associates' strategy advises its clients to rebalance pension assets as the plan becomes better funded. *RC-52*, p. 5,

Referred to as the "Dynamic Investment Policy" approach, the Hewitt plan advises, "the key premise of the Dynamic IP is to develop a well-defined LDI [Liability Driven Investment] asset allocation strategy based on two broad asset categories (risky assets and liability matching assets) that varies as plan funded ratios change." *RC-44*, p. 2. Hewitt also recommends a "flight Path for Investment". *RC-44*, p. 3. Such a path would, for example, involve an asset risk factor of 70% for a fund that is 70% funded, and a 10% asset risk factor for a 100% funded pension fund. The "Flight Path" recommended by Hewitt Associates' supports Mr. Serota's contention that PSE&G's investment decisions were too risky. While Mr. McDonald, a Hewitt Associates partner was not offered as a witness for the purpose of defending PSE&G's investment decisions, and he pointedly declined to do so, it is note-worthy that Hewitt, in the advisory materials available to all clients of the firm, supports the position advocated by Mr. Serota that a less risky strategy should be pursued as funding levels increased. If Hewitt Associates recommendations were applied to PSE&G's pension plan, at the beginning of 2008, it would have adopted a less risky strategy. If they chose not to, they should not look to ratepayers to absorb their full losses.

PSE&G has not offered testimony to establish that its investment strategy encompassed an appropriate level of risk or to support its position that once it determined to pursue such a strategy, that ratepayers should assume full responsibility for that risk. PSE&G's case consisted entirely of establishing that the pension plans had in fact incurred the claimed losses, thus maintaining that the Company and its shareholders bore no obligation to pursue a less risky investment strategy or contribute to the unfortunate consequences that resulted from their choice to invest in riskier assets. As emphasized in

the Brief filed by BPU Staff, PSE&G bears the burden of proof in demonstrating that its proposed pension expense increase is just and reasonable. Staff, based on the evidence established in the record has concluded that "Rate Counsel's adjustment to the Company's recommended amount is reasonable and justified." *SIB*, p. 29 Rate Counsel urges that Your Honor reach the same conclusion and Order the sharing as proposed in Mr. Serota's testimony.

PSE&G also has the burden to justify its proposed Pension Expense Tracker ("PET"). *SIB*, p. 6. Staff noted that PSE&G failed to carry its burden of proof in this regard, stating "absent the Company's proof that it would suffer financial hardship without a tracker, trackers and formula rate mechanisms should be rejected by the Board." *SIB*, p. 27. In discussing Mr. Kahrer's testimony regarding the necessary long-term strategies of pension plan investments, Staff opposed the PET and concluded that "sound regulation calls for Your Honor and the Board to reject cost-tracker mechanisms between rate cases". *SIB*, p. 29.

As argued by Rate Counsel in its initial brief, the PET is a departure from long held Board policy and should be rejected. It represents an extreme reaction to the unusual conditions of the current financial markets. The amount, in terms of total cost sought by PSE&G for pension expense is distorted by the risky nature of the pension fund assets, a factor that resulted from a Company decision, not, as asserted by PSE&G, something that was "largely beyond the Company's control." *PIB*, p. 118. PSE&G's argument is that any cost that is "volatile" should be addressed in a clause, thus seeking permanent immunization from imprudent investment decisions. These arguments represent a significant departure from traditional rate regulation which is designed to

account for a full analysis of the Company's expenses and revenues and provide an opportunity to earn a fair return. It is not designed to insulate shareholders from risk or the Company from the consequences of its decisions. For these reasons and those set forth in Rate Counsel's Initial Brief, Your Honor should reject the PET and accept Rate Counsel's pension expense adjustments of $8,155,000 for electric and of $9,187,000 for gas, respectively, as more fully set forth in Ms. Crane's allocation, *RC-133*.

POINT V

PSE&G'S INCENTIVE COMPENSATION PROGRAMS SHOULD BE FUNDED BY SHAREHOLDERS WHO RECEIVE THE MOST BENEFIT FROM THESE PROGRAMS.

In this filing PSE&G has requested that ratepayers pay the costs associated with three incentive compensation programs: $2.3 million for the Management Incentive Company Plan ("MICP"); $14.5 million for the Performance Incentive Plan ("PIP"); and, $9.5 million relating to the Long-Term Incentive Plan ("LTIP"). *S-73.* Interestingly, while PSE&G has requested recovery for all three programs, the only one mentioned by name in the PSE&G Initial Brief is the PIP, the only program that is available to employees other than upper management. PSE&G's arguments ignore that these programs are geared not at encouraging low level employees to improve operations, but at high level executives to improve profits.

PSE&G repeatedly argues that the recent implementation of wage freezes for union and MAST (Management, Administrative, Secretarial and Technical) employees makes the funding of incentive programs "more important than ever." *PIB* p. 121. Initially, it should be noted that it is not Rate Counsel's position that PSE&G cannot choose to reward its executives with bonuses for outstanding performance. Rate Counsel's position is that because the measurement for outstanding performance is based in large part on PSE&G's profitability and enhanced shareholder value, PSE&G's shareholders should pick up the cost of these programs.

PSE&G repeatedly claims that its incentive compensation programs are "not simply additive" but that the incentive compensation portion was "carved out" of base

wages over a three year period starting in 1995. *PIB,* p. 123. While it may be true that in 1995 PSE&G's base compensation level was set below market-based prices, there is nothing in the record to indicate that this situation continues today. Indeed, the record in this proceeding shows quite the opposite, that base salary levels paid to PSE&G employees are targeted to meet market levels. For example, in 2008, "base salaries for the [named executive officers] as a group were increased by 5.6% over 2007 to reflect general market adjustments for comparable positions." *NJLEUC-4*, p. 196. In 2009, Mr. LaRossa received a 10% "salary adjustment," "to reflect a level of salary within the competitive range." *Id.* Mr. DiRisio received a 3.5% "salary adjustment" to "provide a level of salary within the competitive range." *Id.* Indeed, since at least 2004, MAST employees have consistently been awarded annual payroll increases from 3.0% to 4.0%. *RC-131*, p. 57, RCR-A-8. Thus, the record in this proceeding does not support PSE&G's contention that base salaries for PSE&G MAST employees are below market levels.

Further, as explained in PSE&G's Form 10-K, the base salary or fixed cash part of PSE&G's executive compensation program is intended to reward these executives for performing "his/her basic job functions." *NJLEUC-4,* p. 192. The basic job function of a PSE&G employee is to provide safe reliable energy service at the lowest possible cost. Indeed, as pointed out at the hearing by Mr. Kahrer, providing safe and reliable service is an integral part of each employees' job.

> Q. Do you believe that good customer service is an integral part of an employee's job at PSE&G?
>
> A. I would believe that, yes.
>
> Q. And do you believe that safety is an integral part of each employee's job?

A. It is absolutely one of the most important things that we do in our jobs on a daily basis.

Q. And do you think PSE&G employees should be expected to provide reliable service as part of their job?

A. Yes, we do. And I think the record is pretty clear when you compare us to everyone else in the industry, that we lead – last night, in fact, I took a look at the top quartile performance in safety and reliability PSE&G is absolutely there in every metric that we measure.

T1398:L12 – T1399:L2.

Thus, PSE&G employees are compensated through their base salary for "basic job functions" of providing safe and reliable service. This is the amount of compensation that should be recovered from ratepayers.

On the other hand, the "Annual Cash Incentive" is "intended to reward for driving strong operating results over a one year time-frame" and "creates a direct strong connection between business success and financial reward." *NJLEUC-4*, p. 198. Similarly, the "Long-Term Incentive" plan rewards "strong operating and stock performance" and "provides for strong alignment with shareholders." *Id*. As noted in PSE&G's Form 10-K, shareholder "value creation" is a driving force behind PSE&G's executive compensation plan,

> Given the dynamics of the market place, we regularly evaluate the compensation philosophy, strategy and programs to ensure they accomplish the following objectives:
> - Drive and reward performance;
> - Align with long-term shareholder value creation;
> - Allow us to attract and retain the talent needed to effectively execute our strategy; and
> - Provide a competitive total compensation opportunity

NJLEUC-4, p. 190.

These bonus plans are focused on financial goals and shareholder enhancement and the costs of these programs should not be recovered from ratepayers.

Furthermore, while PSE&G may have decided that there will be no wage increase in 2010 for employees, this does not mean that executive bonuses should be allowed in rates to compensate already highly compensated employees for deferred 2010 increases. PSE&G would have Your Honor believe that it is the secretaries and the linemen who gave up their salary increases would be the ones receiving these bonus payments. However, bargaining unit employees are not eligible for these bonuses. And, as discussed in our initial brief, two of these programs are not open to all MAST employees but are limited to officers and executives, Grade levels 10-12. *T1399:L25*. The PIP is open to all MAST employees, including Grade levels 10-12, but, like the LTIP and the MICP, the PIP has a strong focus on enhanced shareholder value. The PIP overview provided by PSE&G provides "highly successful business areas and/or individuals who contribute greatly to enhance PSEG shareholder value will be rewarded through a pay differentiation in their final PIP payout." *P-52*. Thus, as shareholders are the primary beneficiary for outstanding employee performance for all three incentive compensation programs, shareholders should assume the costs of these programs.

PSE&G further claims in its brief, with no citation to the record, that "the record demonstrates that these programs support a broad range of goals, including goals that directly as well as indirectly benefit PSE&G customers." *PIB,* p. 122. Indeed, there is nothing in the record in this proceeding that would enable Your Honor and the Board to determine what specific elements were measured and weighed in making incentive compensation to these employees or how these elements "directly benefit" ratepayers.

Mr. Kahrer may tell us that the emphasis is on "safety, customer satisfaction, system reliability and cost control" but the fact remains that these factors are not

specified in any of the plan documents provided by PSE&G. Moreover, the PSE&G workers on the street, the linemen, meter readers, appliance mechanics and underground technicians - the very workers most affecting safety and reliability goals and most visible to utility ratepayers - are not eligible for these bonuses. Thus, while Mr. Kahrer may tell us that the emphasis is on safety and reliability, there is nothing in the record to support this statement.

Finally, PSE&G argues incorrectly that Ms. Crane's "characterization of 'Board policy' is off base." *PIB,* p. 128. As noted by Board Staff, "the BPU has consistently disallowed incentive compensation that is tied to financial performance objectives." *SIB,* p. 31. Indeed, in its brief in this proceeding, Board Staff cites to several Board Orders "establishing Board policy." *SIB,* p. 31-32. And the policy is that incentive compensation programs rewarding high earnings and enhanced shareholder value, do not belong in base rates.

Accordingly, for the above reasons, Your Honor should reject PSE&G's proposal to collect in rates from New Jersey ratepayers $26.30 million in incentive compensation expenses.

POINT VI

THIRTY YEAR PERIOD SHOULD BE USED TO DETERMINE NORMAL WEATHER.

Rate Counsel set forth legal, scientific and statistical reasons for the Board to adjust the sales projections of PSEG's pro forma revenue claim based on a thirty-year period of normal weather data, rather than the twenty-year time period used by PSE&G to determine its original test year revenue forecast. PSE&G has failed to rebut any of those objective reasons, instead serving up its opinions supported only by invective. The burden of proof to show that the [proposed rate] increase ... is just and reasonable [is] upon the public utility making the same." N.J.S.A. 48:2-21(d); *see*, In re Public Service Elec. and Gas Co., 304 N.J. Super. 247, 265 (App. Div. 1997), certif. den., 152 N.J. 12 (1998); Public Service Coordinated Transport v. State, 5 N.J. 196 (1950). Since PSE&G has not carried its burden of proof, Rate Counsel recommends use of thirty rather than twenty years of normal weather data.

A standard using thirty years of normal weather is more appropriate because it is based upon the meteorological science used by the National Oceanic and Atmospheric Administration ("NOAA")[2] and other weather experts such as the United Nations' World Meteorological Organization ("WMO").[3] PSE&G failed to rebut the fact that both

---

[2] NOAA, an agency with the U.S. Department of Commerce, is responsible to collect, forecast and distribute "meteorological information in the interests of agriculture and commerce." 15 U.S.C. § 313; see 33 U.S.C. §§ 311, 1101: 15 U.S.C. § 1503b, Reorganization Plan No. 4 of 1970; http://www.noaa.gov/about-noaa.html (last viewed 3/15/10).

[3] Convention of the World Meteorological Organization, done at Washington Oct. 11, 1947, entered into force Mar. 23, 1950. TIAS 2052; 1 UST 281; see 22 U.S.C. § 288; http://www.wmo.int/pages/about/index_en.html (last viewed 3/15/10).

NOAA and the WMO continue to rely on thirty years of normal weather data.[4] The position of those government agencies is an undisputed fact.

PSE&G's brief confuses the roles of regulatory agencies in determining and applying standards within their respective areas of expertise. *PIB,* p. 89. The role of the Board is to regulate utility rates, and adjudication of such a matter involves applying a variety of standards. The Board, however, does not set those standards. Those standards include, among others, the Generally Accepted Accounting Principles, determined by the Governmental Accounting Standards Board,[5] and the meteorological practices for calculating "normal" weather, determined by NOAA and the WMO. The application of well-established, credible and reliable standards, rather than experimental proposals, provides firm support for the decisions of this court and the Board. *See*, City of Newark v. Natural Resource Council, 82 N.J. 530, 539, cert. denied, 449 U.S. 983, 101 S.Ct. 400, 66 L.Ed.2d 245 (1980) (agency exercise of its statutorily delegated duties presumed reasonable).

Thirty years of normal data yields a more accurate projection since it is less prone to extreme variations due to unusual weather in a particular year. Such extremes would introduce an erroneously large variability into the standard to measure "normal." Rate Counsel respectfully disagrees with Board Staff on this point. *SIB,* p. 38.

Board Staff correctly recounted Andrea Crane's explanation that

---

[4] *See,* http://www.crh.noaa.gov/grr/climate/normals/ (explaining NOAA calculation and use of 30-year normal climate calculations) (last viewed 3/15/10); *see also* Secretariat of the WMO, Technical Regulations, Volume I, "General Meteorological Standards and Recommended Practices," Geneva, 1988 edition, WMO No. 49, at xiii ("climatological standard normals").

[5] *See*, http://www.gasb.org/facts/facts_about_gasb_2010.pdf (last viewed 3/24/10). The GAAPs have been accepted by the New Jersey courts as authoritative accounting methods. *See* In re Public Serv. Elec. & Gas Co.'s Rate Unbundling, 167 N.J. 377, 405, cert. denied, Co-Steel Raritan v. N.J. Bd. of Pub. Utils., 534 U.S. 813, 122 S.Ct. 37, 151 L.Ed.2d 11 (2001).

longer time periods are preferable to shorter ones for purposes of weather normalization, because (1) longer time periods tend to average out weather and temperature extremes much better than shorter periods, and (2) a shorter time period may fail to include extreme weather (very cold or very warm temperatures) in computing average degree days. *SIB, p.* 35-36 *(citing RC-131,* p. 41-42*)*.

In particular, Ms. Crane explained that

a single data point has a 5% impact on a twenty-year average, but only a 3.3% impact on a thirty-year average. Therefore, the effect of a single data point is 50% greater with a twenty-year average than with a thirty-year average. *RC-131*, p. 41-42.

An average based on twenty years of data, therefore, will be less accurate than an average based on thirty years of data because any one year with an extreme average temperature will cause a disproportionately (50%) larger variation in the "normal" average. PSE&G has not attempted to rebut this mathematical fact.

Indeed PSE&G concedes, as Mr. Wreschnig admitted on cross, that more electric and gas utilities use a 30-year rather than a 20-year period for weather normalization. *T:1352:L25-1353:1 (citing RC-119).* PSE&G itself filed its last electric and gas base rate cases using a thirty-year weather normalization, *P-17-RB-1*, p. 4 -5 and *RC-131*, p. 40, lines 15-16. Thus, both the agency that determines meteorological practice (NOAA) and the majority of electric and gas utilities continue to use the 30-year standard.

Although PSE&G's Mr. Wreschnig testified that Elizabethtown Gas Company and New Jersey Natural Gas Company use a 20-year period of normal weather, both companies provide only gas service, while PSE&G provides both gas and electricity service. As PSE&G observes, warmer weather may reduce the sale of gas for heating but may increase the sale of electricity for cooling. *PIB,* p. 87. In addition,both matters

involved implementation of an experimental weather normalization charge for a trial period. *See,* I/M/O Elizabethtown Gas Co., *supra*, p.3 ¶8 ("It is the intent of the parties that the weather normalization charge be implemented on an experimental basis ...") see Rate Counsel's Appendix to Initial Brief p.71; I/M/O New Jersey Natural Gas Co., *supra*, p. 2 (allowing implementation of clause "on an experimental basis …") see Rate Counsel's Appendix to Initial Brief p.85 - 87.

The attempt in PSE&G's brief to undercut NOAA's 30-year standard instead reveals an apparent misunderstanding of that standard. The company cites what appears to be a PowerPoint presentation by a NOAA researcher for the proposition that the 30-year average is "first on the list of 'experimental' NOAA measures." *PIB*, p. 91 *(citing RC-119, referenced as RCR-A-259).* In fact, the referenced PowerPoint presentation describes the subject of inquiry by that researcher, Anthony Arguez, as "a suite of Experimental Products that supplement the Traditional 30-Year Normals." *RC-119,* p.3 of 84 (emphasis added)*; id. at 8 of 84 ("Supplement, Not Replace, 30-Year Normals").* PSE&G's citation is simply incorrect.

Accordingly, Rate Counsel recommends that the Board adjust the sales projections of PSE&G's pro forma revenue claim based on a thirty-year period of normal weather data, rather than the twenty-year time period used by the company to determine its original test year revenue forecast.

POINT VII

PSE&G'S WEATHER NORMALIZATION CLAUSE PROPOSAL SHOULD BE REJECTED AS FILED, AND, IF SUCH A PROGRAM FOR THE COMPANY WERE APPROVED, IT SHOULD ADHERE TO THE ESTABLISHED BOARD POLICY BEING FOLLOWED BY THE OTHER GAS UTILITIES IN THE STATE.

In its initial brief, PSE&G continues to erroneously argue that Rate Counsel's version of the application of a weather normalization clause (WNC) is "asymmetrical" and that the Company's proposal is actually "symmetrical" and fairer to customers and its shareholders. *PIB,* p. 96. PSE&G also stated in its initial brief that Rate Counsel's WNC position is "contrary to common sense and virtually punitive." *Ibid.* However, what PSE&G ignores is that Rate Counsel's position represents the established Board policy for applying a gas WNC that has been in operation for almost 20 years and has been uniformly complied with by the other gas utilities in the state. *RCIB*, p. 67. None of the other gas utilities are allowed to retain revenues through their WNCs if there is colder than normal weather; and none of the other utilities are allowed to "self-determine" if they are under-earning their approved rate of return. *RCIB*, p. 68. As explicitly explained in Rate Counsel's initial brief, the rationale for this is simple and well-established in ratemaking principles: if a utility has a belief that it is under-earning, the solution is to file a base rate petition. *RCIB,* p. 70 -71.

The proper function of a WNC is to adjust for variations in weather and the resultant impact on captive ratepayers; not to rectify any perceived lack of earnings by the utility. *Ibid.* As succinctly addressed in its initial brief, Staff agreed with Rate Counsel's position on the application of a WNC in relation to any recovery and a

company's rate of return. *SIB*, p. at 39. Staff further recommended that Your Honor and the Board specifically reject the provision in PSE&G's proposed WNC tariff that would allow the company to retain margin revenues perceived to be achieved when they are "under-earning", and, that "… [t]he risk that the Company may earn less than its authorized rate of return on equity is one the Company must be expected to take." *Ibid.* As this is the standard applied to every other gas utility, it would be unfair to grant PSE&G a special preference to use its WNC as a hedge against normal risk. A WNC should only be used to account for weather. Rate Counsel relies upon its position in its initial brief and reiterates that PSE&G's WNC tariff should be rejected as filed as being contrary to established Board policy and ratemaking principles.

POINT VIII

PSE&G HAS NOT JUSTIFIED ITS PROPOSED EXPANSION OF THE COMPANY'S CAC CLAUSE TO ENCOMPASS ROUTINE CAPITAL EXPENDITURES OR ITS REQUEST TO RECOGNIZE PROJECTED PLANT-IN-SERVICE IN RATE BASE AS OF AUGUST 31, 2010.

As set forth in Rate Counsel's initial brief, the present Capital Adjustment Clause mechanism ("CAC") represents a limited departure from traditional ratemaking principles in an effort to stimulate utility infrastructure investment during a crippling nationwide credit crunch and the worst economic recession since the Great Depression. *RCIB*, p. 72-79. In its Order approving the Capital Infrastructure Investment Program ("CIIP"), the Board clearly stated that the CAC rate recovery mechanism approved for PSE&G's 38 CIIP projects did not set a precedent: "This [CAC] authorization in no way sets a new framework for future actions; instead, it reflects the realities of today's economic situation." *RC-85*, PSE&G CIIP Order, p. 10. Here, PSE&G has not presented any credible argument to support its contention that the CAC should be expanded to encompass routine capital additions or that its projected capital expenditures through August 31, 2010 – eight months beyond the test year – should be included in rate base. *PIB,* p. 18-20.

As Staff has correctly stated, PSE&G's request is essentially a request to institute "formula rates," allowing the Company to recover its routine capital investments contemporaneously, before a review to determine prudency. PSE&G argues that any routine capital additions covered by its proposed CAC expansion would still be subject to disallowance in a subsequent prudency review, thereby maintaining an incentive for management to control costs. *Id*. at 19. PSE&G also claims that an expanded CAC is

needed to "reduce regulatory lag." *Id*. Finally, PSE&G argues that an expended CAC would "enhance its ability to raise funds to meet its manifest infrastructure needs." *Id*. PSE&G's arguments beg the question of whether such concerns merit a departure from established ratemaking principles in this instance. The CAC was established in the face of an acute nationwide credit crunch and the greatest economic downturn since the Great Depression. Clearly, the Company has not demonstrated that its ongoing ability to finance its routine necessary capital additions has been severely impaired indefinitely, amounting to a permanently distressed national financial climate. As set forth in Rate Counsel's and in Staff's initial briefs, the Company has not made that case. *SIB*, p. 43-53. The Company has not presented any credible argument to dispense with traditional ratemaking principles which foster prudent expenditures and cost control, and which have not been shown to hamper necessary investment because of "regulatory lag."

Traditional rate base/rate of return ratemaking is premised on the matching principle, whereby utility expenditures are matched with utility income. Here PSE&G proposes to institute a permanent CAC to recover the cost of its routine capital additions which would result in annual rate increases of approximately 1-1.2% per year going forward. *PIB,* p. 20. Unlike a base rate case where all revenue requirement items are considered, the proposed additional CAC rate recoveries would not be offset by savings in other expense categories or additional utility revenues. The expected rate increases from PSE&G's proposed CAC expansion would go unmitigated. PSE&G has not provided any credible argument to support such a dramatic departure from fundamental ratemaking tenets.

PSE&G has also failed to address the fact that expanding the CAC would operate to shift risk away from its shareholders, as noted by Board Staff, Rate Counsel and NJLEUC. *SIB* at 23-27, 43-53; *RCIB* at 77-79; *NJLEUC* at 3. As set forth in Rate Counsel initial brief and the testimony of its witnesses, expansion of the CAC would operate to increase the percentage of PSE&G revenue tied to clause type mechanisms, thereby reducing risk for the Company. *RCIB*, p. 77-79. Rate Counsel witness Mr. Lelash found that if PSE&G's CAC expansion proposal were adopted, approximately 85 percent of all of the Company's forecasted capital expenditures through the end of 2010 would receive rate treatment through the CAC, rather than through traditional rate base/rate of return recovery. *RC-22*, p. 22. The traditional constraints on excess spending and costs that traditional rate regulation provides cannot be maintained through a subsequent prudency review as asserted by PSE&G when the percentage of the Company's capital expenditures at issue is so high. With 85% of the Company's expenditures at issue, it is not realistic to expect a probing prudency review after the fact.

In sum, expansion of the CAC to include additional distribution capital expenditures between base rate cases would amount to single-issue ratemaking, and would unfairly shift risk from shareholders to ratepayers. Ultimately, as calculated by Ms. Crane, PSE&G's expansion proposal would cost ratepayers millions of dollars in higher utility bills. *RCIB*, p. 72-73. PSE&G has not presented any credible argument to support its proposed departure from established ratemaking principles. For all of the above reasons, PSE&G's proposal to expand the CAC with an "Infrastructure Tracker" should be denied.

PSE&G asks that if the Infrastructure Tracker is rejected, that the Company's rate base be set using its projected plant-in-service as of August 31, 2010. *PIB,* p. 18-20. As set forth above in the brief subsection addressing post-test year capital additions and in Rate Counsel's initial brief, PSE&G's proposed post-test year capital additions do not meet the Board's standards for inclusion in rate base. The Company's proposed claims do not include quantitative support, have not been reviewed for prudency, and have not been reviewed to determine if the proposed plant additions are revenue producing. *RCIB*, p. 22-26. Therefore, PSE&G's proposal to include in its rate base its projected routine capital expenditures through August 31, 2010 should be rejected.

POINT IX

PSE&G'S ARGUMENTS THAT IT SHOULD NOT HAVE TO REPORT ON SPECIFIED SERVICE METRICS AND BENCHMARKS SHOULD BE IGNORED BECAUSE THEY ARE WITHOUT MERIT AND CONTRARY TO THEIR OBLIGATION TO PROVIDE ADEQUATE CONSUMER SERVICE.

The evidence of PSE&G's decreased performance on key industry customer service metrics and benchmarks is well-established and has not been contradicted by PSE&G in either its testimony or initial brief. Rate Counsel's recommended metrics and benchmarks are purely for monitoring purposes as non-compliance with the benchmarks does not trigger automatic penalty assessments. The metrics and benchmarks proposed by Rate Counsel and supported by Board Staff will serve as an invaluable tool for PSE&G and the Board to troubleshoot and track potential problem areas of customer service before problems and complaints escalate. *SIB*, p. 147-148.

PSE&G alleges that its service metric scorecard already tracks Rate Counsel's proposed service metrics. *PIB,* p. 160. It does not. *RC-1,* p. 11. It fails to track at least three important service metrics and benchmarks: customer service response time, abandoned call percentage, and service appointments met. *RC-21A,* p. 13, 24-25*; RC-22,* p. 28 and *Exhibit DCP-1.* Furthermore, PSE&G does not report the eight (8) recommended metrics to both the Board and Rate Counsel and Board Staff concurs with Rate Counsel's recommendation to require the filing of quarterly reports. *SIB,* p. 150.

PSE&G alleges that Rate Counsel's proposed benchmarks are unreasonable and arbitrary, but fails to support this by providing allegedly reasonable industry standards for comparison. *PIB,* p. 166. Moreover, PSE&G erroneously claims that the proposed benchmarks do not take into account PSE&G's unique operational characteristics. *PIB,*

p. 170-171. However, under Rate Counsel's recommendation the company would be allowed to submit exceptions and other reporting to address the problems the company is having with a particular industry metric and benchmark. *RC-21A,* p. 19. Therefore, as further discussed below, PSE&G's arguments against requiring them to track and report on the metrics and benchmarks proposed by Rate Counsel are without merit and should be rejected in their entirety.

A. There is no Reason to Require the Recommended Service Metrics and Benchmarks through a Rulemaking.

It is undisputed that the Board has the power to direct utilities to furnish safe, adequate and proper service, N.J.S.A. 48:2-23, and to that end it may fix just and reasonable standards and practices, such as customer service metrics and benchmarks. N.J.S.A. 48:2-25. The court has consistently upheld the Board's power to "… impose such conditions as to … service or operation as the public convenience and interests may reasonably require," and "… require public utilities to … furnish periodically a detailed report of finances and operations, N.J.S.A. 48:2-16(2)(a), (b)." [N.J.S.A. 48:2-14.]" In the Matter of the Petition of South Jersey Gas Company Against SunOlin Chemical Company and the B.F. Goodrich Company, 116 N.J. 251, 258, 259, 561 A.2d 561, 564, 565 (1989). Courts have held that "agencies have wide latitude in improvising appropriate procedures to effectuate their regulatory jurisdiction," and "…enjoy a great deal of flexibility in the proceedings most suitable to achieving their regulatory aims." Metromedia, Inc., v. Director, Division of Taxation, 97 N.J. 313, 333-334 (1984). Moreover, it is well settled that both the rule-making and the adjudicatory mode may be used by an agency to effectuate legislative and administrative policy. Id., at 334.

Herein, as noted by both Rate Counsel and Board Staff, the evidence of PSE&G's decreased performance on key industry customer service metrics and benchmarks is clear and has not been contradicted by PSE&G. *SIB,* p. 146-148*; RCIB,* p. 80-83*; RC-21A,* p. 17-21, and *Exhibit DPC-1.* Rate Counsel acknowledges that PSE&G is the only dual service utility in the state of New Jersey, with a diverse customer base. However, Mr. Forline erroneously states that Rate Counsel does not account for the company's unique characteristics. *PIB,* p. 170-171. Mr. Forline includes in "unique" characteristics the company's substantial appliance service operation. *PIB,* p. *171.* However, the appliance service operation is a non-regulated service that is irrelevant to the services regulated by the Board and the benchmarks recommended by Rate Counsel. Similarly, Mr. Forline states that the Company responds to no-heat calls. This is not a unique service; it is a tariff obligation that all utilities must follow. *Id.*

Contrary to PSE&G's allegations, the metrics and benchmarks recommended by Rate Counsel are specific to PSE&G and take into account PSE&G's unique operational characteristics. For instance, the industry benchmark for meter reading is generally 95% within cycle. PSE&G's benchmark is 90% read within cycle. Both Rate Counsel and Board Staff are aware of the large number of internal meters that must be individually read, and Rate Counsel is therefore recommending that this benchmark remain at 90% and not the industry standard of 95%. Requiring PSE&G to track these service metrics provides an invaluable tool for PSE&G and the Board to troubleshoot and track potential problem areas related to PSE&G's customer service before problems and complaints escalate and, as pointed out by Board Staff, will ensure that customers receive safe,

adequate and proper service, as required under the New Jersey Administrative Code. *SIB,* p. 145-146.

Therefore, contrary to PSE&G's argument, no rulemaking is not required for the Board to confirm its existing policy in this case. In re Dep't of Insurance' Order Nos. A89-119 & A90-125, 129 N.J. 365, 382-384 (1992). This is particularly true since a failure to meet benchmarks will not trigger automatic penalty assessments if not met, but rather will trigger exception reporting to address PSE&G's unique circumstances in meeting a benchmark. The Company's argument that rulemaking is required is baseless and should be rejected.

B. PSE&G's Claim that its Metric Scorecard Contains Comparable Service Metrics Proposed by Rate Counsel is Inaccurate.

While the service metric scorecard that PSE&G uses tracks numerous performance measures, it fails to include three essential service metrics and benchmarks: (1) service appointments met for other than appliance service repair, (2) customer service representative response, and (3) abandoned call percentage. In addition, PSE&G's scorecard does not track the submittal of exception reports when PSE&G fails to achieve its 60 minute response time for gas leaks. The evidence also shows that PSE&G has consistently fallen below typical industry standards in certain vital customer service metrics, such as: (1) average speed of answer ("ASA") at call centers; (2) meter reading; (3) billing accuracy; and (4) overall customer satisfaction based on the number of complaints filed with the Board. *RC-21A,* p. 13, 24-25; *RC-22*, p. 28 and *Exhibit DCP-1.*

Rate Counsel's recommended service metrics and benchmarks are typical and accepted industry standards that are reasonable and necessary to measure customer interface with PSE&G. Contrary to PSE&G's allegations, similar metrics and

benchmarks are reported quarterly to the Board and Rate Counsel by New Jersey Natural Gas and Elizabethtown Gas companies pursuant to I/M/O Petition of New Jersey Natural Gas Company for Approval of an Increase in Gas Rates, BPU Docket No. GR071100889, p. 6, Decision and Order, October 3, 2008, and IMO Petition of Pivotal Utility Holdings, Inc.. d/b/a Elizabethtown Gas for Approval of Increased Base Tariff Rates and Charges for Gas Service and Other Tariff Revisions, BPU Docket No. GR09030195, p. 6, Decision and Order (12/17/09), Stipulation, p. 8, Appendix A respectively. They should similarly be reported by PSE&G. Therefore, in order for the Board and Rate Counsel to perform their legislative mandates, quarterly reports should be filed on the eight service metrics and benchmarks recommended by Rate Counsel and discussed in its testimony and initial brief.

C. PSE&G's Claims that Rate Counsel's Proposed Benchmarks are Arbitrary and Unreasonable are Without Merit.

Mr. LeLash has provided in-depth testimony on customer service metrics in more than a dozen proceedings in various jurisdictions that have examined and adopted the industry metrics and benchmarks recommended for PSE&G herein. *T251:L22-25; T253:L7-25.* PSE&G's attempts to criticize Rate Counsel's expert testimony are ineffective and without merit.

First, PSE&G argues that Mr. LeLash's testimony is a net opinion. Courts have held that "the net opinion rule has been succinctly defined as a prohibition against speculative testimony. An expert is required to give the why and wherefore of his opinion, not just a mere conclusion. When an expert opinion is based merely on unfounded speculation and unqualified possibilities, or is unsupported by factual evidence, it is inadmissible." Koruba v. American Honda Motor Co, 396 N.J. Super, 517,

525 (2007). Experts must be "able to identify the factual bases for conclusions, explain their methodology, and demonstrate that both the factual bases and the methodology are scientifically reliable." Id., *citing to* N.J.R.E. 703; … "They must also be able to point to a generally accepted, objective standard of practice and not merely to standards personal to the witness. Otherwise, an opinion lacking in foundation is worthless and ceases to aid the trier of fact to understand the evidence or determine a fact in issue." Koruba at 526.

Herein, Mr. LeLash's testimony clearly satisfies these criteria and cannot be characterized as a net opinion. Mr. LeLash collected industry data including but not limited to the Navigant Consulting Report, of which PSE&G has a copy. *PIB,* p. 167. He conducted empirical research and analysis quantifying typical industry metrics and benchmarks, *T251:L22-25; T253:L7-25,* and compared that to information received from PSE&G in discovery regarding certain service performance measures. *RC-22,* p. 25-31. Contrary to PSE&G's claims, Mr. LeLash's expert opinion testimony is based on over twenty years of experience in this field and does not fall within the parameters of what a Court would hold as "net opinion."

Second, PSE&G claims that imposing Rate Counsel's recommended service metric benchmarks would be counter to the Navigant Report which recommends not using the same metrics and benchmarks for all utilities in an area or region. *PIB,* p. 167-168. However, Mr. LeLash used the Navigant Report to develop the service metric benchmarks recommended for PSE&G, and Rate Counsel is not recommending the typical industry benchmarks in all respects for PSE&G. For example, Rate Counsel's recommendation regarding the percentage of meters read on-cycle is 90% for PSE&G, where as the industry benchmark is set at 95%. In response to the alleged additional

deficiencies in Rate Counsel's benchmark recommendations discussed by the Company in its Initial Brief at 171-172, Rate Counsel submits the following:

- Rate Counsel's recommended meter read metric for PSE&G is 90% and not the 95% industry standard stated by the Company;

- the re-bill issue is more than a matter of inaccessible meters as claimed by the Company. The installation of "System X" and/or Credit Worthiness Score ("CWS") resulted in erroneous and duplicative bills, and erroneous shut-off notices which ultimately resulted in the need to re-bill these customers. Prior to "System X" and CWS the Company's number of re-bills was lower. Rate Counsel does not understand why the benchmark target should not return to pre-"System X" and CWS levels, particularly since the number of inaccessible meters has not changed;

- the Company misinterprets the benchmark of less than one BPU Complaint per 1,000 customers annually, which refers to account(s) rather than individuals. Rate Counsel notes that some customers such as Rutgers University or Hoffman-LaRoche have numerous meters even though they are in fact one customer, and family household normally have one meter even though several people live in that household;

- although PSE&G argues that service appointments should not include appointments for discontinuance or reconnects, the Company fails to articulate reasons why these should not be included as service appointments.

PSE&G also argues that Rate Counsel's proposed benchmarks are in excess of industry standards. *PIB,* p. 168. However, PSE&G fails to provide what it claims are industry standards, or any documentation in support of this allegation. The only evidence in the record on this issue is that of Mr. LeLash and Ms. Callaghan that establishes the reasonableness of these metrics, as compared to industry standards. Accordingly, these service metrics and benchmarks are fully supported and should be adopted.

Lastly, PSE&G claims that customer service tracking and reporting requirements would impose unnecessary costs and resource constraints. *PIB,* p. 164. PSE&G's allegations in this regard are not supported by cost studies or other empirical evidence.

They therefore carry no weight. Rate Counsel submits that its proposed service metrics and benchmarks are a reasonable and balanced approach, based on generally accepted industry standards, and are supported by Board Staff. Therefore, PSE&G should be required to track the proposed metrics and benchmarks and provide quarterly reports to the Board and Rate Counsel.

D. PSE&G's Opposition to Providing the Credit Worthiness Score ("CWS") in its Tariff and to Post the Information on the Company's Website is Arbitrary, and Unreasonable and in Violation of Board Regulations.

Rate Counsel fails to comprehend PSE&G's reluctance to provide the CWS in Tariffs and post the measure on its website for customer review. Since a delinquent payment of $100 or more with a score of 109 will trigger a Notice of Discontinuance, *RC-21A,* p. 22-23, it makes sense to inform customers about the criteria and the process in order to avoid delinquent payments and shut-offs, a goal for both customers and the company. Current Board regulations require PSE&G to post its credit and deposit requirements on its website:

> (g) If a utility requires a deposit or requires that customers establish a credit record, the utility shall apply the same credit and deposit requirements throughout the utility service area, and, if the utility maintains a website, the utility shall post these requirements on that website. A utility shall not set different credit or deposit requirements for different municipalities or locations." N.J.A.C. 14:3-3.4(g)

PSE&G acknowledges that the Company uses the CWS to evaluate the need for customer deposits and to determine whether a customer has a good credit rating with PSE&G. *PIB,* p. 173. Because the CWS constitutes PSE&G's credit and deposit requirements, PSE&G is required under N.J.A.C. 14:3-3.4(g) to post the CWS on its website.

The Company's only rationale for failure to disclose its CWS to its customers and incorporate it in its tariffs is that it might result in customer confusion and unwarranted

customer concerns. *PIB,* p. 173. While any information provided to the public may cause confusion for some, this is not a sufficient reason to withhold this important information from the public. How the CWS is determined is important for customers to know since it drives the imposition of a deposit as well as notices of discontinuance. Customer understanding of the CWS is more likely to result in customers improving their bill paying behavior to avoid getting CWS points. Whether customers are confused by the CWS is a function of how PSE&G explains it on its website, not that the CWS is intrinsically confusing to customers.

Likewise, PSE&G further states in its Initial Brief that customers are already advised to pay their bills on time to maintain a good credit rating with PSE&G. *PIB,* p. 173. Yet, the CWS calculates points based on almost 20 factors -- not just on-time payment. These factors include whether incorrect bank information is given for a direct debit or check payment (8 points); whether an installment plan is deactivated due to nonpayment (8 points); whether the customer receives a reminder for a particular delinquent amount (10 points); whether the customer receives a soft disconnect notice for a particular delinquent amount (15 points); or a hard disconnect notice for a greater delinquent amount (20 points). *RCR-CI-76.* It is completely reasonable to require the Company to post its criteria so that its customers can take steps to avoid accumulating points.

Finally, Rate Counsel believes it is important for customers to obtain access to their CWS to ascertain whether PSE&G has calculated it in error and to correct any such errors. Without knowledge and understanding of the CWS, customers could be subject to unwarranted deposits and to erroneous disconnect notices. Therefore, Rate Counsel

recommends that the company be required to conspicuously post the CWS in both its tariffs and on its website in compliance with current state consumer protection regulations. N.J.A.C. 14:3-3.4(g)

For all the foregoing reasons, Rate Counsel relies upon its Initial Brief and recommends that Your Honor and the Board conclude that PSE&G should be required to comply with Board regulations to post its CWS on its website and in its tariff, and track and report the service metrics and standards proposed by Rate Counsel in its initial testimony.

POINT X

RATE COUNSEL RECOMMENDS THAT PSE&G INVEST IN IMPROVEMENTS THAT ARE COST-EFFECTIVE AND IMPROVE THE RELIABILITY OF ITS POOREST-PERFORMING ELECTRIC CIRCUITS.

PSE&G has failed to establish that it has satisfied the Board's Electric Distribution Service Reliability and Quality Standards requiring it to ensure the reliable performance of all its circuits and to improve its distribution reliability. *See,* N.J.A.C. 14:5-8.1(c), -8.2(a), -8.3(b), and -8.5.[6] PSE&G has also has failed to rebut any of the evidence that Rate Counsel has placed in the record that its electric service is not as reliable as its awards suggest. *PIB,* p. 1, 3.

Rate Counsel recommends that PSE&G review and adjust its project selection process to improve reliability in specific areas with chronic local reliability problems. After reviewing its project selection process, the company should report its proposed revisions to Board Staff and Rate Counsel to recommend any further adjustments to the process. PSE&G can thereby remedy the poor reliability that persists on dozens of circuits.

Rate Counsel also recommends that PSE&G measure the reliability of its network using non-traditional performance metrics that consider the actual number of people and businesses adversely affected by unreliable service. PSE&G should report proposed

[6] The Electric Service Reliability Standards, N.J.A.C. 14:5-8.1 to 8.12, mandate that each electric distribution company provide reliable service, improve its distribution reliability, exceed its minimum standards, and ensure the reliable performance of all its circuits. See N.J.A.C. 14:5-8.1, -8.2, -8.3, and -8.5.

alternative reliability performance metrics to Board Staff and Rate Counsel to recommend any further adjustments to those metrics.

Accordingly, Rate Counsel recommends that PSE&G invest in cost-effectively improving the reliability of its poorest-performing electric circuits.

POINT XI

THE ISSUES RAISED BY MEG AND NJLEUC REGARDING ALLEGED DISCRIMINATORY TREATMENT SHOULD BE ADDRESSED AS RECOMMENDED IN RATE COUNSEL'S INITIAL BRIEF.

The Morris Energy Group ("MEG") (referred to at the hearing as the "Electric Customer Group" or "ECG") submitted an Initial Brief arguing, consistent with MEG's prefiled testimony, that PSE&G has engaged in undue discrimination in favor of its affiliate PSEG Power. MEG proposed the establishment of a special tariff, to be available only to electric generators, that would allow PSE&G considerable discretion to grant discounts to electric generators taking natural gas distribution service from PSE&G. *MEGIB,* p. 30-31.

The New Jersey Large Energy Users Coalition ("NJLEUC") filed an Initial Brief in which it joined MEG's assertions that PSE&G engaged in undue discrimination. NJLEUC argues that Your Honor and the Board should address the asserted discrimination by requiring PSE&G to re-calculate, back to 2002, its SBC, RGGI and CAC charges to include PSEG Power, so that the Board can consider a "disgorgement mechanism." *MEGIB,* p. 52-54.

Rate Counsel has reviewed the MEG and NJLEUC briefs, as well as PSE&G's arguments regarding the asserted discrimination, and affirms the recommendations in its Initial Brief:

(1) If the Board wishes to consider a special tariff for electric generators such as that proposed by MEG, it should do so in a generic proceeding, with notice, in which it can fully explore the broad statewide implications of such a tariff.

(2) Any future grants of preferential terms of service, and any extensions of existing preferences, including the negotiated rates and terms of service presently being provided to PSEG Power and MEG's facilities, should be based on explicit findings by the Board as to the factual and legal basis for the preference, after a contested proceeding.

(3) PSE&G should not be permitted to allow special contracts with "evergreen" provisions that automatically renew without Board approval in a contested proceeding.

(4) Waivers of Societal Benefit Charge ("SBC"), the Regional Greenhouse Gas Initiative ("RGGI") Recovery Charge, and the Capital Adjustment Charge ("CAC"), should be permitted only upon a Board of compelling circumstances after a contested proceeding.

Rate Counsel reiterates the arguments in Point XI of its Initial Brief in support of the above recommendations.

MEG's Initial Brief, in addition to arguing that there has been undue discrimination, also challenged the validity of the Company's Rate Schedule TSG-NF – Non-Firm Transportation Gas Service. MEG argued that the Company's TSG-NF rate is "unjust and unreasonable, even absent discrimination." *MEGIB,* p. 14. According to MEG's Initial Brief, the TSG-NF rate is "very similar" to the rate charged for firm service under Rate Schedule TSG-F – Firm Transportation Gas Service.[7] *MEGIB,* p.15-16; *P-1, Schedule 4,* First Revised Sheet 87. This claim, even if true, is not a sufficient basis for invalidating the Company's TSG-NF rate. The TSG-NF rate schedule is not

[7] Rate Schedule TSG-F has been closed to new customers since December 1994. P-1, Schedule 4, First Revised Sheet 87.

newly proposed in this case, but was previously approved by the Board. *P-1, Schedule 4,* Second Revised Sheets 93-94, Original Sheets 95-97. Thus, this rate schedule carries a presumption of validity. In re Petition of Jersey Central Power & Light Co., 85 N.J. 520, 527 (1981). MEG has not specified what it means by "very similar," nor has it presented any evidence to dispute the testimony in the record as to how any gas distribution rate change that results from this proceeding should be allocated among the PSE&G's rate classes, including TSG-NF. Since MEG has failed to meet its burden of coming forward with evidence in support of its position, its argument that the TSG-NF rate is "unjust and unreasonable" should be rejected. In re Petition of Public Service Electric and Gas Co. 304 N.J. Super. 247, 274 (App. Div.), certif. denied, 152 N.J. 12 (1997).

POINT XII

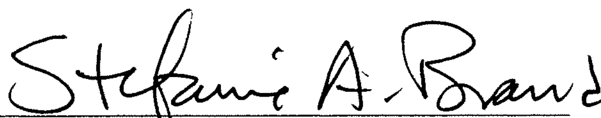
YOUR HONOR AND THE BOARD SHOULD ADOPT THE RATE COUNSEL'S RECOMMENDED CLASS REVENUE ALLOCATION AND RATE DESIGN PRINCIPLES AS SET FORTH IN RATE COUNSEL'S INITIAL BRIEF.

With regard to the allocation of Rate Counsel's recommended electric rate increase and natural gas rate decrease, and the design of the Company's rates for electric and gas distribution service, Rate Counsel rests on Point XII of its Initial Brief.

CONCLUSION

For the reasons stated in our Initial Brief and this Reply Brief, in the testimonies of our witnesses, and in the balance of the record, the Rate Counsel respectfully urges Your Honor and the Board to reject the Company's petition for a rate increase in this matter. If Your Honor and the Board should decide to approve any portion of the Company's request, Rate Counsel respectfully urges that it be based upon the recommendations of Rate Counsel and our witnesses in this matter.

Respectfully submitted,



Stefanie A. Brand
Acting Public Advocate &
Director, Division of Rate Counsel

Dated: April 5, 2010