

April 12, 2005

**VIA HAND DELIVERY**

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

Re: I/M/O the Petition of Public Service Electric and  
Gas Company for a Bondable Stranded Cost Rate  
Order in Accordance with N.J.S.A. 48:3-49 et seq.  
to Recover its Basic Generation Service Transition  
Costs  
BPU Docket No. EF03070532

Dear Secretary Izzo:

Enclosed please find the original and eleven copies of the comments of the  
Division of the Ratepayer Advocate (Ratepayer Advocate) on the above-referenced  
matter. Kindly stamp the extra copy as “filed” and return it in the enclosed, self-  
addressed stamped envelope. Thank you for your assistance.

**INTRODUCTION**

On or about July 9, 2003 Public Service Electric & Gas Company (PSE&G or  
Company) filed a Petition with the Board of Public Utilities (Board or BPU) for authority  
to securitize its deferred balance of Year Four Basic Generation Service (BGS) costs for  
future recovery from its retail customers. The deferred balance is for the unrecovered

generation supply costs incurred by the Company during the fourth year of the restructuring transition period and covers the time from August 1, 2002 through July 31, 2003. The Company proposes to securitize only the net of tax deferred amount. *RA-1, p. 9*. PSE&G's most recent estimate of the net of tax deferred amount as of March 31, 2005 is approximately \$114.6 million. T46:L6-17.<sup>1</sup>

The actual BGS deferred balance as of July 31, 2003 was \$234.7 million pre-tax. *PS-103 (RAR-PSE&G-74)*. PSE&G provided an update to the pretax amount as of December 31, 2004. That amount was approximately \$200,000,000. *RA-1, p. 9*.

Pursuant to a prehearing conference convened by Commissioner Frederick F. Butler, the parties agreed to a procedural schedule in this matter that was memorialized in a January 18, 2005 letter from Senior Deputy Attorney General Helene S. Wallenstein. Later amendments to the procedural schedule resulted in PSE&G and the Ratepayer Advocate prefiling simultaneous direct testimony on March 15, 2005. PSE&G prefiled the direct testimony of Morton A. Plawner and Wayne Olson (Exhibits PS-128 and PS-130). The Ratepayer Advocate prefiled the direct testimony of Matthew I. Kahal (Exhibit RA-1). Subsequently on March 28, 2005, PSE&G prefiled the rebuttal testimony of Morton A. Plawner (Exhibit PS-129). A combined public hearing and legislative-type hearing was convened on April 1, 2005 at which Commissioner Butler presided. At this hearing the Board received the oral testimony of Messrs. Plawner, Olson and Kahal. In addition, the Board received the oral testimony of Joseph Fichera of Saber Partners, LLC, who serves as the financial adviser to the Board and Board Staff. T79:L18-22.

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<sup>1</sup> The above notation indicates transcript page 46, lines 6 to 17. The Ratepayer Advocate will use this format throughout these comments.

## ARGUMENT

### Point I

#### **THERE IS INSUFFICIENT DATA IN THE RECORD IN THIS MATTER TO DECIDE THAT THE REMAINING YEAR FOUR BGS DEFERRED BALANCE SHOULD BE SECURITIZED.**

As stated by the Ratepayer Advocate's witness, Matthew I. Kahal, securitization of the Year Four BGS deferred balance would only be reasonable if the balance is sufficiently large to make securitization cost beneficial. *RA-I*, p. 7. However, as Mr. Kahal noted, the information needed to make this determination is still outstanding. The question turns on whether or not the ratepayers continue to owe a sufficiently large sum to the utility for BGS costs to make securitization cost beneficial. The Ratepayer Advocate also made this point at the April 1 public hearing.

MR. UBUSHIN: . . . I suppose in the end the ultimate issue is whether or not it is correct to securitize that amount or whether or not the ratepayers have actually paid into the Company's accounts other funds for other rate [clauses] and that should be used to offset the BGS deferral . . . .

T77:L2-8.

While it may be uncontroverted that the Year Four BGS deferred balance standing alone could be sufficiently large, the record is devoid of data concerning other overrecovered deferred balances in which the utility owes funds to be credited back to ratepayers. There is currently outstanding the final results of the Phase 2 audit of all components of PSE&G's deferred balances. *RA-I*, p. 7. It had been hoped that this data from the final Phase 2 audit would be available by now, but the final audit report has apparently not been completed and has not been released publicly. The Ratepayer Advocate recommends that the Board not permit securitization of the Year Four BGS

deferred balance until this data can be released publicly, submitted for review by the Ratepayer Advocate and finally approved by the Board.

In PSE&G's recent deferred balance proceeding, the Board found that PSE&G's ratepayers had overpaid certain deferred rate clauses. The Board approved a stipulation of a few parties to that matter which permitted credits to be given to ratepayers over 29 months (beginning August 1, 2003) to return the overpayment to the customers. I/M/O Petition of Public Service Electric and Gas Company's Deferral Filing Including Proposals for Changes in its Rates for its Non-Utility Transition Charge (NTC) and its Societal Benefits Charge (SBC) for the Post Transition Period Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, BPU Docket No. ER02080604, Order dated April 22, 2004, page 28 (Deferral Order).

The Board had found that the overrecoveries in the SBC would reduce revenues by an annual \$202.1 million and that overrecoveries in the NTC should be used to reduce rates by \$36.2 million annually. The total revenue reduction for these deferred balances approved by the Board was \$238.3 million annually to be returned to ratepayers over 29 months beginning August 1, 2003. *Id.*

It has now been 20 months since the beginning of the 29-month amortization period for the non-BGS deferred balances overrecovery refund. It is reasonable to conclude that a significant portion of the annual \$238.3 million refund has yet to be returned to customers. Essentially, PSE&G still owes ratepayers 9 months of the annual \$238.3 million refund. This remainder may serve to offset all or a significant portion of any underrecovered BGS deferral. And yet PSE&G continues to seek BPU approval of

additional securitized financing for the BGS deferred balance underrecovery as if this unpaid overrecovery does not even exist.

A simplified hypothetical example should serve to illustrate this point. Consider an example where a customer owes PSE&G \$1,000, but PSE&G simultaneously owes the customer \$1,500 for a different account. It would make no sense for the customer to borrow \$1,000 to pay PSE&G and incur the transaction costs and interest expense, when the customer could simply agree with PSE&G to net the two balances together and have PSE&G credit the customer's account with the \$500 net overrecovery. In fact, this may be the situation that ratepayers find themselves in today with PSE&G. Until the Board requires PSE&G to reveal the net balance of all deferred accounts, then the parties cannot know with certainty whether or not there is a BGS deferred balance large enough to warrant securitization.

The Ratepayer Advocate tried to discover how much of the overrecovery refund is still outstanding, but PSE&G refused to provide this data for the record in this matter. *PS-101 (RAR-PSE&G-72)*. This data will most likely be contained in the final report on the Phase 2 audit of the deferred balances. The Ratepayer Advocate recommends that the BPU defer the decision on securitization until this data is made public and finalized, and the BPU can then determine whether the net balance of the Year Four BGS costs exceeds the non-BGS remaining overrecovery amount by a large enough underrecovery to make securitization of the net BGS underrecovery cost beneficial. In considering whether to net the total deferred balances, the BPU would obviously also consider the net rate impact of using any overrecovered balance to offset the BGS deferral. As PSE&G notes, the SBC and NTC overrecoveries are now being amortized as a current rate reduction. *Id.* Using

these overrecoveries to offset the BGS deferral could necessitate a reversal of the current rate reductions. Part of the decision on whether to net the total deferred balances would include a review of whether the net rate impact is reasonable and acceptable.

The utility may complain that any delay in approving securitization bears the risk of increasing interest rates. However, any delay due to the dearth of information is due to the utility's own actions. If this results in any additional costs for securitization, then the Board should determine that any additional costs should be borne by the utility itself and not its customers. Such a decision should not be construed as a threat to the revenue stream dedicated to payment of securitization bond costs from customers. However, the Board should then provide ratepayers an offsetting revenue reduction in some other non-securitization rate clause that would in effect credit them for any higher costs due to delays caused by the utility's actions.

This method would be similar to PSE&G's proposal concerning what to do if the amount actually securitized exceeds the actual BGS deferral at the time of the securitization. In that circumstance, PSE&G proposes to credit ratepayers through a NTC rate change in which customers would be credited with the difference between the principal amount securitized and the actual BGS deferral at that time.<sup>2</sup> Similarly, if the Board should decide that a delay in this matter caused additional securitization costs, then the ratepayers could be credited for those additional costs through some other nonsecuritization rate clause.

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<sup>2</sup> *PS-128*, p. 1, l. 17-20 (Morton A. Plawner direct testimony). "Although the precise amounts are subject to change, I recommend that the Board approve \$122 million for securitization, and upon reconciliation, if that number is too large, a credit to the customers for any overage should be provided through one of the Company's adjustment clauses."

## Point II

### **THE COMPANY'S ARGUMENT TO USE THE OVERALL RATE OF RETURN AS THE CARRYING CHARGE IF SECURITIZATION IS NOT APPROVED SHOULD BE REJECTED AND THE BOARD SHOULD FIND THAT PSE&G HAS NOT SHOWN THAT SECURITIZATION WILL BENEFIT RATEPAYERS.**

PSE&G incorrectly assumes that the only valid ratemaking alternative to securitization of the BGS deferred balance is rate base, rate of return treatment which would charge ratepayers a carrying cost equal to the utility's approved overall rate of return. T52:L18-24; T54:L25 to T55:L9. In fact, the BPU has often permitted the utility much less than the overall rate of return as a carrying charge for a cost amortization. Contrary to the Company's claim, it has even been required to amortize some costs with no carrying costs at all.

During the four-year transition period, the BPU required the utility to amortize many of the deferred balances at an interest rate equal to the seven-year Treasury rate plus 60 basis points. That carrying charge was much less than the then-approved overall rate of return. As PSE&G itself has acknowledged, some of its amortizations have included no carrying charge at all. *PS-118 (S-PSEG-INF-3)*. Therefore, it is evident that the Company's claim of entitlement to the overall rate of return absent securitization is baseless.

Mr. Kahal also noted that the Deferral Order does not mention using a rate base, rate of return method to determine a proper carrying charge. *RA-1*, p. 12. He stated that the Deferral Order and settlement agreement do not specifically authorize a rate base rate of return, although the Order does not definitively rule it out. The Deferral Order (page 15) states:

In the event that the Board does not approve a securitization of the Year Four BGS under-recovery or securitization cannot be accomplished, the settling parties recommend that the appropriate carrying charge effective August 1, 2003 reflect a cost of capital that is commensurate with the time frame of amortization authorized by the Board.

Mr. Kahal testified that:

It is notable that this language makes no reference to the use of the Company's authorized return on rate base, a mix of different capital types or income tax gross up to the equity return. If that had been intended, the Board easily could have so stated. Instead, the only variable mentioned that would determine the carrying charge rate is "the time frame of amortization," presumably a longer time frame would support a higher carrying charge rate than a shorter amortization. Since the rate of return on rate base is unrelated to the amortization period (i.e., the return on rate base is the same under five, seven or ten year amortizations), the Company's interpretation does not seem consistent with the Order.

*RA-1*, p. 13. The points mentioned in this testimony argue strongly against the Company's position that the only alternative to securitization is the overall rate of return. For these reasons, the Company's argument in favor of using the overall rate of return should be denied.

Since PSE&G's claim that securitization will save ratepayers money depends upon its comparison to rate base, rate of return treatment, the absence of any entitlement to that treatment refutes the validity of the Company's claim of ratepayer savings. The statute permitting, but not requiring, securitization of BGS costs does however require a showing of ratepayer savings before securitization can be approved. In fact, one of the necessary criteria to approve securitization of BGS costs is that securitization "will produce benefits for customers of the electric public utility which include the lowest transition bond charges consistent with market conditions and the terms of the bondable stranded costs rate order." *N.J.S.A. 48:3-6(c)(3)*. Since PSE&G has not proved the

necessary criterion of customer benefits, the remaining BGS deferral should continue to be financed via a nonsecuritization method.

The Ratepayer Advocate witness, Mr. Kahal, described various alternatives to securitization including financing with conventional, nonsecuritized debt, or some fixed amortization at an appropriate interest rate. *RA-1*, p. 12. As Mr. Kahal stated at the public hearing, the decision to issue new nonsecuritized debt would be up to PSE&G. T70:L16-23. If the Company decided to issue new nonsecuritized debt for this purpose, then the Board could use the actual cost rate of that dedicated debt as the applicable carrying charge. *RA-1*, p. 14.

If PSE&G chose not to issue new debt, then the Board could determine an appropriate length of time to amortize the BGS deferral and also determine an appropriate carrying charge. T70:L23 to T71:L5. Mr. Kahal believes that ten years would be a reasonable time to use for the amortization. *RA-1*, p. 12 and pp. 15-16. The interest rate would be fixed at the time of the BPU order and would not vary during the course of the amortization. *Id.*, p. 14. The Ratepayer Advocate notes that the net total deferred balance including the BGS deferral could be amortized over a period less than ten years if the net balance was not significant. Mr. Kahal's original ten-year recommendation employed the assumption of a large amount to be amortized, i.e., the \$200 million pre-tax balance identified by PSE&G at that time. The overall rate impact of any amortization should play a large part in deciding the length of the amortization.

PSE&G had previously disputed the use of a nonsecuritized debt rate alone for the carrying charge. The Company claimed that financing the BGS deferral was the same as financing any other assets used for ratepayers which should be financed at the overall rate

of return including an equity component. Mr. Kahal testified that if this entails the utility increasing its equity balance or reducing other debt to compensate for this “on balance sheet” debt, then this might be a consideration for the securitization case. *RA-1*, p. 15. He stated that discovery on this issue was outstanding at the time he filed his testimony in March. However, the Company’s eventual response to the discovery indicated that it had not intended its previous comment to mean that it would in fact issue new equity as a balance for any additional debt. *PS-92 (RAR-PSE&G-62)* Given that response, the Company’s complaint against reflecting only a nonsecuritized debt rate as the carrying costs can be dismissed.

### **Point III**

#### **IF SECURITIZATION IS APPROVED, THEN ALL COST SAVINGS THAT ACCRUE FROM THE USE OF THE PROCEEDS OF THE TRANSITION BONDS MUST BE PASSED THROUGH DIRECTLY TO CUSTOMERS.**

If the BPU approves securitization of the BGS deferral, and the securitization occurs, PSE&G plans to use the entire amount of the net proceeds of the BGS transition bonds to “refinance or retire its outstanding debt or equity or both.” *Petition*, p. 6.

PSE&G has stated that it cannot currently provide a more specific use of the proceeds beyond the retirement of debt and/or equity. *PS-13 (S-PSEG-13) and PS-14 (S-PSEG-14)*.

The Ratepayer Advocate recommends that all cost savings that accrue from the use of transition bond proceeds be passed through directly to ratepayers and that this be done in a timely manner. For instance, if long-term debt is retired, then the interest expense and any other savings from the retirement should be credited to ratepayers

through one of the deferred balance rate clauses in between base rate cases. We recommend that the BPU not permit the utility to wait until the next electric base rate case to reflect this cost reduction in rates. This recommendation is fully supported by the statute that permits securitization of BGS deferred costs.

The **entire amount of cost savings achieved** as a result of the issuance of such transition bonds, whether as a result of a reduction in capital costs or a lengthened recovery period associated with . . . basic generation service transition costs . . . shall be passed on to the customers of the electric public utility in the form of reduced rates or mitigated rate increases for electricity. (Emphasis added).

*N.J.S.A. 48:3-62(a).*

If the BPU permits PSE&G to wait until its next electric base rate case to reflect in its rates the cost savings from debt retirement, then it will not be the case that “the entire amount of cost savings achieved” would have been passed on to customers. This is because the delay in passing through the cost savings until the next electric base rate case would permit the utility to receive the financial benefit of the cost savings until that next base rate case. The statute does not permit this and the Board should not allow it.

#### **Point IV**

#### **PSE&G IMPROPERLY INCLUDED A RETROACTIVE INTEREST INCREASE OF \$645,581 IN THE PROPOSED BGS DEFERRED BALANCE.**

The Company’s interim interest calculations include \$645,581 of what it calls “retroactive interest” based on its understanding of the Deferral Order addressing the interim interest calculations. *PS-129*, pp. 2-3. Mr. Kahal stated that it is not clear from

the language of the Deferral Order that the Board intended to allow “retroactive interest”, and thus the \$645,581 of additional interest accruals may not be proper. *RA-1*, p. 8.

For the period August 2003 through April 2004, PSE&G accrued interest at a rate of 1.81% (i.e., the one-year Treasury rate plus 50 basis points). Since May 2004, the Company has been accruing interest at a rate of 2.45% (the two-year Treasury rate plus 60 basis points). However, for the month of May 2004 the Company included a one-time only adjustment of \$645,581 (added to the deferred balance) to reflect the additional interest had the 2.45% interest rate been used from the beginning, rather than the 1.81% figure. *Id.*, pp. 10-11.

As stated by Mr. Kahal, the Deferral Order does not refer to retroactive interest under the current circumstances. Subparagraph (b) on page 15 of the Deferral Order discusses carrying charges under three scenarios: (1) securitization occurs by May 1, 2004; (2) securitization is authorized but occurs later than May 1, 2004; and (3) securitization is not authorized. The issue at hand is the interest accrual under scenario (2). The operative language is as follows:

The recovery of the BGS under-recovery will be accounted for by first assessing on a monthly basis a carrying cost to the net of tax BGS under-recovered balance equal to a monthly rate based on the two-year constant maturity treasuries as shown in the Federal Reserve Statistical release on or closest to August 1, 2003 plus 60 basis points.

There is no reference to “retroactive interest” or any clear statement that the higher interest rate should be applied beginning August 2003, rather than just prospectively, i.e., May 2004. The Company’s position is that the **intent** (if not the language) of the settlement and the Deferral Order is that the higher interest rate should be used at the outset of interim recovery on August 1, 2003, not just after May 1, 2004.

The support for this interpretation is not clear, and the use of a retroactive change in the interest rate is an unusual procedure, although the Board seems to approve such a procedure in scenario (3). *Id.*, p. 11.

While PSE&G may claim that the Deferral Order's approval of retroactive interest in scenario (3) supports the Company's claim for retroactive interest in scenario (2), this interpretation does not necessarily follow from the actual text of the Deferral Order. On the contrary, it should be noted that had the Board intended that retroactive interest should apply in both scenarios (2) and (3), then the Board could very easily have specified that case. It would be at least as valid to assume that because the Board specified retroactive interest in one case, but omitted to specify retroactive interest in the other case, then the Board must have decided not to allow retroactive interest in scenario (2). The Ratepayer Advocate submits that it is unfair to go back now and attempt to rewrite the Deferral Order to allow retroactive interest in a situation in which the original Order does not allow it. However, that is exactly what PSE&G argues for. The Ratepayer Advocate urges the BPU to reject this argument and prohibit PSE&G from including the \$645,581 in the BGS Year Four deferred balance.

Respectfully submitted,

SEEMA M. SINGH  
RATEPAYER ADVOCATE

By: \_\_\_\_\_  
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c: President Jeanne M. Fox  
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