

BEFORE THE STATE OF NEW JERSEY

BOARD OF PUBLIC UTILITIES

**IN THE MATTER OF THE PETITION OF)
PUBLIC SERVICE ELECTRIC AND GAS)
COMPANY FOR APPROVAL OF A)
SOLAR LOAN III PROGRAM AND AN)
ASSOCIATED COST RECOVERY) BPU DOCKET NO. EO12080726
MECHANISM AND FOR CHANGES IN THE)
TARIFF FOR ELECTRIC SERVICE,)
B.P.U.N.J. NO. 15 ELECTRIC PURSUANT)
TO N.J.S.A. 48:2-21 AND N.J.S.A. 48:2-21.1)**

**SURREBUTTAL TESTIMONY OF ANDREA C. CRANE
ON BEHALF OF THE
NEW JERSEY DIVISION OF RATE COUNSEL**

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FILED: March 1, 2013

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1 **I. INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Andrea C. Crane and my business address is 90 Grove Street, Suite 211,
4 Ridgefield, Connecticut 06877. (Mailing address: PO Box 810, Georgetown,
5 Connecticut 06829)

6
7 **Q. Did you previously file testimony in this proceeding?**

8 A. Yes, on January 11, 2013, I filed Direct Testimony on behalf of the State of New Jersey,
9 Division of Rate Counsel. My Direct Testimony addressed cost recovery and other
10 financial issues relating to the Petition filed on July 31, 2012 by Public Service Electric
11 and Gas Company (“PSE&G” or “Company”). In its Petition, the Company requested
12 approval to implement a Solar Loan III Program. The Company is proposing to make
13 loans of up to \$193 million over a three-year period to parties interested in developing up
14 to 97.5 MW of solar generation systems. The total cost of the Solar Loan III program is
15 projected to be \$359.1 million, which includes the cost of the loans issued, return to
16 investors, and administrative costs. PSE&G estimates that \$126.6 million would be paid
17 by ratepayers, \$20.1 million of administrative costs would be paid by borrowers, and the
18 remainder would be recovered from sales of Solar Renewable Energy Certificates
19 (“SRECs”).

20 In my Direct Testimony, I recommended that the BPU deny the Company’s Solar
21 Loan III Program as proposed. In the event that the BPU does approve a Solar Loan III
22 Program for the Company, I recommended that the BPU approve carrying costs for the
23 program that reflect a return on equity of no higher than 9.75%, consistent with the most

1 recent equity award by the BPU in an electric utility base rate case. I also stated that a
2 lower return may be reasonable, given the significant differences in risk between the
3 Company's proposed program and a utility's traditional recovery of investment in electric
4 plant through base rates. In addition, I recommended that the BPU utilize the Company's
5 current embedded debt cost and current capital structure to calculate carrying costs. In
6 the event that the BPU approves a Solar Loan III Program, I also recommended that the
7 BPU deny the Company's request to recover administrative costs from ratepayers,
8 consistent with its May 23, 2012 Order in BPU Docket No. EO11050311V, In the Matter
9 of the Review of Utility Supported Solar Programs.

10
11 **Q. What is the purpose of your Surrebuttal Testimony?**

12 A. The purpose of my Surrebuttal Testimony is to address certain statements contained in
13 the Rebuttal Testimonies of Stephen Swetz, Paul S. Moul, and Terrence J. Moran filed on
14 February 4, 2013.

15
16 **II. RESPONSE TO THE COMPANY**

17 **Q. Please comment on Mr. Swetz's update to the Company's cost of debt, provided on
18 page 2 of his Rebuttal Testimony.**

19 A. In his Rebuttal Testimony, Mr. Swetz states that the Company's November 2012
20 embedded cost of debt was 5.3482%, which is higher than the October 2012 embedded
21 cost of 5.05% that I had cited in my Direct Testimony. It is unclear whether Mr. Swetz is
22 recommending that an updated cost of debt be used to determine the carrying costs
23 applied to the Solar Loan III Program, in the event that the Solar Loan III Program is

1 approved, or whether he is simply providing this update for informational purposes.
2 Regardless of Mr. Swetz's intent, I have no objection to using the most recent embedded
3 cost of debt to determine the appropriate carrying costs.
4

5 **Q. Please comment on Mr. Swetz's statement at page 2 of his Rebuttal Testimony that**
6 **in each of PSE&G's programs conducted pursuant to N.J.S.A. 48:3-98.1, "the Board**
7 **has approved cost recovery mechanisms providing that the utility will earn a return**
8 **at a rate equal to the weighted average cost of capital approved in its most recent**
9 **base rate case."**

10 **A.** Mr. Swetz suggests that just because the BPU approved a stipulation for a program that
11 included carrying costs at the weighted average cost of capital, the BPU is now required
12 to include carrying costs at the weighted average cost of capital ("WACC") in all
13 subsequent cases. Mr. Swetz ignores the fact that each of the prior programs was
14 resolved by a Stipulation and, as in any settlement, there was give and take among the
15 parties with regard to the various issues. Moreover, each of these Stipulations included
16 language that the provisions contained in each of the Settlement Agreements was for the
17 purpose of resolving only the program that was at issue in that particular proceeding, and
18 was not intended to set any precedent for future cases. I am not aware of any Stipulation
19 or BPU Order in which the parties agreed, or the BPU ordered, that the weighted average
20 cost of capital approved in the most recent base rate case would be used for all future
21 programs that may be proposed by PSE&G. In addition, Mr. Swetz's Rebuttal Testimony
22 also ignores the fact that the Company's last base rate case was resolved almost three
23 years ago. As one moves further away from the date of the Order in that case, it becomes

1 less and less likely that the rate of return found to be appropriate at that time is still
2 reasonable. In fact, as demonstrated in my Direct Testimony and in the Surrebuttal
3 Testimony of Rate Counsel witness Matthew I. Kahal, the 10.3% return on equity that the
4 parties agreed to in the Stipulation resolving the Company's last base rate case is
5 excessive given current market conditions, and given subsequent returns on equity
6 approved by the BPU.

7
8 **Q. Please comment on Mr. Swetz's statement on page 3 of his Rebuttal Testimony that**
9 **PSE&G is not guaranteed recovery of 100% of its costs under the Solar Loan III**
10 **Program.**

11 **A.** Mr. Swetz is correct that the BPU could disallow a cost incurred pursuant to the Solar
12 Loan III, if it found that such a cost was imprudent. However, as noted in the response to
13 RCR-ROR-17, the BPU has never disallowed a cost incurred by the Company for any of
14 its energy efficiency or renewable energy programs on the basis that such a cost was
15 imprudent. More importantly, Mr. Swetz ignores the significant differences between
16 base rate recovery and the recovery of costs through a surcharge mechanism, as is
17 proposed here. First, between base rate case proceedings, utilities are at risk for
18 recovering all costs that have not been previously included in base rates. This includes
19 investment made since the Company's last base rate case as well as new or increased
20 operating expenses. These costs are recovered between base rate cases only if sales have
21 increased or other costs have declined relative to the level of revenues and expenses
22 included in the utility's last base rate case.

1 Second, with base rate recovery, the Company and its shareholders are at risk for
2 actually recovering costs even if those costs have been found to be prudent and included
3 in rates. This is because base rate recovery does not include a true-up process. Rather,
4 rates are determined based on an approved revenue requirement and shareholders bear the
5 risk of recovery between base rate cases. During this period, if revenues exceed
6 expectations or if actual expenses are less than those reflected in rates, then the Company
7 may earn more than its authorized return and shareholders would retain any such benefit
8 between base rate cases. However, the converse is also true. If revenues are less than
9 anticipated or if expenses are higher than those reflected in rates, then the Company and
10 its shareholders will not earn their authorized rate of return in any given year. Thus,
11 shareholders bear considerably more risk when costs are recovered through base rates
12 than when recovery is essentially guaranteed on a dollar-for-dollar basis through a rate
13 rider. It is in recognition of this risk that shareholders are awarded an authorized return
14 on equity that reflects a premium over a risk-free rate.

15 Assuming that all of the Company's estimates are correct, the proposed Solar
16 Loan III Program will cost ratepayers \$126.6 million, while providing the Company with
17 a guaranteed income stream (pre-tax) of \$145.5 million. However, while PSE&G would
18 be virtually guaranteed to recover its approved return, ratepayers would be at risk for any
19 changes in the revenues or costs reflected in the filing. Therefore, if SREC prices are
20 lower than the \$200 assumed by PSE&G, or if administrative costs are greater than
21 projected, then the costs to ratepayers could be even higher than those reflected in the
22 filing. To the extent that costs or recoveries deviate from those reflected in the filing, it is
23 ratepayers, and not shareholders, that would bear 100% of any variation from estimates.

1 Moreover, ratepayers would also be responsible for any shortfalls in recovery due to
2 lower than projected sales, as well as interest on any under-recovery. Given the
3 mechanism proposed by PSE&G, there is virtually no chance that shareholders would
4 earn less than the 10.3% proposed by PSE&G, while the actual costs borne by ratepayers
5 could vary significantly from those estimated in the Company's filing.

6
7 **Q. Please comment on Mr. Swetz's statement on pages 3-4 of his Rebuttal Testimony**
8 **that surcharge mechanisms provide the parties "with a regular opportunity to**
9 **pursue a detailed review of the Company's activity within each program" and that**
10 **ratepayers "can actually benefit from these types of reviews."**

11 **A. Mr. Swetz's statement ignores the fact that in a base rate case, the parties have the**
12 **opportunity to undertake a comprehensive review of the Company's revenues, expenses,**
13 **investment and return requirements. No such opportunity exists for cost recovery filings**
14 **made pursuant to surcharge mechanisms. Instead, such filings constitute single-issue**
15 **ratemaking with the examination limited to only those revenues and costs relating to a**
16 **particular program. Thus, it is possible for the BPU to approve an increase in the rates**
17 **for a program whose costs are recovered through a surcharge mechanism, such as the**
18 **Solar Loan III Program proposed in this case, even if PSE&G is earning more than its**
19 **authorized return on equity.**

20 Given the fact that ratepayers bear all of the risk for recovery with a surcharge
21 mechanism, and given the fact that the surcharge process does not entail a comprehensive
22 review of the Company's overall earnings, ratepayers are unlikely to "benefit" from a
23 surcharge mechanism as alleged by Mr. Swetz.

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Q. Please comment on Mr. Swetz’s criticism on page 4 of his Rebuttal Testimony of your statement that surcharge mechanisms are “big business for the electric and gas utilities in New Jersey.”

A. First, I note that Mr. Swetz does not dispute my statement, although he claims that I have ignored the fact that such programs have been approved by the Board and are consistent with New Jersey’s energy and environmental policies. While this is not the forum to debate the impact of previously-approved surcharge programs, it is non-controvertible that such programs provide shareholders with a virtually guaranteed regulated revenue stream. PSE&G’s parent company, Public Service Enterprise Group, Inc. (“PSEG”), has the ability to undertake solar investment programs on an unregulated basis if it believes that the risks of such programs warrant this investment. Apparently, PSE&G’s parent is not willing to undertake such investment on an unregulated basis, at least not in New Jersey, and hence it is attempting to obtain approval for regulated solar programs that provide shareholders with assurance of cost recovery, including assurance of recovery of a return on equity of 10.3%. Since such surcharge programs are particularly lucrative for shareholders, it is not surprising that PSE&G recently announced a \$3.9 billion program for which it is seeking similar guaranteed ratemaking treatment.¹ While one can debate the merits of any particular investment in renewable energy programs, in my opinion ratepayers have clearly been harmed, not helped, by the proliferation of surcharges that now appear on the customers’ bills.

¹ See PSE&G’s February 20, 2013 press release, available at: <http://www.pseg.com/info/media/newsreleases/2013/2013-02-20.jsp>

1 **Q. Does the proliferation of surcharge mechanisms also make it easier for utilities to**
2 **over-recover their costs?**

3 **A.** Yes, they do. The potential for over-recovery can occur in at least two ways. First, while
4 theoretically costs recovered through surcharge mechanisms are intended to be
5 incremental to those recovered in base rates, it is virtually impossible for any party to
6 verify that employees (and other costs) originally included in base rates are not also being
7 allocated to one or more surcharge riders. This is because employees are not strictly
8 identified as being either “base rate” employees or “surcharge” employees, but instead
9 may charge costs to both base rates and one or more riders. Employees are also
10 continuously joining and leaving the company, making it difficult to track movement
11 between base rate cases.

12 Second, it is my understanding that all costs, both those recovered through base
13 rates and those recovered through surcharge mechanisms, are allocated overhead costs.
14 Moreover, not only do overhead costs include direct employee-related benefit costs, but
15 they may also include costs of entire administrative departments that are deemed
16 “overhead” by PSE&G. To the extent that these overhead costs were included in base
17 rates and are now being allocated to new surcharge mechanisms, there is a potential for
18 over-recovery, which again is very difficult to track between base rate cases. In my
19 view, the potential for double-recovery of labor costs and overhead costs is another
20 reason why ratepayers are unlikely to “benefit” from surcharge mechanisms.

21
22 **Q. How many surcharges are currently being recovered in a typical residential**
23 **customer’s bill?**

1 A. A review of the Company's tariff indicates the following are currently being recovered
2 through surcharge mechanisms: Social Programs, Energy Efficiency and Renewable
3 Energy Programs, Manufactured Gas Plant Remediation, Universal Service Fund
4 Programs, Lifeline Programs, Non-Utility Generation Charges, Securitization Transition
5 Charges, Solar Pilot Recovery Charges, the Carbon Abatement Program, Energy
6 Efficiency Economic Stimulus Program, Demand Response Program, Solar Generation
7 Investment Program, Solar Loan II Program, the Energy Efficiency Economic Extension
8 Program, and Capital Adjustment Program Charges.² These are in addition to the Basic
9 Generation Service charges that are recovered by the Company on a dollar-for-dollar
10 basis and which constitute a significant portion of the customer's overall bill.

11
12 **Q. Please comment on Mr. Moul's statement on page 2, lines 22-23 of his Rebuttal**
13 **Testimony that you ignore "the reality that the utility can choose between**
14 **alternative investments."**

15 A. This fact is not ignored in my Direct Testimony, rather, it is one of the critical points of
16 my Direct Testimony. If the BPU approves a return on equity of 10.3% for the Solar
17 Loan III Program, the Company will have an overarching incentive to invest as much as
18 possible in the Solar Loan III Program, or in other programs where its return on equity is
19 essentially guaranteed. It is not surprising that PSEG does not want to undertake solar
20 investment projects on an unregulated basis, if it can earn an assured return on equity of
21 10.3% by undertaking such projects on a regulated basis through its New Jersey utility.

22 Approving a virtually guaranteed 10.3% return on equity for the Solar Loan III
23 Program will also make this program substantially more attractive than investments in the

2 PSE&G Tariff for Electric Service, B.P.U.N.J. No. 15 Electric, Tariff pages 57-59, 60, 62, 64, 65 and 66-68.

1 distribution system that are recovered through base rates. If the Company truly has a
2 “finite amount of capital that the Company can commit to its rate base and renewable
3 investments” as suggested by Mr. Moul on page 3 at line 6 of his Rebuttal Testimony,
4 and if the BPU awards the same cost of capital for both investments recovered through
5 surcharges and investments recovered through base rates, then PSE&G will have a clear
6 incentive to direct investments to those programs that have the greatest likelihood of
7 earning their authorized rate of return, i.e., those recovered through the surcharge
8 mechanisms.

9
10 **Q. Please comment on Mr. Moul’s statement on page 4 at lines 20-22 of his Rebuttal**
11 **Testimony that today’s low interest rates should be viewed relative to the long**
12 **recovery period for the solar programs that the Company has proposed.**

13 A. Mr. Moul seems to suggest that whatever carrying costs are approved in this case would
14 remain in effect during the entire recovery period of the Solar Loan III Program, which is
15 currently projected through 2027, or approximately 15 years. He therefore states that it is
16 necessary to consider if the low interest rate environment will prevail over the entire
17 recovery period and also states that it is necessary to understand why interest rates are
18 currently so low. However, it is unreasonable to suggest that any carrying cost
19 established today, by whatever measure, should prevail for the entire recovery period,
20 unless carrying costs were limited solely to debt costs related to project financing. In fact,
21 Mr. Moul acknowledged that carrying costs are likely to change over the recovery period
22 in his response to RCR-A-51, where he stated that “Mr. Moul recognizes that the rate of
23 return established in this case has the potential to change during the twenty-five year

1 lifespan of the recovery of costs for the proposed Solar Loan III program.” This response
2 recognizes that capital costs change over time, and that such changes should be reflected
3 in the Company’s carrying costs if the BPU approves carrying costs based on a weighted
4 average cost of capital. This position is also consistent with my recommendation that the
5 cost of capital utilized for recovery of surcharge program costs should be updated
6 between base rate cases if it is no longer reasonable. Otherwise, the Company could
7 continue to recover excessive carrying costs by delaying the filing of a base rate case.
8 Given the proliferation of surcharge mechanisms, and the Company’s continued attempt
9 to recover more and more costs through such surcharges, it is reasonable to assume that
10 the Company may not have the need to file a base rate case in the foreseeable future,
11 especially if its capital costs have declined and the Company fears that this decline would
12 be reflected in new base rates.

13 As to the Company’s second point, that it is necessary to determine why interest
14 rates are so low at the present time, I disagree with Mr. Moul’s position that this factor is
15 relevant to the determination of an appropriate carrying cost for the Solar Loan III
16 Program. Regardless of the reason for the current low capital cost environment, the fact is
17 that capital costs have declined since the Company’s last base rate case and that this
18 decline should be recognized in any carrying costs approved for the Solar Loan III
19 Program. Moreover, as discussed in Mr. Kahal’s Surrebuttal Testimony, it is likely that
20 low interest rates will continue for some time. This does not mean to suggest that low
21 interest rates will prevail until 2027 or over the entire recovery period, only that any
22 carrying cost approved in this case should reflect the currently low capital costs. In the
23 event that the Board approves the use of a weighted average cost of capital as an

1 appropriate carrying cost, it is my understanding that Rate Counsel does anticipate that
2 any such WACC would be updated periodically, either through base rate case filings or
3 through some other review mechanism, to ensure that the costs being charged to
4 ratepayers reflect reasonable capital costs.

5
6 **Q. Please comment on Mr. Moul's statement on page 7, lines 1-9 of his Rebuttal**
7 **Testimony, that the Blue Chip Financial Forecasts provide "evidence that the trend**
8 **of interest rates is upward....".**

9 A. In support of his statement, Mr. Moul referenced the December 1, 2012 Blue Chip
10 Financial Forecasts for 30-Year Treasury Bonds, Aaa-rated Corporate Bonds and Baa-
11 rated Corporate Bonds, all of which he states are projected to increase significantly in the
12 2014-2018 and 2019-2023 periods. However, a review of prior Blue Chip Financial
13 Forecasts suggests that these "consensus" forecasts can deviate greatly from actual
14 results. For example, in the response to RCR-A-54, Mr. Moul provided the December 1,
15 2010 forecasts for 2012-2016 and 2017-2021. As shown in that response, the December
16 1, 2010 consensus forecasts for 2012 interest rates for 30-year Treasury Bonds, Aaa-rated
17 Corporate Bonds and Baa-rated Corporate Bonds were significantly overstated. For
18 example, in December 2010, the 2012 consensus forecast for 30-year Treasury bonds was
19 4.8% while actual rates for 30-year Treasury Bonds were below 3.0% for most of 2012,
20 declining to 2.88% in December 2012 as stated in my Direct Testimony. Similarly, the
21 2010 Blue Chip consensus forecast for Aaa-rated Corporate Bond rates during 2012 was
22 5.4%, while actual interest rates for Aaa-rated Corporate Bonds were below 4.0% in 2012
23 and declined to 3.65% by December 2012. Finally, the December 2010 Blue Chip

1 consensus forecast for 2012 interest rates for Baa-rated Corporate Bonds was 6.4%, while
2 actual Baa-rated Corporate Bond rates were under 5.0% for most of the year and declined
3 to 4.63% by December 2012. As demonstrated, the December 2010 consensus forecasts
4 were not a good indicator of 2012 interest rates and such forecasts are likely to be even
5 less accurate when projecting interest rates even further in the future.

6 Moreover, even if the BPU believed that these long-term projections were valid, it
7 would still be inappropriate to utilize those future rates to determine the Company's
8 carrying charges in this case. Projections about future interest rates are speculative and
9 should not be used to set regulated utility rates. Rather, the BPU should base its carrying
10 costs on current capital costs, and should state its intention to update these costs in the
11 future as the Company's capital costs change.

12
13 **Q. Please comment on Mr. Moran's statement on page 19 of his Rebuttal Testimony**
14 **that the Board's May 23, 2012 Order, which directed that "all administrative fees**
15 **would be paid for by the solar developer or the generation customer", should not**
16 **apply to the Company's auction costs.**

17 **A.** In support of his statement, Mr. Moran notes that "[f]rom the beginning of PSE&G's
18 solar loan program, it has been recognized that SRECs are auctioned (rather than simply
19 sold) for the benefit of ratepayers, and that the cost of the running the auction should be
20 netted against the auction proceeds and are not considered part of the Company's
21 administrative costs." Mr. Moran's statement is irrelevant to this case. In the Company's
22 prior solar loan programs, all administrative costs that were not recovered from either
23 fees or SREC sales were charged to ratepayers. Therefore, there was no need to

1 distinguish auction costs from other administrative costs, since the ratepayers were
2 responsible for all of these costs, to the extent such costs were not recovered from other
3 sources. This has now changed with the May 23, 2012 Order, which establishes a policy
4 against charging administrative costs to ratepayers.

5 Mr. Moran goes on to state that because the auction process “is somewhat
6 complicated and expensive”, then “[i]t would be inappropriate...to require borrowers to
7 pay for the cost of running the auction in addition to PSE&G’s administrative costs.”
8 However, under the Company’s proposal, borrowers are only paying \$20.1 million of the
9 overall cost of \$359.1 million, which does not even cover all of the administrative costs
10 excluding auction costs. Ratepayers, however, are being asked to pay \$126.6 million,
11 and their cost responsibility could be even higher if SREC prices fall or administrative
12 costs increase over the amounts estimated in the Company’s filing. Moreover,
13 shareholders pay nothing under the Company’s proposal, and indeed benefit from a
14 virtually guaranteed return on equity of 10.3%.

15 One of the objectives of the BPU Staff in formulating the positions that the BPU
16 adopted in its May 23, 2012 Order was to “wean the solar industry from ratepayer
17 subsidies”, as stated in my Direct Testimony at page 20. This remains a valid objective
18 for any future programs approved by the BPU. The BPU recognized in the May 23, 2012
19 Order that ratepayers have contributed significant subsidies to the development of the
20 solar industry. In order to begin to mitigate these subsidies, it is appropriate to require
21 other parties to share in the burden of financing solar investment in the State of New
22 Jersey. One way of achieving some sharing is to require that administrative costs,
23 including auction costs, be recovered from parties other than the New Jersey ratepayers.

1 There is no reason to distinguish auction costs from other administrative costs that are
2 necessary in order to run the program. Accordingly, if the BPU approves the proposed
3 Solar Loan III Program, it should not permit PSE&G to recover administrative costs,
4 including auction costs, from ratepayers.

5

6 **Q. Does this complete your testimony?**

7 **A. Yes, it does.**