STATE OF NEW JERSEY
OFFICE OF ADMINISTRATIVE LAW
BEFORE HONORABLE RICHARD MCGILL, ALJ

I/M/O the Verified Petition of JCP&L	)	
for Review and Approval of Increases in	)	
and Other Adjustments to its Rates and	)	**OAL Docket No. PUC 16310-12N**
Charges for Electric Service, and For	)	
Approval of Other Proposed Tariff	)	**BPU Docket No. ER12111052**
Revisions in Connection Therewith; and	)	
for Approval of an Accelerated	)	
Reliability Enhancement Program	)	
("2012 Base Rate Filing")	)	

REPLY BRIEF ON BEHALF OF THE DIVISION OF RATE COUNSEL

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PUBLIC VERSION

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POINT I

THE CYCLE OF JCP&L'S POOR PERFORMANCE SHOULD BE STOPPED AND THE COMPANY SHOULD BE REQUIRED TO IMPROVE ITS RELIABILITY PERFORMANCE OR FACE SPECIFIC FINANCIAL CONSEQUENCES

A. Introduction

The Company, in its Initial Brief, reiterated many of the same arguments made in testimony and addressed by Rate Counsel in its Initial Brief. Attempting to shield itself from responsibility for poor reliability performance, the Company continues to argue that because it has passed the minimum reliability standard set by the Board, no relief related to its reliability should be granted in this case. *JCP&L Initial Brief*, p. 190. Although it is true that Mr. Lanzalotta conceded that the Company passed the Board's minimum reliability standard, Rate Counsel most certainly did contest whether the Company's reliability performance is adequate. Mr. Lanzalotta argued that the CAIDI and SAIDI reported by the Company on an annual basis may be misleading because the definition of major events is "too liberal" and allows the Company to remove so many events from its reporting that it "does not appropriately reflect the magnitude of reliability deficiency." *RC-74,* pp 8-16. As discussed extensively in Rate Counsel's initial brief, Mr. Lanzolatta also noted that the current regulations for "reliability performance for periods outside major storms are outdated and so flexible that JCP&L could have a significant decline in its reliability performance, excluding major storm events, and still meet the statutory minimum performance levels." *RC-87*, p. 22 and *JCP&L Initial Brief*, p. 185. In addition, the minimum reliability levels applicable to JCP&L are based on 5 year average from 2002-2006, the worst performing years for JCP&L, causing the benchmark to remain so low that it allows very poor performance to satisfy the Board's regulations.

Rate Counsel also extensively challenged the claim that the Company's capital investment levels and O&M spending levels were reasonable. Rate Counsel also argued in its Initial Brief that both capital improvements and expense spending such as vegetation management should have been more robust. The Company's claim that these issues were uncontested is therefore without merit.

Rate Counsel will not repeat the arguments already made in prior filings but instead will focus on specific issues not addressed in our Initial Brief.

B. JCP&L'S Storm Performance is Squarely Within the Scope of the Present Proceeding Before Your Honor and the Board

As discussed extensively in Rate Counsel's initial brief, an electric utilities' reliability performance, both during blue sky and major event days is the cornerstone of safe, adequate and proper service. N.J.S.A. 48:2-21 and N.J.S.A. 48:2-23. Nevertheless, JCP&L argues that the storm performance is "outside the scope of this base rate proceeding and should not be addressed in the Initial Decision in this matter" because the Board relegated the review of JCP&L's storm response in a separate Generic Proceeding. *JCP&L Initial Brief*, pp. 186-187. JCP&L misinterprets the Board's Generic Storm Order to bar the parties from having a venue to address this important issue. Upon review of the Generic Storm Order, it becomes abundantly clear that the storm proceeding is focused purely on the costs incurred by the New Jersey utilities associated with specific Major Events that occurred in 2011 and 2012. Reliability issues, prolonged outages and outage restoration efforts were not within the scope of the Generic Storm Order. I/M/O The Board's Establishing A Generic Proceeding To Review the Prudency of Costs Incurred by NJ Utility Companies In Response To Major Storm Events in 2011

and 2012, Establishment of a Generic Proceeding (March 20, 2013) ("Generic Storm Order (3/20/13)"). Those issues were left to be addressed in the present case. In response to JCP&L's motion for reconsideration and/or clarification in the Generic Storm Proceeding, the Board again stated its position: "The Major Storm Event costs incurred by JCP&L in 2011 and 2012 will be reviewed for prudency within the Generic Storm Costs Proceeding. (emphasis added). I/M/O The Board's Establishing A Generic Proceeding To Review the Prudency of Costs Incurred by NJ Utility Companies In Response To Major Storm Events in 2011 and 2012, BPU Dkt. Nos. AX13030196 and EO13050391, Order Denying Motion for Reconsideration and Clarifying Original Order (May 31, 2013)). In both the March and May 2013 Orders in that docket, the Board strictly limited the issue to the review of "Major Storm Event expense" to be reimbursed by ratepayers and did not seek information that touched upon reliability issues or improvements. Generic Storm Order (3/20/13) p. 3. Reliability issues are often addressed in rate case proceedings, including JCP&L's prior rate cases.[1] By foreclosing the parties from addressing storm reliability issues in this base rate case, the Company is essentially attempting to foreclose any discussion of JCP&L's reliability or its storm performance. The Company's attempt to use the Generic Storm Proceeding to stifle an examination of its reliability should be rejected. We respectfully request that Your Honor

[1] I/M/O the Verified Petition of JCP&L for Review and Approval of an Increase in and Adjustments to Its Unbundled Rates and Charges for Electric Service, and for Approval of Other Proposed Tariff Revisions in Connection Therewith, et. al., BPU Docket No. ER02080506 et. al., Final Order, (May 17, 2004) ("JCP&L 2004 BRC Order") and I/M/O the Verified Petition of JCP&L for Review and Approval of an Increase in and Adjustments to Its Unbundled Rates and Charges for Electric Service, and for Approval of Other Proposed Tariff Revisions in Connection Therewith, et. al., BPU Docket No. ER02080506 et. al., Decision and Order Adopting Stipulations of Settlements Approving Phase II Rate Increase and Resolving Motion and Cross Motion for Reconsideration, (May 31, 2005) ("JCP&L 2005 Order").

and the Board review the Company's performance during the storm, its failure to invest in its infrastructure and its inability to provide reliable service.

C. The Amount of Capital Investment and Operation and Maintenance Expenditures Have a Direct Impact on JCP&L's Reliability Performance During Major Events

It its initial brief, JCP&L claims that industry standards dictate that major events be excluded from electric system performance analysis. There is no question that data that shows CAIDI and SAIFI without Major Events is information that is useful to regulators. Rate Counsel argued, however, that an additional metric that the Company already tracks, "CAIDI and SAIFI with Major Events", can also be informative to regulators who currently view Major Event Reports on a piecemeal basis shortly after each storm occurs instead of aggregate performance numbers that encompass an entire year. The Company mischaracterizes Rate Counsel's position suggesting that Rate Counsel would substitute reporting of "CAIDI and SAIFI with Major Events" for current reporting requirements. In fact, Rate Counsel is seeking reporting of "CAIDI and SAIFI with Major Events" in addition to current reporting as it will provide a more comprehensive picture for the Board.

JCP&L argues against this additional reporting expressing concern that providing additional information may somehow lead the regulators astray:

> It would not be helpful, as Mr. Strah explained, to include the impact of events over which utilities have no control; indeed, to do so would only negatively skew the perception of utility reliability performance.

JCP&L Initial Brief, p.195

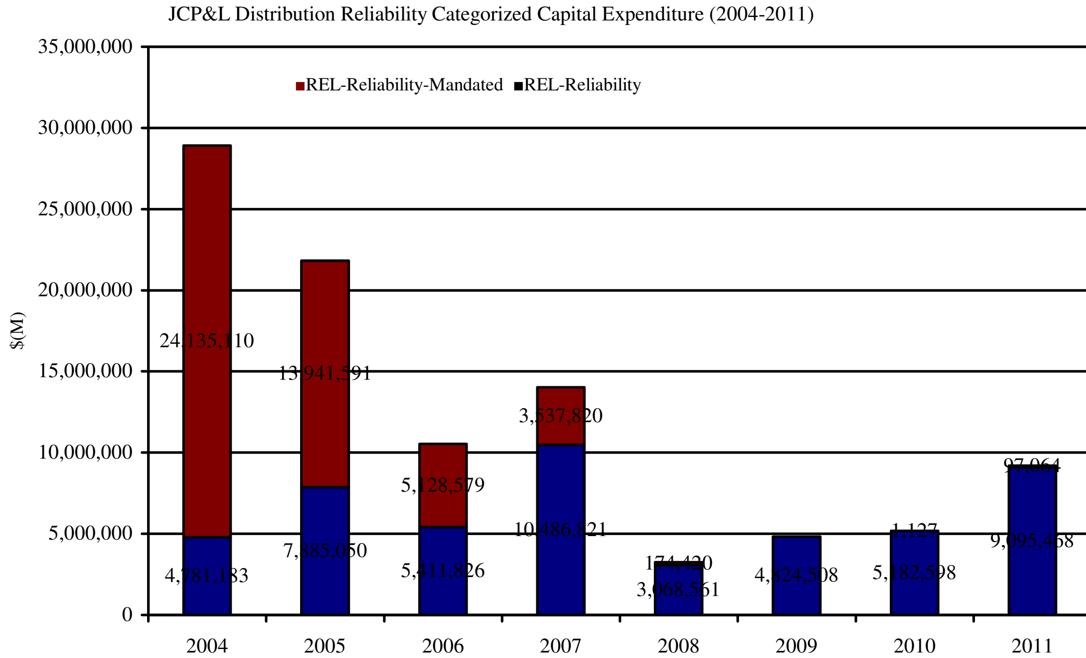
As the agency tasked with insuring electric reliability in New Jersey, it is doubtful that the Board will be unable to review CAIDIs and SAIFIs with Major Events in the appropriate context.

What is more troubling about the Company's argument, however, is its view that it has "no control" over how the Company performs during Major Events. This is the crux of the difference between Rate Counsel's position and the Company's. Rate Counsel believes that if sufficient capital investments are made and enough operation and maintenance expenses are spent especially on vegetation management, the electric system should have fewer outages, all else being equal. According to the Company, the severity of the blackout is purely a function of the magnitude of the storm. We vehemently disagree. As discussed extensively in Rate Counsel's initial brief, JCP&L deferred needed tree trimming from 2008 through 2011, critical periods prior to Hurricane Irene and Hurricane Sandy. *RC-87*, Table 7, p. 31. The overgrown vegetation on the Company's system had, no doubt, a detrimental effect on the severity of the outages. The Company claims that the Corridor Widening Initiative, an off-right-of-way program, diverted funds away from right-of-way vegetation management. *JC-16,* p. 11. But no explanation was provided as to why the budget could not have accommodated both programs when the Company was clearly over-earning.

With respect to capital investments, as Company witness Mr. Jeffrey Cummings' prefiled testimony illustrated, the Company chose to substantially decrease the amount of Capital Expenditures starting in 2008, a critical time period prior to the 2011 and 2012

Major Events. As the Company's own data, sponsored by Mr. Cummings, shows:

Figure IV.15 – Distribution Reliability Capital Expenditures



Source: Analysis of JCP&L Capital Expenditure Records

JC-15, p. 89 Figure IV.15.

In fact, the only reason the Company is able to make the claim that "JCP&L's capital investment levels have been strong and above that of the industry median" is because, as Mr. Cumming's chart clearly shows, JCP&L was "mandated" to invest in capital and given additional revenues to do so**.** *JCP&L Initial Brief*, p. 179[2] . Once that mandated work was completed in 2007 and JCP&L was left to its own devices, it appears the Company's capital spending returned to lackluster levels. The Company should be Ordered to improve, and then maintain, its reliability spending.

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[2] See, also I/M/O the Verified Petition of JCP&L for Review and Approval of an Increase in and Adjustments to Its Unbundled Rates and Charges for Electric Service, and for Approval of Other Proposed Tariff Revisions in Connection Therewith, et. al., BPU Docket No. ER02080506 et. al., (May 31, 2005)

D. Customers Experiencing Multiple Interruptions ("CEMI") is an Important Metric to Identify and Correct the Pockets of Poorly Performing Circuits

The public hearing in this case brought large numbers of JCP&L customers complaining about the Company's reliability performance, even on blue sky days.

> Since we moved down here fourteen years ago, we have experienced nothing but outages, mini, micro, nano, major. I saw a statement in the paper once that said if you sneeze your lights go out. That is the absolute truth with JCP&L.
> Ms. Marie Ritchie T16:L25-T17:L4 (April 8, 2013 Public Hearing)

> There are elderly people by us, as well, there's small children. And they're speaking about other neighborhoods, you know, I'm from Chicago we even get outages – my kid said when power used to go off by you how long was it out for? A half hour, maybe, in a severe storm. But here it could be, as they said before, it could [be] seventy degrees, a random day, and the power is out, you know, our freezer is defrosting. What happened? Was there lightening? No. Did someone have an accident? No. The power just went out, random.
> Mr. Moshe Raitzik T43:L1-L12. (April 8, 2013 Public Hearing).

> To be honest, I am a little bit astounded that we are here talking about a JCP&L rate increase, given JCP&L's [] chronic inability to perform. I have lived on [] Road in Morris Township for a little under two years. During that time my power has gone out over a dozen times not in terms of minutes but typically hours and often days. I have had to throw out the food in my refrigerator and freezer twice during that time; it's like living in the Third World.
> Michael Shipe T35:L21-T36:L6. (April 16, 2013 Public hearing).

These JCP&L customers and many more like them attended the six public hearings held by Your Honor complaining on behalf of their families and the communities they represented. Many of them had severe reliability problems that affected small areas on blue sky days with no apparent reason.

To address these issues, Rate Counsel witness Mr. Peter Lanzalotta suggested that the Board implement additional benchmarks utilizing other measures, such as customers experiencing multiple interruptions ("CEMI") to address pockets of poorly performing

areas that may be too small to be captured by system or region-wide SAIFI and CAIDI. *T22:L19 to T23:L4* (October 2, 2013). JCP&L argues that a metric such as CEMI is unnecessary and even harmful to report to the Board. Much like the "confusion" that the Company claims SAIFI and CAIDI with Major Events will create, JCP&L is similarly concerned about using CEMI metric to identify pockets of poor performance:

> Finally, regarding the use of the CEMI metric, Mr. Strah indicated that JCP&L uses the metric as one of an assortment of tools for certain circuit-related assessments in the priority circuit program, but cautions against using it as a general regulation-required metric because of the need for engineering judgments to determine the priority and criticality of actions that will lead to overall system reliability improvements.

JCP&L Initial Brief, p. 195.

JCP&L concedes that the Company itself tracks its CEMI and uses the data under limited circumstances. However, according to the Company, JCP&L's own engineers are the only people that have sufficient knowledge and expertise to interpret CEMI data correctly. This argument lacks credibility and the Company should not be permitted to hamper regulatory review of poor performance by witholding this tool from regulators. To counter Mr. Lanzalatta's recommendation to require CEMI reporting, the Company argues that such reporting is unnecessary, citing to the Board's pilot program to increase the number of priority circuits to be reviewed and remediated from 4% to 8%. *JCP&L Initial Brief*, p. 195 and <u>I/M/O the Board's Initiative to Revise Reporting Requirements and Improve Reliability Programs By the Electric Distribution Companies Operating in New Jersey</u>, BPU Docket No. EO12170650, Order (February 20, 2013). However, the Company's argument that CEMI is unnecessary does not address Mr. Lanzalotta's real

concern that the pilot program may not be granular enough to address small pockets of poorly performing neighborhoods:

> A. I am aware of the Board's recent initiative addressing poorest performing feeders. The approach of identifying poorest performing feeders, however, does not necessarily address smaller pockets of poor reliability performance on the system.
>
> I feel there's a need for the metric such as CEMI, C-E-M-I, refers to customers experiencing multiple interruptions, which provides information about the existence of pockets of customers smaller than entire distribution feeders that have been experiencing poor performance.

CEMI is another tool that can be used by the Board to identify and address the problems such as the ones brought to the Board's attention during the six Public Hearings. Rate Counsel urges that the Company be required to report this metric, which they are admittedly already tracking and using.

E. Conclusion

Therefore for the reasons set forth in this reply brief and the initial brief Rate Counsel respectfully request that the Your Honor and the Board adopt the following:

1. JCP&L should be required to meet a modified minimum reliability benchmark by using more recent, SAIFI and CAIDI data, and additional benchmarks utilizing other measures such as CEMI to address pockets of poorly performing areas that may be too small to be captured by SAIFI and CAIDI. Rate Counsel respectfully requests that Your Honor and the Board acknowledge JCP&L's poor performance and specifically order the Company to establish an improvement plan with specific deadlines and consequences, such as a reduction of its Return or Equity, if reliability does not improve.

2. JCP&L should be required to include in its annual system reliability report the Company's CAIDI and SAIFI both including and excluding major events. In addition, the Board should better define "major events" so that the definition cannot be modified to skew the Company's performance results.

3. JCP&L should be ordered to maintain an increased level of vegetation management spending and require reporting and sanctions if its vegetation management practices and spending are not maintained at a sufficient level.

POINT II

THE EVIDENCE IN THE RECORD SUPPORTS RATE COUNSEL'S RECOMMENDATION THAT JCP&L SHOULD BE REQUIRED TO CONDUCT A RING-FENCING STUDY TO PROTECT ITS FINANCIAL PROFILE AND ITS RATEPAYERS.

Rate Counsel respectfully requests that the Your Honor and the Board accept Mr. Kahal's recommendation and order JCP&L to conduct a "ring fencing" study - within 90 days of the Board Order resolving the instant case - to evaluate the Company's financial status as an affiliate of FirstEnergy and identify mechanisms to insulate JCP&L from the business and financial risks of its corporate parent and affiliates. See *Rate Counsel Initial Brief*, pp. 33-35. The Company has presented nothing which credibly refutes the evidence in the record which supports the need for a ring-fencing study.

JCP&L's opposition to a ring-fencing study focuses on the cost of such a study, which the Company claims is an "unnecessary expense." *JCP&L Initial Brief*, pp. 39-40. Notably, the Company fails to provide a cost estimate for such a study and, therefore, there is no evidence to render such an expense unreasonable or to support the Company's claim that it would be an "unnecessary expense." However, the concerns expressed by credit rating agencies about financial risks attributable to the JCP&L's relationship to parent FirstEnergy persist despite the Company's existing measures. In testimony, Mr. Kahal discusses numerous credit rating agency reports that cite the financial risks attributable to JCP&L's relationship to its parent FirstEnergy as the basis for lower ratings. *RC-111*, pp. 9, 23-28; *T97:L9-T99:L20* (October 4, 2013). JCP&L claims that it has already implemented "most" of the ring-fencing measures recommended by Mr. Kahal in a Maryland Public Service Commission case involving a Maryland public utility, Potomac Edison, which JCP&L identifies as sister company. *JCP&L Initial Brief*,

p. 39. However, given the rating agencies' continuing concerns about JCP&L's affiliation with FirstEnergy such measures, apparently, are not sufficient. Furthermore, although JCP&L cites its witness Mr. Staub's testimony that the credit rating agencies do not specifically call for ring-fencing measures, the Company fails to address the adverse financial affects of JCP&L's relationship to FirstEnergy. Id., p. 40. Clearly, any ring-fencing measures now in place at JCP&L, as set forth in Exhibit *RC-96*, are not sufficient to alleviate the credit rating agencies' concerns. Similarly, JCP&L's argument that management audits by the BPU negate the need for a ring-fencing study fails to address the concerns of the credit rating agencies. Id., p. 40. In fact, a ring-fencing study was specifically recommended in a management audit of the Company performed for the BPU, which the Company did not contest at that time. *T71:L24-T72:L20*. (October 4, 2013); *RC-106*. Therefore, a study should be conducted to examine whether additional ring-fencing measures should be implemented to protect JCP&L.

The testimony of one of JCP&L's own witnesses contradicts its claims that a ring-fencing study is not needed. JCP&L witness Ms. Ahern calls for a 55 basis point risk adder for her ROE calculation to compensate for the weaker credit agency ratings of JCP&L relative to its proxy group peers. *JC-6*, pp. 43-44. What the Company fails to reconcile is the fact that JCP&L's weaker ratings are attributable to its relationship to FirstEnergy and its exposure to its parent's unregulated operations. *See RC-111*, pp. 9, 23-28. The contradiction is quite clear: the Company's ROE witness calls for a risk adder to compensate for financial risk - which is attributable to the Company's relationship to FirstEnergy - while the Company argues that no further ring-fencing measures are necessary. A ring-fencing study would address the risk identified by the credit rating agencies.

Finally, Rate Counsel again notes that in a recent Order the Board acknowledged the potential benefit of ring fencing for JCP&L's customers and specifically provided *inter alia* that "the study of potential ring-fencing measures is a reasonable proposal which would be best pursued in the context of the Company's pending base rate case or other relevant proceeding."[3] Rate Counsel, therefore, respectfully requests that the issue of ring-fencing should be addressed in the instant case and JCP&L be ordered to conduct a "ring fencing" study to enhance the financial status of JCP&L within 90 days of the Board Order resolving the instant case. *See RC-111*, p. 27.

[3] I/M/O the Provision of Basic Generation Service Pursuant to the Electric Discount and Energy Competition Act, N.J.S.A. 48:3-49 et. seq., BPU Dkt. Nos. EX01110754 and EO13080721, Decision and Order (September 19, 2013), p. 6.

POINT III

EVIDENCE IN THE RECORD SUPPORTS RATE COUNSEL'S PROPOSED RETURN ON EQUITY OF 9.25%, DEBT RATE OF 6.26%, AND PROPOSED CAPITAL STRUCTURE OF 50% COMMON EQUITY, RESULTING IN AN OVERALL RATE OF RETURN OF 7.76%

As set forth below, JCP&L has presented nothing which seriously refutes Rate Counsel's recommended Rate of Return, Debt Cost, Capital Structure, and overall Rate of Return recommendations. For the reasons set forth below and in its initial brief and testimony of its witness, Rate Counsel respectfully requests that Your Honor and the Board adopt Mr. Kahal's recommendations of an overall weighted average cost of capital for JCP&L's jurisdictional electric distribution rate base of 7.76 percent, based on a ROE of 9.25 percent, a 6.26 percent cost of debt, and a hypothetical capital structure of 50 percent long-term debt and 50 percent common equity. See *Rate Counsel Initial Brief*, pp.33-62; *RC-111*, p. 5; Schedule MIK-1, page 1 of 1. In contrast, JCP&L proposes overall weighted cost of capital of 8.66 percent, based on a ROE of 11.0 percent, a debt cost of 5.93 percent, and a capital structure of 53.8 percent equity and 46.2 percent debt. *JCP&L Initial Brief*, p. 15; *JC-SR-1*.

A. Return on Equity

JCP&L did not present any credible evidence which refutes the overwhelming evidence that its proposed ROE of 11.0 percent is unreasonable. The Company's currently authorized ROE is 9.75 percent which was set in 2005, when capital costs were significantly higher.[4] Thus, it was not unexpected that the financial analyses performed by witnesses for Rate Counsel and Gerdau yielded lower ROE figures. In contrast to the

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[4] *See* I/M/O JCP&L, BPU Dkt. No. ER02080506 et al (May 31, 2005) ("2005 JCP&L Base Rate Case Order"); *RC-111*, pp. 10-14.

Company's proposed 11.0 percent ROE and based on current economic realities, Rate Counsel recommends a ROE of 9.25 percent and Gerdau recommends an ROE of 8.9 percent. *Rate Counsel Initial Brief*, pp. 37-55; *Gerdau Initial Brief*, pp. 8-29. Staff recommended a ROE of 9.75 percent, citing recent ROE figures approved by the Board in base rate cases involving other utilities and reports of base rate case ROE awards in other jurisdictions compiled by SNL Financial. *Staff Initial Brief*, p. 22. However, in contrast to Staff's observations, Rate Counsel and Gerdau presented the testimony of their respective expert witnesses, replete with financial analyses supporting their ROE recommendations. <u>See</u> *RC-111*; *Gerdau-1*.

Notably, even Staff noted that its recommended ROE was high compared to the Company's 9.75 percent ROE set in 2005. Citing recent spreads between 10-year Treasury yields and Baa utility yields compared to those in 2003-2005, Staff noted that "from the Company's perspective, [Staff's recommended 9.75 percent ROE] is even better than the same ROE the Company was awarded in the last rate case." *Staff Initial Brief*, p. 22. AARP supports Rate Counsel's proposed 9.25 percent ROE and argues that JCP&L's current 9.75 percent "allows the Company to continue to over earn beyond that which is reasonable." *ARRP Initial Brief*, pp. 6 and 8. Walmart also supports Rate Counsel's 9.25 percent ROE recommendation. *Walmart Initial Brief*, p. 7. In sum, on its face, JCP&L's proposed ROE of 11.0 percent is demonstrably unreasonable in an environment of historically low equity cost rates.

Although JCP&L now criticizes reliance on the DCF method, JCP&L witness Ms. Pauline M. Ahern's application of the DCF method in her rebuttal testimony, using different data inputs and proxy companies, produced results which support Mr. Kahal's

conclusion. Mr. Kahal found that Ms. Ahern's updated DCF analysis presented in her rebuttal testimony, using her proxy companies and with certain data input adjustments by Mr. Kahal, resulted in an ROE figure of "around 9 percent." *T129:L13-14* (October 4, 2013). This comports with Mr. Kahal's DCF results, where he computed a range of 8.4 to 9.5 percent for JCP&L's ROE. *RC-111*, p. 7. This also comports with Gerdau witness O'Donnell's ROE study results, which yielded a range of 8.1 to 9.0 percent. See *Gerdau Initial Brief*, pp. 28-29; *Gerdau-1*, p.18.

Mr. Kahal testified that the DCF method yields the most reliable measure of the cost of equity and a reasonable ROE for a low-risk regulated utility. See *RC-111*, pp. 11-12. Both Mr. Kahal and Gerdau's Mr. Kevin W. O'Donnell relied primarily on the Discounted Cash Flow ("DCF") method to develop their respective ROE recommendations. See *RC-111*; *Gerdau-1*. Furthermore, each validated their DCF analyses with other methodologies as a check. Mr. Kahal validated his DCF results using the Capital Asset Pricing Model ("CAPM") method as a check. *RC-111*, p. 7. Mr. O'Donnell validated his DCF results using a comparable earnings analysis. *Gerdau-1*, pp. 17-18. In contrast to the DCF method, Mr. Kahal found the various other methodologies utilized by Ms. Ahern are "poorly explained, unconventional cost of equity methods." *RC-111*, p. 57. As set forth in Mr. Kahal's testimony, Ms. Ahern's conclusions on ROE, upon which Mr. Pearson relied for his recommendation, are based on flawed analyses. *RC-111*.

Additionally, JCP&L has not presented any convincing evidence to support a finding that its proposed Flotation Cost and Credit Risk adders are reasonable. Ms. Ahern proposed ROE adders for stock flotation costs and credit risk, which were

overwhelmingly refuted in the testimonies of Mr. Kahal and Mr. O'Donnell. *JCP&L Initial Brief*, pp. 36-39; *RC-111*, pp. 55-56; *Gerdau-1*, pp. 40-41. Mr. Kahal found that Ms. Ahern's calculation of the Company's flotation cost adder was too high and, more importantly, based on costs incurred too far in the past (more than ten years ago) for inclusion in the instant case. *RC-111*, p. 27. With respect to Ms. Ahern's credit risk adder, the overwhelming evidence in this case supports the conclusion that JCP&L's affiliation with its corporate parent FirstEnergy adversely affects its risk profile. See *RC-111*, pp. 21-25, p. 30, and pp. 55-56. The Board's FirstEnergy-GPU Merger Order includes a provision which prohibits FirstEnergy from subjecting JCP&L' ratepayers to costs and risks attributable to FirstEnergy's activities:

> 14. FirstEnergy shall not subject JCP&L's customers to any financial costs, risks or consequences from subsidiaries Ohio Edison, Pennsylvania Power, or any other of FirstEnergy's nuclear or fossil generation operations....[5]

The inclusion of a credit risk adder would cause JCP&L's ratepayers to pay a penalty for JCP&L's affiliation with parent FirstEnergy. Appropriately, a reasonable ROE for ratemaking purposes should reflect a reasonable ROE for stand-alone electric distribution utility, without a credit risk adder to compensate for risks attributable to its corporate parent. See *Rate Counsel Initial Brief*, pp. 53-55.

In sum, JCP&L's proposed ROE of 11.0 percent is much higher than the overwhelming evidence supports in this case. In the face of lower equity costs than 2005, JCP&L's Mr. Pearson recommends an unreasonably high ROE that is 125 basis points

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[5] *See* I/M/O the Joint Petition of FirstEnergy Corp. and Jersey Central Power and Light company, d/b/a GPU Energy, For Approval of a Change in Ownership and Acquisition of Control of a New Jersey Public Utility and Other Relief, BPU Dkt. No. EM00110870, Order of Approval (October 9, 2001) ("GPU Merger Order"), p.23.

higher than JCP&L's currently authorized ROE that was established in the Company's 2005 base rate case, and 175 basis points above Mr. Kahal's recommendation.

JCP&L claims that an ROE of 11.0 percent is needed to instill investor confidence. *JCP&L Initial Brief*, pp. 24-25. This argument is unconvincing. If such a high ROE was needed, surely JCP&L would have initiated action to increase its authorized 9.75 percent ROE and not oppose Rate Counsel's and Gerdau's filings in support of their position that the Board order the Company to file the instant base rate case.

For the reasons set forth herein and Rate Counsel's initial brief as well as in Mr. Kahal's testimony, Rate Counsel respectfully submits that the Company's proposed ROE is overstated and should be rejected in favor of Mr. Kahal's well-supported 9.25 percent ROE.

B. Cost of Long-Term Debt

Mr. Kahal recommends adopting a 6.26 percent cost of debt for JCP&L, which is the actual June 30, 2012 embedded cost of debt rate originally presented in Mr. Staub's direct testimony. *RC-111*, p. 21. Mr. Kahal's recommendation did not reflect the $500 million debt issuance in August 2013 (at a cost rate of 4.91 percent) since it was issued too far beyond the end of the historic test year for inclusion in this case. *JC-5*, Sched. SRS-3; *JC-5A*. The Company argues that this new debt issuance should be reflected in its embedded cost of debt, yielding an embedded cost of debt of 5.93 percent. *JCP&L Initial Brief*, pp. 17-18; *T66:L12-17* (October 4, 2013); *JC-5A*.

JCP&L focuses its criticism of Mr. Kahal's cost of debt recommendation by contrasting it with updated measures of dividend yields and other inputs utilized to derive

a return on equity recommendation. *JCP&L Initial Brief*, pp. 17-18. However, JCP&L's argument fails to recognize the prospective nature of the ROE figure, which encompasses investors' expectations of future earnings growth and dividend payouts. Hence, more recent data would undoubtedly help refine the derivation of an ROE recommendation. Furthermore, by recommending a cost of debt which is higher than the Company's own figure, Mr. Kahal's cost of debt recommendation is actually quite conservative. Mr. Kahal's recommended 6.26 percent cost of debt is reasonable and should be adopted. *See Rate Counsel Initial Brief*, p. 55.

Rate Counsel also supports Staff's recommended debt refunding study. *See Staff Initial Brief*, p. 23. Staff recommends the Board order a study of the potential economic benefit of refunding the $300 million 7.35 percent unsecured notes and provide the results of the study to the Board. In light of today's very low capital cost environment, such a study appears reasonable.

C. Capital Structure

Mr. Kahal recommended a capital structure of 50 percent equity and 50 percent debt. *RC-111*, p. 5. In contrast, the Company proposed a capital structure of 53.8 percent equity and 46.2 percent debt, derived from its (adjusted) actual capital structure which improperly includes $1.8 billion of goodwill attributable to FirstEnergy's purchase of GPU, JCP&L's then parent company. *RC-97*; *JC-5*, p. 4, Sched. SRS-2; *JC-5R*, p. 2. JCP&L concedes that it included goodwill in the equity component of its capital structure for ratemaking purposes. *JCP&L Initial Brief*, pp. 19-20. While the Company claims that "goodwill represents a real investment by FirstEnergy for plant, property and equipment," goodwill does not represent actual utility assets or outside investor-supplied

funds, which Mr. Kahal found adversely affects the quality of JCP&L's balance sheet and the Company's credit agency ratings. *JCP&L Initial Brief*, pp. 19-20; *T98:L19-T99:L20* (October 4, 2013). In fact, in response to a discovery request, JCP&L's witness stated that "the $1.8 billion of goodwill on its [JCP&L's] books represents a premium over book value that FirstEnergy paid for GPU." *RC-97*.

Moreover, the Board's Order approving FirstEnergy's acquisition of JCP&L specifically disallowed recovery of costs related to goodwill:

> 13. In connection with the 2002 base rate case and in all subsequent rate cases, appropriate pro forma adjustments to the test year shall be made by JCP&L, as necessary, to ensure that any costs related to *goodwill*, merger transaction costs (i.e., investment banker and attorneys fees associated with the merger agreement), the acquisition premium and executive separation costs (i.e., "golden parachutes" listed on pages 62-63 of the Proxy) which costs are listed in full on Exhibit 1 to Attachment A of the Stipulation shall not be used to reduce merger savings and shall not be included in JCP&L's test-year cost of service or otherwise charged to JCP&L's customers for ratemaking purposes.[6]

Contrary to JCP&L's assertion, the Board's ruling on goodwill is not limited only to instances where goodwill is included in rate base or where goodwill is amortized as an expense. *JCP&L Initial Brief*, p. 19. By increasing the more expensive equity component of the Company's capital structure, the inclusion of goodwill in the Company's capital structure increases the overall cost of capital, resulting in higher rates for its customers. See *RC-111*, pp. 17-20. The increased cost of capital related to the inclusion of goodwill directly contravenes the terms of the Board's FirstEnergy-GPU Merger Order.

However, as Mr. Kahal testified, removal of goodwill from JCP&L's capital structure would result in an "imprudent and overleveraged capital structure with too little

[6] See FirstEnergy-GPU Merger Order (EM00110870), pp. 22-23.

common equity." *RC-111*, p. 19. Therefore, in accordance with industry norms and JCP&L's own stated target capital structure range, Mr. Kahal recommended a 50/50 capital structure. *RC-111*, p. 20. Notably, Mr. Kahal's 50/50 capital structure recommendation was equal to the midpoint of what one JCP&L witness called "the traditional 45%-55% common equity range typically sanctioned by the Board." *JC-5R*, p. 6; *RC-97*. Furthermore, JCP&L itself has identified a target capital structure range of about 45 to 55 percent common equity. *RC-98*. In addition, a 50/50 capital structure favorably compares with the capital structures found in both Mr. Kahal's proxy group and Ms. Ahern's two proxy groups of companies. *See RC-111*, p. 17, MIK-3; *JC-6*, PMA-4, p. 1, and PMA-5, p. 1. Finally, Mr. Kahal found that the 50/50 structure is "approximately consistent" with the approved ratemaking capital structures of Atlantic City Electric ("ACE") and Public Service Electric and Gas Company ("PSE&G"). *RC-111*, p. 17. Board Staff, as well as intervenors Gerdau and AARP, also recommend the adoption of a 50/50 capital structure. See *Staff Initial Brief*, p. 21; *Gerdau Initial Brief*, pp.29-40, *AARP Initial Brief*, p.6.

Thus, Mr. Kahal's recommended 50/50 capital structure is reasonable, falling at the precise midpoint of the Company's own capital structure target equity range of 45 to 55 percent. Thus, Rate Counsel respectfully submits that Your Honor and the Board adopt the 50/50 capital structure recommended by Rate Counsel's witness.

D. Conclusion

For the reasons set forth above and in its initial brief and testimony of its witness, Rate Counsel respectfully submits that Your Honor and the Board make the following findings:

1. The appropriate capital structure is 50 long term debt and a 50 percent common equity, as recommended by Mr. Kahal, and JCP&L's proposed capital structure of Mr. Staub which inappropriately includes goodwill should be rejected;

2. That Mr. Kahal's ROE of 9.25 percent was developed using an appropriate proxy group and DCF analysis, was supported by Mr. Kahal's CAPM analysis and should be adopted;

3. Ms. Ahern's updated DCF evidence and Mr. O'Donnell's testimony support Mr. Kahal's recommendation and Ms. Ahern's other methodologies, adders, and calculations are improper, non-standard and fail to support a ROE recommendation above 9.25 percent; and

4. JCP&L's overall weighted average cost of capital is 7.76 percent, based on a 9.25 percent ROE, a 6.26 percent cost of debt, and a 50/50 capital structure.

POINT IV

RATE COUNSEL'S RECOMMENDED RATE BASE OF $1,324,452,526 SHOULD BE ADOPTED

As discussed in Rate Counsel's Initial Brief the appropriate starting point of the rate base to be used to determine JCP&L's distribution rates is $1,247,783,394 rather than the $2,024,166,188 sought by the Company. With the inclusion into rate base of the 2011 Major Storm costs, Rate Counsel's recommended rate base would increase by $74,007,396 for costs incurred in response to Hurricane Irene and to the October snowstorm. In addition, Rate Counsel's proposed rate base does not include $2,661,736 for costs incurred by JCP&L in response to the July 2011 Heat Storm. If the Board approves the pending stipulation in the generic storm costs proceeding, Rate Counsel's recommended total net rate base is $1,324,452,526. Rate Counsel's recommended adjustments to the Company's proposed rate base are discussed below.

A. Post test year adjustments

In their Initial Brief, JCP&L argues that based on what is "clearly an inappropriate and stale test year," the Company should be allowed to include out of period adjustments beyond the standard for post test year adjustments established by the Board in the Elizabethtown Water[7] case. *JCP&L Initial Brief*, p. 41. In Elizabethtown Water the Board set forth the 3-6-9 rule for post test year adjustments:

> [P]etitioner shall have the opportunity to make a record with regard to (a) known and measurable changes to income and expense items for a period of nine months beyond the end of the test year; (b) changes to rate base for a period of six months beyond the end of the test year, provided there is a clear

[7] In re Elizabethtown Water Company Rate Case, Docket No. WR8504330, Decision on Motion for Determination of Test Year and Appropriate Time Period for Adjustments (May 23, 1985).

> 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; (c) changes to capitalization for a period of three months past the end of the test year, provided that such changes are major in nature and consequence, and that the results of said proposed financing are actual prior to the Board's determination in this case.

At the evidentiary hearing, Rate Counsel witness Mr. Henkes disagreed with the Company's position on post test year adjustments, saying:

> I disagree with this position because what Mr. Mader completely ignores in this position is the fact that the recognition of adjustments that are too far removed from the test year bring the test year ratemaking formula out of whack. So he misses the whole concept about proximity to the test year.
>
> The test year – the 2011 test year – includes almost all of the components in the ratemaking formula used in this case and it would be wrong to then give rate recognition to certain selected events that have happened, say, in 2013 or almost two years after the end of the test year. This is because if you start giving rate recognition to certain selected changes way beyond the end of the test year without considering other changes in the ratemaking formula that may have happened during that same time, you clearly bring the ratemaking formula out of whack with the result of arriving at the wrong revenue requirement conclusions. *T56:L11 – T60:L3* (October 7, 2013).

Rate Counsel urges the Board to abide by the decision in <u>Elizabethtown Water</u> and reject the Company's effort to include post test year adjustments to this base rate proceeding that utilizes 2011 data. A fully retrospective test year does not mean that the <u>Elizabethtown Water</u> standard does not apply.

B. Unamortized Net Losses on Reacquired Debt (Net of Tax)

As discussed in Rate Counsel's Initial Brief, JCP&L proposes to include as an addition to rate base $17,920,314 of unamortized losses on reacquired debt. *Rate Counsel*

Initial Brief, pp.64-65. Mr. Henkes adjusted this proposal to include just the distribution-related portion of the unamortized balance and to recognize the deferred income tax balance related to the net loss on reacquired debt. The resulting recommended net-of-tax loss on reacquired debt balance is $8,350,574 which is $9,569,740 lower than JCP&L's proposed balance of $17,920,314. *RC-145, Sch. RJH-4*.

The Company argues that the loss on reacquired debt rate base addition should not be net of tax, but only because this adjustment was not made in the Company's prior base rate case. *JCP&L Initial Brief,* p.78. As noted by Mr. Henkes in his Initial Testimony:

> I disagree with this argument. Even if something "slipped through the cracks" in the prior base rate case, this does not mean that therefore the same error should be reflected in the current case. Two wrongs do not make a right. The fact is that the Company only incurs a carrying cost on the net-of-tax loss on reacquired debt balance and it would be wrong to allow them a return on the gross balance while completely ignoring the offsetting accumulated deferred income tax balance as a rate base deduction. *RC*-145 p.16.

Board Staff agreed with Rate Counsel's adjustments and recommended rate base and expense adjustments of ($9.570 million). *Staff Initial Brief*, p.71. As noted by Board Staff:

> While Staff acknowledges the Company has consistently treated unamortized net gains and losses on reacquired debt as a separate rate base and operating income issue consistent with the Board-approved methodology over the past thirty years, Staff recommends the approach offered by Rate Counsel to incorporate deferred tax benefit. Staff, therefore, recommends rate base and expense adjustments of ($9.570 million) and ($0.376 million) to rate base and expense, respectively. *Staff Initial Brief*, p. 71.

C. Storm Damage Cost

JCP&L, Board Staff and Rate Counsel have executed a stipulation of settlement in the Board's generic storm damage proceeding. If adopted by the Board, JCP&L will be allowed to include in rate base in this proceeding additional plant in service of $74,007,396 resulting from the 2011 storm events[8].

There will also be a separate amortization of the deferred O&M costs incurred as a result of the 2011 Major Storms. This amortization will be discussed in the operating income section of this brief. However, in addition to the increase in plant in service, the Company proposes to add to rate base the net of tax unamortized balance associated with the deferred O&M storm costs. Specifically, the Company is proposing to include in rate base the *average* net-of-tax unamortized storm cost balance it will carry on its books during the Company's proposed three year amortization period. This *average* net-of-tax unamortized balance is equivalent to 50% of the net-of-tax unamortized starting balance.[9] Rate Counsel objects to the inclusion of this unamortized balance into rate base as contrary to Board policy and unfairly detrimental to JCP&L's customers.

While Rate Counsel does not object to the Company earning some return on the unamortized balance, the use of the overall weighted average cost of capital (by way of JCP&L's proposed rate base inclusion of the unamortized balance) is not fair to JCP&L ratepayers. JCP&L's proposed weighted average cost of capital is 8.61%. *JC-5 Rebuttal*,

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[8] he parties did not reach an agreement on whether 2012 storm costs can be included in rate base in this proceeding. That question is being briefed and will be decided by the Board.

[9] For example, as shown on exhibit JC-3, Sch. SDM-2, p.17 of 24, the Company's proposed total gross unamortized 2011 storm cost balance amounts to $89,504,499 for which the average balance during the proposed 3-year amortization is 50% or $44,752,250. The proposed rate base inclusion is the net-of-tax portion of this average unamortized balance of $44,752,250 or $26,470,956. JC-3, Sch. SDM-5.

Sch. SRS-5R. Because this return includes an equity component, the rate must be grossed up for taxes, resulting in a carrying charge for this deferral of over 12%. Arguably, a carrying charge well in excess of the Company's actual cost to fund this unamortized balance.

Rate Counsel proposes that the Company be allowed to earn the same return on this unamortized deferred balance that is applied to over/under recoveries in the Company's SBC clause. The Company should be allowed to earn on its net of tax unamortized balance the same return as ratepayers are allowed to earn on amounts over-collected from ratepayers by JCP&L. Thus, the net-of-tax average unamortized deferred 2011 storm cost balance should not be included in rate base, rather the return requirement should be based on the SBC rate and be separately applied to the average net-of-tax deferred cost balance and be part of the amortization costs charged to ratepayers.

In sum, the equitable result is that the Company earns a reasonable carrying charge on the unamortized deferred costs. Unlike the Company's proposal, the use of the deferred balance carrying charge used for the Company's other deferrals is reasonable and fair to the Company and to its customers. The appropriate addition to rate base resulting from the 2011 Major Storms should be limited to $74,007,396 only. *RC-145, Sch. RJH-3*.

D. Excess Cost of Removal Reserve

JCP&L proposes to remove the $107.2 million excess cost of removal reserve from accumulated depreciation as the cost of removal expense is no longer included in depreciation rates but is being collected from ratepayers through a separate charge. *JCP&L Initial Brief*, p. 74. JCP&L argues that JCP&L's customers have received a

"return" on the $107.2 million since the Company's rates were reset in 2003 and that Rate Counsel's witness Robert Henkes has failed to "acknowledge or account for that customer benefit." *JCP&L Initial Brief*, p. 74.

What Rate Counsel is recommending in the current case is entirely consistent with the treatment ordered by the BPU in the Company's prior rate case. The excess cost of removal reserve balance has forever been a part of the Company's accumulated depreciation reserve balance which is always treated as a rate base deduction. And this is for good reason because the ratepayers have funded the accumulated depreciation reserve balance, including the excess cost of removal reserves. Therefore, it should be crystal clear that the ratepayers ***should*** receive the "customer benefit" of receiving a return on these reserves.[10] Thus, while JCP&L makes it sound as if this customer benefit is a windfall for the ratepayers, this is not true at all. This is something that ***should*** accrue to the ratepayers in accordance with generally accepted financial theory and consistent with prior Board precedent. The Company should not be allowed to deprive ratepayers of the appropriate return on these ratepayer supplied funds during the period that these funds are finally being returned to ratepayers.

Board Staff agrees with Rate Counsel that the full excess depreciation reserve, including the negative net salvage amount, should be treated as a rate base deduction. *Staff Initial Brief*, p. 32-33.

[10] Treating these reserves as a rate base deduction in essence is the same as providing the ratepayers with a rate of return on these reserves in the sense that they don't have to pay the Company its overall rate of return on these balances, so they are "saving" themselves the rate of return requirement which is the same as saying that they are getting the return.

E. Materials and Supplies ("M&S")

Board Staff agrees with Rate Counsel's recommended use of a 13-month average to establish the appropriate M&S balance. *Staff Initial Brief*, p.2. JCP&L, on the other hand, argues that this adjustment "is a transparent attempt to artificially reduce rate base and should be rejected." *JCP&L Initial Brief,* p. 76.

Rate Counsel's position is not an attempt to "artificially reduce rate base" but rather is an appropriate rate base adjustment based on long standing Board precedent. As the Board has stated:

> The issue of whether to use a test year-end balance or a thirteen month average in establishing a value for materials and supplies has arisen repeatedly in the context of rate cases for utilities in the State. The Board is in agreement with the use of a thirteen month average as recommended by the ALJ. As stated in our previous Order, the use of an average balance "more accurately reflects the level needed to provide service in the future by normalizing seasonal fluctuations." The Board is convinced that its position on this issue should be consistently applied to all utilities on a uniform basis and, therefore, indicates that it shall be Board policy for the future that the thirteen month average balance be employed in valuing materials and supplies unless particular circumstances can be shown to warrant a specific departure from this policy.[11]

Utilizing a 13-month average, Mr. Henkes calculated an M&S balance of $14,821,243, which results in a rate base deduction of $1,877,767. *RC-146,* Sch. RJH-3R.

F. Cash Working Capital ("CWC")

Rate Counsel witness David E. Peterson recommended a CWC allowance of approximately $76,484,029. Mr. Peterson opined that this amount is reasonable when appropriate adjustments are made to the Company's lead-lag study. *RC-152,* p. 8. In calculating the Company's CWC requirement, Mr. Peterson adjusted three lead-lag

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[11] I/M/O the Atlantic City Electric Company Increasing Its Rates for Electric Service, BPU Docket No. 8310-883, Decision and Order, (August 17, 1984), p.3 (internal citation omitted).

components included in the Company's study, namely: (1) the payment lead days that Mr. Adams assigned to JCP&L's federal income tax payment, which was significantly understated in Mr. Adams' study, (2) the inclusion of non-cash expenses and (3) the incorrect expense lead days that Mr. Adams assigned to the debt and equity components of JCP&L's revenue requirement. *RC-152,* p.10.

1. Expense Lead on Federal Income Taxes

JCP&L objects to Rate Counsel using equalized estimated quarterly income tax payments when calculating expense lead days for federal income tax payments in the lead-lag study. *JCP&L Initial Brief*, pp 44-47. In doing so, JCP&L essentially raises two arguments. First, a uniform accrual of the Company's tax liability throughout the year is an unrealistic assumption. Second, JCP&L's expense lead days is based on the Company's actual estimated tax payments (and refund).

As for JCP&L's first argument, while Rate Counsel does not disagree that JCP&L's tax liability does not accrue uniformly throughout the year, this does not mean that the assumption of uniform estimated tax payments is unrealistic. At the hearing, Rate Counsel introduced an exhibit that was the federal income tax form concerning estimated tax payments by corporations. *RC-150*, *T122:L2-18.* (October 10, 2013).That tax form spelled out a number of options for corporations to annualize income for the purpose of submitting estimated tax payments. Using the income annualization methods that the IRS makes available to corporations, it is not unrealistic and indeed is quite possible for a corporation to make uniform estimated tax payments throughout the tax year even though the corporation's tax liability did not accrue uniformly. This is one of

the options that is available to FirstEnergy. Thus, the uniform estimated tax ***payment*** (as opposed to accrual of the liability) assumption is not unrealistic.

As for JCP&L's second argument, again no one questions JCP&L's actual estimated tax payments. What Rate Counsel is questioning is whether it is appropriate to use those tax payments for cash working capital purposes given the Company's acknowledgment that those tax payments are primarily the result of unusual events that took place during the fourth quarter of 2011. In ratemaking, we seek to normalize abnormal events that occurred during the test period. JCP&L's uneven tax payments and refunds is one of those abnormal events that should be normalized in the rate setting process.

Board Staff agrees with Rate Counsel that the proper normalizing adjustment is to assume equal estimated tax payments, which the IRS permits under its income annualization options. *Staff Initial Brief*, p. 43.

2. Non-Cash Expenses

While JCP&L disparages Rate Counsel's argument for excluding non-cash expenses in the lead-lag study, JCP&L's CWC witness Adams makes several adjustments to exclude certain non-cash expenses from the lead-lag study for exactly the same reasons that Rate Counsel excluded depreciation from the lead-lag study. *JC-12*, pp 6-7. Rate Counsel agrees that the non-cash expenses JCP&L excluded from the CWC analysis are properly excludable from a lead-lag study. But the same reasoning (and fair treatment) applies to ***all*** non-cash expenses; not just those arbitrarily selected by the Company.

There is no argument that these non-cash expenses do not involve a cash outlay by investors ***during the test year.*** A cash outlay by investors during the test year is the

very essence of a cash working capital requirement. While never addressing this fundamental inconsistency in its approach, JCP&L instead argues that investors should be compensated for the period of time between when the non-cash expense is recorded on the Company's books and when cash payment is received from ratepayers for the associated expense. Thus, what JCP&L is really attempting is a collateral attack on the accrual accounting method; a method that is required of all utilities under the uniform system of accounts. Depreciation expense, for example, must be accrued on the Company's books prior to the Company's receipt of cash from ratepayers. Investors are fully aware of the existence of accrual accounting, including its implication on the recognition of revenues and expenses prior to the time that cash is physically received, and that awareness is reflected in the prices that investors pay for purchasing the Company's equity and securities. No additional compensation through a lead-lag study is necessary or appropriate. Board Staff has adopted the Company's reasoning on this issue. *Staff Initial Brief*, p. 35

Rate Counsel believes that its recommended position is correct and urges its adoption by Your Honor and the Board. Cash working capital reflects the need for investor-supplied funds to meet the day to day expenses of operations that arise from the timing differences between when JCP&L must expend money to pay the expenses of operation and when revenues for utility service are received by the utility. *RC-4,* p.15. Only those items for which actual out-of-pocket cash expenditures are made should be included in the Company's CWC lead-lag calculation. Rate Counsel therefore recommends that the Board reconsider its current policy on this matter and exclude depreciation and amortization expenses from the lead-lag study for purposes of

determining the Company's appropriate cash working capital allowance in this case. *RC-4, Sch. ACC-7*. As the expenses that relate to depreciation and amortization simply do not represent or require cash outlays by JCP&L investors, a properly conducted lead-lag study should exclude these non-cash expenses. *RC-152,* p.15.

On the other hand, Board Staff distinguishes deferred taxes from other non-cash expenses and agrees with Rate Counsel that deferred taxes should be excluded from the calculation of the appropriate working capital requirement. *Staff Initial Brief*, p. 38. Concerning JCP&L's arguments for including deferred taxes in the lead-lag study using a zero-day expense lead, Rate Counsel notes that no new arguments were raised in the Company's brief that have not already been considered and rejected by the Board. Therefore, consistent with Board precedent, deferred taxes should be excluded from the lead-lag study.

Rate Counsel urges the Board to continue its past policy of excluding deferred income taxes from lead-lag analyses. Like depreciation, deferred taxes are also non-cash expenses to the utility. However, including deferred taxes in the lead-lag analysis, as JCP&L proposes, is even more egregious than including depreciation expense in that no investor-supplied funds were ever used or required for deferred taxes.

3. Return on Investment in CWC

JCP&L argues that its return on investment should be included in the lead-lag study with a zero payment lag. The Company states in its Initial Brief:

> In an unbroken line of decisions, the Board has held that return of, and return on, all invested capital, including interest on long-term debt, dividends on preferred stock and the return on common equity capital, are earned and become the property of the utility's investors at the time that service is rendered. Because such returns are not actually received by investors until the related revenue is collected from customers, the Board

> has repeatedly held that such returns must be included in the lead-lag study with a zero payment lag in order to compensate investors for that delay. *JCP&L Initial Brief*, pp. 52-53.

The first sentence in JCP&L's argument quoted above is a red herring. Ownership of earnings is not the issue. The utility and its investors own all revenues, not just those associated with a return on invested capital. In a lead-lag analysis, the utility's ownership of revenues is not a relevant consideration because all utility revenues are owned by the utility. Rather, the only relevant consideration in a lead-lag study is the timing of the receipt of revenues vis-à-vis the timing of the utility's cash outlays.

The second sentence, in which the Company states: "[b]ecause such returns are not actually received by investors until the related revenue is collected from customers….," is clearly wrong. Regardless of when the utility collects revenues from ratepayers, investors do not receive a "return" until the Company declares and pays a dividend in the case of stockholders, until a stockholder sells his stock, or until the Company makes semi-annual interest payments to long-term debt holders. The utility's cash transaction associated with the return on equity lies within these three instances; not when the Company receives payment from ratepayers. Therefore, if the purpose of the lead-lag study is to measure the working cash requirements associated with a unit of service, it must do so with reference to the Company's payment of the return to investors in the form of dividend and interest payments.

In sum, ownership of earnings is irrelevant; the only relevant factor in measuring a utility's cash working capital requirement is the relationship between the receipt of revenues from customers and JCP&L's cash payments to employees, vendors, and investors.

4. CWC Conclusion

In summary, based on the above described approach and based upon the cash operating expenses and taxes recommended by Rate Counsel in this case, Your Honor and the Board should adopt a positive lead-lag study cash working capital requirement of approximately $76,484,029. *RC-152,* Sch. DEP-2. This is approximately $61,654,653 less than the cash working capital requirement of approximately $138,138,683 claimed by the Company.

G. Consolidated Income Tax Benefit

It is undisputed that the Consolidated Tax Adjustment ("CTA") proposed by Rate Counsel in this proceeding is the only CTA in the record. The Company argues that it "is clearly time for the Board to revisit its overall policy" and "at a minimum, should reject Ms. Crane's 'methodology' for calculating a CTA." *JCP&L Initial Brief*, p. 56. The Company has drawn a line in the sand and, disregarding case law and rejecting Board precedent, has failed to provide Your Honor and the Board any alternative CTA calculation. In fact, Company witness James I. Warren "can't imagine" any CTA that he thinks would be reasonable. *T33:L10-13* (September 12, 2013).

Rate Counsel's proposed CTA is based not on "Ms. Crane's methodology" but on the methodology established by the Board in the Rockland Electric proceeding, followed by Ms. Crane in calculating the appropriate CTA in this proceeding, and supported by Board Staff in their Initial Brief.

> 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 RECO Decision and is consistent with current Board policy. Therefore, consistent with the Board's finding in the 2013 Generic CTS Order, the current consolidated tax savings policy shall apply until such time as the Board makes a final determination on the

> consolidated tax adjustment issues. *Ibid.* Staff recommends the adoption of Rate Counsel's adjustment in this proceeding. *Staff Initial Brief*, p. 48.

Rate Counsel's proposed consolidated tax adjustment fully conforms with New Jersey case law and Board precedent and provides a benefit to ratepayers in exchange for the consolidated group's use of ratepayer funds to subsidize unregulated and unprofitable entities.

JCP&L next argues that "any CTA that would reduce a utility's rate base by more that 25% as is the case here with Rate Counsel's proposed CTA is *de facto* arbitrary and unreasonable." *JCP&L Initial Brief*, p. 57. While Rate Counsel would agree that the proposed CTA in this proceeding is significant, it does not necessarily follow that the adjustment is arbitrary or unreasonable. As testified to by Ms. Crane at the evidentiary hearing:

> Q. Do you think that a CTA that reduces a distribution utility's rate base by more than 25% is reasonable?
>
> A. I think it can be reasonable depending on the methodology used.
>
> I mean, if in fact the Company had taken rate payers' funds over the years, you know, for the past 20 plus years for taxes that have not been paid to the Internal Revenue Service then yes, I think it is reasonable to give rate payers the benefit of that.
>
> I don't think it's reasonable to charge ratepayers in your view or in your filing $56 million of income tax expense that won't be incurred. That is what I don't think is reasonable.
>
> So I think that rate payers should get the benefit of the tax payments that they have provided that have not been paid by FirstEnergy or GPU to the Internal Revenue Service.
>
> *T100:L3-21* (September 12, 2013).

The remainder of the Company's brief is a re-hash of the arguments made by Company witness Warren in his filed testimony and at the evidentiary hearings, all of which were effectively refuted by Ms. Crane in her surrebuttal testimony. *T66:L15-71:L25* (September 12, 2013). Those arguments will not be repeated here. In concluding her surrebuttal, Ms Crane noted that not only were the "six concerns" set out by Mr. Warren "without merit" but that Mr. Warren had failed to quantify the impact of his "concerns." *T70:L7-11* (September 12, 2013).

Ms Crane then concluded:

> I would just like to briefly address one of his comments today on cross-examination where he indicated that he did not believe that rate payers were entitled to the CTA because they essentially didn't pay the underlying freight. I am paraphrasing and I apologize if I'm not getting this exactly right. But I believe he used those terms and that ratepayers are not paying for the underlying transactions.
>
> Well on page 10 of his rebuttal testimony, Mr. Warren actually agrees that rate payers are the source of funds for the JCP&L tax payments. It's indisputable that it is the taxable income of income-earning companies that give value to the tax losses. That is, there's no value of having a tax loss, unless you can offset that loss against income from another entity. So, in fact, it's the companies with taxable income that are giving value to those tax losses.
>
> There are real economic benefits from . . . filing a consolidated income tax, and as filing as part of a consolidated income tax group. Once you do that, all parties are actually liable for the entire consolidated income tax liability.
>
> JCP&L is an important part of that consolidated income tax group. And that is why we believe that it's essential that rate payers get their fair share of the resulting benefits. It's not going into the underlying transactions of other entities, it's not reaching out. You know, it's simply the recognition that they are filing as part of a group. There are benefits as filing as part of a group and rate payers deserve a portion of those benefits.

T70:L12 – T71:L21 (September 12, 2013).

In sum, as discussed in Ms. Crane's pre-filed testimony, at the evidentiary hearing, and in Rate Counsel's Initial Brief, Rate Counsel's proposed CTA fully conforms with New Jersey law and Board precedent and provides a benefit to ratepayers in exchange for FirstEnergy's use of ratepayer funds to subsidize unregulated and unprofitable affiliates.

Accordingly, Your Honor and the Board should adopt Rate Counsel's recommended CTA and reduce JCP&L's rate base by $511,030,428.

H. Customer Refunds

The Company carries on its books a certain level of customer refunds. Mr. Henkes recommended that the 2011 test year average customer refund balance of $1,163,573 be deducted from rate base. *RC-145,* Sch. RJH-3. The Company argues that there is "no justification" for this adjustment other than the fact that "the amount represents 'ratepayer-supplied funds.'" *JCP&L Initial Brief*, p. 76. The fact that the "customer refunds" account contains ratepayer funds rather than investor supplied funds is really all the justification needed. The law is clear, FirstEnergy investors should not be allowed to earn a return on funds supplied by ratepayers. Federal Power Commission v. Hope Natural Gas, 320 U.S. 591 (1944), Bluefield WaterWorks v. Public Service, 262 U.S. 679 (1923). Rate Counsel's adjustment should be adopted. Board Staff agrees with Rate Counsel's customer refund rate base adjustment. *Staff Initial Brief*, p. 2.

I. Operating Reserves (Net of Tax)

The Company has agreed that operating reserves (net of deferred tax) should be deducted from rate base. *JC3-S2,* p.4, Sch. SDM-5 Supplemental No.2. Accordingly, the

Company's operating reserve (net of tax) balance of $4,237,102 should be deducted from rate base in this proceeding. *RC-146,* RJH-3R.

J. Three Mile Island – Unit 2 ("TMI-2") Non-Qualified Decommissioning Trust Fund Deferred Tax

As discussed in Rate Counsel's Initial Brief, the Company proposed not to include in its rate base $19.7 million associated with prepaid deferred taxes related to the TMI-2 Non-Qualified Decommissioning Trust Fund because this asset will be eliminated in 2013. Rate Counsel witness Mr. Henkes rejected this proposal as the balance in this account will not be eliminated until the end of 2013, well beyond the 2011 test year. Mr. Henkes therefore has treated the $19.7 million prepaid deferred tax balance as a rate base addition. Board Staff agreed with Rate Counsel's position. *Staff Initial Brief*, p. 2.

J. Summary of Rate Base Adjustments

(1) The appropriate rate base to be used to determine JCP&L's distribution rates is $1,247,783,394 rather than the .$2,024,166,188 sought by the Company. Including the 2011 Major Storm costs will increase Rate Counsel's recommended total net rate base to $1,324,452,526.

(2) Your Honor and the Board should reject the Company's proposal to add the average net-of-tax unamortized deferred storm damage balance into rate base. Instead, the return requirement should be based on the SBC rate and be separately applied to the average net-of-tax deferred cost balance and be part of amortization costs charged to ratepayers.

(2) Your Honor and the Board should adopt Rate Counsel's $9,569,740 adjustment to JCP&L's unamortized net losses on reacquired debt balance. The appropriate net-of-tax distribution net loss on reacquired debt is $8,350,574. *RC-145,* Sch.RJH-4.

(3) Your Honor and the Board should reject the Company's removal from rate base of the excess cost of removal reserve balance of $107.2 million. It is inequitable and contrary to Board policy to force ratepayers to pay JCP&L its overall rate of return on that part of rate base funded by ratepayers. *RC-145,* Sch.RJH-3.

(4) Your Honor and the Board should adopt Mr. Henkes recommended 13-month average M&S balance of $14,821,243. *RC-145,* Sch. RJH-6.

(6) Your Honor and the Board should adopt a positive lead-lag study cash working capital requirement of approximately $76,484,029. *RC-152,* Sch. DEP-2. This is approximately $61,654,653 less than the cash working capital requirement of approximately $138,138,683 claimed by the Company. *RC-146,* Sch. RJH-3R.

(5) Your Honor and the Board should adopt Rate Counsel's recommendation that the 2011 test year average customer refund balance of $1,163,573 be deducted from rate base. *RC-145,* Sch. RJH-3.

(6) To properly share with ratepayers the benefits of the tax sharing agreement between FirstEnergy and JCP&L, Your Honor and the Board should adopt Rate Counsel's recommended Consolidated Tax Adjustment, a deduction from rate base of $511,030,428. *RC-145,* Sch.RJH-3*; RC-13,* Sch.ACC-1.

(7) Your Honor and the Board should treat the Company's operating reserve (net of tax) balance of $4,237,102 as a rate base deduction. *RC-146,* RJH-3R.

(8) The Company's prepaid deferred tax balance related to the TMI-2 Non-Qualified Decommissioning Trust Fund will not be eliminated until 2013. Accordingly, Your Honor and the Board should treat the $19.7 million prepaid deferred tax balance as a rate base addition.

K. Conclusion

In sum, Rate Counsel respectfully requests that Your Honor and the Board adopt Rate Counsel's recommended rate base adjustment of $699,713,662 for a total rate base, including 2011 Major Storm Costs, of $1,324,452,526.

POINT V

THE APPROPRIATE PRO FORMA OPERATING INCOME AMOUNTS TO $215,208,689 WHICH IS $47,473,771 MORE THAN JCP&L'S' PROPOSED UPDATED AND REVISED PRO FORMA OPERATING INCOME OF $167,734,919

On November 28, 2012, JCP&L filed a Petition with the Board seeking a base rate increase of $31,471 million, including sales and use tax. JCP&L subsequently updated its filing to reflect the results of the depreciation study ordered by the Board and again to remove all 2012 storm damage costs from the filing. JCP&L ultimately requested a revenue requirement increase of $10,958,240. Pending Board approval of the stipulation of settlement executed by JCP&L, Rate Counsel and Board Staff, Rate Counsel is recommending a rate decrease of $214.9 million. With the inclusion of the 2011 Major Storm costs, as summarized on Schedule RJH-IRB attached to this Reply Brief, the recommended rate decrease is approximately $190.2 million. Following are Rate Counsel's proposed Revenue and Expense adjustments in support of our recommended rate decrease.

A. Major Storm Costs – Amoritization of Deferred O&M Expenses

JCP&L, Board Staff and Rate Counsel have executed a stipulation of settlement in the Board's generic storm damage proceeding. As discussed above, if adopted by the Board, JCP&L will be allowed to include in rate base in this proceeding additional plant in service of $74,007,396 resulting from 2011 major storms.[12]

In addition, the stipulation provides that $81,912,314 in deferred O&M costs associated with the 2011 Major Storm Costs would be recovered from ratepayers. The

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[12] I/M/O the Board's Review of the Prudency of the Costs Incurred by Jersey Central Power & Light Company in Response to Major Storm Events in 2011 and 2012, BPU Docket Nos. AX13030196 and EO13050391.

Company has proposed that this amount should be recovered over three years with the net-of-tax unamortized balance added to rate base. Rate Counsel has addressed the Company's proposal to include the unamortized balance in rate base in the previous section of this Reply Brief. In this section, Rate Counsel will address the Company's proposal to amortize the $81.9 million deferral over three years.

This issue was addressed by Rate Counsel witness Mr. Henkes at the evidentiary hearing.

> It is my recommendation that these costs be amortized over a six-year period rather than the company's proposed three-year amortization period in order to mitigate a potential significant ratepayer risk as explained by the following:
>
> The company's proposed annual amortization amount for the 2011 deferred storm based on a three-year amortization period is almost $30 million per year. If the rates in this case stay in effect for a period longer than three years which is highly likely because the rate effective period of the company's most recent two base rate cases has been ten years in both cases. But if the rates were to stay in effect for longer than three years, then the ratepayer runs the risk of the company over recovering its storm damage cost to the tune of $30 million a year and that is a real risk.
>
> And I am proposing to mitigate that ratepayer risk by recommending a longer amortization period and that is why I recommend a six year amortization period.
>
> *T73:l24 – T74:L18* (October 7, 2013)

Accordingly, Rate Counsel recommends that Your Honor and the Board allow recovery of the deferred O&M 2011 major storm cost over a six year amortization period. As shown on the attached Schedule RJH-5RB, line 2 and footnote (2), based on a 6-year amortization period Rate Counsel's recommended annual deferred cost amortization amounts to $14,621,075. This consists of $13,652,052 for the annual amortization of the deferred storm damage costs and $969,023 for the annual amortization of the return on the unamortized balance during the 6-year amortization period. The rate of return on the

unamortized deferred cost balance is based on the SBC rate[13] estimated for the 6-year amortization period. At this time, Rate Counsel has estimated this average SBC rate to be equal to approximately 4%.

B. Pro Forma Revenue Adjustments

The Company in its Initial Brief objects to Rate Counsel's proposal to use the average number of customers in the 2011 test year to establish the *pro forma* test year sales level. *JCP&L Initial Brief*, p.81. As discussed at length in Rate Counsel's Initial Brief, Rate Counsel's position is consistent with long standing Board policy to recognize customer growth when establishing rate case revenues. *Rate Counsel Initial Brief*, pp. 85-86 As noted by the Board in JCP&L's prior base rate case "The Board **HEREBY FINDS** the inclusion of revenues related to such growth is appropriate when matching revenues with the use of test-year end rate base and annualized depreciation expense based on year end plant." JCP&L 2004 BRC Order, p.48.

Staff agrees with Rate Counsel "that the number of customers as of June 30, 2012 should be reflected in the revenue normalization adjustment, and that operating revenue should be increased by $0.824 million." *Staff Initial Brief,* p. 85.

C. Expense Adjustments

1. Deferred Amortization Expense

The 2011 test year includes $562,500 in amortization expenses related to the Werner CT plant and includes $3,320,472 in amortization expenses related to certain deferred Other Post Employment Benefit ("OPEB") costs. The amortization of these assets has expired but Rate Counsel has not removed the amortization expense from the

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[13] This rate is equivalent to the 7-year constant maturity treasury rate, plus 60 basis points.

test year for either asset as the amortization expiration dates are too far removed from the end of the 2011 test year to be given rate recognition in this proceeding.[14]

This issue was not briefed by the other parties. If however, the Board decides to go more than 9 months beyond the test-year in this case, then this $562,500 amortization expense should be removed from the test-year.

2. Amortization of Net Loss on Reacquired Debt

Board Staff agrees with Rate Counsel that the Company's use of the total electric operations balance is incorrect and that only the distribution portion of the net loss on reacquired debt amortization should be allowed for recovery in this distribution rate case. *Staff Initial Brief*, p.71. "JCP&L does not dispute this adjustment." *JCP&L Initial Brief*, p. 78. The recommended expense amount is $376,168 lower than the Company's proposed amortization expense amount of $1,772,706. *Rate Counsel Initial Brief*, p.87

3. Rate Case Expenses

In its brief, JCP&L seeks to limit the long standing Board policy on 50/50 sharing of rate case expense arguing that it should be applicable "only when the utility has voluntarily filed a rate case seeking an increase." *JCP&L Initial Brief*, p.87. The Company cites to no Board Order that supports that position.

Rate Counsel discussed this issue at length in our Initial Brief and that argument will not be repeated here. *Rate Counsel Initial Brief*, pp. 87-90. What bears repeating is not whether the Company was directed by the Board to file a base rate case but why the Company was directed to come in for a base rate case. The Company had to be directed to come in for a base rate case due to justified concerns that the Company has been

[14] In re Elizabethtown Water Company, Dkt. No. WR8504330.

significantly over-earning for the past several years. As noted in Rate Counsel's Initial Brief, during 2009-2011, JCP&L paid out 170 percent of its earnings as dividends to its parent FirstEnergy. *Rate Counsel Initial Brief,* p.89. To charge customers full rate case expenses because the Company was over-earning and therefore declined to file a rate case voluntarily would defy logic.

Board Staff agreed with Rate Counsel's recommended adjustments, that is, 50/50 sharing of rate case expenses amortized over a six year period. This reduces the Company's annual rate case expense amount of $802,025 by $534,684 for a total recommended annual rate case expense amount of $267,342. *Staff Initial Brief,* p. 65

4. Cost to Achieve Merger Savings

JCP&L argues in its Reply Brief that "Rate Counsel's evidence amounts to nothing more that Mr. Henkes' unsupported statement that the demonstrated savings might have occurred absent the merger." *JCP&L Initial Brief*, p.86. The Company has it wrong, it is not Rate Counsel's burden to prove a negative. As with any cost for which the Company seeks recovery in rates, the Company must prove that the $14.5 million in claimed merger savings cost is appropriate for recovery from its customers.

As noted in Rate Counsel's Initial Brief, the Company has failed to provide necessary information regarding exactly what costs are included in the cost to achieve merger saving amount, when these costs were incurred, and by whom. *Rate Counsel Initial Brief,* p. 91. The Company has failed to introduce into this proceeding any specific information regarding these costs, vaguely stating that the costs to achieve "are related to materials, outside services and employee separation necessary to produce the synergy savings." *JCP&L Initial Brief*, p. 83-84.

Furthermore, the Company has failed to support the claimed merger savings. The Company has failed to adequately demonstrate that the merger is the reason for any reduction in the Company's Indirect Cost Allocation from the Service Company. As discussed in Rate Counsel's Initial Brief, this allocator can be affected by many factors. *Rate Counsel Initial Brief*, pp. 92-94. Indeed. JCP&L has failed to demonstrate that ratepayers have at all benefitted from the merger. To the contrary, the Board has recognized that the merger actually resulted in a detriment to New Jersey ratepayers. *Rate Counsel Initial Brief,* p. 93.

Staff agrees with Rate Counsel and recommended "rejecting the Company's costs to achieve merger savings request for failure to document any specific savings resulting from the merger. Therefore, the amortization expense of $4.288 million should be denied." *Staff Initial Brief*, 74.

Accordingly, Rate Counsel recommends that Your Honor and the Board reject the Company's proposal to include in base rates $14,466,766 in cost to achieve merger savings.

5. Normalize Forestry Maintenance Expenses

Rather than use the "abnormally low" 2011 actual tree trimming expense amount of $9.3 million, JCP&L proposes a "normalization adjustment" of approximately $5.1 million to set tree trimming expense based on a projected tree trimming expense level of $14.4 million. *JCP&L Initial Brief*, p. 96. JCP&L argues that 2011 tree trimming expense should be "normalized" based on deferred O&M spending due to the 2011 major storms and the corridor widening program which increased capital spending with a

"corresponding reduction in operations and maintenance (O&M) spending." *JCP&L Initial Brief*, p. 97

This assertion was refuted by Rate Counsel witness Mr. Henkes at the evidentiary hearing during cross examination.

> Q. Do you agree that JCP&L's service territory experienced unusual weather last in 2011?
>
> A. Yes.
>
> Q. In fact, Hurricane Irene impacted the service territory from the end of August through a good part of the month of September. Would you agree with that?
>
> A. Yes. And I addressed that in my surrebuttal testimony. It goes to the argument of the company where they say that the test year is understated, that the test year tree trimming costs are understated because a deferral of 416 miles of tree trimming activity from the last quarter of 2011 to the first quarter of 2012.
>
> At the same time the company is pointing out in its rebuttal testimony that there was a deferral of tree trimming activities from 2009 and 2010 into 2011.
>
> *T93:L24-T94:L14* (October 7, 2013)
>
> Q. Do you agree in 2010 the company's corridor widening initiative which resulted in an unusual reduction in the level of tree trimming O&M expense was on-going in 2010.?
>
> A Well, I am aware that there was a program that is called a corridor widening program. I am not convinced that you can claim, therefore, there was unusual reduction in test year costs. I am aware also that, as the company has admitted, there were a number of tree trimming activities in 2009 and 2010 that were transferred into 2011.
>
> *T96:L3-14* (October 7, 2013)
>
> Q. And do you agree in 2012, the company again experienced what we might refer to as unusual weather in fall of 2012, specifically Superstorm Sandy?
>
> A. Well, what I understand is that – and again I address this in my surrebuttal testimony, but even though the tree trimming activities in the last quarter of 2011 were moved or they were carried over to the first quarter of 2012, that did not keep the company from completely finishing up its tree

trimming program in 2012, it's regular tree trimming program. So 2012 includes all of the activities associated with the regular tree trimming program, as well as the extra tree trimming activities from what was transferred from the last quarter in 2011. And I look at the actual expenses, . . . , and its $10.9 million. So that to me is telling. It's certainly not $14.4 million. And was there activity in 2012, at the end of 2012 due to storm damage, yes. I have not heard the company saying that therefore a certain level of tree trimming activity was moved into 2013.

T97:L4-24 (October 7, 2013)

As can be seen from Mr. Henkes' testimony, tree trimming expenses vary significantly from year to year and are strongly influenced by factors such as the weather and financial condition of the Company. The actual 2011 test year amount of $9.3 million is very much in line with the five year average (2007-2011) expense level of $8.7 million and the 6-year average (2007-2012) of $9.1 million., *RC-145*, p.36. The Company's $5.1 million "normalization" adjustment should be rejected.

Board Staff agrees with Rate Counsel that Your Honor and the Board should reject this proposed increase of $5.1 million in tree trimming expense. As noted by Staff:

> Staff agrees with Rate Counsel's position set forth by Mr. Henkes for the reasons he espouses. Staff also notes that the $9.340 million spent by the Company in test year 2011 is comparable to the Company's average annual expenditures over the six year period ending in 2012 ($9.067 million). Consequently, no adjustment to the test year actual is warranted.
> *Staff Initial Brief*, p. 80.

6. Account 935 – Maintenance of General Plant Expense Normalization

The Company's account 935 – Maintenance of General Plant expense, for the 2011 test year totals $2.74 million. This amount is significantly higher than amounts posted to this account in 2007 ($1.55 million), 2008 ($1.50 million), 2009 ($1.56 million), and 2010 ($1.27 million). *RC-141*.

The Company argues in its Initial Brief that "as JCP&L witness Carol Pittavino made clear in her rebuttal testimony, a review of the overall level of the Company's distribution O&M expense reveals that the 2011 amount is actually lower than the 2012 level." *JCP&L Initial Brief*, 104

This statement was refuted by Rate Counsel witness Mr. Henkes in his surrebuttal testimony.

> Q. Could we turn now to Ms. Pittavino's rebuttal testimony? And do you have any comments on Ms. Pittavino's testimony regarding Account 935 maintenance expense adjustment?
>
> A. Yeah. Well, she disagrees with my proposed adjustment and instead in her rebuttal testimony and as we started to discuss with her this morning, she presents an analysis of the company's overall distribution O&M expenses which concludes that the overall 2011 distribution O&M expenses are lower than the overall distribution O&M expenses in 2012.
>
> With all due respect to Ms. Pittavino, her analysis is – is misleading to say it mildly. And she compares apples to oranges and uses inconsistent financial data. One part of her analysis is based on distribution only data and the other part of her analysis is based on total company data which includes a lot of other non-distribution related elements. And no matter what she stated this afternoon or this morning trying to explain why, it still doesn't change the fact that she is combining total company data with distribution-only data.
>
> . . .
>
> And if you correct for that and put the entire analysis on the basis of distribution –only data, then again it shows that the test year – the 2011 test year overall distribution O&M expenses were substantially higher than the 2012 distribution O&M expenses. And so that means that when you properly correct it, her analysis very much supports my proposed Account 935 adjustment.
>
> *T67:L5 – T68:L14* (October 7, 2013)

Board Staff "concurs with the analysis and reasoning of Mr. Henkes and supports adoption of the $1.72 million normalized Account 935 expense level recommended by Rate Counsel." *Staff Initial Brief*, p. 78.

Accordingly, because the test year level of $2.74 million appears to be abnormally high, Rate Counsel recommends that Your Honor and the Board use a 5-year historic average expense level of $1.72 million.

7. Incentive Compensation

As discussed at length in Rate Counsel's Initial Brief, Rate Counsel recommends that Your Honor and the Board disallow JCP&L's claimed incentive compensation expense because it is a totally discretionary expense tied to the financial performance of FirstEnergy. Board Staff agrees with Rate Counsel that incentive compensation payments should not be recovered from ratepayers as "ratepayer funding of such awards is contrary to Board policy and there is prior Board precedent consistently ruling against it for ratemaking purposes." *Staff Initial Brief*, p. 54.

The Company claims that Rate Counsel's "knee-jerk reaction to classify (and disallow) anything other than standard 'base salary' is simply outdated and unsupportable." *JCP&L Initial Brief*, p. 92. This argument is belied by JCP&L's acknowledgement that in JCP&L's prior base rate case Rate Counsel "supported the recovery of incentive compensation costs for bargaining unit employees, where such costs were linked to the achievement of operational goals." *JCP&L Initial Brief*, p.96. Rate Counsel's position in this proceeding is based on our analysis of the specific incentive compensation programs for which the Company is seeking recovery from ratepayers. Rate Counsel's analysis showed that FirstEnergy shareholders must achieve a certain level of earnings per share before any incentive compensation award is given. Simply, it is Rate Counsel's position that if the Company decides to offer "at risk"

compensation packages based on the financial performance of FirstEnergy, then FirstEnergy shareholders should pay the cost.

The Company next argues that Rate Counsel's position that incentive compensation is discretionary and not "known and certain" is a "red herring" and that the same argument could be made about any test year expense. *JCP&L Initial Brief*, p. 93. That is not exactly true. The same argument could not be made about other expenses included in the Company's cost of service. Certainly the Company is not arguing that it could reasonably ignore base salary expenses or fuel costs if FirstEnergy's earnings per share were not satisfactory. In fact, it is difficult if not impossible to think of any other expense included in JCP&L's cost of service that is considered "at-risk" based on FirstEnergy's financial performance. The Company has advised of no other contract that "may be amended or terminated at any time by the Company during any plan year." *RC-116,* Attachment 1, p. 1. Thus, whether or not awards will be made in the future and, if made, the total amount that will be awarded is unknown and entirely within management's discretion.

Furthermore, the Company has not presented any evidence in this case showing the specific benefits that are accruing to ratepayers as opposed to JCP&L's shareholders as a result of the incentive compensation plans for which these same ratepayers are asked to pay 100% of the costs. Nor has JCP&L presented any evidence in this case showing that there is any appreciable difference in the productivity level of JCP&L and JCP&L's employees or that the ratepayers are receiving more efficient service at reduced overall costs as a direct result of the Company's incentive compensation programs.

Rate Counsel therefore recommends that JCP&L's incentive compensation expenses be disallowed. FirstEnergy's shareholders are the primary beneficiaries of such corporate financial performance improvements by virtue of the resulting increases in their stock value or dividend receipts. For that reason, JCP&L's stockholders should be made responsible for these discretionary costs. To do otherwise violates all sense of fairness to the ratepayers of the regulated entity. Accordingly, Rate Counsel recommends that JCP&L's proposed incentive compensation expenses of $8.4 million be disallowed for rate making purposes in this case.

8. Supplemental Executive Retirement Program (SERP) Expense

As discussed in Rate Counsel's Initial Brief, the Company is seeking recovery for $408,576 in expenses associated with the FirstEnergy Supplemental Executive Retirement Program. These costs relate to supplemental retirement benefits for key executives that are over and above the normal retirement programs provided by FirstEnergy for its employees. Rate Counsel recommends that Your Honor and the Board reject the Company's proposal that SERP expenses be recovered from ratepayers. JCP&L ratepayers are already paying for the regular retirement benefits of these top executives and should not be forced to also fund these SERP perks. If the Company wants to provide additional retirement benefits to these key employees, then shareholders rather than ratepayers should fund these additional benefits.

Board Staff agreed with Rate Counsel's position.

> Following review of the exhibits and testimony submitted on SERP, the Company has presented no evidence that specific benefits are accruing to the ratepayers, that there is any appreciable difference in the productivity level of JCP&L and the company's employees, or that the ratepayers are receiving more efficient service at reduced overall costs as a result of

> SERP funding. Staff concurs with Rate Counsel. SERP costs should not be included in the Company's costs of service. *Staff Initial Brief*, p. 62
>
> JCP&L did not brief this issue.

In sum, Rate Counsel does not object to the Company offering SERP benefits to these nine top executive officers whose retirement benefits are "limited" by the IRS. Rate Counsel does object, however, to including these extra benefits in rates. Accordingly, Rate Counsel recommends that the Board exclude the SERP benefit from JCP&L's distribution rates, thereby reducing the Company's operating expense by $408,576. *RC-145,* Schedule RJH-12.

9. Pension Expense

Based on the testimony of Rate Counsel witness Mitchell Serota, (see Point VI) Rate Counsel recommends a reduction in pension expense of $37,664,418. *RC-145,* RJH-8.

10. OPEB Expenses

Based on the testimony of Rate Counsel witness Mitchell Serota, (see Point VI) Rate Counsel recommends a reduction in OPEB expense of $814,905. *RC-145,* RJH-8.

11. Miscellaneous O&M Expense Adjustments.

As noted in its Initial Brief, JCP&L has agreed to remove from the 2011 test year certain miscellaneous expense amounts related to Employee Clubs, advertising expense, and private club membership. *JCP&L Initial Brief*, p. 115. However, JCP&L claims that cost recovery from ratepayers is appropriate for the "Celebrate Success" program expenses, service award expenses, and civic membership costs.

The Company claims that the "Celebrate Success" awards are "modest gifts" given to employees for "noteworthy contributions in situations where the employee does not receive overtime compensation." *JCP&L Initial Brief*, p. 115. What "noteworthy contribution" would qualify for one of these gifts is not specified. Rate Counsel is unable to come up with anything in the record in this proceeding to identify what type of "contribution" would qualify, who is eligible for an award and when such awards are given. The Company did not provide one example of an instance where an employee received such an award. There is nothing in the record in this proceeding to support recovery from ratepayers for "modest gifts" given to employees for "noteworthy contributions."

The Company next claims that the service award expense of $37,875 "provides local management a means for recognizing service anniversaries." *JCP&L Initial Brief*, p. 116. The Company claims that these awards "assist in keeping employees engaged and promote recognition for longevity within the FirstEnergy organization…" Id. Again, the Company has failed to provide even the most basic information about these awards. Who is eligible to receive and when remains unanswered. A portion of this amount is not incurred directly by JCP&L but is allocated from the service company. The Company fails to explain how longevity of service company employees is directly related to the provision of safe adequate and proper service in New Jersey. Rate Counsel would argue that it is not.

The Company has also included civic membership expenses of $25,295 to a number of civic organizations such as chambers of commerce, mayor

associations, area associations, Jersey Shore partnership association and economic development associations. The Company claims this contribution to civic organizations creates "a forum to promote communication between the Company and the municipalities it serves." *JCP&L Initial Brief*, p. 115. Rate Counsel submits that the promotion of communication is not adequate justification to support the inclusion of these costs in rates. The Company has failed to explain what local organizations are favored with these "memberships" and which are not. Certainly these costs are discretionary and the discontinuation of this practice would have no impact on the Company's provision of safe and adequate service.

In sum, as these miscellaneous expenses are not related to the provision of safe, adequate and reliable service, they are not appropriate for inclusion in rates set for utility service. Accordingly, Your Honor and the Board should reject the Company's proposal to include the above listed $79,258 in miscellaneous expenses in claimed operating expenses.

12. Depreciation Expense

Rate Counsel's recommended *pro forma* annualized depreciation expenses for JCP&L in this case is based on the depreciation rates recommended by Rate Counsel witness Michael Majoros. *RC-166*. Mr. Majoros' recommended depreciation expense is detailed in Point VII.

In addition, Mr. Henkes removed $1,673,516 from the Company's proposed depreciation expenses associated with the December 31, 2011 plant in service balances associated with the 2011 major storms. *RC-146,* Sch. RJH-14R. Depreciation expense, updated to reflect the 2011 storm damage plant in service balance that will be reflected in the base rates set by this proceeding.

13. Amortization Expenses – Summary

The Company's per books test year distribution-related amortization expenses amount to $3,912,364. This balance consists of the deferred OPEB amortization and Werner CT amortization which were discussed above. In addition, Rate Counsel recommends that Your Honor and the Board adopt the following three recommended adjustments to the Company's proposed amortization expense.

Storm Damage Cost Amortization

Rate Counsel recommends that the Company's proposed three year amortization of deferred costs associated with the 2011 major storms be removed from this base rate case until the prudence of these deferred costs has been established in JCP&L's Generic Storm Damage Cost proceeding. As discussed above and in Mr. Henkes' surrebuttal testimony a six year amortization is more appropriate. *T73L:24-T74L:18* (October 7, 2013).

Net Salvage and Cost of Removal

In the Company's previous base rate case, the Board adopted a recommendation to exclude estimated net salvage and cost of removal costs from JCP&L's depreciation rates and instead allow a separate recovery of these costs based on a five year historical average of actual net salvage and removal costs. *RC-126,* p. 54. In directing JCP&L to use the five-year average, the Board noted, "a five year average of actual salvage expense in depreciation expense is reasonable as it more closely aligns the amount recovered in base rates with the historical level of expenses incurred." *RC-126,* p. 54.

JCP& has rejected the use of the traditional five-year historical average and has used a two-year historical average (2012-2011) in its place. JCP&L bases its position on

higher cost capitalization. The two-year historical average proposed by the Company produces an average net salvage and removal cost of approximately $4.8 million, twice the annual cost based on the traditional five-year historical average.

Rate Counsel witness Mr. Henkes recommended the continued use of the five year average. Mr. Henkes noted that the five year average has been ordered by the Board for all utilities. Mr. Henkes also argued that the use of only two years of data does not provide sufficient information upon which to base a reliable normalized cost level. Board Staff agreed with Rate Counsel's position.

Rate Counsel urges Your Honor and the Board to continue using a five-year historical average for the determination of net salvage and removal cost recovery for a net salvage allowance of $2.415 million. The Company has provided no instance of another New Jersey utility using a two-year average for the net salvage determination.

Production Related Regulatory Asset Amortization

JCP&L has included in the test year $109,008 in amortization expenses for two regulatory assets involving Oyster Creek and TMI-1 design basis documentation studies. *JC-3, Sch. SDM-2, p. 22*. JCP&L argues that as the Company no longer owns these facilities the amortization period should be accelerated to three years. The company has proposed a *pro forma* annual expense amortization of $1,629,650, which is $1,520,642 higher than the per books test year amortization expense of $109,008. Id.

As discussed in Rate Counsel's Initial Brief, Rate Counsel recommends that the Oyster Creek amortization expense amount of $83,000 be excluded from rates in this proceeding as this amortization has expired. The amortization of the TMI Design Basis documentation continue at its current level of $26,000 a year.

D. Operating Income Conclusion

1. Rate Counsel recommends that the Your Honor and the Board adjust the sales projections of Petitioner's *pro forma* revenue claim to reflect customer growth to June 30, 2012. Rate Counsel's recommendation will increase the Company's *pro forma* revenues by $823,138.

2. Your Honor and the Board should reduce JCP&L's claimed Total Electric New Loss on Reacquired Debt Amortization by $376,168 to reflect only that portion properly allocated to distribution-related amortization expense.

3. Your Honor and the Board should adopt Rate Counsel's recommended adjustments, that is, 50/50 sharing of rate case expenses amortized over a six year period for a total annual rate case expense amount of $267,342. *RC-146,* RJH-9R.

4. Your Honor and the Board should reject the Company's proposal to include in base rates $14,466,766 in cost to achieve merger savings.

5. Your Honor and the Board should reject the increase of $5.1 million in tree trimming expense proposed by the Company. Rate Counsel recommends that the actual 2011 test year expense amount of $9.3 million is the appropriate amount. *RC-145,* p. 36.

6. Because the test year level of $2.74 million in account 935-Maintenance of General Plant appears to be abnormally high, Rate Counsel recommends that Your Honor and the Board use a 5-year historic average expense level of $1.72 million.

7. Rate Counsel recommends that the Company's proposed incentive compensation expenses of $8.419 million be disallowed for rate making purposes in this case.

8. Rate Counsel recommends that Your Honor and the Board exclude the SERP benefit from JCP&L's distribution rates, thereby reducing the Company's operating expense by $408,576. *RC-145,* Schedule RJH-12.

9. Based on the testimony of Rate Counsel witness Mitchell Serota, Rate Counsel recommends a reduction in pension expense of $37,664,418. *RC-145,* RJH-8.

10. Based on the testimony of Rate Counsel witness Mitchell Serota, Rate Counsel recommends a reduction in OPEB expense of $814,905. *RC-145,* RJH-8.

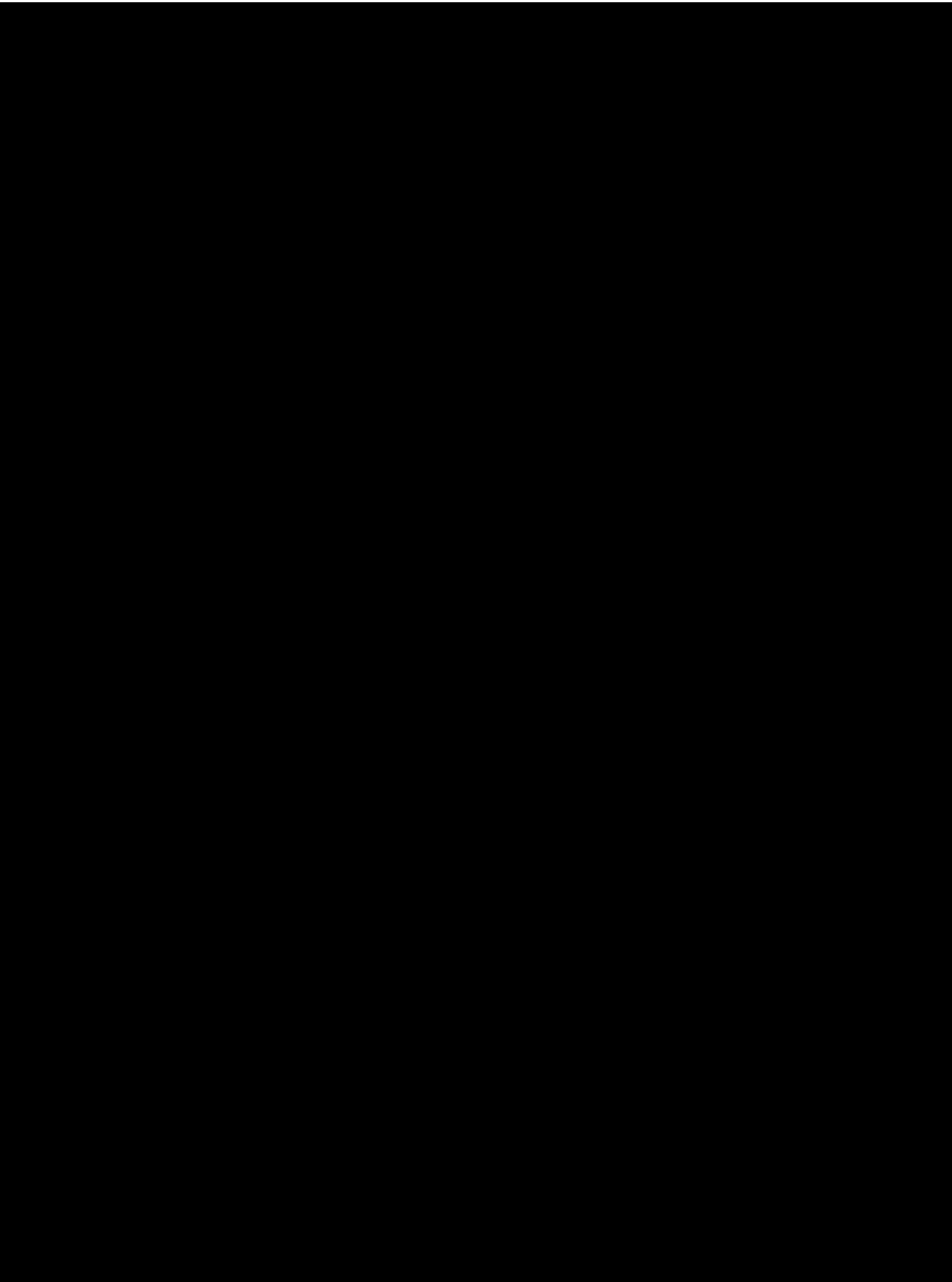
11. Your Honor and the Board should reject the Company's proposal to include $79,258 miscellaneous expenses such as club memberships and institutional and goodwill advertising in claimed operating expenses.

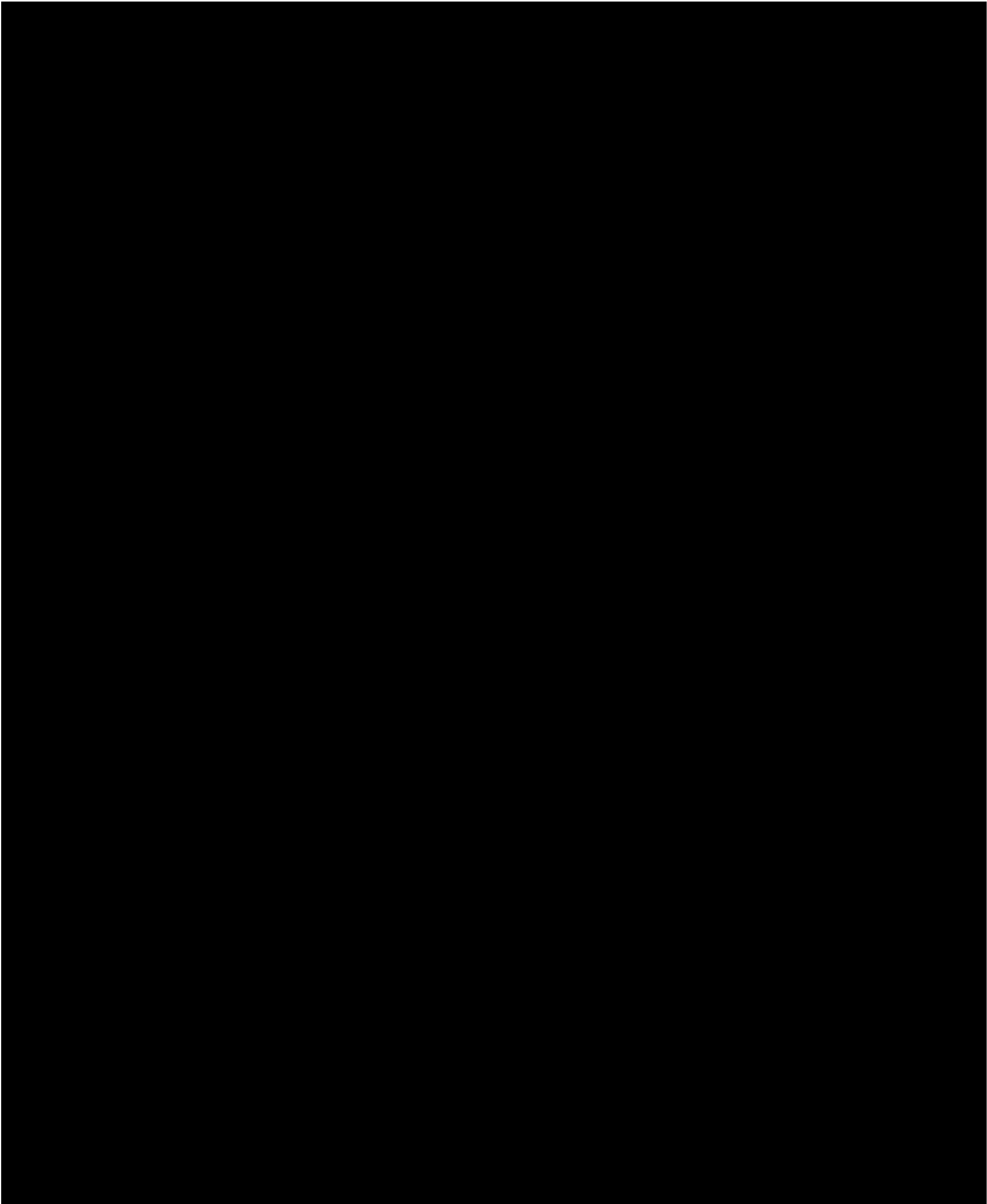
12. Rate Counsel recommends that Your Honor and the Board reduce the Company's claimed depreciation expense of $83,826,938 by $9,479,504 for a total depreciation expense including 2011 Major Storm Costs of $74,347,434. *RC-146,* Sch. RJH-14RB. Depreciation expense should be updated when the 2011 storm costs are include in rate base.

13. Rate Counsel recommends that Your Honor and the Board adopt Rate Counsel's three recommended adjustments to the Company's proposed amortization expense: (1) the storm cost amortization expenses should be reduced by $29,834,833 to remove costs associated with 2011 major storms; (2) the net cost of removal amortization should be reduced by $2,346,633 to reflect Rate Counsel's recommended 5 year average expense level and (3) the production related regulatory asset amortization test year expense level should be reduced by $83,000 to reflect the expiration of the amortization of TMI Design Basis document study costs.

POINT VI

(CONFIDENTIAL)





POINT VII

RATE COUNSEL SUPPORTS BOARD STAFF POSITION TO INCLUDE INCREASED DEPRECIATION AS RESERVE EXCESS

Both Mr. Spanos (*T37-38:L20-7* (November 19, 2013)) and Mr. Majoros (*RC-166, p. 5*) agree that excessive depreciation results in the extraction of capital contributions from ratepayers rather than shareholders. This undisputed fact should be recognized in the initial decision and the Board's final order.

The wide disparity between JCP&L's depreciation proposals and Rate Counsel's depreciation proposals result from the application of "judgment" by the Company's witness, Mr. John Spanos.

> Q. Do you use statistical life studies --
>
> A. We don't necessarily use statistical life studies because you're not keeping track of the statistical data. So you have to make judgments based on the nature of the asset.
>
> …
>
> Q. So it's a matter of judgments that you use?
>
> A. Yes…

T39:L11-16- T40:L12-14 (November 19, 2013).

The disparity is largely caused by JCP&L's judgmental adjustments to the results of Mr. Spanos' own statistical life studies. Rate Counsel witness Mr. Majoros relied upon objective, statistical analysis in reaching his results. *RC-166, p. 32-33*. The Company's adjustments based upon Mr. Spanos judgment served to reduce the life estimates and thus increase Mr. Spanos's proposed depreciation expense. These shorter lives also served to reduce the calculated depreciation reserve excess relative to what it would be, had Mr.

Spanos adhered to his own statistical life studies. Mr. Spanos calculates a $371 million depreciation reserve excess while Mr. Majoros who relied on the best fit statistical results, calculated a $662 million depreciation reserve excess.[16] The $291 million difference between these two numbers results solely from Mr. Spanos's judgment, not an objective, statistical analysis.

While Rate Counsel's recommended $662 million depreciation reserve excess may appear high in relative terms, it should be judged against Mr. Majoros testimony discussing JCP&L's free cash flow which he quantifies in his Exhibit___(MJM-7.) *RC-166, p. 33-35.*

As Mr. Majoros explains: "Free cash flow is the cash leftover after the Company has paid all of its expenses, including interest and all of its capital expenditures." *RC-166, p. 34, l 7-8*. As an example, Mr. Majoros demonstrates; "[The Company's] free cash flow was $2.1 billion after it paid cash for the $1.9 billion it added to plant since 2001." *RC-166, p. 34*.

The "Net Cash Provided by (Used in) Operating Activities" is cash flow provided to JCP&L by New Jersey Ratepayers through the service rates charged. Not only did JCP&L's cash net income far exceed its ratemaking income, but it paid for all plant additions out of it operating cash, and still had $2 billion to send to its parent. In that context, the $662 million regulatory liability proposed by Rate Counsel is very reasonable. *RC-166, Exhibit___(MJM-7.)*

Rate Counsel urges that this court specifically Order its statistically supported $662 million depreciation reserve excess be transferred out of accumulated depreciation and into account 256-Other regulatory liabilities and remain as a rate base deduction until

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[16] See Exhibit___(MJM-5), pages 1 to 22.

fully amortized at Rate Counsel's proposed 48-year $13.9 million annual amortization.[17]
RC-166, p. 5-6. The Board should also specifically recognize that Rate Counsel's recommended $13.9 amortization is a negative amortization against ongoing depreciation expense, thus reducing the net depreciation and amortization expense charged to ratepayers.

[17] Exhibit___(MJM-6, p.2 of 2.)

POINT VIII

THE PROPOSED ACCELERATED RELIABILITY ENHANCEMENT PROGRAM SHOULD BE REJECTED

In this proceeding, JCP&L is seeking Board approval for an Accelerated Reliability Enhancement Program ("AREP"). *JC-2,* p. 17. The Company has proposed no specific projects to include in this program, nor has the Company even suggested a budget for this program. The only thing for sure is that cost recovery will be in what the Company views as "a timely manner." *Id.*

Rate Counsel addressed at length in our Initial Brief why the proposed AREP should not be adopted by Your Honor and the Board. *Rate Counsel Initial Brief,* pp. 125 -132. In our Initial Brief, Rate Counsel discussed the failure of the Company to identify specific projects or specifics budgets for the AREP. Rate Counsel discussed the Company's proposal for accelerated cost recovery, an alternative rate mechanism that would require ratepayers to pay for certain costs earlier than they would under traditional ratemaking. Rate Counsel discussed the reduction in shareholder risk without any reduction in shareholder return. And finally, Rate Counsel argued that the Company's proposal to increase rates for one component of the ratemaking equation without consideration of the overall revenue requirement raised the problem of single issue ratemaking.

In their Initial Brief, JCP&L argues that Rate Counsel witness Andrea Crane's criticisms of the Company proposed cost recovery mechanism "are standard Rate Counsel fodder" and "ignore the fact that Rate Counsel has entered into Board-approved settlement agreements with other New Jersey electric and gas utilities that resulted in rate clause mechanisms very similar to what JCP&L has proposed for the AREP". *JCP&L*

Initial Brief, p. 236. Apparently the Company's entire argument in support of the AREP is that other companies got accelerated recovery, so JCP&L should too.

In 2009, JCP&L was given the very same opportunity as the other New Jersey electric utility companies to participate in the State's accelerated infrastructure programs. The 2009 infrastructure programs were filed pursuant to the Board's implementation of then Governor Corzine's economic stimulus initiative. The fact that the Company failed to implement a program at that time, is not an adequate basis to support the adoption of such a program now. Moreover, the 2009 infrastructure programs were intended to stimulate the State's economy by the acceleration of specific infrastructure construction projects and were not based on vague assertions regarding what kind of projects would be considered for recovery through the AREP. As noted by Board Staff: "In previous accelerated infrastructure programs approved by the Board, specific projects were identified prior to Board approval of those programs." *Staff Initial Brief,* p. 129.

Further, at the evidentiary hearing, Ms. Crane recommended that the AREP be rejected and concluded:

> . . . the costs are not defined at all, the programs are not defined and there are no service quality measures. So not only is the program in our view unnecessary, but also it is far too ill-defined to be approved by the BPU.
>
> And if, in fact, the Company believes that it needs some sort of special program in order to deal with recent storm damage events or to enhance its infrastructure to see that it is better able to handle such storm events in the future, it's my understanding that there is a separate proceeding that's addressing those issues.
> *T63:L1-11* (Sept. 12, 2013).

Board Staff also recognized that "by Order dated March 20, 2013, the Board directed all regulated utilities to submit detailed proposals for infrastructure upgrades to protect utility infrastructure from future storm events." *Staff Initial Brief*, p. 129. Staff

concluded that the generic proceeding would be a “more appropriate venue to review the Company’s AREP proposal.” *Id*. At the hearing, Mr. Mader, when asked by Board Staff if the Company had filed a petition in the generic proceeding, replied “I wasn’t sure if in that particular docket the Company has filed anything. I don’t recall the procedural schedule.” *T24:L2-4* (September 12, 2013.).

In sum, the AREP results in single-issue ratemaking, provides a disincentive for utility management to control costs, and shifts risks from shareholders to ratepayers. The AREP will put a further and unnecessary financial burden on ratepayers. The Company’s AREP proposal should be rejected by Your Honor and the Board.

POINT IX

RATE COUNSEL'S PROPOSALS REGARDING RATE DESIGN MORE ACCURATELY REFLECT CLASS COST OF SERVICE; AND REPRESENT A FAIR AND REASONABLE RATE IMPACT

Rate Counsel's most significant objection to JCP&L's cost study is the Company's use of a minimum grid study to allocate the cost of transformers among the various rate classes. A minimum grid study postulates that there are certain types and sizes of facilities that must be installed by the utility to provide customer access to the utility's electrical service, regardless of customer usage requirements. Under JCP&L's minimum grid study, 26 percent of the Company's investment in transformers were classified as a customer-related cost and allocated to customer classes based on the relative number of customers served. The remaining 74 percent was classified as a demand-related cost and allocated to the classes using the average and excess demand ("A&E") method. *JC-7*, p. 6. Mr. Peterson's testimony opposed the use of the minimum grid study and the classification of any transformer-related cost as a customer-related cost. *RC-152,* p. 24.

The Company's response to Mr. Peterson's testimony concerning the usefulness of a minimum grid study misstates Mr. Peterson's objections to the minimum grid study. Mr. Peterson did not concede "that some portion of the line transformer costs is related to the number of secondary voltage customers served…" *JCP&L Initial Brief*, pp. 148-149. Rather, Mr. Peterson disagreed entirely with the use of a minimum grid study as a means to determine class cost of service. As stated in Mr. Peterson's Direct Testimony, minimum distribution system studies such as JCP&L's minimum grid study are based on

the unfounded notion that a "minimum size transformer" will be installed irrespective of the customer's usage requirements when, in fact, a "minimum grid" is pure fiction and has no basis in fact. Mr. Peterson's testified that; "The minimum size distribution equipment that a utility will install, however, is based on expected customer loads, not on the number of customers served by the utility or minimum service requirements." *RC-153,* p. 24. Mr. Peterson further testified: "Rather, the facilities that JCP&L installs are sized, designed, operated and maintained in order to meet the individual customer's peak and annual service requirements." Id. The Company, at hearing, did not challenge this testimony and waived its right to cross-examine Mr. Peterson while he was available in Newark. The Company's argument that Mr. Peterson conceded this point is therefore not supported by the record.

The Company also, inappropriately, argues that "Mr. Peterson misstated the record evidence in contending that 'the only support' the Company provided for classifying a portion of the line transformer investment as customer related is Ms. Moreland's statement that '[g]enerally speaking, as the number of customers increases, the number of line transformers installed also must increase to avoid excessive voltage drop'" *JCP&L Initial Brief*, p. 149. Mr. Peterson's statements concerning the lack of evidence provided by JCP&L in support of classifying a portion of the transformer investment as customer related was accurate at the time that Mr. Peterson filed his Direct Testimony in this proceeding. The exhibits referenced in JCP&L's Initial Brief (*p. 149*) that allegedly lend support for JCP&L's customer classification of a portion of its transmission investment are rebuttal exhibits. But, ultimately, as pointed out in Staff's Initial Brief (*pp. 97-107*), the evidence cited by JCP&L in support of its position that

some portion of transformer investment is customer-related actually supports Mr. Peterson's testimony that the transformers that JCP&L actually installs are sized, designed, operated and maintained in order to meet the individual customer's peak and annual service requirements; and not, as the Company argues, on the number of customers served.

JCP&L's reliance on NARUC's 1992 Electric Utility Cost Allocation Manual as support for its allocation of transformers using a minimum grid study is similarly misplaced. *JCP&L Initial Brief*, p. 150. The referenced NARUC Cost Allocation Manual does not advocate any particular cost allocation method, notwithstanding JCP&L's inferences to the contrary. The preface to the NARUC's 1992 Cost Allocation Manual states one of the objectives in preparing the manual was that: "The writing style should be non-judgmental; not advocating any one particular method by trying to include all currently used methods with pros and cons." *NARUC Electric Cost Allocation Manual, preface page ii, 1992.*

Board Staff raised a number of thoughtful concerns regarding JCP&L's class cost of service allocation study; including the sub-functionalization to primary and secondary service of Accounts 364 through 367; JCP&L's classification of a portion of line transformer as customer-related; JCP&L's classification of all meter costs as customer-related; and, JCP&L's use of class non-coincident peak demands ("NCP") rather than coincident peak demands ("CP") when allocating demand-related costs using the average & excess demand ("A&E") allocation method. Unfortunately, Staff's positions on these issues appear to be based largely on its introduction of hypothetical system design examples through its cross-examination of Company witnesses. While many of Staff's

cost allocation recommendations appear favorable to Rate Counsel's position. Rate Counsel was not able to explore the depth and breadth of Staff's analyses through discovery and cross-examination. Thus, Rate Counsel is unable based on this record to endorse or support Staff's proposed alternative cost allocation method.

For example, Staff raised what Rate Counsel believes are legitimate questions concerning JCP&L's underlying analysis supporting its segmentation of certain costs between primary and secondary service. But, rather than conducting an independent analysis of primary and secondary service, Staff *assumed* a 50-50 split of those costs. There is no analytical or quantitative support in the record for Staff's 50-50 split. Similarly, Staff argues, without analytical or quantitative support and despite JCP&L witness sworn testimony to the contrary, that "JCP&L sizes and operates its primary voltage distribution system to meet primary voltage CP and sizes and operates it secondary voltage system to meet secondary voltage CP." *Staff Initial Brief*, p. 111. From this conclusory statement, Staff recommends overturning decades of Board-approved cost allocation precedent by replacing NCP demands in the A&E allocation method with CP demands. In so advocating, Staff assumes, without record support, that the basis for using NCP's in the A&E allocation method is system planning; which it is not. Staff also concludes, again without record support, that JCP&L no longer considers individual and class service requirements other than CP's when designing its distribution system. Despite these significant shortcomings in the Staff's position on cost allocation it is Rate Counsel's belief that Rate Counsel's proposed spread of the revenue decrease will move class unitized rates of return closer to unity even under the Staff's recommended allocation method.

JCP&L correctly noted that Rate Counsel agreed with the Company's proposed revenue increase distribution to the various rate classes. *JCP&L Initial Brief*, p. 159. But, missing in JCP&L's discussion was the fact that Mr. Peterson proposed a revenue decrease distribution among the rate classes that was intended to move each class closer to its indicated cost of service (excluding the effects of the minimum grid study). *RC-152,* p. 27.

A. Response to Gerdau Steel.

As primarily a transmission customer under Gerdau's service contract with JCP&L, Gerdau's sole distribution assets consist of meter and related equipment. In this proceeding, Gerdau argues that JCP&L incorrectly applied the average & excess demand ("A&E") method (the same method that JCP&L used to allocate a large portion of its distribution facilities) to the Company's administrative and general ("A&G") assets and costs. Gerdau's witness Mr. Pollock testified that A&G costs should instead be allocated among the various service classes in proportion to the distribution plant that is allocated to each service class. Gerdau's method, obviously, will allocate an almost negligible amount of A&G costs to Gerdau.

Gerdau relies, in part, on Rate Counsel's testimony to support its position. *Gerdau Initial Brief*, p. 49. While it is true that Rate Counsel does not support JCP&L's allocation of A&G costs to Gerdau, Rate Counsel cannot support Gerdau's A&G's allocation approach either. Rate Counsel Witness Mr. Peterson testified that neither JCP&L's approach nor Gerdau's approach to allocating A&G costs to Gerdau is appropriate in this instance because of the unusual nature of Gerdau's service characteristics (i.e., establishing distribution rates for a primarily transmission service

customer). Mr. Peterson testified that under JCP&L's approach, Gerdau will be allocated too many A&G costs. Under Gerdau's approach, too few A&G costs will be allocated to Gerdau. Therefore, Mr. Peterson recommended an allocation that is half way between JCP&L's approach and Gerdau's approach as being a reasonable result in this proceeding. *RC-153,* p. 5.

B. Miscellaneous Service Charges.

JCP&L argues that, "the Company's proposal for a $15.00 Returned Payment Charge is patently reasonable and appropriate…" *JCP&L Initial Brief*, p. 169. This conclusory statement is contrary to the evidence provided largely by the Company itself. Specifically, the Company's only cost analysis determined that the Company's cost associated with returned payments was a little more than $12; not $15. There is nothing "patiently reasonable and appropriate" for the returned payment charge to be set 25 percent above the Company's cost. Rate Counsel submits that JCP&L's proposed $15 Returned Payment Charge is patiently unreasonable and inappropriate and urges the Board to set the rate at $12 to reflect JCP&L's actual cost associated with returned payments.

As for the Reconnection Charge, Rate Counsel is fully aware that both JCP&L's proposed $45.00 charge and Rate Counsel's $30.00 charge is significantly below the Company's cost ($68.57). Thus, the only issue to be decided is to what extent should rate moderation influence the setting of a new Reconnection Charge. Given JCP&L witness Ms. Cheong's testimony on the principle of gradualism and moderating customer impact in establishing new rates, *JCP&L Initial Brief*, p. 157, Rate Counsel urges the Board to

set the Reconnection Charge at $30.00, which represents a 36 percent increase over the existing Reconnection Charge.

Rate Counsel continues to object to the $1.00 Convenience Fee that JCP&L proposes to institute for the use of live agent phone calls to process customer payments. According to the Company, JCP&L Witness Connelly "effectively described the proposal as a "win-win…." *JCP&L Initial Brief*, p. 171. To the contrary, it is not a "win" for the customer to be forced to pay an additional amount for the "privilege" of paying his/her monthly bill. The fee is a complete misnomer – it is an Inconvenience Fee and a nuisance for customers. Since delinquent accounts are a cost to all customers, the Company should encourage all forms of payment, including live agent calls. The proposed Convenience Fee is completely unnecessary.

POINT X

JCP&L'S BRIEF REFLECTS A CONTINUED FAILURE TO ADDRESS CONCERNS RAISED AT HEARING REGARDING ITS INADEQUATE STORM COMMUNICATIONS AND POOR CUSTOMER SERVICE PROCESSES

A. JCP&L Continues to Erroneously Assert that Customer Service Issues Are Not Part of This Base Rate Case While Continuing to Provide Poor Service

JCP&L, like every other regulated public utility, has a legal obligation to provide safe, adequate and proper service in exchange for the rates it charges. N.J.S.A. 48:2-23; N.J.A.C. 14:3-3.1(a); In re Valley Road Sewerage Co., 285 N.J. Super. 202, 210 (App. Div. 1995), aff'd, 154 N.J. 224 (1998) (internal cite deleted). While a regulated public utility must comply with Board regulations governing customer service, simple compliance with Board regulations does not fully satisfy its duties of "good management, honest stewardship and diligence." See Valley Road, supra, 285 N.J. Super. at 210. The quality of customer service is always a critical issue in base rate cases.

JCP&L's initial brief merely recycles arguments it lost when the Board ordered it to file this base rate case. The Company objected to a review of its accountability for customer service. I/M/O Petition of Rate Counsel,[18] p. 8. Likewise, the Company denied having any reliability problems, while claiming that its undeniable problems were "concluded" and therefore unrelated to its base rates. Id. JCP&L repeats these assertions in its post-hearing brief. The Board properly rejected those arguments and ordered JCP&L to file this base rate petition addressing each of those issues. In the order initiating this proceeding, the Board specifically recognized that JCP&L was deficient in

[18] I/M/O the Petition of Rate Counsel Requesting a Board Order Directing Jersey Central Power and Light Company to File a Base Rate Case Petition and Establishing a Test Year of 2010, BPU Dkt. No. EO11090528, Order (July 31, 2012)

its communications with customers and public officials. I/M/O Petition of Rate Counsel, p. 12. These issues were specifically cited by the Board in finding the need for this base rate case. Id. The Board determined that, while any of these issues could be evaluated independent of a base rate case, "given the complexity of the individual issues, the number of issues, and the fact that the issues may very likely be inter-related, the Board HEREBY FINDS that directing JCP&L to file a base rate case is the most efficacious method to address a number of regulatory concerns.", Id., p. 11. It is clear that storm communications and customer service issues were to be addressed in this matter.

That the Board Order contemplated these issues is further evidenced by this Court's March 7, 2013 Prehearing Order, which included "service concerns" among the issues in this proceeding. Moreover, during the hearing, Your Honor accepted into the record significant testimony on customer service as well as related reliability issues.

Customer Service issues go to the heart of JCP&L's provision of proper service. These issues are squarely presented here and JCP&L's effort to avoid an examination of those issues by foreclosing a forum in which to do so, should be rejected.

B. JCP&L's Communications Related to Outages Require Improvement

Regulated utilities must provide adequate communications during storm events. N.J.A.C. 14:3-3.3(c). Rate Counsel's witness Roger Colton testified on improved storm-related communications that the Company could adopt, *RC-72*, p. 4. The Company, however, rejected almost all of Mr. Colton's recommendations, without offering adequate justification. The Company claims that Mr. Colton "conflated" the three 2011 and 2012 storms, thereby failing to understand the Company's approach to addressing these issues evolved and progressed over the course of the major storms. *JCP&L Initial Brief*, pp.

204-206. This argument is wrong. First, Mr. Colton distinguished Board recommendations in the separate storm-related Orders, acknowledged Board-ordered improvements that JCP&L has made, and then recommended non-duplicative improvements. Second, Mr. Colton recommended additional improvements that should improve the Company's performance during the next storm. E.g. *RC-72*, p. 11 and p. 13.

Some of the Company's excuses for not taking further action lack any common sense. For example, JCP&L asserts that communicating estimated times of restoration and actual service restoration to its customers would deprive them of their "choice" of how to interact with the Company. *JCP&L Initial Brief*, pp. 214-215. Emergency customer communications are an essential service, and the record is devoid of any suggestion that customers felt overwhelmed with accurate Company communications. As Mr. Colton explained, customers need to know when power will be and has been restored. *RC-72*, p. 14. Customers at the public hearings expressed that they are not satisfied when they are left in the dark about how long they will be in the dark. E.g. *T72:L1-13* (Public Hearing, Freehold, April 24, 2013, 6:30 p.m.). No customer asks for the "choice" to be left *incommunicado*. Mr. Colton provided specific recommendations for JCP&L to improve communication of estimated times of restoration and actual service restoration, each of which requires only minor modifications to the Company's existing practices. See *RC-72*, pp. 14 to 18.

Many customers complained about a long history of poor communications. E.g. Public Hearing, Morristown, April 16, 2013, 1:30 p.m.: *T68:L2-3*(Public Hearing, Morristown, April 16, 2013)("I had never experienced so many outages in my life"); *T69:L5-15* (Public Hearing, Morristown, April 16, 2013) (power out due to drizzle);

T69:L16-25 (Public Hearing, Morristown, April 16, 2013)(customers received no outage explanation so they bought generators). State Assemblywomen Amy Handlin and Caroline Casagrande submitted a petition with 1,500 signatures from JCP&L customers. *T18:L23-19:4* and *T26:L4-8* (Public Hearing, Freehold, April 24, 2013, 6:30 p.m.). Those customers objected to JCP&L's history of poor service, e,g, *T17:L16 to T18:L16; T23:L10-20* (April 24, 2013, 6:30 p.m.) and inadequate communications, *T73:L1-7* (April 24, 2013, 6:30 p.m.). The Company's blanket refusal to improve is cause for concern that it simply does not understand its responsibilities on these issues.

C. JCP&L Has a Growing Credit and Collection Problem and Has Not Taken Sufficient Measures to Address It

The facts in this record establish that JCP&L has a serious credit and collection problem that continues to worsen. This problem reduces the Company's revenue and imposes higher costs on other ratepayers. JCP&L has not taken sufficient measures to address the problem, and some of its customer service practices exacerbate it. *RC-72*, p. 3, and p. 27.

The 2011 Management Audit showed that the Company's unpaid customer arrearages, and the time they remained unpaid, worsened from 2006 to 2009. *RC-65*, p. 425 and Exhibit X-34, p. 426; *RC-72*, p. 27. Since 2009, that arrearage trend has worsened. *RC-50*, Attachment 2; *RC-72*, p. 28. For example, in 2009, 25% of JCP&L's arrears were more than 120 days old; which increased to 34% by 2012. *RC-72*, p. 28. The Company concedes these facts. *JC-20 Rebuttal*, p. 3. In its initial brief, the Company failed to refute the seriousness of its credit and collection problem, its worsening trend, or its failure to adjust its unsuccessful management practices.

Instead, the Company continues to blame its worsening credit and collection problem on the 2006 to 2009 recession, relying on the testimony of Gary Grant. *JC-20 Rebuttal*, p. 19, lines 3-8. Mr. Grant, in turn, unconvincingly tries to support his views with the 2011 Management Audit, *RC-65*. What that audit actually stated, and the Company acknowledges, is that JCP&L's worsening credit and collection problem from 2006 through 2009 "likely reflects the economic condition changes during this period <u>and the increase in power bills</u>." *RC-65*, p. 426 (emphasis added). In other words, in the opinion of the auditors, during 2006-2009, the recession was as likely as customers' increased power bills to have contributed to the Company's credit and collection problem.

Even if the recession contributed to JCP&L's credit and collection problems, effective management must adapt its methods. As Mr. Colton explained, "To say that the Company cannot now be critiqued because it is simply doing the same things it always had done, even though the economy had fallen apart and customers were facing historic financial and economic difficulty, is simply bad management." *T144:L7-12* (September 23, 2013). The Company has not proposed an effective response to JCP&L's growing credit and collection problem.

Moreover, JCP&L has failed to explain why it continues its marginal compliance with the Board's customer service rules. Mr. Colton opined that the Company's failure to take three actions contributes to its collection problems. JCP&L does not: 1) offer reasonable Deferred Payment Agreements; 2) provide clear and believable disconnection notices; or 3) provide adequate service to customers seeking to contact the Company

(thereby hindering efforts to timely resolve payment disputes). *RC-72*, p. 28. The Board's customer service rules support the Company taking each of those actions.

1. The Company does not offer reasonable Deferred Payment Agreements

Of JCP&L's 2,432 collection-related complaints from October 2009 through 2012, most were related to payment arrangements and down payments. *RC-30*. Mr. Colton explained that JCP&L worsens the problem by failing to comply with the spirit, if not the letter, of the consumer protections in the Board's Deferred Payment Agreement ("DPA") regulation, N.J.A.C. 14:3-7.7.

In its post-hearing brief, Rate Counsel identified three issues with the Company's DPAs. Rate Counsel Brief at 150-152. The Company appears to concede these issues have merit. See *JCP&L Initial Brief*, pp. 222-224. First, the Company will now clarify its policy such that when a customer requests a DPA, financial circumstances need to be taken into consideration. Id., p. 223. Second, the Company now concedes that the 25% down payment cannot be based only on consumption charges and implies that it will discontinue its prior practice of excluding other charges from the total amount deferred. Id., p. 223. Third, the Company will now permit a customer service representative to "negotiate the percentage of the required down payment if the customer is unable to pay a 25% down payment due to his or her financial circumstances." Id., p. 223. The implication here, is that 25% is the Company's default position, and the customer must request a lower down payment than the maximum permitted by Board regulation.

Mr. Colton acknowledged Mr. Grant's commitment that JCP&L will change certain of its DPA policies. *T142:L24-143:L3* (September 23, 2013). To ensure the Company takes these actions, Rate Counsel urges Your Honor and the Board to order

them to do so in compliance with N.J.A.C. 14:3-7.7. See *Rate Counsel Initial Brief*, pp. 150-152.

2. The Company Does Not Provide Clear and Believable Notices Warning of the Disconnection of Service

A utility must send a shutoff notice to provide a clear and believable warning of the impending disconnection of service due to nonpayment. See N.J.A.C. 14:3-3A.3. Instead, JCP&L fails to provide clear and believable notice of disconnection by repeatedly issuing notices with no intention of actually disconnecting service. *RC-72*, p. 33; *RC-72*, pp 34-35. In 2011, over 98.8% of JCP&L's 880,539 residential shutoff notices did not result in a shutoff, whether a customer paid the bill or not. *RC-17*; see *RC-72*, p. 34 (2012 numbers similar). Indeed, JCP&L concedes that it uses shutoff notices as a prompt to contact the Company; not to convey the threat of a shutoff. *JCP&L Initial Brief*, p. 226.

Rather than concede, as it did in discovery, that issuing its disconnection notices is simply an automated computer process, *RC-16*, the Company now asserts that its computers are "used to simulate the regulations and determine which customers qualify to receive a disconnection notice." *JCP&L Initial Brief*, p. 227. The Company further argues that, in its opinion, this massive issuance of disconnection notices is not prohibited by Board rules. Id., p. 228. The governing Board rules, however, expressly contradict the Company's position: N.J.A.C. 14:3-3A.1(e). A shutoff notice is to provide a clear and believable warning of the impending disconnection of service due to nonpayment, not to spur customers into discussions with the Company.

3. JCP&L Provides Inadequate Service to Customers Seeking to Contact the Company, Thereby Hindering Efforts to Timely Resolve Payment Disputes

JCP&L contributes to its collection problems by failing to provide adequate service to customers who seek to contact it to resolve payment troubles, and providing incorrect bills. *RC-65*, Finding X-5, pp. 411 & 412. The Company's performance has declined even further since the 2011 Management Audit. *RC-48*, Attachment 1; *RC-72*, p. 38. The Company's own data also shows that the performance of its call center for New Jersey is First Energy Corporation's worst, and its performance is deteriorating. *T144:L13-20* (September 23, 2013); see *RC-28*.

JCP&L's response to its poor showing is twofold. First, it argues that an additional 30 seconds[19] for a call to be answered is a "minimal increase" and "does not represent an inability to contact the Company." *JCP&L Initial Brief*, p. 231. Second, it argues that customers can call its automated IVR recording system to resolve their problems. Id., p. 232. These are inadequate responses. Significantly, the 30 second increase is on top of the 60 second average wait time for the prior eight years. Id., p. 341. Thus, in 2013, when customer service issues were clearly at the forefront, the Company admits that the wait time to speak to a live customer service representative increased 50%.

Board rules also require regular meter readings. N.J.A.C. 14:3-7.2(e)(1). However, the undisputed facts establish that JCP&L's rate of meters not read has nearly tripled from its "relatively high" rate of 9.7% in 2009 to 27.9% in 2013. *RC-65*, Finding X-12, at 419; *RC-49*, Attachment 1; *RC-72*, p. 39-40. In reply, the Company flatly

[19] This number is likely low, as discovery revealed that the average time to reach a customer service representative tripled from 2006 (41 seconds) to 2013 (127 seconds). *RC-72*, p. 38-39, *RC-65*, Finding X-5, p. 412; *RC-48*, Attachment 1.

asserts that it has customer service practices that "address" the problem. *JCP&L Initial Brief*, p. 230. The Company also dismisses this fact because RC-65 makes "no recommendation" regarding this issue. Id. Regardless of whether the Audit directed the Company to implement a specific action, JCP&L is responsible to use effective management methods to comply with its customer service obligations such as regular meter readings. The Company cannot reject valid recommendations solely on the basis that the Board never told them to do it. Rather, the Company should use well thought out judgment to assure that it provides ever-evolving and better service to its customers. JCP&L's ever-escalating failure to perform regular meter readings, coupled with its ever-increasing credit and collection problems, indicate that its customer service practices are simply not addressing these problems.

D. Conclusion

JCP&L has not adequately refuted the customer service issues raised by Rate Counsel at hearing or in Rate Counsel's post-hearing brief. Indeed, while asserting Rate Counsel provides no evidence to support its positions, the Company relies upon blanket statements by its witnesses; statements that directly contradict the discovery provided by the Company in this matter. The evidence in this matter demonstrates a serious lack of concern for customer service issues and an entrenched position that the Company will only do that which is explicitly required of it by the Board. Therefore, to assure that ratepayers receive the customer service for which they pay (and have paid for in the past), this Court and the Board should order the remedies set forth by Rate Counsel in its post-hearing brief. See *Rate Counsel Initial Brief*, pp. 145-46; 146-47; 147; 148-49; 149;152; 153; and 154.

CONCLUSION

For the foregoing reasons, as well as for the reasons set forth in our Initial Brief, Rate Counsel urges Your Honor and the Board to deny JCP&L's request for an increase of $10,958,240 in its distribution rates. Rate Counsel recommends Your Honor and the Board adopt Rate Counsel's recommended rate decrease of $190,189,222. Specifically Rate Counsel requests the following relief:

I. Reliability

JCP&L should be required to meet a modified minimum reliability benchmark by using more recent, SAIFI and CAIDI data, and additional benchmarks utilizing other measures such as CEMI[20] to address pockets of poorly performing areas that may be too small to be captured by SAIFI and CAIDI. Rate Counsel respectfully request that Your Honor and the Board acknowledge JCP&L's poor performance and specifically order the Company to establish an improvement plan with specific deadlines and consequences, such as a reduction of its Return on Equity, if reliability does not improve.

JCP&L should be required to include in its annual system reliability report the Company's CAIDI and SAIFI both including and excluding major events. In addition, the Board should better define "major events" so that the definition cannot be modified to skew the Company's performance results.

JCP&L should be ordered to maintain an increased level of vegetation management spending and require reporting and sanctions if its vegetation management practices and spending are not maintained at a sufficient level.

II. Ring Fencing

[20] Customers experiencing multiple interruptions ("CEMI").

JCP&L should be required to conduct a ring fencing study within 90 days of the Order resolving the instant case.

III. ROE and Capital Structure

Rate Counsel's proposed Return on Equity of 9.25% and proposed capital structure of 50% common equity should be adopted, resulting in an overall rate of return of 7.76%.

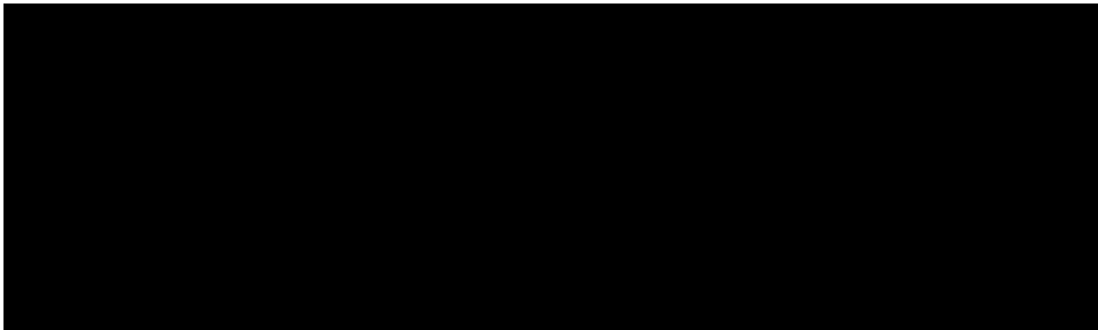
IV. Rate Base

Rate Counsel's recommended rate base of $1,324,452,526 should be adopted.

V. Operating Income

The appropriate pro forma operating income amounts to $215,208,689 which is $47,473,771 more than JCP&L's proposed updated and revised pro forma operating income of $167,734,919 should be adopted.

VII. Pension



VI. Depreciation

Rate Counsel's recommended overall $15,503,635 reduction in depreciation expense should be adopted. This $15,503,635 adjustment consists of a $1,606,919 decrease in depreciation expense as well as an annual negative amortization of the Company's reserve excess of $13,896,716.

VII. AREP

JCP&L's proposed Accelerated Reliability Enhancement Program ("AREP") should be rejected.

IX. Rate Design

Rate Counsel's recommendation to the Company's service charges more appropriately reflects just and reasonable charges for those services and should be adopted. The Company's attempt to "automatically" recover potential future costs for interval meters that may or may not be required depending on future Board decisions should be rejected.

Consolidated Edison's request for special treatment and tariff relief from on peak demand charges should be rejected.
Rate Counsel recognizes that the allocation of costs to the SC-GT rate class may be disproportionately large, therefore recommends that a 10 percent larger-than-average revenue reduction for the GP and GT rate classes should be adopted. This reflects a measured, gradual step toward a unitized rate, avoiding the potential for "rate shock" among the other rate classes.

X. Customer Service

JCP&L should be required to: a) identify the local officials with whom it expects to directly exchange storm-related communications, and keep those contacts up-to-date; b) develop uniform communication templates for exchanging storm-related information with local officials; c) execute a written communications agreement with interested local governments; and d) expand and enhance its storm preparedness planning and training with local officials outside the context

of an impending storm event to improve its storm-related communications with local government officials.

JCP&L should be required to: a) actively communicate accurate estimated times of restoration (ETRs) to *all* residential customers; b) automatically call customers as service is restored to their area; c) generate and communicate municipality-wide ETRs when an entire community has lost service; d) improve the language of its automated ETR calls to ensure they are clear for the widest range of demographics; e) secure secondary contact information such as mobile phone numbers, for use where the customer is unlikely to be at a residential land-line telephone; and f) promote a customer pre-registration process on a website, that also offers easy access to outage information during emergency events to improve its communication of estimated and actual service restoration times.

JCP&L should be required to develop performance metrics that rate the effectiveness of its communications to improve its communications planning and follow-up.

JCP&L should be required to: a) automatically provide such communications to at least the vulnerable populations it already identifies; b) provide messages that reflect the cycle of a storm event, through confirmation of service restoration; and c) provide such customers' contact information, upon consent, during storm emergencies to local emergency or social service providers to improve its communications with vulnerable customer populations,.

JCP&L should be required to: a) offer reasonable deferred payment agreements; b) provide clear and believable disconnection notices; and c) promptly and effectively resolve customer payment disputes to improve its credit and collection problem.

UPDATED SCHEDULES

Docket No. ER12111052
Test Year 2011

Sch. RJH-1RB

JERSEY CENTRAL POWER AND LIGHT COMPANY
REVENUE REQUIREMENT

SUPPLEMENTAL DIRECT TESTIMONY

		Updated JCP&L (1)	Adjustments	RC	
1.	Pro Forma Rate Base	$ 2,024,166,188	$ (699,713,662)	$ 1,324,452,526	RJH-3RB
2.	Rate of Return	8.61%		7.76%	RJH-2RB
3.	Income Requirement	174,216,745	(71,505,452)	102,711,293	
4.	Pro Forma Income	167,734,919	47,473,771	215,208,689	RJH-7RB
5.	Income Deficiency	6,481,827	(118,979,222)	(112,497,396)	
6.	Revenue Conversion Factor	1.69061	1.69061	1.69061	
7.	Rate Increase	$ 10,958,240	$ (201,147,462)	$ (190,189,222)	
8.	Rate Increase Percentage	1.90%		-32.93%	(2)

(1) Exhibit JC-3 Supplemental No. 2, Schedule SDM-1 Supplemental No. 2

(2) Rate increase on line 7 above divided by pro forma test year electric sales revenues on Schedule RJH-7RB, line 1.

JERSEY CENTRAL POWER AND LIGHT COMPANY
RATE OF RETURN

SUPPLEMENTAL DIRECT TESTIMONY

JCP&L PROPOSAL:	Ratios	Cost Rates	Weighted Cost Rates
	(1)	(1)	(1)
Long Term Debt	46.20%	5.82%	2.69%
Common Equity	53.80%	11.00% (3)	5.92%
Total Cost of Capital	100.00%		8.61%

RCRECOMMENDATION:	Ratios	Cost Rates	Weighted Cost Rates
	(2)	(2)	(2)
Long Term Debt	50.00%	6.26%	3.13%
Common Equity	50.00%	9.25%	4.63%
Total Cost of Capital	100.00%		7.76%

(1) Schedule SRS-4
(2) Testimony of Matthew Kahal, Schedule MIK-1, page 1
(3) Rebuttal testimony of Pauline Ahern

Docket No. ER12111052
Test Year 2011

Sch. RJH-3RB

JERSEY CENTRAL POWER AND LIGHT COMPANY
DISTRIBUTION RATE BASE

SUPPLEMENTAL DIRECT TESTIMONY

	Updated JCP&L (1)	Adjustments	RC	
1. Utility Plant in Service	$ 3,948,975,061	$ (451,418) (2)	$ 3,948,523,643	
Deductions:				
2. Reserve for Depreciation	(1,502,324,772)		(1,502,324,772)	
3. Accumulated Deferred Income Tax	(687,624,687)		(687,624,687)	
4. Customer Advances (Net of Tax)	(13,264,190)		(13,264,190)	
5. Customer Deposits	(23,745,666)		(23,745,666)	
6. Total Deductions	(2,226,959,315)		(2,226,959,315)	
Additions:				
7. Unamort. Net Loss on Reacq. Debt	17,920,314	(9,569,740)	8,350,574	RJH-4RB
8. Unamort. Storm Cost (Net of Tax)	26,470,956	(26,470,956)	-	RJH-5RB
9. Excess Cost of Removal Reserve	107,158,582	(107,158,582)	-	(3)
10. Total Additions	151,549,852	(143,199,278)	8,350,574	
Other Rate Base Components:				
11. Materials & Supplies	16,699,010	(1,877,767)	14,821,243	RJH-6RB
12. Cash Working Capital	138,138,682	(61,654,653)	76,484,029	(4)
13. Consolidated Income Tax Benefits	-	(511,030,428)	(511,030,428)	(5)
14. Customer Refunds	-	(1,163,573)	(1,163,573)	(6)
15. Operating Reserves (Net of Tax)	(4,237,102)	-	(4,237,102)	(7)
16. Deferred Taxes - TMI-2 Non-Qual. Decommisioning Trust Fund	-	19,663,455	19,663,455	(7)
17. Total Other Rate Base Components	150,600,590	(556,062,966)	(405,462,376)	
18. TOTAL NET RATE BASE	$ 2,024,166,188	$ (699,713,662)	$ 1,324,452,526	

(1) Exhibit JC-3 Supplemental No. 2, Schedule SDM-5 Supplemental No. 2
(2) Overhead credits of $451,418 to be removed from JCP&L's proposed rate base plant in service as per Attachment A of the Stipulation in JCP&L'[s Generic Storm Cost proceeding.
(3) Testimony of Robert Henkes
(4) Testimony of Dave Peterson
(5) Testimony of Andrea Crane
(6) Average monthly 2011 test year balance as per RCR-A.128 Attachment
(7) Response to RCR-A-126

JERSEY CENTRAL POWER AND LIGHT COMPANY
UNAMORTIZED NET LOSS ON REACQUIRED DEBT (NET OF TAX)

SUPPLEMENTAL DIRECT TESTIMONY

	Updated JCP&L	Adjustments	RC	
IMPACT ON RATE BASE:				
1. Total Electric Net Loss on Reacquired Debt	$ 17,920,314		$ 17,920,314	(1)
2. Distribution Allocation Factor	-		78.78%	(2)
3. Distribution Net Loss on Reacquired Debt	17,920,314		14,117,623	
4. Offsetting Deferred Tax Benefits @40.85%	-		(5,767,049)	(3)
5. Net-Of-Tax Distribution Net Loss on Reacquired Debt	$ 17,920,314	$ (9,569,740)	$ 8,350,574	
IMPACT ON EXPENSES:				
6. Total Electric Net Loss on Reacquired Debt Amortization Expenses	$ 1,772,706		$ 1,772,706	(4)
7. Distribution Allocation Factor	-		78.78%	(2)
8. Distribution Net Loss on Reacquired Debt Amortization Expense	$ 1,772,706	$ (376,168)	$ 1,396,538	

(1) Exhibit JC-3 Supplemental No. 2, Schedule SDM-5 Supplemental No. 2, line 8
(2) Response to RCR-A-102c
(3) Responses to RCR-A-12 and RCR-A-18(a)
(4) Exhibit JC-3 Supplemental No. 2, Schdule SDM-2 Supplemental No. 2, page 6 of 27

JERSEY CENTRAL POWER AND LIGHT COMPANY
STORM DAMAGE COSTS (NET OF TAX)

SUPPLEMENTAL DIRECT TESTIMONY

	Updated JCP&L (1)	Adjustments	RC
IMPACT ON EXPENSES:			
1. Average Storm Damage Costs 2007-2011 Excluding Major Storms	$ 10,201,290		$ 10,201,290
2. 2011 Test Year Major Storms - 3 Yr. Amortization	29,834,833	(15,213,758)	14,621,075 (2)
3. Total Annual Storm Damage Costs	40,036,123	(15,213,758)	24,822,365
4. Less: Amortization Included in Test Year	(8,556,720)		(8,556,720)
5. Amortization Expense Adjustment	$ 31,479,403	$ (15,213,758)	$ 16,265,645
IMPACT ON RATE BASE:			
6. Average Unamortized Storm Damage Balance 2011 Test Year Major Storms - 3 Yr. Amortization	$ 44,752,250	(44,752,250)	$ -
7. Offsetting Deferred Tax Benefits @40.85%	(18,281,294)	18,281,294	-
8. Average Unamortized Balance Net Of Tax	$ 26,470,956	$ (26,470,956)	$ -

(1) Exhibit JC-3 Supplemental No. 2, Schedule SDM-2, page 17 of 27

(2)

- Total 2011deferred storm cost balance per Attachment A to Stipulation in JCP&L's Generic Storm Cost proceeding.	$ 81,912,314	
- Recommended amortization peirod (yrs)	6	
- Recommended annual amortization of deferred costs without carrying charges		$ 13,652,052
- Average deferred cost balance during 6-yr. amortization period	$ 40,956,157	
- Deferred tax benefits @ 40.85%	(16,730,590)	
- Average net-of-tax deferred cost balance	24,225,567	
- SBC carrying charge (based on estimate for entire 6-year amortization period)	4%	
- Recommended annual amortization of carrying charges		969,023
- Recommended annual amortization of deferred costs including carrying charges		$ 14,621,075

JERSEY CENTRAL POWER AND LIGHT COMPANY
MATERIALS AND SUPPLIES

SUPPLEMENTAL DIRECT TESTIMONY

1.	Distribution M&S Balance at 6/30/12 Proposed By JCP&L	$ 20,461,958	(1)
2.	Required Correction to Distribution M&S Balance at 6/30/12	(3,762,948)	
3.	Corrected Distribution M&S Balance at 6/30/12	16,699,010	(2)
4.	Adjustment to Reflect 13-Month Average Corrected Distribution M&S Balance for 13 Months Ended 6/30/12	(1,877,767)	(2)
5.	13-Month Average Corrected Distribution M&S Balance	$ 14,821,243	

(1) Exhibit JC-3, Schedule SDM-2, page 17 of 24
(2) RCR-A-14 Attachment

Docket No. ER12111052
Test Year 2011

Sch. RJH-7B

JERSEY CENTRAL POWER AND LIGHT COMPANY
OPERATING INCOME

SUPPLEMENTAL DIRECT TESTIMONY

	Updated JCP&L (1)	Adjustments	RC	
1. Operating Revenues				
a. Electric Retail Sales	$ 576,804,153	$ 823,138	$ 577,627,291	(2)
b. Other Operating Revenues	16,736,984		16,736,984	
c. Total Operating Revenues	593,541,137	823,138	594,364,275	
2. Operating Expenses:				
3. O&M Expenses	208,732,611	(59,245,119)	149,487,492	RJH-8RB
4. Depreciation Expense	83,826,938	(9,479,504)	74,347,434	RJH-14RB
5. Amortization Expense	38,467,576	(19,081,033)	19,386,543	RJH-15RB
6. Taxes o/t Income Taxes	16,700,324	(589,323) (3)	16,111,001	
7. Total Operating Expenses	347,727,449	(88,394,980)	259,332,469	
8. Operating Income Before FIT	245,813,688	89,218,118	335,031,806	
9. Income Taxes	78,078,769	41,744,347	119,823,116	RJH-16RB
10. Net Utility Operating Income	$ 167,734,919	$ 47,473,771	$ 215,208,689	

(1) Exhibit JC-3 Supplemental No. 2, Schedule SDM-1 Supplemental No. 2
(2) RCR-A-106 Attachment
(3) Incentive compensation expense adjustment on Schedule RJH-11 x estimated payroll tax ratio of 7%

Docket No. ER12111052
Test Year 2011

Sch. RJH-8RB

JERSEY CENTRAL POWER AND LIGHT COMPANY
OPERATION AND MAINTENANCE EXPENSES

SUPPLEMENTAL DIRECT TESTIMONY

	Updated JCP&L (1)	Adjustments		RC	
1. Unadjusted Test Year O&M Expenses	$ 194,393,842			$ 194,393,842	
Pro Forma O&M Expense Adjustments:					
2. Reclassify SNFD & PDMS RA Amort.	(1,819,000)			(1,819,000)	
3. Interest on Customer Deposits	30,912			30,912	
4. Annualize Wage Increases at 3%	3,392,898			3,392,898	
5. Amortization of Net Loss on Reacq. Debt	1,772,706	(376,168)		1,396,538	RJH-4RB
6. BPU & RC Assessments	(94,855)	1,819	(2)	(93,036)	
7. Management Audit Fees	114,959	-	(3)	114,959	
8. Rate Case Expenses	802,025	(534,683)		267,342	RJH-9RB
9. Cost to Achieve Merger Synergy Savings	4,822,255	(4,822,255)		-	(4)
10. Reclassify Deferred USF Admin Costs	51,923			51,923	
11. Incremental BGS Meter Costs	75,655			75,655	
12. Normalize Forestry Maintenance Exp.	5,108,966	(5,108,966)		-	(4)
13. Acct. 935 Expense Normalization	-	(1,018,802)		(1,018,802)	RJH-10RB
14. Remove Incentive Compensation Exp.	-	(8,418,907)		(8,418,907)	RJH-11RB
15. Remove SERP Expenses	-	(408,576)		(408,576)	RJH-12RB
16. Pension Expense Adjustment	-	(37,664,418)		(37,664,418)	(5)
17. OPEB Expense Adjustment	-	(814,905)		(814,905)	(5)
18. Miscellaneous Expense Adjustments	-	(79,258)		(79,258)	RJH-13RB
19. Service Co. Depreciation at JCP&L rates	80,325			80,325	(6)
20. Total O&M Expense Adjustments	14,338,769	(59,245,119)		(44,906,350)	
21. Total Adjusted Test Year O&M Expenses	$ 208,732,611	$ (59,245,119)		$ 149,487,492	

(1) Exhibit JC-3 Supplemental No. 2, Schedules SDM-1 and SDM-2 Supplemental No. 2, page 1 of 27
(2) Recommended revenue adjustment on RJH-7, L1(c) x assessment rate of 0.00221
(3) Response to RCR-A-113
(4) Testimony of Robert Henkes
(5) Testimony of Dr. Mitchell Serota
(6) Response to RCR-SC-13

JERSEY CENTRAL POWER AND LIGHT COMPANY
RATE CASE EXPENSES

SUPPLEMENTAL DIRECT TESTIMONY

	Updated JCP&L (1)	Adjustments	RC	
1. Estimated Rate Case Expenses				
a. Legal	$ 2,848,256			
b. Consultant Fees and Expenses	314,289			
c. Court Reporter Fees, Publ. Notices, Postage	45,556			
d. Total	3,208,101	-	3,208,101	
2. Less: Stockholder Sharing @ 50%	-	(1,604,051)	(1,604,051)	(2)
3. Ratepayer Expense Portion	3,208,101	(1,604,051)	1,604,051	
4. Amortization Period (Yrs)	4		6	(2)
5. Annual Amortization Expense	$ 802,025	$ (534,684)	$ 267,342	

(1) Response to data request S-JREV-14
(2) Testimony of Robert Henkes

JERSEY CENTRAL POWER AND LIGHT COMPANY
ACCOUNT 935 - MAINTENANCE GENERAL PLANT EXPENSE NORMALIZATION

SUPPLEMENTAL DIRECT TESTIMONY

		(1)	
1. Actual Account 935 Expenses - Distribution Related Only:			
	2007	$ 1,552,757	
	2008	1,495,386	
	2009	1,564,891	
	2010	1,265,905	
	2011	2,743,237	
	5-Yr. Average	1,724,435	Normalized
2. Difference Between 2011 Test Year and Normalized Expenses		$ (1,018,802)	Recommended

(1) RCR-A-86 Attachment, page 2

JERSEY CENTRAL POWER AND LIGHT COMPANY
INCENTIVE COMPENSATION EXPENSE ADJUSTMENT

SUPPLEMENTAL DIRECT TESTIMONY

1.	Total Short Term Incentive Plan (STIP) Expenses Included in Distribution Related 2011 Test Year Expense	$ 6,657,938	(1)
2.	Total Long Term Incentive Plan (LTIP) Expenses Included in Distribution Related 2011 Test Year Expense	$ 1,760,969	(2)
3.	Test Year Distribution STIP and LTIP Expenses	$ 8,418,907	

(1) RCR-A-57 Attachment 3
(2) RCR-A-57 Attachment 4 ($420,208 + $1,340,761)

JERSEY CENTRAL POWER AND LIGHT COMPANY
REMOVAL OF SUPPLEMENTAL EXECUTIVE RETIREMENT PLANT (SERP) EXPENSES

SUPPLEMENTAL DIRECT TESTIMONY

1. Direct JCP&L SERP Expenses in Test Year:			
a. Total Electric Expense	$ 207,417.0		
b. Distribution Allocation Factor	93.16%		
c. Distribution Related Expense		$ 193,230	(1)
2. SERP Expense Allocated from Service Company to JCP&L's Distribution Related Expense		215,346	(2)
3. Total Distribution Related SERP Expenses to be Removed from Test Year		$ 408,576	

(1) Response to RCR-A-64 Supplemental
(2) Response to RCR-A-110c

JERSEY CENTRAL POWER AND LIGHT COMPANY
MISCELLANOUS EXPENSE ADJUSTMENTS

SUPPLEMENTAL DIRECT TESTIMONY

1.	Remove Employee Clubs Expense	$	(1,387)	(1)
2.	Remove "Celebrate Success" Expenses		(5,707)	(2)
3.	Remove Service Award Expenses		(37,875)	(2)
4.	Remove Institutional/Goodwill Advertising Expense		(8,140)	(3)
5.	Remove Civic Membership Expenses		(25,295)	(4)
6.	Remove Private Club Expenses		(854)	(5)
7.	Total Miscellaneous Expense Adjustments	$	(79,258)	

(1) Response to RCR-A-132
(2) Response to RCR-A-87(d)
(3) RCR-A-85 Attachment 2
(4) RCR-A-119 Supplemental, page 2
(5) Response to RCR-A-87(h)

JERSEY CENTRAL POWER AND LIGHT COMPANY
DEPRECIATION EXPENSES

SUPPLEMENTAL DIRECT TESTIMONY

	Updated JCP&L (1)	Adjustments	RC	
1. Depreciation on Depreciable Distribution Plant at 12/31/11	$ 69,121,125	$ 8,194,772	$ 77,315,897	(3)
2. Depreciation on Post-Test Year Distribution Plant Additions from 12/31/11 - 6/30/12	1,314,250	155,814	1,470,064	(3)
3. Total Distribution Plant Depreciation Expense	70,435,375	8,350,586	78,785,961	
4. Allocated General Plant Depreciation Expense	9,753,528	(3,923,578)	5,829,950	(3)
5. Allocated Intangible Plant Depreciation Expense	3,625,292		3,625,292	(3)
6. Excess Depreciation Reserve Amortization	-	(13,896,716)	(13,896,716)	(3)
7. BGS Metering Depreciation (Normalization Adj. 11)	12,743		12,743	(4)
8. Depreciation Expense Reduction Associated With 6/30/13 Plant in Service Adjustment	-	(9,796)	(9,796)	(2)
8. Total Pro Forma Depreciation Expense	$ 83,826,938	$ (9,479,504)	$ 74,347,434	

(1) Schedule CP-2 Supplemental No. 2
(2) Depreciation expense associated with the removal of 12/31/11 distribution plant in service for major storms in 2011:
See Schedule RJH-3RB, line 1: $ (451,418) x 2.170000% = $ (9,796)
(3) Testimony of Michael Majoros
(4) Exhibit JC-3, Schedule SDM-2, page 12 of 24

JERSEY CENTRAL POWER AND LIGHT COMPANY
AMORTIZATION EXPENSES

SUPPLEMENTAL DIRECT TESTIMONY

	Updated JCP&L	Adjustments	RC	
1. Unadjusted Test Year Amortization Exp.	$ 3,912,364		$ 3,912,364	(1)
2. Storm Damage Cost Amortization	31,479,403	(15,213,758)	16,265,645	RJH-5RB
3. Net Cost Of Removal Amortization	4,762,102	(2,346,633)	2,415,469	(2)
4. Excess Cost of Removal Amortization	(3,758,513)		(3,758,513)	(3)
5. Gain on Sale of Property Amortization	(420,786)		(420,786)	(4)
6. Eliminate DOE SNFD Fees Amortization	(1,569,000)		(1,569,000)	(5)
7. TMI-2 PDMS Amortization	608,947		608,947	(6)
8. Production-Related RA Amortization Acceleration	1,520,642	(1,520,642)	-	(7)
9. Reclassify SNFD & PDMS RA Amort.	1,819,000		1,819,000	(8)
10. RA Amortization Recoverable via Riders	113,417		113,417	(9)
10. Total Amortization Expenses	$ 38,467,576	$ (19,081,033)	$ 19,386,543	

(1) See response to RCR-A-82. This balance consists of the test year deferred OPEB amortization and the Werner CT amortization which amortization expenses have expired in December 2012 (RCR-A-63) and April 2013 (RCR-A-47), respectively. To be consistent with BPU post-test year ratemaking policy, Rate Counsel has not removed these amortization expenses from the test year.
(2) See Exhibit JC-3, Schedule SDM-2, p. 16 and RCR-A-35 Attachment: JCP&L's proposed net COR amortization is based on the 2-yr. average net COR expenses for 2010 - 2011 and Rate Counsel's recommended net COR amortization is based on the traditionally allowed 5-yr. average net COR expenses for 2007 - 2011.
(3) Normalization Adjustment No. 17
(4) Normalization Adjustment No. 18
(5) Normalization Adjustment No. 19
(6) Normalization Adjustment No. 20
(7) See Exhibit JC-3, Schedule SDM-2, p. 22: JCP&L proposes to accelerate the test year amortization period to 3 years, whereas Rate Counsel rejects this proposal
(8) Normalization Adjustment No. 2
(9) Exhibit JC-3 Supplemental No. 2, Schedule SDM-2 Supplemental No. 2, page 1 of 27

Docket No. ER11112052
Test Year 2011

Sch. RJH-16R

JERSEY CENTRAL POWER AND LIGHT COMPANY
PRO FORMA INCOME TAX

SUPPLEMENTAL DIRECT TESTIMONY

	Updated JCP&L	Adjustments	RC	
1. Net Revenues Before FIT	$ 245,813,688	$ 89,218,118	$ 335,031,806	RJH-7RB, L8
2. Pro Forma Interest	(54,426,590)	12,971,226	(41,455,364)	(2)
3. Taxable Income	191,387,098	102,189,344	293,576,441	
4. FIT and SIT @ 40.85%	78,181,629	41,744,347	119,925,976	
5. ITC Amortization	(102,860)		(102,860)	(3)
6. Net Pro Forma Income Taxes	$ 78,078,769	$ 41,744,347	$ 119,823,116	

(1) Response to RCR-A-138

(2)	Updated JCP&L	RC	
Rate Base	$ 2,024,166,188	$ 1,324,452,526	Sch. RJH-3RB
Weighted Cost of Debt	2.69%	3.13%	Sch. RJH-2RB
Pro Forma Interest	$ 54,426,590	$ 41,455,364	

(3) Response to RCR-A-138