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**Remarks of Stefanie A. Brand
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Regarding Senate Bill S2428
Presented at the Senate Economic Growth Committee and Senate
Environment Committee Public Hearing
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Good afternoon. My name is Stefanie Brand. I am the Director of the Division of Rate Counsel in the Department of the Public Advocate. I would like to thank the Chairman and the members of the Committee for the opportunity to testify today regarding S2428, which authorizes electric and gas public utilities to implement "formula based rates."

The Division of Rate Counsel represents and protects the interest of all utility consumers—residential customers, small business customers, small and large industrial customers, schools, libraries and other institutions in our communities. Rate Counsel is a party in cases where New Jersey utilities seek changes in their rates or services. Rate Counsel also gives consumers a voice in

setting energy, water and telecommunications policy that will affect the rendering of utility services well into the future.

This bill makes fundamental changes in the way this state determines and monitors what people pay for gas and electricity, removing important protections for residential and business customers. At a time when consumers and businesses are barely making ends meet, we can not afford to remove the basic protections that keep them from paying even higher rates. In addition, while we all share a desire to find productive solutions during these difficult economic times, as I will explain in this testimony, this bill will not help solve our economic problems and may in fact exacerbate them. I strongly urge you to reject this legislation.

By way of background, since utilities are monopolies, their activities are not constrained by the forces of competition and the marketplace. Thus, the traditional role of regulation is to replicate the environment that would exist if the utility operated subject to such competition. Utility rates are regulated and are based on their costs plus the opportunity to earn a reasonable return on investment for shareholders. Regulation replaces the market, and while shareholders assume the risk of the initial investment, they receive reasonable returns as long as their investments are reasonable and prudent.

This bill removes those safeguards and creates an essentially risk-free business environment for utilities. Shareholders are held harmless by the ratepayers from all economic risks, and yet they retain the benefit of the regulatory compact through an assured return on their investment. The

regulatory replication of the market would be removed and utilities would become unique among business entities, in that, as monopolies, they would reap unregulated private sector profits without any offsetting private sector risks. Their return would be based on the money they spend, not on the service they provide. There is no justification for granting a private business enterprise such a protected status.

This is particularly true because the purported goals of the legislation, encouraging efficiency, modernization of the grid, continued investment by utilities and jobs creation, will not be accomplished through this bill. If anything, this bill encourages inefficiency, and may, in the end, cost more jobs than it creates. If our goal is to spur the economy and create jobs in a way that provides true benefits to consumers and businesses in this state, there are better, and fairer ways to achieve that goal. I'll offer a few suggestions along the way.

1. The Regulatory Changes Set Forth in the Bill are not Needed to Ensure Investment in Energy Efficiency, Renewable Energy or Infrastructure.

The language of the bill suggests that these changes are needed in order for the utilities to continue to invest in energy efficiency (EE), renewable energy (RE) and infrastructure improvements. However, the recently-enacted provisions of P.L 2007, c.340, commonly referred to as the Regional Greenhouse Gas Initiative or "RGGI," which amended Title 48 to allow utilities to invest in energy efficiency and renewable energy, also permit the recovery of costs for those programs without the need for a full rate case. The mechanism that the Board

has approved to date in EE and RE cases allows the utilities to recover their costs (including an appropriate return on investment) through separate charges on ratepayer bills. No utility has been asked to wait to recover until the next rate case. Under RGGI, cost recovery mechanisms for EE and RE programs are approved up front, at the same time the program itself is reviewed and approved. Thus, this bill has nothing to do with increasing investments in energy efficiency or renewable energy. Rather it extends a similar mechanism – although one with even less protection for ratepayers – to traditional utility investments such as pipes and wire.

However, these regulatory changes are not necessary to ensure that the utilities continue to invest in traditional utility infrastructure. The existing regulatory framework has historically supported necessary and prudent infrastructure development and expansion for all regulated utilities. While recovery of investments in “pipes and wires” has traditionally awaited a rate case, they are almost always recovered as long as they are prudently incurred. Recent upheaval in the capital markets has not changed this, and does not justify the abandonment of rate regulation as encompassed in this bill. At times like this, utilities often are viewed as safe havens, far less risky than other investments, and thus they continue to be able to access the capital markets. Indeed, PSE&G was able to borrow \$250 million a couple of weeks ago and Atlantic Electric borrowed \$275 million earlier in November. Even if they were unable to borrow capital, or were required to pay higher rates, the current system provides mechanisms through which utilities may petition the BPU for relief in order to

make sure they can make the investments necessary to maintain their systems. If a greater investment was needed the Board could consider alternatives between rate cases to provide the necessary regulatory certainty. Dispensing with rate regulation is therefore not necessary to allow the utilities to access the capital markets.

2. The Bill Removes any Requirement or Incentive for the Utility to Spend Ratepayer Money Wisely

What this bill will do, however, is allow a return on imprudent or unnecessary investments. Unlike the provision in RGGI for EE and RE programs, this bill eliminates any review by the Board of the reasonableness of utility spending. Under the RGGI provisions, the program itself must be approved by the Board, which includes an analysis of the costs and benefits of the proposed program, and an analysis to ensure that the costs of the program are prudent. This bill eliminates any such review for traditional utility investment. Instead, the utility will propose the types of investments that would be paid for through formula rates, and may submit a forecasted budget for the upcoming year, but specific expenses will not be reviewed to ensure that they are reasonable. Thus, if the utility decides to build a new or duplicate substation, it may do so in the most expensive way possible, and the Board will be powerless to rein in their spending.

While Section 3(d) references the concept of just and reasonable rates, the procedure set forth in that section for reviewing the initial petition will not

provide a meaningful review because specific projects and costs will not be specified, and the statute provides insufficient time for discovery or evidentiary hearings as part of that process. The annual true-up will not provide that opportunity either, as that review only looks at over and under-recovery of the utility's actual expenditures. Thus, the utilities will be able to spend whatever they choose without any scrutiny, and will have no incentive to control costs.

The legislative findings discussing smart grid provide a good illustration of this problem. The fact is that "smart grid" means many things. Some aspects of "smart grid" will result in operational savings that exceed the costs. Under the current system, there is an incentive for the utilities to undertake those projects, as they will reap the benefits of those savings. Other spending that could be characterized as being for "smart grid," relates to projects that cost more than the benefits they provide. This bill will encourage spending for those projects even though they are not cost-effective. This is because the ratepayers will be paying the costs while the utility retains the savings. I submit that even – or particularly - in these economic times, we do not want to encourage spending that is not cost effective.

Not only will the utility's spending be unchecked, but their profit will be tied not to their level of service, or whether they operate an efficient system, but to how much they spend. Thus, this bill actually provides an incentive for the utilities to overspend. If they do buy gold-plated infrastructure, their profits will be calculated off of the higher investment cost. The bill therefore creates a disincentive for the utilities to operate efficiently.

3. The Regulatory Changes in the Bill will not Create Jobs, and May Result in Job Losses

It is likely that this bill may cost more jobs than it will create. Many of the state's large and small commercial and industrial energy users cannot afford significant additional rate increases. You will hear today about businesses that may be forced to close their New Jersey facilities in part due to the high cost of electricity in this State. In short, by passing this bill, the Legislature will be choosing to maximize the return for one industry at the expense of other businesses throughout the state. While it is difficult to quantify the job gains or losses that will result from this bill, the job losses that may result if businesses cannot afford the subsequent unregulated increases in electricity and gas prices may outnumber any increased short term hiring by the utilities.

In addition, if the utility investments are used for "smart grid," some projects that are often characterized as "smart grid," such as Advanced Meter Infrastructure, or AMI, provide operational savings because they require fewer employees to, for example, read meters. While some utilities have stated their intention to redeploy workers whose jobs are eliminated in this way, not all have, and some net loss in jobs may occur. This factor also needs to be taken into consideration when assessing the job-creating potential of this bill. Overall, if we are going to spend the limited amount of ratepayer or public money that we can afford to create jobs in the utility sector, we are much better off spending that money on energy efficiency programs. These programs will actually create jobs

and save businesses and consumers money overall. Over time, energy efficiency will hopefully create downward pressure on energy prices by lowering overall demand. This is the goal of the recent Energy Efficiency initiative announced by the Governor which is aimed at creating jobs and meeting the Energy Master Plan goals, and is a far better focus for our scarce ratepayer and public dollars.

4. The Regulatory Changes in this Bill Far Exceed FERC Transmission Formula Rates and are Unprecedented on the State Level

The Legislative findings suggest that the provisions of this bill are modeled on the formula-based rates “used by utilities in the region served by PJM Interconnection, LLC.” It is important to note that no other states in the PJM area have adopted formula rates on a state level such as that proposed in this bill. The only states that have adopted formula rates on the state level are Alabama, Louisiana, Mississippi, and South Carolina. Even in those states, consumers receive greater protections from, for example, setting a baseline through a full base rate case conducted prior to utilizing formula rates (South Carolina), establishing performance benchmarks (Mississippi), and caps on the amount of increases permitted in consecutive years (Alabama).

Proponents of the bill have also cited the formula-based rates for transmission costs permitted by the Federal Energy Regulatory Commission (FERC) as a model for the regulatory changes proposed in this bill. But again, this bill goes far beyond what is allowed on the federal level. For costs

associated with the construction of transmission lines, an application for formula rates is not even made to the FERC unless the construction of those lines has already been reviewed and deemed necessary by PJM. Thus, the necessity of building the lines in the first place is not determined by the utility that will profit from it, but by an independent system operator that is charged with managing the regional grid. Once PJM determines that a line is needed to ensure reliability, the utility may then apply to the FERC for formula-based or incentive rates. In that proceeding, objectors have the ability to challenge the project costs and the utility's rate request. This is far different than the process proposed in the bill, where there is no such opportunity.

5. The Regulatory Changes in the Bill Will Lead to More Frequent Rate Increases and Price Volatility

Under this bill, distribution rates are likely to go up every year. Previously, utilities were granted relief from volatile commodity prices by allowing those costs to fluctuate each year without a rate case, but commodity costs, unlike distribution costs, are not determined by the utility but by the markets. This bill will add volatility to the distribution portion of ratepayers' bills. It will also lead to less frequent or no rate cases, as the factors that would lead a utility to file a rate case, *i.e.*, a need for more revenue, or a loss of earnings, will be addressed by the utilities' unilateral decision to spend, and the consequent application of formula-based rate increases. There is also no mechanism to credit to ratepayers any overall cost savings a utility may have as a result of these

investments, or other cost-saving factors, between rate cases. Thus, ratepayers will see steady and frequent rate increases and will have less frequent opportunities to conduct a comprehensive review to determine if utility rates are just and reasonable.

6. The Bill Conflicts with Several Other Statutes and Unconstitutionally Infringes on Due Process Protections

There are many legal issues raised by this bill. The bill explicitly exempts utilities seeking formula based rates from the provisions of N.J.S.A. 48:2-21, which authorizes the Board to set just and reasonable rates and requires hearings and public notice of rate increases. While the Legislature may alter a statute in a subsequent statute, the requirement that rates be “just and reasonable,” are constitutionally based, and cannot, and should not, be eliminated. Nor may the Legislature dispense with the requirement of a hearing. Under the Constitution and the Administrative Procedure Act, the public has a right to a hearing before rates are increased and a right to an evidentiary hearing when those rates are contested. Yet the bill specifically waives the hearing requirement in N.J.S.A. 48:2-21, and requires final orders in shortened review periods (four months for the initial petition and 90 days for the “true-up”) that preclude any meaningful due process. Meaningful review is also hampered by basing the initial review of these rates on the utility’s forecasted budget or audited books, using accounts that may be six years old. Finally, the bill precludes the Board from denying a utility’s application for formula rates, even if

the Board views those rates as unjust or unreasonable. Although the Board has limited authority under the bill to modify the “amount” a utility seeks, it cannot deny the request for formula rates or limit the items that may be incorporated into a utility’s rates through application of the formula.

The bill is also inconsistent with RGGI. As noted above, under Section 13 of RGGI, the Board must approve utility Energy Efficiency and Renewable Energy programs as well as the proposed cost recovery mechanism. This bill, however, would allow spending for the “promotion of energy efficiency and renewable energy goals” without a prior review by the Board of whether the program is prudent.

7. Changes of this Magnitude should not be Done Without a Careful and Thorough Review Particularly in the Midst of Economic Upheaval.

There is no denying that the current financial climate is extremely uncertain. However, given this uncertainty, legislators and regulators should be even more cautious about adopting a new form of regulation. They should not overreact to current financial conditions but should go slowly and understand all the impacts before jumping into something new. Ratepayers are also facing uncertain times. It is not the best time to force a new regulatory scheme on them, especially one that will result in more frequent rate increases and therefore greater volatility of rates. In this regard, the bill calls for a study by the Board of the experience with formula-based rates and recommendations concerning

whether the provision of the bill should be extended or repealed. A study of this kind should precede consideration of this bill, not follow it.

In addition, if what we seek to do is find a way to encourage utility investment to spur economic growth and create jobs, the better way is to focus on the recent Energy Efficiency initiative proposed by the Governor and currently under discussion at the Board. Investment in Energy Efficiency will create jobs for plumbers, electricians, building contractors and utilities. It has the benefit of lowering costs, so that the customers participating in the programs can pay at least a portion of the costs out of the savings. Energy Efficiency may help reduce the need for new generation and ultimately lower costs by lowering demand. These are also worthwhile programs that might not be funded if not encouraged by the government or backed by ratepayers.

Utilities are already obligated to maintain their systems and they will invest in cost-effective infrastructure as those investments improve their system and ultimately are incorporated into their rate base and are included in the calculation of a reasonable return. This bill is not needed to encourage cost-effective investment in utility infrastructure; it merely protects the utility shareholders from investments that are not cost-effective. That is not something the businesses and consumers in this state – who are already struggling to pay their bills – can afford right now. I therefore urge this committee not to pass S.2428.

Thank you for the opportunity to testify. I am happy to answer any questions you may have.