AGENDA DATE: 7/25/03
AGENDA ITEM: LSB

STATE OF NEW JERSEY

Board of Public Utilities
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ENERGY

IN THE MATTER OF THE PETITION OF ATLANTIC CITY ELECTRIC COMPANY FOR AN ADMINISTRATIVE DETERMINATION OF THE VALUE OF CERTAIN FOSSIL GENERATION ASSETS	FINAL DECISION AND ORDER DOCKET NO. EO03020091
IN THE MATTER OF THE ATLANTIC CITY ELECTRIC COMPANY – RATE UNBUNDLING, STRANDED COSTS AND RESTRUCTURING FILINGS	DOCKET NO. EO97070455, EO97070456 AND EO97070457

(SERVICE LIST ATTACHED)

BY THE BOARD:

This Final Decision and Order is a follow-up to the Board of Public Utilities' ("Board" or "BPU") April 21, 2003 Order ("April 21, 2003 Order") in the above docketed matters. Specifically, this Order addresses various issues raised in Atlantic City Electric Company's ("ACE" or "Company") January 31, 2003 petition in BPU Docket No. EO03020091, supra, including, among other things, the Company's request for a determination and quantification by the Board of a portion of the recovery-eligible stranded costs associated with ACE's investment in its B.L. England Generating Station ("B.L. England"). This Order also addresses issues concerning the appropriate rate of return to be allowed on B.L. England beginning April 21, 2003, which rate was made interim as of that date by the Board's April 21, 2003 Order.

BACKGROUND

The background to these issues is extensive and has already been set forth in some detail in prior Board Orders. However, for the sake of completeness and to put the instant issues in proper context, a brief recapitulation is set forth below.

On February 9, 1999, the Electric Discount and Energy Competition Act ("EDECA"), N.J.S.A. 48:3-49 et seq. was signed into law. Among other things, EDECA required the Board by Order, to provide that by no later than August 1, 1999, each electric public utility provide retail choice of electric power suppliers for its customers, N.J.S.A. 48:3-53(a); reduce its aggregate level of rates for each customer class by no less than five percent, N.J.S.A. 48:3-52(d)(2); unbundle its

rate schedules and establish so-called "shopping credits" applicable to customers who choose alternative electric power suppliers, N.J.S.A. 48:3-52(a); implement a Societal Benefits Charge ("SBC") to recover the cost of previously approved social, environmental and demand side management programs which were included in each utility's unbundled rates, N.J.S.A. 48:3-60(a); and implement a Market Transition Charge ("MTC") to allow each utility the opportunity to recover an approved level of stranded costs as determined by the BPU. N.J.S.A. 48:3-61(a) (c) (i) and (j).

EDECA also required that for at least three years, and thereafter until the Board specifically finds otherwise, each electric public utility provide, at prices regulated by the Board, Basic Generation Service ("BGS") to customers who have not chosen an alternate electric power supplier. Further, EDECA permits, but does not require, electric public utilities to either functionally separate or divest to an unaffiliated company, all or a portion of their electric generation assets, subject to Board approval upon a finding by the Board that certain conditions are met. N.J.S.A. 48:3-59. Thus, EDECA gives the electric utilities the flexibility to make economic business decisions regarding the sale of their generation assets and the purchase of energy and capacity to meet the electricity needs of their customers.

In May 1999, ACE's then parent Company, Conectiv, announced that it intended to sell certain nuclear and fossil generation assets owned by its wholly owned utility subsidiaries, ACE and Delmarva Power & Light Company ("Delmarva").[1] Conectiv indicated that its decision to divest ACE's and Delmarva's generation assets was motivated by, among other things, the development of an active market for the sale of electric generation units, its strategic business plans, and the passage of EDECA.

Pursuant to EDECA, on July 15, 1999, the Board issued a Summary Order adopting, with significant modifications, a Stipulation of Settlement ("Stipulation") in ACE's rate unbundling, stranded cost and restructuring proceeding. I/M/O Atlantic City Electric Company – Rate Unbundling, Stranded Costs and Restructuring Filings ("Restructuring Proceedings"), BPU Docket Nos. EO97070455, EO97070456 and EO97070457 ("Summary Order"). The Summary Order approved ACE's unbundled rates and the various components to be embedded in rates pursuant to EDECA, including delivery and BGS rates, as well as non-bypassable SBC and MTC charges. The Stipulation provided, among other things, that, subject to certain conditions, and Board approval, ACE would divest itself of its interests in its nuclear generation assets, as well as its fossil generation assets, which included its 100% interest in B.L. England, its 3.83% interest in the Conemaugh Generating Station ("Conemaugh"),[2] its 2.47% interest in the Keystone Generating Station ("Keystone"),[3] and that the net proceeds of the divestiture would be used to determine ACE's generation-related stranded costs. The Summary Order also approved, subject to certain conditions, the Company's proposal to transfer its 100% interest in the Deepwater Station ("Deepwater") to an unregulated affiliate of the Company, but required that the transfer value be set at net book value, thereby resulting in zero stranded costs associated with the transfer.

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[1] Delmarva is an electric and gas utility serving parts of Delaware, Maryland and Virginia.

[2] Conemaugh is jointly owned by ACE, Baltimore Gas & Electric Company, Delmarva Power & Light Company, Pennsylvania Power & Light Company, PECO Energy, Potomac Electric Power Company, Sithe Energies, Inc., and UGI Utilities, Inc.

[3] Keystone is jointly owned by ACE, Baltimore Gas & Electric Company, Delmarva, Pennsylvania Power & Light Company, PECO Energy, Public Service Electric and Gas Company, and Sithe Energies, Inc.

On March 30, 2001, the Board issued its Final Decision and Order ("Final Order") in the Restructuring Proceedings, which provided more detail and reasoning for the Board's summary decision. The Final Order also provided guidance with respect to the planned divestitures generally, including how the stranded costs of the divested units would be determined. (Final Order at 79-82, 89-92). The Final Order also set forth the accounting treatment for the to-be divested generating assets (which were to be used to provide BGS service prior to divestiture) and the revenues received therefrom, between August 1, 1999 and the completion of the divestitures, which accounting treatment included a 13.0% pretax return on investment. (Id. at 92, paragraph 22).

On November 23, 1999, ACE filed a petition seeking Board approval of the sale of its minority interests in the Salem Nuclear Generating Station, Units 1 and 2, the Peach Bottom Atomic Power Station, Units 2 and 3, and the Hope Creek Nuclear Generating Station to PSE&G Power, LLC and PECO Energy Company. By Order dated July 21, 2000, the Board approved the sale. By separate Decision and Order dated September 17, 2001, the Board determined the amount of recovery-eligible stranded costs associated with the sale.[4]

On February 9, 2000, ACE filed a petition requesting that the Board approve the sale of the Company's 100% interest in B.L. England, its 3.83% interest in Conemaugh, its 2.47% interest in Keystone, and related assets (collectively, "the Fossil Assets") to NRG Energy, Inc. ("NRG") for $178.4 million subject to certain adjustments*. I/M/O the Petition of Atlantic City Electric Company Regarding the Sale of Certain Fossil Generating Assets, BPU Docket No. EM00020106. The petition also requested that the Board make certain findings concerning Deepwater's eligibility for exempt wholesale generator ("EWG") status under Section 32 of the* Public Utility Holding Company Act ("PUHCA"). Although in its Summary Order the Board had authorized ACE to transfer Deepwater to an affiliate of the Company, ACE never transferred the plant, and now proposed to include that plant in its sale to NRG.

On March 29, 2000, the Board adopted a procedural schedule to allow interested parties the opportunity to review and provide input to the Board regarding the proposed sale of the fossil generation assets to NRG. The parties to the proceeding included Conectiv, ACE, Board Staff and the Division of the Ratepayer Advocate ("RPA").[5] The procedural schedule included an opportunity for the parties to propound discovery, participate in a public/legislative-type hearing, and submit post-hearing comments and reply comments to the Board. On June 7, 2000, the Board revised the procedural schedule to allow additional time for the parties to provide discovery and extended the remaining procedural schedule accordingly. Both Board Staff and the RPA propounded discovery on the Company.

On June 22, 2000, Commissioner Frederick F. Butler presided over a public/legislative-type hearing at the Board's offices concerning the proposed sale of the Fossil Assets to NRG. At the hearing, the Company presented testimony by Thomas S. Shaw, Executive Vice President of the Company and its parent company, Conectiv; Donna Powell, Financial Services Coordinator for Conectiv; Charles Mannix, Manager of Taxes for Conectiv; and James M. Coyne, Managing Director, Navigant Consulting. Board Staff and the RPA cross-examined ACE's witnesses on a number of issues regarding the proposed sale to NRG, including the sale process, the sale price and reliability issues. The RPA opposed ACE's petition and expressed its concerns with

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[4] I/M/O the Petition of Atlantic Electric Company Regarding the Sale of Nuclear Assets, Docket No. EM99110870. The recovery-eligible stranded costs were subsequently securitized on December 19, 2002, pursuant to the Board's Bondable Stranded Costs Order issued in Docket No, EF01060394 on September 20, 2002.

[5] NRG subsequently also became a party to this proceeding.

respect thereto to the Board. The RPA was critical of the absence of a parting contract between ACE and NRG for the sale of power to ACE, similar to an agreement that had been negotiated between NRG and Delmarva. The RPA contended that, in the absence of a parting agreement, ACE's customers would be exposed to undue supply and price risks during the transition to a fully competitive supply market. The RPA argued that the issues presented required the Board to conduct full evidentiary hearings prior to deciding the matter.

On July 7, 2000, the Board received written comments from the Company and the RPA. These parties also submitted reply comments to the Board on July 14, 2000.

On April 12, 2001 ACE amended its filing to include a proposed Master Power Purchase and Sale Agreement ("PPA") between itself and NRG Power Marketing, Inc., an affiliate of NRG, for the purchase by ACE of 400 megawatts ("mW") of unforced capacity and associated firm energy from NRG Power Marketing Inc. for the period commencing on the closing of the sale through August 31, 2002. By letter dated April 16, 2001, ACE supplemented its amended filing with additional documentation relating to the PPA.

By letter dated May 25, 2001, the RPA provided its comments regarding the PPA. The RPA asserted that the terms of the PPA compared poorly to those of the parting contract that NRG had negotiated with Delmarva. The RPA further asserted that New Jersey customers would receive even less value from the sale as the result of the costs associated with the PPA, and that the terms of the PPA were not prudent or reasonable. The RPA argued that the amount of contracted-for energy and capacity and the limited duration of the PPA through August 31, 2002 would not adequately protect customers.

At its public agenda meeting on June 20, 2001, on its own motion, the Board determined to bifurcate the Company's petition and rule upon the Company's request that the Board make certain findings to enable Delmarva's ownership interest in certain fossil generation assets being sold to NRG qualify for eligible facilities status under Section 32 of PUHCA.[6] Delmarva's fossil generation assets that were being sold to NRG consisted of Delmarva's interest in Conemaugh, Keystone, the Indian River Station and the Vienna Station (collectively, "Delmarva Fossil Assets"). By order dated June 21, 2001, the Board determined that allowing the Delmarva Fossil Assets to be eligible facilities, pursuant to Section 32 of PUHCA, will benefit New Jersey consumers, is in the public interest and does not violate State law.

By letter dated July 27, 2001, ACE informed Board Staff that the Company had received a letter dated July 11, 2001 from the New Jersey Department of Environmental Protection ("DEP") advising ACE that the DEP had denied the Company's request to continue to burn up to 2.6 percent sulfur coal at Unit 1 of B.L. England after July 31, 2001. Although ACE indicated that it was trying to resolve this matter with the DEP, the Company expressed concern that any continued operation of Unit 1 beyond that date would violate DEP permit requirements.

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[6] The sale of the Delmarva Fossil Assets did not require Board approval since Delmarva is not a New Jersey public utility. However, the Company maintained that, as a condition to closing, NRG had to qualify as an exempt wholesale generator ("EWG"). EWG's are exempt from regulation under PUHCA. Section 32(a) of PUHCA defines an EWG as "any person determined by the [FERC] to be engaged directly, or indirectly through one or more affiliates . . . and exclusively in the business of owning or operating, or both owning and operating, all or part of one or more eligible facilities and selling electric energy at wholesale. . . ." Because Delmarva is an affiliate of a New Jersey utility, in order for its fossil generation assets to be considered eligible facilities by FERC under Section 32(c) of PUHCA, the Board had to make a specific determination that allowing such assets to be eligible facilities: (1) will benefit consumers; (2) is in the public interest; and (3) does not violate State law. . . ."

By letter dated July 30, 2001, ACE advised the Board that, on July 27, 2001, the DEP issued a 60-day stay of its fuel permit denial. By further letter dated August 2, 2001, ACE updated Board Staff on the operational status of Unit 1.[7]

At its public agenda meeting on October 25, 2001, on its own motion, the Board determined to reopen the record in this matter for additional proceedings before ruling on the Company's outstanding requests with respect to its petition. Specifically, the Board determined that additional proceedings, including an evidentiary hearing, would be necessary to: (1) supplement and update the record as to whether the proposed sale price of the Fossil Assets reflects the current market price; (2) review the fuel permit situation at B.L. England; and (3) provide the Company an opportunity to explain why it was proposing to sell its interest in Deepwater to NRG rather than transferring the facility to an affiliate, as the Company had previously requested and received Board approval to do, with modifications and subject to certain conditions in the Summary and Final Orders. The Board established a supplemental procedural schedule for the filing of additional testimony by the parties, including the opportunity to propound discovery, submit testimony, cross-examine witnesses in an evidentiary hearing, and submit post-hearing comments and reply comments to the Board. The Board's actions were memorialized in a letter from the Board Secretary dated October 25, 2001.

On November 7, 2001, ACE filed supplemental testimony and exhibits. Among other things, the supplemental testimony included additional amendments to the PSAs between ACE and NRG, extending the agreements through February 28, 2002. The testimony also provided information relating to the permit status of B.L. England and the proposed transfer of Deepwater to NRG.

The RPA propounded discovery with respect to the Company's supplemental filing. On December 3, 2001 and December 4, 2001, the RPA filed confidential and redacted versions of its supplemental testimony.

On December 11, 2001, Commissioner Frederick F. Butler presided over an evidentiary hearing held at the Board regarding the pending sale of the Company's Fossil Assets to NRG.[8] At the hearing, the Company presented supplemental testimony in support of its amended filings by Thomas S. Shaw and James M. Coyne, as well as testimony by D. Bruce McClenathan, Director of Generation for Conectiv, Mark W. Finfrock, Director of Risk Management for Conectiv, Craig A. Mataczynski, President and Chief Executive Officer of NRG North America, and F. Reed Wills, Vice President, Mid-Atlantic Region of NRG North America. The RPA presented testimony by Paul Chernick of Resource Insight, Inc., who asserted that B.L. England was worth more than NRG was prepared to pay on the open market. The Company, Board Staff and the RPA cross-examined the witnesses. The Company and the RPA filed initial supplemental comments on December 21, 2001 and reply comments on January 4, 2002. NRG also filed comments on January 4, 2002 in response to the RPA's initial comments.

By Decision and Order dated February 20, 2002, the Board approved the sale of ACE's Fossil Assets, including Deepwater, to NRG. The Board also determined that allowing the Fossil Assets to be eligible facilities, as defined by Section 32 of PUHCA, would benefit New Jersey consumers, was in the public interest and did not violate state law. The Board specifically

[7] Subsequent 60-day stays were issued by the DEP. By letter dated May 29, 2003, the DEP eventually issued a certificate to operate Unit 1 for three years (through July 30, 2006), as well as a permit addendum to test burn lower sulfur coal.

[8] Then-President Connie O. Hughes also attended portions of the hearing.

indicated that this determination was based on the facts of the NRG transaction that were presented and would not set precedent for any future requests by ACE or any other company for similar determinations for other transactions. However, by letter dated April 1, 2002, NRG exercised its option to terminate the purchase agreement.[9]

Following NRG's termination of the agreement to purchase ACE's ownership interests in the fossil generation assets, in May 2002 ACE determined to re-offer the units for sale via an auction process. The auction process was conducted during the summer and fall of 2002.

Although four bids were received for Keystone and Conemaugh, only one bid for B. L. England was received. Moreover, the B.L. England bidder required capacity payments as part of a 10-year purchase power agreement, or "parting contract." The capacity payments made the B.L. England bid substantially negative (a net payment to the bidder on a net present value basis). It appears that economic conditions generally, and a deteriorating market for generating assets in particular, as well as B.L. England's high operating costs and continuing air quality issues, likely contributed to a lack of bidder interest and the low bid, as compared to previous sale prices for coal plants. ACE rejected the bid for B. L. England. The Company also rejected the bids for Keystone and Conemaugh, which, while above book value, did not, in the Company's judgment, fully reflect the true market value of these units. Thus, on January 13, 2003, the Company announced that although it remained interested in selling the Fossil Assets on acceptable terms, it had rejected all bids and had terminated the auction process.

PROCEDURAL HISTORY

On January 31, 2003, ACE filed the within petition seeking the Board's determination and quantification of a portion of the stranded costs associated with B.L. England. The Company estimated that B.L. England's stranded costs were $151.4 million. ACE indicated that it intended to separately file for approval to securitize the stranded costs associated with B.L. England.

ACE's inability to market B.L. England at an acceptable price and the uncertainty as to when, if ever, it would be divested, together with B.L. England's high operating costs compounded by environmental uncertainties, led the Board to question whether a return as high as 13% could continue to be justified. Accordingly, on February 5, 2003, the Board issued an Order Seeking Comments in ACE's restructuring dockets, to consider the issue of whether the ratemaking treatment set forth in the Final Order should be prospectively modified pending the Board's decision on the Company's securitization petition, which at that time had not yet been filed.[10]

Specifically, the Board's February 5, 2003 Order sought comments on the following options:

1) Amortization of the Company's B. L. England investment over an appropriate term, and at an appropriate debt rate;[11]

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[9] On May 14, 2003, NRG Energy, Inc., and certain of its U.S affiliates, filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. In re: NRG Energy Inc. et al., Case No. 03-13024.

[10] Subsequently a petition to securitize the B.L. England stranded costs was filed by ACE on February 14, 2003. I/M/O the Petition of Atlantic City Electric Company for a Bondable Stranded Costs Rate Order in Accordance with N.J.S.A. 48:3-49 et seq., BPU Docket No. ER03020121 ("securitization petition").

[11] Mirroring a securitization transaction, similar to the ratemaking treatment previously accorded to Jersey Central Power & Light Company's ("JCP&L's") Oyster Creek nuclear unit prior to securitization. I/M/O Jersey Central Power and Light Company, d/b/a/ GPU Energy - Rate Unbundling, Stranded Costs and Restructuring Filings, Docket Nos EO97079458 et al. (dated March 7, *2002).*

2) Reducing the currently-allowed 13% pre-tax return to provide for the recovery of the Company's embedded debt cost, or embedded debt and preferred costs, with no, or a reduced, allowance for common equity return;

3) Continuing the current ratemaking treatment, but capping it by pricing the B.L. England generation at the energy and capacity component of the BGS auction price (i.e., the dollar amount of B. L. England costs recoverable from ratepayers would be the lesser of the capped amount or the station's revenue requirement as currently calculated by the Company); or

4) Such other option as the Board may consider and approve after reviewing the Company's and the RPA's responses to its Order.

The Company and the RPA filed comments on February 18, 2003. After review of the comments, and in light of the changed circumstances regarding the divestiture of B.L. England and its high operating costs, on April 21, 2003, the Board issued an Order Setting Interim Rates ("April 21, 2003 Order"), making the allowed return on the Company's investment in B.L. England interim as of the date of the Order pending final Board action after hearings on the pending B.L. England matters.[12]

On May 1, 2003, the Company filed a Motion for Reconsideration, requesting that the Board reverse its April 21, 2003 decision. On May 8, 2003, Commissioner Connie O. Hughes, the Commissioner designated to preside over the hearings, issued an Order setting forth the schedule to be followed and issues to be addressed by the parties ("Procedural Order"), including:

(a) the appropriate return to be earned by ACE on the B.L. England plant on and after April 21, 2003;

(b) the valuation of stranded costs associated with the B.L. England plant;

(c) appropriate financing alternatives for recovery-eligible stranded costs; and

(d) measures that can and should be taken by the Company, consistent with its obligation to provide safe, adequate and proper service at just and reasonable rates, to ensure that by a date certain to be determined by the Board, the B.L. England plant will no longer be on the utility's books or recoverable in utility rates.

[Procedural Order at 2].

On May 19, 2003, ACE filed a letter with the Board seeking a decision on its Motion for Reconsideration and also reconsideration of the Procedural Order. The Board denied ACE's reconsideration motions by Order dated June 20, 2003.

Pursuant to the timetable set forth in the Procedural Order, the Company filed testimony by Thomas S. Shaw (Executive Vice-President of Pepco Holdings, Inc. and President of Conectiv), Anthony J. Kamerick (Vice-President and Treasurer of Pepco and Treasurer of ACE), Gary L.

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[12] I/M/O Atlantic City Electric Company - Rate Unbundling, Stranded Cost and Restructuring Filings, BPU Docket Nos. EO97070455, EO97070456 and EO97070457, Order Setting Interim Rates (dated April 21, 2003).

Hanson (Finance Director for Conectiv and Assistant Treasurer and Assistant Secretary of ACE), Robert B. Hevert (President of Commonwealth Energy Advisors, Inc.), and Paul R. Moul (Managing Consultant of P. Moul & Associates). The RPA filed the testimonies of Paul Chernick (President of Resource Insight, Inc.), Andrea Crane (Vice-President of the Columbia Group) and James A. Rothchild (President of Rothchild Financial Consulting). Subsequently, ACE filed rebuttal testimony on June 12, 2003. On June 17, 2003 the Company moved to strike portions of the testimony of Paul Chernick.

An evidentiary hearing was held before Commissioner Hughes on June 19, 2003. During the hearing, Commissioner Hughes ruled upon various motions, including ACE's motion to strike certain portions of the RPA's prefiled testimony. These rulings are HEREBY AFFIRMED by the entire Board, essentially for the reasons set forth by Commissioner Hughes in the transcript. Initial Briefs were filed by the Company and the RPA on July 8, 2003, and by Board Staff on July 10, 2003. Reply Briefs were filed by the Company and the RPA on July 17, 2003.

POSITIONS OF THE PARTIES

The positions of the parties on the various issues are summarized briefly below:

1) Return on B.L. England on and after April 21, 2003

ACE

ACE asserts that its investment in B.L. England should continue to earn the 13.0% pre-tax return allowed on all of its to-be-divested generating units by the Board's Summary and Final Orders in the restructuring dockets. According to Company witness Shaw, these Orders reflect a commitment by the Board based upon a proposal presented by the Board's own Staff and arrived at after resolving issues addressed by two competing settlements. Mr. Shaw testified that not only was the Company's investment in B. L. England reasonable and prudent when the plant first entered service 40 years ago, but it remains so today, in that the plant continues to be used and useful in enabling the Company to fulfill its obligation to provide safe, adequate and proper service at just and reasonable rates. As further support for this position, Mr. Shaw noted that the Board found no fault with either the plant's market or book value in its Order approving the aborted sale to NRG.[13] Mr. Shaw further testified that the mere fact that the plant's average cost may be higher than the average costs of other plants is no basis for modifying the ratemaking treatment previously established. Finally, ACE asserts that the plant currently provides reliability benefits in the region it serves, and if it were to be retired in the absence of replacement generation, additional transmission improvements would be needed to meet reliability criteria. (Exhibit P-2 at 3:5 to 7:14).

In rebuttal to the RPA, ACE asserts that short-term debt was not used as permanent financing for the 2002 acquisition of Conectiv by Pepco Holdings, Inc. ("Pepco"). ACE maintains that the debt that would be retired from using the proceeds of a securitization of B.L. England stranded costs would be ACE's own long-term debt issues (and possibly preferred stock), not Pepco's short-term debt. Additionally, ACE noted that Pepco's 10-Q filed with the Securities and Exchange Commission ("SEC") on November 13, 2002 indicated that the $1.462 billion Pepco/Conectiv merger was financed by equity, and the balance of $700 million by a bridge loan, which in September 2002 was replaced by permanent intermediate and long-term debt

[13] Docket No. EM00020106, I/M/O the Petition of Atlantic City Electric Company Regarding the Sale of Certain Fossil Generation Assets, Order dated February 20, 2002.

having maturities of from 5 to 30 years, and bearing interest at rates ranging from 5.50% to 7.45%. (Exhibit P-5 at 2:14 to 3:13).

RPA

RPA witness Rothchild asserts that ACE is effectively financing its B.L. England investment using short-term debt. While conceding that the financing of B.L. England cannot be traced to a specific financing instrument, he contends that B.L. England is being financed using short-term debt because Pepco, ACE's ultimate corporate parent, carries a very high level of debt on its books, relative to equity. He assumes that when it acquired Conectiv, Pepco incurred excessive debt[14] in anticipation of retiring a portion of this debt in the short term with the proceeds from either the sale of B.L. England or securitization of its stranded costs. Therefore, the RPA asserts that the return on B.L. England's investment on and after April 21, 2003 (until permanent financing is established) should be limited to the actual cost of the Company's short-term debt. More specifically, the return should be re-established monthly at a rate equal to Pepco's actual cost of short-term debt. (Exhibit RA-7 at 4 through 18; Tr. 6/19/03 at 136:18 to 137:20).

Staff

In its Initial Brief, Staff agreed with the Company that for purposes of this proceeding, the B. L. England investment should be assumed to be financed in proportion to the Company's overall capital structure, and at the embedded cost rates of the debt and preferred components of the capital structure. Staff recommended that the Board limit the allowable return on the B. L. England investment to just those components, *i.e.*, that the Board disallow any return on the common equity component. Based on the data supplied by the Company in response to the February 5, 2003 Order (the Company's capital structure and embedded costs as of September 30, 2002), Staff calculated that this would reduce the 13.0% pre-tax return to a pre-tax return of 3.86%. In dollar terms, the reduction, including the income taxes on the common equity component, would be about $17.3 million annually ($24.6 million less $7.3 million, as indicated in the April 21, 2003 Order). Even with this reduction, however, and a projected increase in the plant's generation to a presumably more normal level of approximately 1,500 gigawatt hours ("Gwh") per year,[15] the plant's remaining revenue requirement would still likely substantially exceed the revenue received from the sale of its generation. In fact, that revenue is not likely to be sufficient to even cover the plant's operating costs (essentially fuel and O&M costs), which the data supplied in response to the February 5, 2003 Order indicates are about 5.45 cents per kwh, as compared to the energy and capacity component of the auction price paid for BGS supply during the twelve months ended July 31, 2003 (4.65 cents per kwh).

Staff further asserts that, in addition to the reasons advanced by the Board in the February 5 and April 21, 2003 Orders as to why a change in the pre-divestiture ratemaking treatment accorded B. L. England can and should be considered, such a reduction would be in accordance with N.J.S.A.48:3-61(e), which, in pertinent part states that "in fixing the level of the

[14] Total debt (short-term as well as securitized and non-recourse debt) of approximately 70% of capital, or equivalently, an equity ratio approaching the SEC's minimum of 30%.

[15] The plant's generation was inadvertently omitted from the data to be supplied in response to the February 5, 2003 Order. In response to a telephone request by Staff, the Company projected B. L. England generation of 1,534 Gwh for the 12 months ended July 31, 2003, based on actual generation through December 31, 2002, and projected generation for the balance of the period. In a subsequent update in response to a transcript request (Tr. 6/19/03 at 31:8 to 31:11), the estimate was revised to 1,507 Gwh, based on actual data through May 2003.

market transition charge, the board shall reach a determination as to the market value of…eligible assets [i.e., B. L. England]…and may reflect a reduced return, if any, on investment in quantifying stranded costs which the Board determines to be reasonable given the changes in capital costs or risks to the utility, or to reflect the impaired value of the uneconomic generating assets to ratepayers." Staff notes that the ratemaking treatment previously approved for JCP&L's Oyster Creek plant is consistent with this provision. [16]

2) Valuation of B.L. England's Stranded Costs

ACE

ACE asserts that B.L. England has no value in the current market for generating assets. In support of its claim, the Company proffered the testimony of Robert B. Hevert, the President of Commonwealth Energy Advisors. In his testimony, Mr. Hevert described the 2002 auction process used by the Company for marketing ACE's fossil generation assets. He testified that the Company solicited bids from a large number of qualified bidders, but received only one Final Bid for B.L. England. He calculated that this bid, which was contingent upon the execution of a ten-year PPA, had an estimated value of a negative $101.5 million.

In rebuttal to the RPA, ACE witness Hanson testified in support of both the level and the appropriateness of the allocation of the Company's transaction costs associated with its unsuccessful divestiture attempts. He asserts that $2,537,793 of the total transaction costs associated with the NRG sale were allocated equally between ACE and Delmarva and then the ACE share was divided four ways, with B.L. England assigned 25% of these costs.

Mr. Hanson also revised the Company's claimed stranded costs from $151,395,862 to $151,009,991. However, he also indicated that the Company plans to retain the benefit of the unamortized accumulated investment tax credits ("ITC") and excess deferred income taxes ("EDIT"), based on its interpretation of prior letter rulings issued by the Internal Revenue Service ("IRS") on similar issues. He conceded that the IRS has issued a proposed rulemaking that, if adopted, would allow continued amortization of the tax balances to cost of service.

RPA

Although ACE's petition sought Board approval for $151.4 million of B.L. England's stranded cost eligible for securitization, the RPA recommends adjustments that would reduce the amount to $145,805,368.[17] Specifically, RPA witness Crane recommends: (1) disallowance of $4,160,411 in transaction costs associated with ACE's unsuccessful NRG sale; and (2) disallowance of $1,222,053 in transaction costs associated with the failed 2002 auction. (Exhibit RA-10 at 10 to 21). She asserts that these costs are not directly attributable to the provision of generation service and therefore should not be considered stranded costs for the purposes of determining eligible stranded costs in this matter. Moreover, she contends that neither auction resulted in the divestiture of the Company's fossil assets and, with respect to the failed NRG sale, the Company failed to provide sufficient documentation to support the allocation of transaction costs to ACE, as opposed to Delmarva. Ms. Crane also proposes retaining the benefit of the unamortized balances of B.L. England's ITC and EDIT ($3,481,601 and $705,204,

[16] *See* footnote 11, supra and footnote 23 following.

[17] During the hearing it was established that this amount should be adjusted to reflect the after-tax impact of RPA witness Crane's recommended adjustments relating to transaction costs incurred in connection with the fossil sales. (Tr. 6/19/03 at 196:2 to 196:25).

respectively), for ratepayers, either through a reduction in stranded costs or continued flow-through to cost of service.

While seeking the above adjustments, the RPA, through testimony from witness Chernick, generally agrees with ACE that, at this time and under current market conditions, the market value of the B.L. England plant is zero. (Exhibit RA-9 at 5; Tr.6./19/03 at 177:11 to 177:13).

Staff

In its Initial Brief, Staff supported the RPA's position on the ITC and EDIT, and pending the outcome of the IRS' rulemaking, recommended that the unamortized balances of these tax benefits remain on the Company's balance sheet.

Staff also agreed that there could be an allocation issue associated with $2,537,793 of transaction costs, and until explored further, recommended that this amount not be included in stranded costs. Staff also reserved its opinion with respect to ACE's treatment of FAS-109 taxes pending receipt of the Company's response to an open transcript request.

3) Financing Alternatives for Recovery-Eligible Stranded Costs

ACE

Company witness Anthony J. Kamerick testified that because the proceeds of securitization can be used to retire common and preferred equity as well as higher cost debt without otherwise affecting the utility's capital structure, securitization is the financing mechanism that achieves the most significant customer savings. Moreover, assured recovery of principal and interest via nonbypassable collection charges to customers, as well as credit enhancements such as annual true-ups, an up-front capital contribution and overcollateralization, enable securitized debt to be rated triple A by the rating agencies, and thus sold at a lower coupon rate than alternative utility debt. These same characteristics in turn lead the rating agencies to eliminate securitized debt from their determinations of interest coverage and capital ratios when evaluating the utility's creditworthiness. New utility debt on the other hand, because it is not eliminated from such tests of creditworthiness, effectively can only be used to retire other debt issues if a targeted equity ratio is to be maintained, that is, if the equity ratio is not to be reduced, thereby potentially reducing credit quality. (Exhibit P-4, 1-19 to 5-16).

RPA

Although tying his recommendation to his contention that B. L. England is currently being financed wholly by the parent company's short-term debt, the RPA's financial witness, James A. Rothschild, agrees that securitization is the most economical way for ACE to permanently finance its B. L. England investment. Absent securitization, he asserts, Pepco Holdings would have to sell new equity to reduce its excessive debt, thereby driving up its cost of capital and the cost of financing B. L. England with such capital. (RA-7, 4-19 to 5-2; 14-4 to 13).

Staff

In its Initial Brief, Staff expressed its concern that a record on this issue had not been fully developed to date and indicated that it intended to explore this issue further in the ongoing securitzation proceeding (BPU Docket No. ER03020121).

4) Measures to be Taken by ACE Consistent with its Obligation to Provide Safe, Adequate and Proper Service at Just and Reasonable Rates, to Ensure that by a Date Certain to be

Determined by the Board, the B.L. England Plant Will No Longer be on the Utility's Books or Recoverable in Rates

ACE

ACE witness Shaw asserts that the RPA's sharing proposal described below would, under realistic plant sale price assumptions, prevent the Company from recovering a substantial portion of its capital expenditures, thereby providing a strong disincentive for making such expenditures to either reduce operating costs, or enhance the market value of the plant. Additionally, he contends the sharing proposal: (1) conflicts with IRS regulations governing ITC and EDIT; (2) fails to address the treatment to be accorded B.L. England's fuel and other inventories, the cost of terminating the scrubber lease and environmental remediation costs; and (3) is inconsistent with EDECA.

RPA

RPA witness Chernick proposes an equal sharing of the plant's operating costs (O&M, fuel, property taxes, allocated overheads, and tax benefits), net of the revenue received from the sale of the plant's energy, capacity and ancillary services, between ratepayers and shareholders. In this way and in exchange for the benefits of securitization, ACE's shareholders would share with ratepayers the risk and rewards of future operation of the plant, as well as the proceeds from any future sale. The RPA asserts that this measure provides a necessary added incentive for ACE to minimize costs.

Should B.L. England eventually be sold, under the RPA's proposal, ratepayers would receive all of the net proceeds up to the unamortized balances of the ITC and EDIT, with the excess shared between ratepayers and stockholders in proportion to the ratio of the amount securitized to the unamortized amount of the capital additions made by the Company. Prior to B.L. England's sale, capital additions would earn a return determined by the Board.[18] In the unlikely event the sale proceeds exceeded the amount securitized plus the capital additions, the RPA recommends that the excess be shared equally by ratepayers and stockholders.

Staff

In its Initial Brief, Staff supports the RPA's proposed sharing of B.L. England's net operating costs going forward with modifications, including limiting the sharing period to three years from the date of securitization or alternative financing/amortization of stranded costs approved by the Board. If B.L. England's energy and ancillary services continue to be sold in the wholesale market and its capacity credited to the winning bidders in the statewide auction, and if the revenue received from such sales is less than the plant's operating costs, Staff proposes to share the net cost equally between shareholders and ratepayers. However, if the revenue exceeds the costs, Staff recommends that all of the excess be credited to ratepayers.

In the event B.L. England's output is retained for serving BGS, i.e., if so ordered by the Board following the end of the term for BGS supply contracted for pursuant to this year's auction (May 31, 2004), Staff recommends that the recovery of B. L. England's operating costs from ratepayers be capped at the lesser of such costs or the replacement value of B.L. England's energy and capacity (the auction price if the statewide auction continues, or the cost of

[18] The RPA's financial witness recommended that the overall rate of return allowed by the Board in the Company's pending base rate case (Docket No. ER03020110) be used. (Exhibit RA-7 5-3 to 7).

obtaining the equivalent energy and capacity from such other source or sources of BGS supply as the Board might approve if the statewide auction is discontinued).

If the plant is sold, Staff recommends that the full amount of prudently-incurred capital additions made by the Company be deducted in determining the net proceeds from the sale, all of which should then go to ratepayers. In the interim, Staff recommends that the capital additions earn a Board-approved return, as proposed by the RPA, with a requirement that capital expenditures in excess of $1 million be approved by the Board prior to being made.

Staff suggests that the proposed effectiveness of this treatment for a three-year period should to be long enough to re-market and hopefully sell the plant, assuming its operation and the market improves. If the plant continues to be unmarketable due to its high operating costs, Staff believes that three years will provide a sufficient amount of time to put in place an alternative for insuring the reliability of service in the area now served by the plant, after which the plant should be retired.

If the Board should conclude that three years is too long a period for ratepayers to continue to bear the cost of B. L. England's uneconomic operation (operating costs in excess of revenue received), Staff suggests the Board consider directing ACE to immediately functionally separate its non-competitive business functions (its distribution service) from its electric power generator functions (the fossil units), as provided for by N.J.S.A. 48:3-59 (a) (1). Such a separation would eliminate all costs of the fossil units from rates.

Finally, Staff recommends that the Board require ACE to file with the Board, within six months of the date a final Order in this matter, options that can be implemented to maintain reliability in the area now served by B.L. England in the event the plant is sold or retired on or before the expiration of DEP's permit extension.

DISCUSSION AND FINDINGS

1) B.L. England's Return on and after April 21, 2002

Pursuant to the Final Order, B.L. England's costs have been recovered through the MTC, including an overall pre-tax rate of return on plant investment of 13%. The record reflects that the plant consists of three generating units – two burn coal and one burns oil. One coal unit has a scrubber, the cost of which is included in rates. However, the other coal unit (Unit 1) has no scrubber, and its emissions exceed DEP's allowed limits. ACE currently has a permit extension that will allow it to operate B.L. England Unit 1 through July 30, 2006, subject to certain conditions. However, the current DEP permit provides clear notice to ACE that it is unlikely that the current permit will be extended beyond its remaining three-year life.

Based on record evidence, it is clear that the cost of power supplied by B.L. England is significantly in excess of competitive prices. For example, in the Board's February 5, 2003 Order, the Board noted that the all-in cost of B. L. England energy during the 12 months ended July 31, 2002, was over 9 cents per kwh,[19] as compared to less than 2.5 cents per kwh for Keystone and Conemaugh and 4.65 cents per kwh for auction power (energy and capacity) obtained during the fourth year of the transition period, the 12 months ended July 31, 2003. As set forth in the Board's April 21, 2003 Order setting interim rates, the data supplied by the Company in response to the February 5, 2003 Order indicates that the return component of the B. L. England revenue requirement, at 13.0% pre-tax, is about $24.6 million per year, of which

[19] 9.40 cents per kwh, as shown in Attachment B attached to the February 5, 2003 Order.

the debt component (including tax deductible preferred stock) is $7.3 million and the taxable preferred component is less than $0.1 million, yielding an equity component, including related income taxes, of approximately $17.3 million. Based on the same data, the all-in cost of B. L. England generation was projected to exceed the cost of auction power by about $45.6 million during the 12 months ended July 31, 2003.[20] For the same period, updated actual and forecast data supplied in this proceeding indicates the plant's annual revenue requirement, including the 13.0% pre-tax return, is $119.8 million, or 7.95 cents per kwh based on expected generation of 1,507 Gwh.[21] The fuel and O&M components alone are $49.8 million (3.31 cents per kwh) and $36.9 million (2.45 cents per kwh), respectively, or $86.7 million in total (5.76 cents per kwh). On an annualized basis, $66.8 million (4.44 cents per kwh) was received from sales of the plant's energy, capacity and ancillary services during the 12 months ended July 31, 2003. Thus, based on this data, the revenue received from the plant's generation is estimated to fall short of its fuel and O&M expenses by about $20 million annually, and its all-in costs by about $53 million annually.

It is undisputed that in the proposed Stipulation of Settlement submitted by ACE in its restructuring case, which was approved by the Board with certain significant modifications in the 1999 Summary Order (and reaffirmed in the 2001 Final Order), the Company represented that it would divest its owned generation units, including B.L. England. Based on those representations, the Board, in its Summary and Final Orders approved separate and distinct ratemaking treatment for B.L. England and ACE's other generation assets in recognition of their unique and temporary status as to-be-divested plant. The Board anticipated that the owned generation assets would be divested expeditiously, and adopted a transitional ratemaking treatment to govern during the interim period between the start date of retail competition (August 1, 1999) until the time the anticipated divestitures were completed. Clearly, the Board did not intend that the B.L. England rate treatment set forth in the Final Order would continue indefinitely. However, four years have passed since the Board issued its Summary Order and ACE has been unsuccessful in divesting B.L. England at an acceptable price, and has terminated its auction process. It is clear that the plant's high operating costs and significant environmental problems, combined with the current poor market for the sale of generating units generally, have been major contributing factors which have led to the current situation where the Company has been unable to sell the plant at an acceptable price. In light of these circumstances and in recognition of the impaired economic value of the plant, the Board believes that it is necessary at this point to modify the terms of the Final Order with regard to B.L. England in order to more appropriately account for the realities of the present situation.

Under traditional rate base/rate of return regulation, a utility is afforded the opportunity to recover its reasonable operating expenses, as well as a return on its rate base through its base rates for service. An allowed return on investment is applied to the total commingled assets in a company's rate base. Once base rates are set, they remain in effect until the next base rate case, at which time the various elements are reviewed and reset. This encourages the utility to operate efficiently between rate cases. However, since the unbundling of ACE's rates pursuant to the EDECA and the Summary and Final Orders, ACE's base rates reflect only the costs of those assets used to provide distribution service.

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[20] Based on 5 months of actual data through December 2002 and forecast data for the months of January through July 2003.

[21] Company's responses to Transcript Requests 1 (Tr. 6/19/03, at 31:8-11) and 2 (Tr. 6/19/03 at 35:21 to 36:4) provided by letters dated July 7, 2003 and July 21, 2003, respectively. These estimates were based on 10 months of actual data through May 2003 and forecast data for the months of June and July 2003.

The Final Order established a special, transitional ratemaking process for ACE to recover the costs associated with its owned, to-be-divested generating units, including B.L. England pending the anticipated divestiture (including the 13% pre-tax return on investment) through the MTC and deferred accounting, which is distinctly different from the rate base/rate of return treatment afforded its distribution assets.[22] The transitional recovery mechanism which the Board adopted for these assets is more analogous to a revenue requirement adjustment clause, which, subject only to a prudency review, provides for full and complete cost recovery of all costs incurred, on a timely basis, with interest on underrecoverred balances, in contrast to base rate treatment, which requires periodic prospective Board approval of the appropriate level of such costs eligible for recovery based on a test year. Inasmuch as the regulatory treatment which has been accorded the to-be-divested assets substantially reduces the risk of cost recovery associated with these assets, and increases the timeliness of such recovery, financial theory strongly suggests that a lower return on these assets, relative to rate base assets is appropriate. Indeed, in the recently concluded electric restructuring rate cases, Staff contended that the presence of various adjustment clauses substantially reduced the utility's risk, and that a lower rate of return was therefore appropriate. In its return findings in those cases the Board agreed, and adopted the 9.75% return on equity recommendation made by Staff.

While the Company contends that it should continue to earn the 13% pre-tax return for B.L. England, arguing that its investment in B.L. England was and is reasonable and prudent, and that the plant continues to provide reliability in its region, the Board is of the view that, in light of the excessive costs associated with the production of power by the B.L. England plant, as well as its impaired value and environmental problems, ample justification exists for the Board to adjust the rate of return for B.L. England in fixing the level of the plant's stranded costs. Pursuant to N.J.S.A. 48:3-61(e). in determining the magnitude of stranded costs eligible for recovery in the MTC, the Board is authorized to "reflect a reduced return, if any, on investment in quantifying stranded costs which the board determines to be reasonable given the changes in capital costs or risks to the utility, or to reflect the impaired value of the uneconomic generating assets to ratepayers." Moreover, reflecting a reduced rate of return on an impaired asset is consistent with the ratemaking treatment which this Board has previously authorized for another problem asset, namely Jersey Central Power & Light Company's ("JCP&L's") investment in its Oyster Creek nuclear unit prior to the securitization of its stranded costs on June 11, 2002.[23]

As to the appropriate level of return, the RPA has recommended using a short-term debt rate, as argued above. Assuming a rate of 2% and a B. L. England rate base of $190 million, in dollar terms the return would be about $3.8 million annually, or $20.8 million less than the $24.6 million allowed under the current ratemaking treatment, as noted in the February 5, 2003 Order.[24] Staff agrees that a reduced rate of return is appropriate, and notes that EDECA

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[22] Pursuant to N.J.S.A. 48:3-61(a), the MTC charge is to be used to recover certain defined categories of stranded costs and well as "such restructuring related stranded costs, if any, as the board determines to be appropriate for recovery in a market transition charge."

[23] As approved by the Board in its Final Order in JCP&L's restructuring proceedings, effective August 1, 1999, recovery of JCP&L's net investment in Oyster Creek was included in its Market Transition Charge at a level designed to mirror the Transition Bond Charge that would be implemented upon securitization of the unit's stranded costs, and for this purpose, a 13-year amortization at 7% interest was assumed. I/M/O Jersey Central Power and Light Company, d/b/a GPU Energy – Rate Unbundling, Stranded Cost and Restructuring Filings, Docket Nos. EO97070458, EO97070459 and EO97070460, Order dated March 7, 2001 at 100; paragraph 1 on page 101; paragraph 9 on page 105; paragraph 1 of related Stipulation approved, with modifications, by the Board.

[24] The updated data supplied on July 7, 2003 indicates the B. L. England rate base did not change significantly.

expressly permits a reduced return on impaired assets in determining stranded costs. Staff's recommended embedded debt and preferred rate would yield a return of $7.3 million annually. ACE argues that no reduction should be made, inasmuch as the plant continues to be used and useful, and is needed to ensure reliability of service in the region it serves.

With respect to the return issue, in light of the fact that the Company has not been able to successfully divest B.L. England at an acceptable price, and the extremely high cost of operating and maintaining the plant, after reviewing the record in this case, the Board cannot justify the continuation of a return as high as the currently-allowed pre-tax rate of 13.0% on the Company's investment in B.L. England for all the aforementioned reasons. This conclusion is consistent with the authority conferred on the Board under N.J.S.A. 48:3-61(e) to consider the impaired value of uneconomic generation assets in determining the amount to be recovered from ratepayers through the MTC. Accordingly the Board HEREBY ORDERS a two-step reduction in the return component of B.L. England's recoverable costs as follows: First, effective as of April 21, 2003, the date ACE's rates were made interim with respect to this issue, the current ratemaking treatment for costs associated with B.L. England shall continue through the end of the transition period (July 31, 2003), but at the reduced rate of return on common equity of 9.75%. The Board notes that the 9.75% figure corresponds to the upper end of the range of rates of return on equity authorized by the Board in the recently decided restructuring-related base rate cases for the state's other electric utilities.[25] Including the income tax component, this would reduce the 13.0% pre-tax return to 11.3%, and in dollar terms, the $24.6 million to $21.5 million annually. Second, the Board FINDS that a further reduction in the rate of return is warranted for the post-transition period until such time as securitization to be approved by the Board is completed, in order to more fully recognize the impaired value of this stranded asset and to mitigate the burden of this uneconomic stranded asset on customers. Accordingly, the Board HEREBY ORDERS that the return on ACE's investment in B. L. England be reduced to an all-debt rate of 5.25%, effective August 1, 2003 in anticipation of securitizing B. L. England's stranded costs as requested by the Company in Docket No. EF03020121 supra. In dollar terms, this would reduce the return to $10.0 million annually .The 5.25% return reasonably approximates the interest rate which would likely be achieved in a securitization transaction in the current financial markets, as will be discussed further below. The Board believes this two-step reduction to be a balanced and fair resolution of this issue, which, in combination with the Board's decisions on the various other issues addressed in this Order, recognizes and balances the merits of the competing positions and should serve to encourage the Company to proceed expeditiously with securitization.

With respect to the prudency issue noted above, in view of the high level of B.L. England's operating and maintenance expenses relative to other plants, these costs will be undergoing further regulatory review in the Company's pending base rate case. The Company is authorized to continue to defer B. L. England's net operating costs, which shall continue to be subject to

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[25] I/M/O the Verified Petition of Jersey Central Power & Light Company 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, Summary Order dated August 1, 2003, Docket Nos. ER02080506, et al. (I/M/O the Petition of Public Service Electric and Gas Company for Approval of Changes in Electric Rates, For Changes in Tariff for Electric Service B.P.U.N.J. No. 14, Electric, Pursuant to N.J.S.A. 48:2-21 and 48:2-21.1; for Changes in its Depreciation Rates Pursuant to N.J.S.A. 48:2-18, and for Other Relief, Summary Order dated July 31, 2003, Docket Nos. ER02050303 et al); I/M/O the Verified Petition of Rockland Electric Company for Approval of Changes in Electric Rates, Its Tariff for Electric Service, Its Depreciation Rates, and for Other Relief, Order dated July 31, 2003, Docket Nos. ER02100724 and ER02080614. On an interim basis pending the resolution of service reliability issues, JCP&L's rate of return on equity was set at 9.50%

review for reasonableness and prudence as well as a prospective modification in the ratemaking treatment, in the Company's pending base rate case.

2. Valuation of Stranded Costs Associated With B.L. England

As summarized above, with the exception of approximately $5.4 million of costs incurred in connection with ACE's prior attempts to sell the fossil units and the treatment ultimately to be accorded the unamortized balances of the ITC and EDIT, the parties do not disagree with respect to valuation of B.L. England's stranded costs. Moreover, the parties also agree that for the purposes of this proceeding it is appropriate to establish a level of stranded costs that presumes B.L. England has no current market value.

Although the RPA contends that ACE should not be permitted to recover transaction costs related to the auctions conducted by the Company in 1999-2000 and again in 2002, the Company correctly argues that these costs were legitimately incurred pursuant to the Final Order. As asserted by ACE, it would be wholly unfair to now penalize the Company by refusing to recognize these costs in the calculation of stranded costs merely because NRG terminated the agreement. In this regard, it must also be noted that shortly before NRG terminated its agreement to acquire ACE's fossil generation assets, this Board, after thoroughly reviewing the issues, issued a Final Decision and Order concluding that the sale was reasonable. Moreover, in this proceeding ACE witness Hanson, in rebuttal testimony, provided detailed information regarding these costs. (Exhibit P-8 at 3:7 to 4:4). However, the Board believes the allocation issue with respect to $2.5 million of transaction costs was not sufficiently developed on the record, and thus should be reviewed further in ACE's pending base rate case. Accordingly, the Board HEREBY FINDS that pending this review, $2.5 million of transaction costs associated with the unsuccessful auctions, net of tax, should not be included in recovery-eligible stranded costs.

The RPA and Staff also argue that the stranded cost total should be reduced by the unamortized EDIT of $705,204 and ITC of $3,481,601 plus other plant related deferred taxes. However, ACE witness Hanson, citing 26 CFR Part 1 relating to the normalization requirements of Sections 168(f)2 and 168(i)(9) of the Internal Revenue Code (Code), Section 203(e) of the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2146), and former section 46(f) of the Code, argues that to do so would violate existing IRS regulations. Nevertheless, he concedes that the IRS has issued a proposed rulemaking that, if adopted, would allow continued flow through of the tax balances to cost of service.

These regulations require a "normalization" method of accounting under which the ITC and EDIT are remitted to ratepayers ratably over the life of the asset that gives rise to them. Accordingly, the tax reductions are not used to reduce utility rates for ratepayers immediately upon realization of the benefits, and can be invested in other plant as a source of cost-free capital.

However, the existing regulations did not contemplate deregulation or, more precisely, the present situation, whereby the utility generation asset is sold or otherwise disposed of before the ITC and EDIT balances are fully flowed-through to ratepayers. A proposed rulemaking has been initiated by the IRS and the United States Treasury Department ("Treasury") that would allow utilities to continue to flowthrough to ratepayers any remaining ITC and EDIT reserve funds with respect to assets that are no longer public utility property.

The Board supports the IRS' proposed regulation change as providing an appropriate response to changes in the electric power industry resulting from the deregulation of electric generation facilities. By continuing the flowthrough of the ITC and EDIT, the proposed rule reflects the fact

that electric utilities have been permitted to recover stranded costs, and thus ratepayers continue to pay for plant investment even when electricity generation assets cease to be public utility property.

In light of the foregoing, the Board HEREBY ORDERS that the $705,204 in EDIT and the $3,481,601 in ITC be deferred on the Company's balance sheet and not taken into income by the Company pending the outcome of the IRS rulemaking on this issue.

In summary, with regard to B.L. England's stranded cost balance, the Board HEREBY FINDS that the balance eligible for financing at this time is $149.5 million.

Finally, on this issue, the Board accepts the Company's proposal to make a two-stage determination as to potential additional B.L. England stranded costs, i.e. the Company's investment in fuel and non-fuel inventories, the expected cost of terminating Unit 1's scrubber lease, potential site remediation costs that could be incurred pursuant to New Jersey's industrial Site Remediation Act, as well as environmentally required capital expenditures to the extent not prefiled for the Board's approval, i.e. capital expenditures under $1 million per project,[26] and HEREBY ORDERS that these potential additional stranded costs and the ratemaking treatment thereof be addressed in the Company's pending base rate case.

3. Appropriate Financing Method

Both the Company and the RPA have taken the position that securitization appears to be the most economical option for permanently financing B.L. England's stranded costs. While the Board's ultimate finding on this issue, as well as other related findings required pursuant to EDECA will be set forth in detail in a separate Bondable Stranded Cost Rate Order ("BSCRO") to be issued in ACE's pending securitization petition, BPU Dkt. No. EF03020121, the Board will offer some brief comments on his issue here, since the issue has been addressed, albeit preliminarily, by the parties in this proceeding pursuant to the Board's Procedural Order.

As noted above, Company witness Kamerick testified that because the proceeds of securitization can be used to retire common and preferred equity as well as higher cost debt without otherwise affecting the utility's capital structure, securitization is the financing mechanism that achieves the most significant customer savings. Moreover, because of the nature of these bonds, they are typically rated triple A by the rating agencies and carry a lower coupon rate than typical utility debt.

As part of its securitization petition filed on February 14, 2003, the Company included a savings analysis wherein ratepayers savings were estimated to be $58.6 million on a net present value ("NPV") basis over the 15-year life of the transitions bonds.[27] While this issue will be considered and decided as part of the securitization petition pending before the Board, and while the Board does not for accept all the assumptions set forth in the Company's savings analysis, nonetheless, it appears, based on current assumptions regarding interest rates and the financial

[26] Exhibit P-1, Attachment B at 4.

[27] In an update of this analysis submitted in the securitization proceeding, the savings estimate was revised by the Company based on updated assumptions, the net effect of which was to increase the projected savings to $67.4 million on an NPV basis. Also in that proceeding, the RPA , based on different assumptions asserted that the savings from securitization were likely to be lower, falling within a range of $30 million to $50 million, depending on the assumed capital structure, rate of return and discount rate.

markets, that securitization will likely provide substantial ratepayers benefits relative to other financing options.

4. Measures That Can and Should be Taken by ACE Consistent With Its Obligation to Provide Safe, Adequate and Proper Service at Just and Reasonable Rates, to Ensure that By a Date Certain to be Determined By the Board, the B. L. England Plant Will No Longer Be On the Utility's Books or Recoverable in Utility Rates.

Both Staff and the RPA have proposed versions of sharing B. L. England's net operating costs between ratepayers and shareholders. The Company maintains that such net costs, estimated to be about $20 million annually, should continue to be recovered in full from ratepayers. The RPA additionally would extend its sharing proposal to the proceeds received from any future sale of the plant, while Staff and the Company have stated that all such proceeds, to the extent there are any, should go to ratepayers. Indeed, the Company avers that the EDECA requires this result.

Although, as discussed supra, in its Initial Brief, Staff supported the RPA's sharing proposal with modifications, at the Board's July 21, 2003 public meeting, Staff recommended that the Board defer consideration of this issue pending additional review of the reasonableness and prudence of B. L. England's operating costs in the Company's pending base rate case.

In this context, it must also be mentioned that Barrington-Wellesley Group, Inc. ("BWG"), who together with Mitchell and Titus, LLP audited the Company's deferred balances, devoted a substantial portion of its BGS prudence review to B. L. England issues, namely the plant's high O&M costs and the impact its forced outages and reserve shutdowns may have on congestion costs. BWG recommended that a detailed review of the plant's operation and maintenance be performed.[28] The Board believes that such a review would also be most expeditiously accomplished and incorporated in the Company's pending base rate case.

Accordingly, the Board HEREBY DEFERS its consideration of the RPA's and Staff's B.L. England sharing proposals pending additional review in the Company's pending base rate case, and HEREBY DIRECTS the parties to continue in the rate case proceeding to explore these as well as such other alternatives as they deem responsive to the concerns that have been raised regarding this issue to date.

Although, as just indicated, the Board defers its consideration of the RPA's and Staff's sharing proposals, the Board HEREBY ADOPTS Staff's recommendations set forth in its Initial Brief with respect to (1) establishing a safeguard to insure the reliability of service in the area now served by B.L. England and (2) future B.L. England capital expenditures. In this regard, the Board HEREBY ORDERS the Company to file, within 6 months of the date of this Order, a plan for an alternative or alternatives (a transmission upgrade, for example) that can be feasibly implemented on or before the recently-granted extension in the plant's fuel permit expires (July 30, 2006) to provide continued reliability of service in the area served by B. L. England. The Board FURTHER ORDERS that ACE file for Board approval of any B.L. England capital expenditures in excess of $1.0 million.

As noted above, the Company may continue to defer B. L. England's net operating costs, which shall continue to be subject to review for reasonableness and prudence as well as a prospective

[28] See "Audit of Deferred Balances, Atlantic City Electric Company – Phase I" (Exhibit AUD-2 submitted in Docket No. ER02080510, I/M/O the Petition of Atlantic City Electric Company d/b/a Conectiv Power Delivery for Approval of Amendments to its Tariff to Provide for an Increase in Rates for Electric Service, Chapter VIII pgs. 39-52; 56.

modification in the ratemaking treatment, as we may decide in the Company's pending base rate case.

5. EWG Status for Deepwater

Although the Company's petition herein predominately seeks guidance with respect to B.L. England, it also requests that the Board make certain findings in order to meet federal law requirements under PUHCA, 15 U.S.C. sec. 79 et seq., in connection with the transfer of ACE's interest in the Deepwater Station to an ACE affiliate.

Section 32(c) of PUHCA requires that for any generation facility the costs of whose construction or output were included in retail rates as of October 24, 1992, each State Commission with jurisdiction over such rates must make a specific finding that qualifying the facility as an eligible facility (i) will benefit customers; (ii) is in the public interest; and (iii) does not violate state law. 15 U.S.C. sec. 79z-5a(c). For registered holding companies, Section 32(c)(A) imposes an additional requirement that such specific state commission findings be made by every state commission having jurisdiction over the retail rates and charges of the affiliates of such registered holding company. 15 U.S.C. sec. 79z-5a(c)(A).

In the Board's February 20, 2000 Decision and Order approving the sale of the fossil generation assets to NRG, the Board made a determination that allowing the fossil generation assets, including Deepwater, to be eligible facilities pursuant to Section 32 of PUHCA would benefit New Jersey consumers, was in the public interest and would not violate State law. However, the Board clarified that this determination was "based on the facts of this transaction as they have been presented and shall not be precedential for any such future requests, by this or any other company, for similar determinations for other facilities." In the Matter of the Petition of Atlantic City Electric Company Regarding the Sale of Certain Fossil Generation Assets, BPU Docket No. EM00020106, Decision and Order (dated February 20, 2002), at 33.

ACE asserts that it is necessary for the Board to at this time revisit its EWG determination with respect to Deepwater because it intends either immediately, or in the near future, to seek to qualify Deepwater as an "eligible facility."

Having reviewed the petition in this matter, and in recognition that the Board has already conducted an extensive review of this issue and rendered a determination in support of Deepwater receiving eligible facility status in its February 20, 2002 Decision and Order, it continues to appear that the requested determination will not adversely affect either the availability or reliability of electric supply to ACE's customers or the availability of competitive energy supplies in the northeast. Furthermore, it appears that allowing Deepwater to become an eligible facility under PUHCA would enable it to operate more freely in the competitive marketplace, thereby creating greater competition which should lead to lower electric prices, to the benefit of electric customers. Based on the information submitted by ACE, it does not appear that this determination raises any significant generation or transmission market power issues within the State of New Jersey or PJM. The Board further notes that no entity has opposed ACE's request.

Based on the foregoing, the Board HEREBY FINDS that allowing Deepwater to be an "eligible facility": (1) will benefit New Jersey consumers; (2) is in the public interest; and (3) does not violate State law. The Board's determination is based on the peculiar facts presented herein and shall not be precedential for any such future requests, by this or any other company, for similar determinations for other facilities.

DATED: 9/25/03

BOARD OF PUBLIC UTILITIES
BY:

signed
JEANNE M. FOX
PRESIDENT

signed
FREDERICK F. BUTLER
COMMISSIONER

signed
CAROL J. MURPHY
COMMISSIONER

signed
CONNIE O. HUGHES
COMMISSIONER

signed
JACK ALTER
COMMISSIONER

ATTEST:

signed

KRISTI IZZO
SECRETARY