BEFORE THE STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES
OFFICE OF ADMINSTRATIVE LAW

I/M/O THE DEFERRED BALANCES AUDIT OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY'S– PHASE II AUGUST 2002 – JULY 2003	:	OAL DOCKET NO. PUC 01327-07 BPU DOCKET NO. EX02060363 and EA02060366

THE DEPARTMENT OF THE PUBLIC ADVOCATE
DIVISION OF RATE COUNSEL
RESPONSE TO PETITIONER'S MOTION FOR SUMMARY DISPOSITION

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PRELIMINARY STATEMENT AND STATEMENT OF FACTS

Though not specifically cited in the motion and brief filed by Public Service Electric and Gas Company ("PSE&G" or "Company"), presumably the Company moves for summary decision under N.J.A.C. 1:1-12.5. That regulation allows summary decision when the movant's papers "show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to prevail as a matter of law." N.J.A.C. 1:1-12.5(b). As will be seen herein, PSE&G has failed to make the required showings and the motion should be denied.

PSE&G has also requested oral argument on its motion. However, the Department of the Public Advocate, Division of Rate Counsel ("Rate Counsel") believes that this reply will thoroughly demonstrate that the motion should be denied and that oral argument will not be necessary.

The current proceeding is a continuation of the audit of PSE&G's four-year transition period[1] deferred balances including the reconciliation of the Market Transition Charge ("MTC"). The MTC is the ratemaking mechanism created by the Electric Discount and Energy Competition Act of 1999 ("EDECA") in N.J.S.A. 48:3-61 to collect the stranded costs related to PSE&G's electric generating stations. Phase I of the deferred balances audit was handled in I/M/O the Petition of Public Service Electric and Gas Company's Deferral Filing Including Proposals for Changes in its Rates for its Non-Utility Transition Charge (NTC) and its Societal Benefits Charge (SBC)[2], BPU Docket No. ER02080604, Summary Order dated

[1] The four-year transition period ran from August 1, 1999 through July 31, 2003. It was the first four-years after the New Jersey retail electric generation market was opened fully to competition. As noted by PSE&G, Phase I of the audit of the utility's deferred balances covered the first three years from August 1, 1999 through July 31, 2002. Since it was necessary for the Board to reset the deferred balances rates by an effective date of August 1, 2003, the Board obviously could not wait until the end of the four-years on July 31, 2003 to begin a rate proceeding to reset the rates. Therefore, the agency decided to do a partial audit and review of the first three years in Phase I of the audit and then continue the audit for the fourth year in this Phase II proceeding. Since the Phase II proceeding is simply a continuation of the review of the four-year transition period, the rate decisions made in the Phase I proceeding would necessarily have been only temporary in nature until the entire deferred balances review proceeding could be completed. It is undeniable that the Board always intended to complete the review of the four-year deferred balances accounts in this Phase II.

[2] The MTC is one of the cost components that make up the SBC.

July 31, 2003 and Final Order dated April 22, 2004 ("Phase I Deferred Balances"). The instant Phase II audit proceeding will reconcile and finalize the rates that were set for the partial transition period in Phase I.

The Board of Public Utilities ("Board" or "BPU") has twice requested the parties to file comments concerning the proper MTC over-recovery calculation.[3] Rate Counsel responded to those requests by filing comments dated June 13, 2005, June 28, 2005 and May 12, 2006. PSE&G filed one set of comments on June 13, 2005. A copy of those comments are attached to this brief. In our comments Rate Counsel set out what we believed to be ample reasons for the Board to correct the utility's MTC over-recovery calculation. We requested that the Board require PSE&G to increase the MTC over-recovery refund as of July 31, 2003 by the amount of $114,359,000. We also requested that the Board require PSE&G to pay interest on this amount for the period subsequent to July 31, 2003. Rate Counsel continues to maintain that ratepayers are entitled to this additional over-recovery refund and that additional interest should be accrued and refunded to ratepayers as well.[4]

Rate Counsel will summarize the factual bases for our additional refund requests herein but refer Your Honor to additional details contained in our three sets of comments attached. Our first basis for increasing the MTC over-recovery is that PSE&G improperly applied the discount rate to the MTC over-recovered revenues on an annual basis instead of the commonly applied monthly basis. Since the cash flows from the MTC revenue collections are available to the utility on a monthly basis as customers pay their monthly bills, PSE&G was able to earn a return on these revenues from the moment they were collected in each month. Applying the discount rate on a <u>monthly</u> basis gives appropriate accounting recognition to the fact that PSE&G has actually enjoyed immediate earnings on these monthly revenue collections during the transition period. The Company's proposed <u>annual</u> discounting approach assumes that the utility does not earn a return on the monthly MTC revenues during the calendar year, but instead earns no return, until the end of the year, on these revenues that it has been holding for that time. This assumption obviously contradicts

[3] Letters from BPU Secretary dated May 13, 2005 and August 18, 2005.
[4] A rough estimate of the additional interest due would be approximately $10 million.

reality and should be rejected. PSE&G should be required to account to ratepayers for the monthly earnings it has enjoyed on the money it overcharged its customers.

Rate Counsel's second basis for increasing the MTC over-recovery is that PSE&G improperly continued to discount back to August 1, 1999 the MTC revenues it received from customers after customers had paid back the $540 million transfer premium in full. The correct method would have been for PSE&G not to discount the MTC over-recovery revenues at all from this point forward. The MTC over-recovery dollar amounts should be stated in their nominal values and not in the net present value which is the result of the Company's improper discounting method. The Company's method improperly assigned to the utility rather than to the ratepayers all earnings on the MTC overcharges during the transition period. Once the Company received enough revenues from its customers to pay back on a net present value, or discounted, basis the entire $540 million transfer premium, then it was no longer proper to continue discounting those MTC revenues. Ratepayers had repaid the full $540 million to PSE&G by December 2001. During the time when some part of the $540 million transfer premium was still owed by the customers, then discounting the revenues back to August 1, 1999 until the $540 million was returned to PSE&G was correct in order to account for the time value of money, i.e., the time it took to pay back the entire transfer premium in 1999 dollars. However, once ratepayers had paid back the entire transfer premium, then PSE&G was essentially holding the additional overpaid revenues for the benefit of customers until the utility could refund those revenues back to them. From that point on, it was the customers who were waiting to get their money, not PSE&G. Therefore, it was improper for PSE&G to discount those over-recovered revenues and thereby improperly reduce the full refund to which customers are entitled.

Rate Counsel's third basis for increasing the MTC over-recovery is the simple premise that customers are entitled to interest earned on the over-recovery until they receive that refund back from PSE&G. Since those funds always belonged to the customers after the transfer premium was completely repaid, customers are entitled to the interest earned on their funds until they receive them back in full from the Company.

Despite the fact that Rate Counsel believed it had provided the Board with sufficient bases to order the increased MTC refund to customers, the Board decided to grant PSE&G's January 31, 2007 request for evidentiary hearings at the Office of Administrative Law ("OAL") to further supplement the record. That was the posture in which this case was transmitted to the OAL.

PSE&G has decided it no longer wants the OAL evidentiary hearings that the utility requested in its January 31, 2007 letter to the BPU. PSE&G's argument for summary decision essentially boils down to a simple, but unsustainable, proposition. The Company alleges that since the Board used the utility's proposed stipulations or joint positions as a framework in the Restructuring Order and the Phase I audit proceeding, then the Board must have specifically approved the precise calculations that were buried within attachments to those joint positions or were provided to the Board after the stipulations for joint positions were executed by some, but not all, of the parties to those dockets. As will be seen below, this allegation is altogether unproven by either the Company's three affidavits or its arguments.

In contravention of its argument that there are no genuine issues of material fact to be decided, PSE&G has also determined to file three affidavits that add allegations of material facts to the record which Rate Counsel believes should be subject to discovery and later rebuttal testimony by our office. The Company has provided additional detail concerning previously confidential settlement negotiations involving the Company's restructuring case and the Phase I deferral audit. It is not entirely clear how these additional allegations relate to the interpretation of the Board's Restructuring Order and the Phase I order. It should be clear, however, that if the Board meant to follow PSE&G's interpretation of the joint position, then the Board would have spelled that out specifically in the orders. It should also be clear that the Board itself has not currently adopted PSE&G's arguments or it would have decided those issues in PSE&G's favor by now. By transmitting this case to the OAL for an additional evidentiary process, the Board appears to be giving the utility the opportunity to supplement the record and bolster its previous arguments. However, that does not give license to PSE&G to add the supplementary allegations and then attempt to foreclose the examination of those allegations through discovery and opposing testimony. PSE&G's motion for summary decision should be denied.

PSE&G appears to believe that simply making these allegations is enough to bind other parties to them as well as Your Honor and the Board. Obviously this cannot be the case.

PSE&G's argument that the Board has previously approved by implication the utility's detailed calculations for interpreting its proposed stipulations or joint positions as a framework for deciding the Restructuring Order and the Phase I audit proceeding is belied by the already existing record in these matters. In fact, the record shows that the Board did not even adopt all the terms of PSE&G's proposed contested stipulation[5] in the restructuring docket and specifically modified certain of its terms. That is clear evidence that while the Board decided to use PSE&G's proposed contested stipulation as a framework for a final decision, that does not justify PSE&G's leap to the conclusion that specific calculation methodologies contained in the stipulation must have been adopted as well.

Nevertheless, the allegations in PSE&G's affidavits and brief are more arguments than reliable evidence and are certainly not statements of undisputed facts. In fact, Rate Counsel disputes that any of those allegations have been proven. The utility's argument is based on allegations that do not appear in the Restructuring Order or the Phase I Order themselves. These allegations need to be tested by the discovery process and cross-examination under oath at evidentiary hearings by the ALJ. On the other hand, Your Honor could also decide that even if PSE&G's allegations are assumed to be true, they do not establish the ultimate conclusion that the Board has previously decided to approve the specific MTC calculation methodology that PSE&G proposes. This would require a denial of the motion for summary decision also. Your Honor could then require PSE&G to prefile testimony supporting its position that its customers should be deprived of the full refund of the overcharges they have paid, since the affidavits unmistakably do not establish the Company's case to continue to withhold the ratepayers' full refund. That testimony would then to be subject to full

[5] PSE&G's proposed stipulation in the restructuring docket was opposed by other parties to that docket. Rate Counsel signed an alternative stipulation of settlement with other parties to the restructuring docket and requested that the Board approve that alternative stipulation. I/M/O Public Service Electric and Gas Company's Rate Unbundling, Stranded Costs and Restructuring Filings, BPU Docket Nos. EO97070461, EO97070462, EO97070463, Final Decision and Order dated August 24, 1999 ("Restructuring Order"), pp. 49-55. While the Board did not adopt specifically our alternative stipulation, the Board did adopt one of the most important elements of that alternative stipulation, i.e., an eventual 13.9% rate reduction as opposed to the 10% rate reduction proposed by the PSE&G stipulation.

discovery and rebuttal testimony by Rate Counsel. Evidentiary hearings should be scheduled to cross-examine the witnesses.

LEGAL ARGUMENT

POINT I

There are genuine issues of material fact alleged in this matter that defeat the motion for summary decision.

As stated above, PSE&G's motion appears to have been filed under N.J.A.C. 1:1-12.5. That regulation allows summary decision when the movant's papers "show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to prevail as a matter of law." N.J.A.C. 1:1-12.5(b). A more complete discussion of the New Jersey law on summary judgment is outlined in Brill v. Guardian Life Ins. Co. of America, 142 N.J. 520, 523 and 540 (1995):

> . . . the determination whether there exists a genuine issue with respect to a material fact challenged requires the motion judge to consider whether the competent evidential materials presented, when viewed in the light most favorable to the non-moving party in consideration of the applicable evidentiary standard, are sufficient to permit a rational factfinder to resolve the alleged factual disputed issue in favor of the non-moving party. (Emphasis added).

and

> . . . the court must accept as true all the evidence which supports the position of the party defending against the motion and must accord him [or her] the benefit of all legitimate inferences which can be deduced therefrom, and if reasonable minds could differ, the motion must be denied [citing to S. Pressler, Current N.J. Court Rules, R.4:40-2 comment (1991)]. . . .

Brill at 535.

Also, "[o]n a motion for summary judgment the court must grant all favorable inferences to the non-movant. But the ultimate factfinder may pick and choose inferences from the evidence to the extent that 'a miscarriage of justice under the law' is not created. R. 4:49-1(a)." *Id.* at 536. In considering this motion, Your Honor is not acting as the ultimate factfinder at this stage of the proceedings, but as a motion judge reviewing the materials set forth in the moving papers and responding papers. Therefore, rather than picking among the

possible inferences from the evidence, Your Honor must grant all favorable inferences to Rate Counsel. This should especially be so, since there has yet to be any discovery on the utility's claims raised in its motion.[6]

In Brill, the Supreme Court was interpreting R. 4:46-2 which contemplates that the trial judge would be reviewing "the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, . . ." Brill at 528-529. In this instant matter, there have been no pleadings yet by the utility on whom the burden of proof always lies, let alone discovery on the allegations contained in the pleadings. Accordingly, Rate Counsel believes that the motion should be denied and a schedule set for PSE&G to prefile testimony supporting its request to finalize the deferred balance and rates regarding the MTC, for discovery on that testimony, for Rate Counsel to prefile testimony concerning the issues and for discovery on our testimony. There may be a possible need for rebuttal and surrebuttal testimony as well before the evidentiary hearings are held.

PSE&G seems to argue that since the Board decided to use the utility's proposed stipulation as a framework in the utility's restructuring docket[7], then this somehow binds Rate Counsel as representative of the utility's customers to the terms of the stipulation as if our office had actually signed that document. As PSE&G necessarily has admitted, Rate Counsel did not sign that stipulation and cannot be treated as if we agreed to each of its terms. PSE&G makes similar arguments concerning the partial stipulation that was signed by several parties in the Phase I deferred balances audit proceeding (not including BPU Staff and Rate Counsel). It is simply incorrect to argue that participation in some settlement discussions that led to a document that is essentially a joint position of a group of parties can somehow bind the other parties who declined to sign and agree to the proposed joint position.

While it is correct that Rate Counsel participated in some of the settlement discussions in the restructuring docket and in the Phase I deferred balances docket, PSE&G attempts to

[6] There has been discovery in the earlier stage of the Phase II audit before the Board, but not yet in this OAL proceeding.

[7] I/M/O Public Service Electric and Gas Company's Rate Unbundling, Stranded Costs and Restructuring Filings, BPU Docket Nos. EO97070461, EO97070462, EO97070463, Final Decision and Order dated August 24, 1999 ("Restructuring Order").

"bootstrap" that participation into the intimation that our office knew all the details about each of the terms of the proposed stipulation and somehow silently agreed to them without signing the stipulation. As will be seen below, this argument cannot be supported and should be rejected.

There is no evidence in the record that the MTC calculation methodology now espoused by PSE&G was specifically detailed to all the parties during any of the settlement meetings in either the restructuring docket or the Phase I of this deferred balances review. As discussed in Rate Counsel's earlier comments to the Board, PSE&G's MTC calculation methodology contradicted the standard methodology that the Board used on other deferred balances. It was inequitable for PSE&G not to point this out specifically when originally making that proposal and providing the background for the specific calculation methodology. It was incumbent on this public utility to highlight its proposed deviation from previous BPU policy. It should not be rewarded now for its failure to abide by this duty. The so-called evidence concerning the calculation methodology that PSE&G presents in its motion for summary decision relates to the periods after the two partial stipulations were signed by parties other than Rate Counsel and BPU Staff. The April 15, 1999 document from PSE&G to BPU Staff[8] is dated almost a month after the partial stipulation in the restructuring docket was submitted to the Board for review on March 17, 1999. Therefore, this document that purported to be an explanation of the partial stipulation was not even created until after the settlement discussions had ended.

[8] Exhibit C to the affidavit of John A. Hoffman. It should be noted that Mr. Hoffman has appeared in this instant docket as an attorney for PSE&G and now appears for the first time as a witness for PSE&G. It is clear that an attorney cannot appear as a witness in a matter and also as an advocate for a party in that matter except in limited circumstances. RPC 3.7(a). "A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness unless; (1) the testimony relates to an uncontested issue; (2) the testimony relates to the nature and value of legal services rendered in the case; or (3) disqualification of the lawyer would work substantial harm on the client." None of the three exceptions to this rule apply here, nor has Mr. Hoffman alleged that they do. It is assumed that Mr. Hoffman will no longer provide any legal services to PSE&G in this matter in order to comply with this rule and that his name will no longer appear, as attorney for PSE&G, on documents filed in this matter. Mr. Matthew M. Weissman and Mr. Thomas P. Kelly, who filed the motion on behalf of PSE&G, can continue to act as attorneys for PSE&G under RPC 3.7(b). However, Mr. Hoffman also may have acted as an attorney in preparing the brief, if that is the meaning of his name appearing at the end of the brief. If not, then as stated above, his name should no longer appear as attorney for PSE&G on documents in this matter.

The same is true for the partial stipulation in the Phase I audit. The October 21, 2004 letter from PSE&G to BPU Staff which purports to explain the utility's position on its version of the MTC over-recovery calculation came more than a year after the July 31, 2003 summary order approving the new deferred balances rates from the Phase I audit proceeding. Therefore, these so-called explanations were not even created until well after the respective settlement negotiations had ended. They cannot be relied upon to establish that either BPU Staff or Rate Counsel agreed to their terms.

As can be seen from the documents that PSE&G alleges as supporting its argument, PSE&G relies on after-the-fact explanations of its MTC calculation methodology that were not provided to all other parties. PSE&G did not point to prefiled testimony or hearing testimony that specified or pointed out as a particular issue the different calculation method for the MTC deferred balance as opposed to the calculation method used for other deferred balances. Neither did PSE&G cite to any Board orders that approved with specificity the annual versus monthly discounting of the MTC recoveries, the disclosure that once the $540 million transfer premium was recovered from customers that PSE&G would continue to discount the revenues recovered in contravention of normal accounting procedures, or that it would refuse to pay interest on the MTC overrecovery. PSE&G simply alleges that because some of this detail was buried in the attachments to its proposed stipulations, then the BPU and other parties to those proceedings are bound to those calculations. Contrary to PSE&G's position, Rate Counsel does not believe that utility ratemaking is a game of hide-and-seek wherein the prevailing party is the one which most successfully hides the details of its positions until they are found out and then claims that it is too late to correct the calculations that are used to charge customers in their electric rates.

The burden of proof is always on the utility to show that its calculations result in just and reasonable rates. This should be especially so when the utility-proposed method deviates from BPU policy. It would be inequitable to permit PSE&G to benefit from its decision not to highlight this deviation from approved BPU policy.

The relevant allegations of fact in the affidavits of PSE&G's witnesses are almost all conclusory and do not by themselves establish that there is no genuine issue as to any material

fact. The affidavits are substantially more argumentative than factual. Therefore the motion for summary decision should be denied.

The BPU's decision to transmit this matter to the OAL for "review, an evidentiary hearing if necessary and an Initial Decision,"[9] is alone sufficient to establish that the agency has already determined that there are factual disputes that need to be decided. Indeed, the Board specifically decided that there exists a "dispute between the Parties over the method of calculation of the MTC over-recovery…."[10]

That agency decision contradicts and defeats PSE&G's motion for summary decision. The essence of PSE&G's allegations of fact is that the BPU has already decided what calculation methods should be applied to the MTC. If that were the case, then the BPU would never have ordered this matter to be transmitted to the OAL for review. Such a review would have been unnecessary, and the Board could simply have decided to follow its alleged prior decisions without sending this case to the OAL.

Once again, it should be clear that the Board's decision to treat this matter as a contested case establishes that the Board certainly believes that there are genuine issues as to material facts. In the Order of Transmittal, the Board also said that it "is not reaching a decision on whether this issue would be appropriate for summary decision pursuant to N.J.A.C. 1:1-12.5 in the event a party files such a motion with the Administrative Law Judge." Order of Transmittal, p. 2. In making this comment, it is apparent that the Board did not want to create any misapprehension that it would prejudge such a motion and would leave the disposition of such a motion with the ALJ in the first instance.[11] This comment cannot be cited as evidence of whether a motion for summary decision would be proper or not.

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[9] I/M/O the Deferred Balances Audit of Public Service Electric and Gas Company, Phase II: August 2002 – July 2003, BPU Docket Nos. EX02060363 & EA02060366, Order of Transmittal to the OAL for Hearing, dated February 7, 2007, p. 2 ("Order of Transmittal").

[10] *Id*.

[11] If Your Honor should grant the motion for summary decision and determine that it resolves all issues, then that would be treated as an initial decision. N.J.A.C. 1:1-12.5(c). That initial decision would then be reviewed by the BPU who can adopt, reject or modify it under N.J.A.C. 1:1-18.6.

PSE&G's January 31, 2007 Request for an OAL Hearing

PSE&G itself clearly believed that genuine issues of material facts are in dispute when it filed its January 31, 2007 request that the Board transmit the matter to the OAL "for the development of an evidentiary record, conduct of the required hearing, and an initial decision." PSE&G Letter to BPU Secretary, dated January 31, 2007, p. 1. PSE&G admitted that this is a "contested case involv[ing] disputed adjudicative facts" and that "[t]hese facts cannot be resolved based on the 'papers'." *Id.* at 2. PSE&G variously described the hearing it requested as a "plenary trial-type hearing" and a "full adversary trial." *Id*. at 3. The utility also stated that a full trial type hearing is mandated. *Id*. at 5.

PSE&G further complained in its January 31 filing that Rate Counsel relied on the interpretation of documents already in the record and had not yet presented the sworn testimony of an expert. *Id*. at 6. However, now that PSE&G has received the opportunity for the plenary trial-type hearing it requested, it has filed this motion for summary decision specifically for the purpose of foreclosing the hearing that it requested. It appears that the utility wants to be able to introduce the additional testimony of its three witnesses by written affidavit without requiring that the witnesses' testimony be subjected to the scrutiny of discovery and cross-examination under oath. This restrictive litigation strategy should be denied. Ratepayers should be allowed the opportunity for full discovery on the testimony and to be able to present testimony from the ratepayers' perspective once that discovery process on the Company's additional prefiled testimony has been completed.

As PSE&G well knows, in the normal course of an adversarial ratemaking proceeding, the burden of proof always remains with the utility seeking approval of its proposed rates. The accepted procedure which PSE&G has previously followed is for the utility to prefile testimony setting out the factual basis for its rate approval[12], then submitting its witnesses to the discovery process. After an ample opportunity to propound discovery and review the discovery responses, the other parties to a ratemaking proceeding including Rate Counsel then prefile their own testimony and submit their witnesses to a similar discovery process.

[12] It should be noted that the Phase I deferred balances audit began with PSE&G's request for rate approval of the deferred balances rates. This Phase II proceeding is merely a continuation of the ongoing audit of the utility's deferred balances, although the matter which the BPU transmitted to the OAL concerns only one part of the deferred balances, the MTC over-recovery.

Commonly, additional prefiled testimony is submitted afterwards and then evidentiary hearings are scheduled in which the witnesses' prefiled testimony is presented and witnesses are cross-examined.

In the instant matter, PSE&G requested that this evidentiary process begin on the Phase II audit concerning the MTC over-recovery and the BPU concurred. See Order of Transmittal. However, now that the process has begun, PSE&G has decided not to follow the long-approved procedure. The utility has decided to file affidavits alleging disputed facts without the opportunity to propound discovery on these allegations and without the opportunity for Rate Counsel to present the sworn testimony of a witness after the discovery process has been completed. Rate Counsel does not propose to present the testimony of a witness until the discovery process is complete. To do so prematurely would not provide Your Honor and the Board with the complete record the BPU sought in the Order of Transmittal. Rate Counsel avers that PSE&G's motion to subvert the process that the Board ordered in this matter should be denied.

PSE&G's litigation strategy in this Phase II proceeding is a continuation of its decisions to disregard the BPU's intent to examine the deferred balances fully and completely. PSE&G has attempted this obfuscation previously. In the PSE&G Restructuring Order, the BPU directed PSE&G to make a filing by August 1, 2002 concerning what unbundled rates it proposed to charge customers for base rates and the deferred balances components after August 1, 2003, the end of the transition period. Despite the fact that the Board ordered the utility to make this filing, PSE&G filed only a distribution service base rate case without the required filing concerning the other unbundled rate components, i.e., the deferred balances rates.[13] The BPU had to order the utility once again to comply and prefile testimony and supporting documents so that the agency and the parties to those proceedings could examine the utility's request for new rates to be effective on August 1, 2003. In this instant proceeding, PSE&G first alleged that it needed evidentiary hearings at the OAL, then after that request was granted, it now desires to truncate that process to its advantage.

[13] I/M/O the Petition of PSE&G for Approval of Changes in its Tariff for Electric Service, BPU Docket Nos. ER02050303, EO97070461, EO97070462 and EO97070463, Order Directing the Filing of Supplemental Testimony and Instituting Proceedings to Consider Audits of Utility Deferrals, dated July 22, 2002, p. 2 (contained in Exhibit D of Hoffman Affidavit).

While Rate Counsel believed that the evidentiary record before the Board in the Phase II audit proceeding was sufficient for the Board to decide this matter on the MTC over-recovery, the Board obviously disagreed when it rejected our request for the Board to decide the matter on the papers and transmitted this case to the OAL for this proceeding.

Rate Counsel abided by the Board's Order and awaited PSE&G's prefiled testimony establishing the basis for its proposed MTC rate approval. PSE&G should not be permitted to present new allegations of disputed facts without requiring them to be tested through the process of discovery and cross-examination under oath in an evidentiary hearing. It should be noted that PSE&G has had the opportunity to present these new allegations ever since the Board requested in May 2005 that the parties to the Phase II audit consider the proper methodology for the MTC over-recovery.[14] While PSE&G responded in June 2005 to the Board request by providing some of the documents it has also provided in its motion for summary decision here, the utility has also taken the opportunity to make additional allegations of disputed facts with allegedly supporting documents. The presentation of these new allegations is also sufficient on their own to defeat the motion for summary decision in that they raise new and genuine issues of material fact.

[14] See May 13, 2005 letter from the Acting Secretary of the BPU. Exh. K to the Hoffman Affidavit.

POINT II

The Board's review of the proper calculation methodology for the MTC over-recovery in this Phase II proceeding is legally permissible; it was contemplated as an extension of the Phase I audit proceeding; and, as an exercise in the long-standing Board procedure for deferred accounting adjustment clauses, does not constitute retroactive ratemaking.

The allegation of retroactive ratemaking is totally inapposite in that the MTC is an example of deferred accounting which by definition is a method which enables a true-up of a previous period's expenses and revenues. That true-up matches the expenses that the BPU decides are reasonable to include in rates with the revenues received in the deferred accounting mechanism. A dollar for dollar matching of the allowed expenses and revenues is performed in order to prevent either the over-collection or under-collection of these costs.

Also, EDECA required the Board to "conduct a periodic review and, if necessary, adjust the market transition charge or implement other ratemaking mechanisms in order to ensure that the utility will not collect charges that exceed its actual stranded costs." N.J.S.A. 48:3-61(g) (emphasis added).

The use of deferred accounting as opposed to base rate treatment is normally an unusual ratemaking mechanism; however it has been permitted in New Jersey for decades. Indeed, PSE&G itself has used deferred accounting for several types of expenses for decades and cannot realistically allege surprise that the MTC deferred accounting mechanism does not violate the prohibition against retroactive ratemaking. The utility has used deferred accounting for fuel expenses for its previously owned generating stations since the 1970's. N.J.A.C. 14:3-13 et seq.

PSE&G has also used deferred accounting for the cost recovery of its previous demand-side management ("DSM") programs, as outlined in the Board's DSM regulations below:

> The DSM Cost Recovery Mechanism shall be a deferred accounting mechanism which shall be adjusted on an annual basis or some other period concurrent with implementation of

> each utility's fuel adjustment clause to reconcile the difference between:
>
> 1. Actual program costs plus incentives or disincentives or standard offer payments plus fixed cost revenue erosion; and
>
> 2. The level of expenditures recovered in rates for the most recent annual period.

N.J.A.C. 14:12-4.1(b).

The Board has permitted such deferred accounting for other utility expenses and has memorialized the legality of such deferred accounting in its regulations. For example, the regulations establishing the Purchased Water Adjustment Clause (PWAC) and the Purchased Wastewater Adjustment Clause (PSTAC)[15] for New Jersey regulated water and wastewater utilities are instances in which the Board has permitted the same type of deferred accounting which it is using for this MTC account.

> A PWAC or PSTAC allows a utility to include in rates the costs of fluctuations in purchased water or purchased wastewater treatment, without the necessity of a full base rate case.

N.J.A.C. 14:9-7.1(a).

> The Board approves a PWAC or PSTAC for one year, based on estimates of a utility's cost of purchased water or purchased wastewater treatment, and expected total volume of water or wastewater.

N.J.A.C. 14:9-7.1(c).

> At the end of each year, a utility with an approved PWAC or PSTAC shall:
>
> 1. Submit to the Board a year-end true up schedule to reconcile the previous year's actual and estimated costs of purchased water or purchased wastewater treatment; and
>
> 2. Submit a petition for an adjusted PWAC or PSTAC for the upcoming year.

N.J.A.C. 14:9-7.1(d).

[15] Previously known as a Purchased Sewerage Treatment Adjustment Clause.

Since the MTC rate mechanism is the same type of rate mechanism as the PWAC and PSTAC, the retroactive ratemaking argument by PSE&G can be seen to be completely incorrect and should be denied. If the prohibition against retroactive ratemaking applied to the deferred accounting mechanism for recovery of utility expenses, then the Board would never have permitted such an accounting mechanism and PSE&G would never have had the benefit of these mechanisms for the past several decades. PSE&G's argument on this issue is completely incorrect and should be rejected. There is no legal impediment to the Board reviewing the MTC over-recovery calculation methodology in this proceeding. Rate Counsel urges Your Honor to deny the motion for summary decision.

The Board's requirement in the Restructuring Order to true-up the MTC recovery with the allowed MTC expense is a clear decision by the BPU that this deferred accounting mechanism does not violate the prohibition against retroactive ratemaking. It was always the intent of the BPU to refund the total over-recovery, if any, to ratepayers at the end of the four-year transition period. Indeed, the stipulation proposed by PSE&G itself also included such a true-up which by definition does not violate the prohibition against retroactive ratemaking. Restructuring Order, p. 44, para. 14. It is inexplicable why PSE&G should raise this completely irrelevant argument. In any case, the argument fails and the motion for summary decision on that argument should be denied.

POINT III

The Board did not determine as a final matter in the Phase I audit proceeding the proper calculation methodology for the MTC over-recovery, so the doctrine of res judicata does not apply to this Phase II audit proceeding. In any case, the Board has clear authority to reopen or reconsider its orders on its own initiative. Therefore, the parties and the Board are not prohibited from reviewing the calculation methodology in this proceeding.

PSE&G's argument concerning res judicata depends on the same allegations of fact that underlie its argument concerning retroactive ratemaking. The Company argues that the MTC calculation methodology was specifically approved by the Board in the Restructuring Order and the Phase I audit order. As Rate Counsel established above, PSE&G's allegations are not supported by the orders themselves or by the untested allegations contained in the Company's brief and affidavits. Therefore, res judicata does not apply in this instance and the Company's motion based on this argument should be denied.

The New Jersey Supreme Court has cited with approval the Restatement (Second) of Judgments, section 27, (1982), on the matter of issue preclusion generally. "When an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or different claim." Olivieri v. V.M.F. Carpet, Inc., 186 N.J. 511, 522 (2006) (emphasis added). It is clear that before Rate Counsel can be precluded from raising this issue in this Phase II audit, it is absolutely necessary that the matter has been determined by a final judgment. The comments already filed before the BPU also make it clear that the Phase I audit was merely the first step in the proceedings to finalize the deferred balances and rates related to the MTC and was certainly not the final judgment on those issues. If the Board believed that the Phase I audit was final on these issues, there were certainly enough filings in this docket already for the Board to reach that conclusion. Obviously, the Board decided that the Phase I order was not final as to PSE&G's alleged MTC calculation methodology, since the Board transmitted this case to the OAL for hearings.

In Olivieri, the Supreme Court also stated, "judicial determinations by administrative agencies are entitled to preclusive effect if rendered in proceedings which merit such deference." *Id*. As has been thoroughly demonstrated in this brief and attachments, the Phase I audit proceeding and the Restructuring Order do not merit such deference as to justify the application of res judicata to the continuing MTC calculation methodology review.

The fact that the Board has sent this matter to the OAL for evidentiary hearings is plainly a decision that the matter has not yet been finally adjudicated. Without such a final judgment, then the doctrine of res judicata cannot apply here, and the motion for summary decision should be denied.

The Board's Restructuring Order setting up the deferred balances rate recovery mechanisms including the MTC specifically stated that while the deferred balances rates would not be changed during the four-year transition period, the Board expected PSE&G to file its deferred balances rate review proceedings no later than August 1, 2002. Restructuring Order, p. 115, para. e. The final decision concerning the ultimate deferred balances rates and cost recovery could not reasonably have been expected until after the four-year transition period had expired and all the revenues and costs from the various deferred balances components were known.

As stated above, the Phase I deferred balances audit order was necessarily a temporary one, essentially a placeholder until all of the actual results of the four-year transition period were known. The Board obviously desired to reset the deferred balances rate no later than August 1, 2003 to coincide with the expiration of the four-year transition period base rate reductions required by EDECA.[16] PSE&G's interpretation of the Phase I audit order as being finally determinative of the MTC over-recovery calculation methodology is inconsistent with the Board's clear decision not to finalize the deferred balances rates until after August 1, 2003. The Board certainly contemplated not finalizing the audit of the deferred balances until after the four-year transition period. Finalizing the audit would necessarily include a final determination of the MTC calculation methodology. The Phase II audit proceeding is the docket in which the final determination of the MTC calculation methodology should be made.

[16] N.J.S.A. 48:3-52.

The doctrine of res judicata does not prevent the Board and other parties from reviewing this calculation in the Phase II audit proceeding since the Board has never issued a final order on that matter. Therefore, PSE&G's motion for summary decision should be denied.

PSE&G also argues that because the Board's orders in the restructuring docket and the Phase I audit do not mention specifically that interest should be collected on any MTC over-recovery, then the Board must have decided to prohibit such interest and that it would be improper to "revisit" this issue and charge the utility for that interest now. PSE&G Brief, dated May 25, 2007, pp. 9 and 19. PSE&G made this same allegation in its June 13, 2005 comments to the BPU. Rate Counsel provided a response to this allegation in our June 28, 2005 reply to the PSE&G comments. On pages 21 and 22 of our June 28, 2005 reply, Rate Counsel stated that PSE&G was using this argument in a selective and self-serving manner in that the utility maintained a position contrary to this argument in the Phase I audit proceeding. Essentially, PSE&G argued that it should be able to increase charges to customers in Phase I based on the utility's later interpretation of the Restructuring Order, but in this Phase II of the same audit proceeding, PSE&G argues that the Restructuring Order should not be open to later interpretation. The Company should not be permitted to maintain such contradictory positions whenever it suits PSE&G to shift arguments.

In the Phase I audit proceeding, PSE&G reduced the MTC over-recovery by $370 million to account for its alleged costs related to the delay in securitizing the majority of its stranded cost recovery. PSE&G alleged that the subsequent appeal of the Restructuring Order required it to delay issuing the securitization bonds for the stranded cost recovery and that this delay caused the utility to incur $370 million in additional financing costs which should be deducted from the MTC over-recovery.[17] It was never claimed that there is a provision in the Restructuring Order to allow for these additional costs if the securitization of the stranded costs were to be delayed. Rate Counsel opposed the reduction of the MTC over-recovery by the $370 million. Despite our opposition, the BPU allowed PSE&G to reduce the MTC over-recovery by the $370 million even though the Restructuring Order had not specifically permitted the utility to charge customers for this alleged cost, apparently deciding that this modification was reasonable, appropriate and justified.

[17] Krueger Affidavit, Exh. D, RAR-DEF-124.

PSE&G maintained that the fact that charging customers these $370 million in additional costs was not specifically included in the Restructuring Order did not bar the utility from charging customers for these costs and did not bar the BPU from adding these costs to customers' bills subsequent to the order. In our June 28, 2005 reply, Rate Counsel made the counter-argument that if the BPU was not barred from making this deferred accounting rate adjustment after the Restructuring Order was issued, then it would be unfair for PSE&G to argue that the Board should be barred from charging interest on the MTC over-recovery for the reason that such an interest calculation was not specifically spelled out in the Restructuring Order. We argued that if the Board was permitted to interpret its Restructuring Order in this way concerning the securitization delay after the fact, then it would be entirely permissible for the Board to interpret its Restructuring Order and its Phase I order to permit interest on the MTC over-recovery as long as the Board determined that this was reasonable, appropriate and justified. PSE&G should not be permitted to argue that the BPU is prohibited by res judicata from interpreting a prior order in a way that was not spelled out in that order when to do so would be unfavorable to the utility, and also argue that res judicata does not prohibit the Board from interpreting a prior order in a way that was not spelled out in that order when to do so is favorable to utility.

PSE&G's argument that the Restructuring Order and the Phase I audit order are final orders for the purposes of determining once and for all the MTC calculation methodology is also inconsistent with New Jersey court rules concerning the finality of an administrative agency decision. A decision by a court or administrative agency is not normally appealable until it is a final order that disposes of all issues for all parties. R. 2:2-3(a)(2);

> Rule 2:2-3. Appeals to the Appellate Division from final judgments, decisions, actions and from rules; Tax Court
>
> (a) As of Right. . . . appeals may be taken to the Appellate Division as of right . . .
>
> (2) to review final decisions or actions of any state administrative agency or officer, and to review the validity of any rule promulgated by such agency or officer excepting matters prescribed by R. 8:2 (tax matters) and matters governed by R. 4:74-8 (Wage Collection Section appeals), except that review pursuant to this subparagraph shall not be maintainable

> so long as there is available a right of review before any administrative agency or officer, unless the interest of justice requires otherwise; . . . (Emphasis added).

See also Hudson v. Hudson, 36 N.J. 549, 552-553 (1962). Here, the Restructuring Order and the Phase I audit order did not dispose of all issues for all parties because the orders were certainly not final as to the ultimate MTC over-recovery amount or the methodology to calculate the amount. The Restructuring Order specifically required a further proceeding on the MTC to reconcile the recoveries from ratepayers with the amounts due to the utility. The Phase I audit order also contemplated a Phase II proceeding to finalize the MTC over-recovery amount and the method to calculate it. It is plain to see that the BPU never contemplated that either of those two orders were final as to these issues. PSE&G's argument applying res judicata to these two orders should be rejected.

Even if one were to assume, arguendo, that the two orders were final when issued, the Board's subsequent decision to request that the litigating parties provide comments on the MTC over-recovery calculation methodology and the decision to transmit this matter to OAL for further evidentiary proceedings were tantamount to a motion to reconsider or reopen those orders. It has been decided that New Jersey administrative agencies have the inherent authority to reassess or reconsider prior decisions and policies in a manner that can preclude the application of the doctrine of res judicata. In this way, it can be seen that res judicata should not be so mechanically applied in administrative matters as PSE&G would have Your Honor and the Board do:

> The application of res judicata, collateral estoppel and kindred doctrines in the setting of an administrative agency is tempered by the recognition that a particular administrative agency may have continuing regulatory responsibilities over the areas within its jurisdiction. The exercise of some of its supervisory functions in a quasi-judicial manner, such as administrative hearings and adjudications, may be an incident to, rather than the essence of, its primary administrative authority. It is fitting, therefore, that subject to statutory restrictions, such an administrative agency, in appropriate circumstances, have the power to reassess or reconsider its actions in order to perform fully its responsibilities as a regulatory body. [Citation omitted.] In this sense, the power to reconsider, to rehear and to revise determinations may be regarded as inherent in administrative

> agencies. [Citation omitted.] This power to reappraise and modify prior determinations may be invoked by administrative agencies to protect the public interest and thereby to serve the ends of essential justice. (Emphasis added.)

Trap Rock Industries, Inc. v. Sagner, 133 N.J. Super. 99, 109 (App. Div. 1975), aff'd, 69 N.J. 599.

It is unquestionably in the public interest for ratepayers to avoid being overcharged for these stranded costs. The BPU previously decided the eventual true-up of MTC revenues and costs would be the best method to protect ratepayer interests. Restructuring Order, p. 117, para. 10 and page 119, para. 14. In paragraph 14, the BPU explicitly stated that any MTC over-recovery "shall in no event be retained by PSE&G . . ." (Emphasis added). Yet, PSE&G's motion for summary decision would accomplish the result that the BPU has previously decided shall never occur, i.e., that the utility would retain the balance of the MTC over-recovery. It is this result, and not the continuing review of the MTC calculation methodology that Rate Counsel supports, that would actually violate the Restructuring Order.

Even PSE&G itself proposed that at the end of the transition period the MTC should be trued up to avoid overcharging customers. Restructuring Order, p. 44, para. 14. The Company should not be allowed to violate this essential term of its own stipulation proposal. The motion for summary decision should be denied, and the review of the MTC calculation methodology should go forward.

The Board also has undeniable statutory authority to move on its own initiative to reopen or reconsider one of its orders.

> …The Board at any time may order a rehearing and extend, revoke or modify an order made by it.

N.J.S.A. 48:2-40. While this statue would certainly not justify the Board reopening or reconsidering cases in a haphazard fashion, such is obviously not the case here. It is evident that the Board has carefully considered the issue of the MTC over-recovery calculation methodology in this continuing audit proceeding. The Board has twice requested the parties to provide comments on this issue before deciding it once and for all. The BPU also apparently decided that PSE&G's original request to supplement the record with additional

evidence on this issue was a reasonable one since it granted that request and transmitted the case to the OAL. This can be seen as a plainly judicious exercise of the Board's authority to reopen or reconsider the case to allow the parties to present additional evidence and not prejudge the issue. PSE&G's complaint that the Board is without this authority is incorrect and the argument applying the doctrine of res judicata should be denied.

CONCLUSION

For all the foregoing reasons, Rate Counsel respectfully requests that Your Honor deny PSE&G's motion for summary decision in this matter. Certainly there are genuine issues as to material facts as demonstrated herein and in our previous filings with the BPU, such that PSE&G has not proved that it is entitled to prevail on the MTC calculation methodology as a matter of law.

Respectfully submitted,

RONALD K. CHEN
PUBLIC ADVOCATE OF NEW JERSEY

Kimberly K. Holmes, Esq.
Acting Director, Division of Rate Counsel

By: *s/ Badrhn M. Ubushin*
Badrhn M. Ubushin
Assistant Deputy Ratepayer Advocate

APPENDIX A

State of New Jersey
DIVISION OF THE RATEPAYER ADVOCATE
31 CLINTON STREET, 11TH FL
P. O. BOX 46005
NEWARK, NEW JERSEY 07101

JON S. CORZINE
Governor

SEEMA M. SINGH, Esq.
Ratepayer Advocate
and Director

May 12, 2006

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

Re: In the Matter of the Deferred Balances Audit of Public Service Electric & Gas Company
Phase II: August 2002 -July 2003
Docket Nos. EX02060363 and EA02060366

Dear Ms. Izzo:

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

The Ratepayer Advocate provides the within comments pursuant to the August 18, 2005 letter from the Secretary of the Board of Public Utilities (Board or BPU) directing the Ratepayer Advocate to submit comments on the Market Transition Charge (MTC) issues concerning the deferred balances of Public Service Electric and Gas Company (PSE&G or Company). In addition to these comments, the Ratepayer Advocate incorporates by reference our June 13, 2005 initial comments and also our reply comments dated June 28, 2005. To place the instant comments in context, the Ratepayer Advocate will include some background information as we have done in our

previous comments. We will also include an update of our answers to certain questions regarding the MTC that the Board posed in the May 13, 2005 letter from the Board Secretary, using the information updates from the discovery materials we recently received. As can be seen from the within comments and attached schedules, the Market Transition Charge over-recovery as of July 31, 2003 due to be refunded to ratepayers should be increased by $114,359,000 over and above the amount claimed by PSE&G. The total outstanding over-recovery should also be increased to reflect accrued interest beginning August 1, 2003.

MARKET TRANSITION CHARGE ISSUES

Background

As part of the restructuring agreement to transfer PSE&G's generating units to PSE&G's unregulated affiliate, PSEG Power, PSE&G received a cash advance of $540 million from PSEG Power toward the recovery of the generating units' stranded costs. This so-called "transfer premium" was to be used to reduce PSE&G's capitalization, and was to be repaid from the revenues collected by PSE&G from (1) its Market Transition Charge (MTC); (2) the amortization of its excess depreciation reserve; and (3) a 2 mill per kWh "retail adder" applied to the Basic Generation Service (BGS). If, at the end of the four-year Transition Period, these three revenue sources were not sufficient to fully repay the $540 million advance, the shortfall was to be absorbed by PSEG Power. If the $540 million were to be over-recovered, the excess revenue recovery was to be refunded to PSE&G's ratepayers by way of credits in the Societal Benefits Charge (SBC).

The Board's Restructuring Order of August 24, 1999 in Docket Nos. EO97070461, EO97070462, and EO97070463 (Restructuring Order) has the following language with regard to the above-described transfer premium:

> ...PSE&G shall be provided with the opportunity to recover $540 million of its unsecuritized generation stranded costs on a net present value (8.42% discount rate) net of tax basis over the Transition Period. This recovery is to be accomplished via a 2 mill per kwh retail adder, an explicit Market Transition Charge (MTC), exclusive of the NTC, as discussed in Attachment 2 to the PSE&G Stipulation, and the amount funded by the excess distribution depreciation reserve amortization. [page 118, paragraph 13]
>
> At the end of the Transition Period, the recovery of the $540 million will be reconciled to actual collections based on actual sales, the net present value of recovery from both the MTC, exclusive of the NTC, and collections from the 2.0 mill per kWh retail adder for customers retained on BGS, and the depreciation amortization. In the event the company fails to collect $540 million, it will be at risk for any such shortfall. In the event the company collects over $540 million, it shall use any such overrecovery to reduce the Company's SBC at the end of the Transition Period when the SBC is reset and shall in no event be retained by PSE&G or remitted to GENCO [PSEG Power] or otherwise utilized to recover unsecuritized generation related stranded costs. [page 119, paragraph 14]

In the Phase I Deferred Balances proceeding, BPU Docket No. ER02080604 (Phase I Proceeding), PSE&G's proposed reconciliation of the revenue received during the Transition Period for the recovery of the $540 million transfer premium was presented in the testimony of its witness Robert C. Krueger, Jr. Specifically, Mr. Krueger's original Schedule RCK-D-9 showed that, based on actual data through July 31, 2002 and projected data for the remainder of the Transition Period, PSE&G had determined that the reconciliation of the actual revenues received for the recovery of the $540 million indicated an over-recovery of $205.1 million as the amount to be refunded to PSE&G's ratepayers via the SBC (see Attachment-1 to these comments).

In this Phase II Proceeding, PSE&G's initial comments dated June 13, 2005 apparently used an MTC over-recovery amount that was subsequently updated to reflect actual Transition Period data through January 31, 2003, which increased the MTC over-recovery from $205.1 million to $207.1 million (see Attachment-2 to these comments).

Finally, in its response to the BPU Staff data request S-DBINF-1 submitted as part of this Phase II Proceeding, PSE&G updated its calculated MTC over-recovery amount based on actual Transition Period data through July 31, 2003. This final update indicated an MTC over-recovery amount of $197.601 million (see Attachment-3 to these comments).

PSE&G's proposed Transition Period over-recovery amounts of $205.1 million (original), $207.1 million (updated) and $197.6 million (final update) included an over-recovery reduction of approximately $370 million for the carrying costs associated with the delay in securitization from January 2000 through January 2001. In the Phase I Proceeding of PSE&G's Deferred Balances case, Docket No. ER02080604, the Board's consultants, Mitchell & Titus, LLP and the Barrington-Wellesley Group, Incorporated (Auditors), concluded that the inclusion in PSE&G's proposed MTC over-recovery determination of the $370 million securitization delay-related carrying costs had not been authorized by a Board order.

The Ratepayer Advocate also took issue with this item and recommended in that case that PSE&G's quantified Transition Period MTC over-recovery amount should be (1) increased by $328.1 million by completely removing the net present value of the $370 million carrying charges; or, alternatively (2) increased by $173.1 million by replacing PSE&G's proposed carrying cost rate with the rate on 7-year constant maturity Treasury notes plus 60 basis points.

Question No. 1

How was the net present value of the MTC over-recovery due ratepayers determined by PSE&G and was it consistent with the determination of the net present value of the MTC recovery due PSEG Power? Please explain in detail, and provide supporting documentation.

Answer:

PSE&G determined the net present value (NPV) of the MTC over-recovery due ratepayers in the same way as it determined the NPV of the MTC recovery due PSEG Power. PSE&G June 13, 2005 initial comments, pages 3-4. The Company's specific calculation methodology for the final updated NPV analysis of the Transition Period MTC collections is detailed in Attachment-3 to these instant comments which is in the format of Schedule RCK-D-9 from the Phase I Proceeding, updated to reflect actual Transition Period data through July 31, 2003. As shown in Attachment-3, the Company first determined the after-tax MTC collections in each month of the 4-year Transition Period from August 1999 through July 2003. Next, the Company accumulated all monthly after-tax MTC collections for each calendar year in the Transition Period, and then applied to these annual calendar year MTC accumulations annual discount factors based on an after-tax annual discount rate of 8.42%. The 8.42% discount rate represents PSE&G's then-allowed overall rate of return (10.08%), expressed net of tax. The NPV results of this annual discounting process are summarized below:

Cumulative MTC Collections in Calendar Year ($million)	Annual Discount Factor Based on Annual Rate of 8.42%	NPV Cumulative MTC Collections in Calendar Year ($million)
1999 (5 mos.): $151.050	0.96687	$146.046
2000 (12 mos.): 251.996	0.89178	224.727
2001 (12 mos.): 195.252	0.82253	160.601
2002 (12 mos.): 97.694	0.75864	74.115
2003 (7 mos.): 71.011	0.72370	51.391
Total $767,002		$656.881

Thus, based on this annual discounting approach, the Company concluded that, during the entire Transition Period, it collected after-tax MTC revenues of $656.881 million on a NPV basis as

of August 1999. Next, the Company subtracted from this total NPV amount the $540 million[1] transition premium owed to PSEG Power, thereby leaving an after-tax NPV amount of $116.881 million as the MTC over-recovery due ratepayers. As the final step, by using a revenue conversion factor of 0.5915,[2] the Company converted this after-tax MTC over-recovery amount of $116.881 million into a total over-recovered revenue amount of $197.601 million[3]. As will be shown below, PSE&G's method of calculation is incorrect and understates the over-recovery due back to its ratepayers.

Question No. 4

In determining the net present value of the MTC recovery, should the discount rate have been applied monthly or annually? Please explain in detail with supporting documentation.

Answer:

It is the Ratepayer Advocate's position that, in determining the NPV of the MTC recovery, the discount rate should have been applied monthly rather than annually. The reason is quite simple.

First, it should be made clear that a discount factor used in a present value analysis represents a time value of money and, in this instance, represents the return presumed to be earned by PSE&G on the available cash flows from the MTC collections. The MTC revenues during the Transition Period were billed and collected by PSE&G on a monthly basis, with the monthly collections clearly shown on Schedule RCK-D-9 in the testimony of PSE&G witness, Mr. Krueger, in the Phase I Deferred Balances proceeding. Since the cash flows from the MTC collections became available to PSE&G on a monthly basis, PSE&G has been able to immediately earn a return on these MTC revenues from the moment they were collected in each month. Applying the discount rate to the

[1] Similar to the amount of $656.881 million, the transition premium amount of $540 million is also stated on a NPV basis as of August 1999.
[2] Inverse of combined federal and state income tax rate of 0.4085.
[3] Calculation: $116.881 / 0.5915 = $197.601 million

monthly MTC collections, instead of using an annual basis as PSE&G does, gives appropriate recognition to the fact that PSE&G has actually enjoyed the immediate returns on these monthly MTC collections during the Transition Period.

The Company's proposed annual discounting approach assumes that PSE&G does not earn a return on its monthly MTC collections during the calendar year. Rather, it assumes that PSE&G will not start earning a return until all monthly MTC collections have been accumulated at the end of the calendar year. This assumption is wrong and completely inconsistent with financial reality.

The appropriate monthly discounting process to use is to take $1/12^{th}$ of the annual after-tax discount rate of 8.42% (equal to a converted monthly discount rate of 0.70167%) and apply this monthly discount rate to PSE&G's monthly after-tax MTC collections during the Transition Period.

On Schedule RPA-1 (Updated for Actuals through 7/31/03) in Attachment-4, the Ratepayer Advocate has calculated that the total Transition Period after-tax MTC collections of $767 million have a present value as of August 1999 of $676.053 million when discounted on a monthly basis using a monthly discount rate of 0.70167%. This after-tax NPV value of $676.053 million is $19.172 million higher than PSE&G's calculated final updated after-tax NPV value of $656.881 million based on the Company's proposed annual discounting approach. Using the same revenue conversion factor of 0.5915, this higher after-tax value of $19.172 million translates into a higher MTC revenue over-recovery of $32.412 million. Thus, based on the monthly discounting approach, PSE&G's calculated final updated MTC over-recovery of $197.601 million should be increased by $32.412 million. This would mean that the correct final updated MTC over-recovery total should be $230.013 million.

PSE&G claims in its June 13, 2005 initial comments that its proposed use of the annual discounting approach is in accordance with the Board's Restructuring Order. Specifically, on page 9 of its initial comments, PSE&G states:

> A review of the language and context of the Board's Restructuring and Rate and Deferral Orders makes clear that, contrary to the Energy Staff's Position in the instant dispute, those Orders included:
>
> 1) a determination that the net present value calculation of the Company's MTC recovery would be on an annual, rather than monthly, basis; ....

This PSE&G claim is based on its reading of the language on page 120, paragraph 13 of the Restructuring Order that "PSE&G shall be provided with the opportunity to recover up to $540 million of its unsecuritized generation stranded costs on a net present value (8.42% discount rate) net of tax basis over the Transition Period." Thus, since the Restructuring Order mentions an annual discount rate of 8.42%, PSE&G believes that, therefore, the Board meant to use the annual discounting approach in determining the NPV of the MTC collections.

The Ratepayer Advocate submits that this Board language does not at all require, or even suggest, that all monthly MTC collections should be accumulated for each Transition Period calendar year and then discounted on an annual basis. The 8.42% rate was stated in the Order to indicate what the annualized rate should be in making NPV calculations with regard to the MTC collections and was not meant to require that the annual discounting method should be used. There is nothing unusual about converting an annualized earnings or discount rate to a monthly rate by dividing the annualized rate by twelve. And there is nothing unusual or unorthodox about applying such a monthly rate if cash flows are realized on a monthly basis rather than on an annual basis. As a matter of fact, this practice of converting an annual rate to a monthly rate (by taking $1/12^{th}$ of the annual rate) and applying the monthly rate to monthly cash flows rather than annual cash flows has

been used by the Board in numerous regulatory matters involving interest or present value calculations.

For example, in many restructuring related matters, Board Orders have ruled that interest be calculated on under- or over-recovery balances based on the annual rate on 7-year constant maturity Treasury notes plus 60 basis points. However, in making the interest calculations, the Board required that interest be calculated on monthly under- or over-recovery balances at a monthly interest rate equal to $1/12^{th}$ of the annual rate on 7-year constant maturity Treasury notes plus 60 basis points.

On page 8 of its June 13, 2005 initial comments, PSE&G states that recalculating the Company's MTC over-collection would be "inconsistent with the Restructuring Order." This claim is apparently based on the fact that the Restructuring Order does not specify the exact methodology of calculating the MTC over-recovery. In this regard, the Ratepayer Advocate notes that the previously discussed carrying charges on the delay of securitization that were allowed to be included in the determination of the MTC over-collection, which significantly reduced the MTC over-collection calculations and correspondingly reduced the refund to ratepayers, were also considered to be "inconsistent with the Restructuring Order" to the extent that the consideration of these carrying charges was not provided for in the Order. Thus, the Board has previously allowed MTC reconciliation-related calculation aspects that were not specifically covered in the Restructuring Order, if these calculation aspects were considered equitable and appropriately justified. The Board should do the same in this instance by re-calculating the MTC over-recovery based on the monthly discounting approach.

Question No. 2

How should the ratepayer MTC over-recovery have been booked during each year of the transition period, i.e., as an allocated portion of the estimated net present value of the over-recovery as of August 1, 1999, as determined and booked by PSE&G, or as the estimated over-recovery occurring in each year of the transition period, in that year's dollars?

Answer:

This question goes to the issue as to how much of the MTC recovery during the Transition Period should be discounted back to August 1, 1999 in the determination of the dollar value of the MTC over-recovery. PSE&G takes the position that all Transition Period MTC recoveries should be discounted. On the other hand, the Ratepayer Advocate believes that only the Transition Period MTC recovery amount needed to recover the $540 million transfer premium should be discounted back to August 1, 1999. Once the NPV amount of $540 million has been collected, any MTC revenues collected after that point in time should be treated as normal over-recovery that would receive the same treatment that has been prescribed by the Restructuring Order for other over- and under-recoveries incurred during the Transition Period. What this means is that these MTC over-recoveries should be deferred at undiscounted, nominal dollar values. Therefore, the Ratepayer Advocate agrees with the latter approach mentioned in Question No. 2 above, *i.e.*, that the ratepayer MTC over-recovery should have been booked as the "over-recovery occurring in each year of the transition period, in that year's dollars."

PSE&G's calculation methodology incorrectly discounts all MTC over-recoveries collected through July 2003 back to the NPV as of August 1, 1999, even though the ratepayer refunds for these MTC over-recoveries take place starting on August 1, 2003. This calculation method inappropriately assigns to PSE&G -- rather than to the ratepayers -- all earnings on the MTC over-recovery amount during the 4-year Transition Period from August 1, 1999 to August 1, 2003. Once

enough MTC revenues have been collected that, on a discounted basis, would equal the $540 million transfer premium value as of August 1, 1999, it makes no sense, from either a sound financial or logical viewpoint, to continue to discount the subsequently collected MTC over-recoveries to a present value as of August 1, 1999 and then use that discounted value as the basis for the determination of the MTC over-recovery ratepayer refund starting on August 1, 2003.

On Schedule RPA-2 in Attachment-5, the Ratepayer Advocate has calculated that, based on the monthly discounting approach, the $540 million after-tax NPV transition premium is fully recovered through MTC collections from August 1999 until sometime in the month of December 2001. The bottom of Schedule RPA-2 also shows that, based on the annual discounting approach used by PSE&G, this full recovery point in time occurs one month later, in January 2002. All MTC collections after those months represent MTC over-recoveries for which there no longer is any need or reason to discount back to August 1999. As stated before, those over-recovered MTC collections should be deferred at undiscounted, nominal dollar values.

The monthly undiscounted MTC recoveries collected after December 2001[4] and through July 2003 are shown in the first column of Schedule RPA-3 (Updated for Actuals Through 7/31/03) in Attachment-6 and amount to a total undiscounted pre-tax MTC over-recovery amount of $298.977 million. This is $101.376 million higher than the final updated pre-tax MTC over-recovery amount of $197.601 million calculated via PSE&G's "total discounting" methodology. Of this $101.376 million pre-tax MTC over-recovery difference, $32.412 million is due to the use of the monthly (vs. annual) discounting calculation method, calculated on Schedule RPA-1 (Updated for Actuals through 7/31/03) in Attachment-4. The remaining $68.964 million difference is due to the premise that all MTC collections after full recovery of the $540 million NPV transition premium should have

[4] December 2001 is the month of full recovery of the $540 million NPV transfer premium based on the monthly discounting approach.

been accrued at undiscounted, nominal dollar values, similar to the treatment prescribed by the Restructuring Order for other over- and under-recoveries incurred during the Transition Period.

The monthly undiscounted MTC recoveries collected after January 2002 (the month of full recovery of the $540 million NPV amount based on PSE&G's annual discounting approach) total approximately $285.217 million,[5] which is $87.616 million higher than the final updated pre-tax MTC over-recovery amount of $197.601 million calculated via PSE&G's "total discounting" methodology.

In its June 13, 2005 initial comments, PSE&G asserts that the Restructuring Order included "a determination that discounting the MTC collection to its August 1, 1999 value should continue throughout the four year transition period, without regard to whether or not the Company was fully reimbursed...."[6] PSE&G bases this assertion on the following statement made in paragraph 14, page 120 of the Restructuring Order:

> At the end of the Transition Period, the recovery of the $540 million will be reconciled to actual collections based on actual sales, the net present value of recovery from both the MTC, exclusive of the NTC, and collections from the 2.0 mill per kWh retail adder for all customers retained on the BGS, and the depreciation amortization.

Based on the above-quoted Restructuring Order language, PSE&G concludes that "[t]here were no requirements to book any ratepayer over collection on a monthly or annual basis"[7] and that "it is clear that in issuing the Restructuring Order, the Board directed that MTC collections would be calculated via an annual discounting throughout the transition period...."[8]

The Ratepayer Advocate disagrees with PSE&G's assertions and conclusions. Nowhere in the Restructuring Order does the Board require that all MTC collections in the Transition Period,

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[5] Total pre-tax MTC over-recovery of $298.977 million less December 2001 pre-tax MTC over-recovery of $13.760 million. *See Schedule RPA-3 (Updated for Actuals Through 7/31/03) in Attachment-6.*
[6] PSE&G June 13, 2005 initial comments, page 9, point 2.
[7] PSE&G June 13, 2005 initial comments, page 4, Answer to Question 2.
[8] *Id.* at page 10, last paragraph.

including any potential MTC over-collections, must be discounted back to their August 1, 1999 value in the determination of the ratepayer refund of over-collections. Since the Restructuring Order is not specific on what exact MTC over-collection calculation method should be used, PSE&G has come up with its own "interpretation" of the Order and has boldly concluded that the Board really meant to order that all Transition Period MTC collections, even the MTC over-collections, should be discounted back to August 1, 1999 in determining the ratepayer refund amount. The Restructuring Order statement that "[a]t the end of the Transition Period, the recovery of the $540 million will be reconciled to actual collections based on actual sales, the net present value of recovery from both the MTC, exclusive of the NTC, and collections from the 2.0 mill per kWh retail adder for all customers retained on the BGS, and the depreciation amortization" does not prescribe the reconciliation methodology that PSE&G has used.

On the contrary, the Ratepayer Advocate submits that this Board-ordered reconciliation process implied that present value discounting should be applied only to all MTC collections required to pay back the August 1999 transfer premium of $540 million and that all Transition Period MTC collections after this point be booked and accrued at undiscounted, nominal values. Not only is this the correct reconciliation approach based on sound financial principles, it is also consistent with the reconciliation approach prescribed by the Restructuring Order for other Transition Period over- and under-recoveries. For example, any over- or under-recoveries for such Transition Period rates as PSE&G's Non-utility Generation Transition Charge (NTC), Social Programs, Decommissioning, and DSM rates were booked and deferred at undiscounted, nominal dollar values.

The premise that NPV discounting should be limited to just those MTC collections needed to fully recover the $540 million transfer premium as of August 1999 and not to the overcollected

amounts after full recovery would appear to be supported by PSE&G's own statement in the second full paragraph on page 8 of its June 13, 2005 initial comments that:

> In exchange for paying a "transfer premium" of $540 million, Genco [PSEG Power] received the right to collect market transition charge ("MTC") revenues during the Transition Period, but only until it was reimbursed the $540 million premium. Any collections above that figure would be retained by Public Service to be refunded to customers after the end of the transition period....
>
> [emphasis supplied]

Question No. 3

Should interest have been booked on the ratepayer MTC over-recovery occurring in each year of the transition period, and if so, what is the appropriate rate? If not, why not.

Answer:

The Ratepayer Advocate believes that interest should have been accrued, at a rate equal to the rate on 7-year constant maturity Treasury notes plus 60 basis points, on all cumulative monthly undiscounted (nominal value) MTC over-recovery balances booked after the point in time that the $540 million NPV amount had been fully recovered. From the moment PSE&G collects MTC over-recoveries that are due ratepayers, the earnings power of the deferred over-recovered MTC balances also belongs to ratepayers, and any earnings accrued on these deferred balances should be passed on to ratepayers along with the deferred MTC over-recoveries themselves. The Ratepayer Advocate takes the reasonable position that, while it is appropriate to use a rate of 8.42% for discounting purposes in calculating the recovery of the $540 million NPV stranded cost amount, this 8.42% overall rate of return would no longer be appropriate to use as an earnings rate once the stranded costs are fully recovered. Instead, the earnings rate to be applied to the deferred MTC over-recovery balances accumulated after the recovery of the $540 million NPV stranded cost should be the rate on 7-year constant maturity Treasury notes plus 60 basis points, the Board-approved rate for accruing

interest on deferred balances during the Transition Period. See Restructuring Order, pages 117 and 118.

On Schedule RPA-3 (Updated for Actuals Through 7/31/03) in Attachment-6, the Ratepayer Advocate has calculated, in accordance with the above-described methodology, the total interest amount accrued on the average monthly deferred MTC over-recovery balances from December 2001 (the point in time that the $540 million NPV amount was fully recovered based on the monthly discounting approach) through July 2003, the end of the Transition Period. As shown on this schedule, the calculations indicate total interest accruals of $12.983 million. If the Board agrees with the Ratepayer Advocate that interest should be accrued on all deferred MTC over-recovery balances and flowed through to the ratepayers, this increases the total ratepayer refund amount by that same amount.

The Ratepayer Advocate also respectfully urges the Board to require PSE&G to continue to accrue interest on the MTC over-recovery for the period beginning August 1, 2003, *i.e.*, the post-Transition Period, at the Board-approved interest rate for PSE&G's other deferred balances.

Question No. 5

Is it appropriate to adjust the determination of the MTC recovery to reflect the fact that under IRS rulings and court decisions, monies properly belonging to ratepayers, such as fuel cost overrecoveries, are not taxable? See United States Tax Court decision, in Florida Progress Corporation and Subsidiaries v. Commissioner of Internal Revenue, No. 2961-97, June 30, 2000; affirmed Florida Progress Corp. and Subsidiaries, v. C.I.R., 348 F.3d 954 (11th Cir. Oct. 21, 2003) (No. 02-14910,02-14911). Please explain in detail, with supporting documentation.

Answer:

The August 18, 2005 letter from the Board Secretary notes that "The issue of the appropriate treatment of Investment Tax Credits associated with the divested generating units will be addressed as part of another proceeding for all for electric utilities." The Ratepayer Advocate discussed this

issue in our June 28, 2005 reply comments. The reply comments addressed the possible tax effects of this issue on PSE&G's MTC deferred balance as well as other non-MTC deferred balance accounts and requested the Board to require PSE&G to provide additional information. The Ratepayer Advocate also requested the Board to allow further comments after the additional information is provided. Ratepayer Advocate June 28, 2005 reply comments, p. 17. To the extent that those issues have not been transferred to the other open Investment Tax Credit proceedings mentioned by the Board Secretary,[9] the Ratepayer Advocate reiterates those comments here and requests the Board to require PSE&G to supply the information sought by the Ratepayer Advocate and permit additional comments by all parties.

NON-UTILITY GENERATION (NUG) CONTRACT COST RECOVERY AND RESTRUCTURING AND RENEGOTIATION

The Ratepayer Advocate requested further examination and consideration by the parties and the BPU concerning other issues related to the Company's NUG contracts cost recovery and PSE&G's efforts to restructure and renegotiate its NUG contracts. Ratepayer Advocate June 28, 2005 reply comments, pp. 22-24. The issues were discussed in the Phase II audit report and also in the June 13, 2005 Ratepayer Advocate's initial comments. The Ratepayer Advocate reiterates those concerns herein. The Ratepayer Advocate requests the Board to continue the examination of those issues in this matter as requested previously, or that they be examined fully in a separate open docket concerning PSE&G's deferred balances, such as Docket No. GR05080686 concerning the electric NTC and the electric and gas SBC deferred balances.

[9] Compare, BPU Docket Nos. EX02060363, EA02060364, EA02060365, EA02060366 and EA02060367.

CONCLUSION

The Ratepayer Advocate respectfully urges the Board to adopt the recommendations contained in the instant comments and in our initial and reply comments in this matter and to require PSE&G to supplement its filings with the additional information the Ratepayer Advocate has requested that is necessary to complete a full review of the Phase II audit report. PSE&G should be required to increase the MTC over-recovery refund by $114,359,000 as of July 31, 2003 and to continue to accrue interest on the total MTC over-recovery after that date at the Board-approved interest rate for the utility's other deferred balances. After the Ratepayer Advocate and other interested parties have received the additional information from PSE&G, the Ratepayer Advocate respectfully urges the Board to provide additional time for our office and the other interested parties to file additional comments concerning the new information provided by PSE&G.

Respectfully submitted,

SEEMA M. SINGH, ESQ.
RATEPAYER ADVOCATE

By: Badrhn M. Ubushin
Badrhn M. Ubushin, Esq.
Asst. Deputy Ratepayer Advocate

c: President Jeanne M. Fox
Commissioner Frederick F. Butler
Commissioner Connie O. Hughes
Commissioner Joseph L. Fiordaliso
Commissioner Christine V. Bator
Service list (by hand delivery or US regular mail)

ATTACHMENT-1

Schedule RCK-D-9
Original

MTC Deferral Work (millions)

	MTC Net Revenues from Customers	Carrying Cost Due to Delay in Securitization	Net MTC Revenues	Depreciation MTC	Retail Adder	Total Pre-tax MTC	Tax on MTC	After Tax MTC	Annual Sum	NPV of After-tax MTC @ 8.42%
Aug-99	61.321	-	61.321	-	8.201	69.522	28.400	41.122		
Sep-99	30.721	-	30.721	-	6.702	37.423	15.287	22.136		
Oct-99	44.044	-	44.044	-	6.277	50.321	20.556	29.765		
Nov-99	41.466	-	41.466	-	6.002	47.468	19.391	28.077		
Dec-99	44.224	-	44.224	-	6.409	50.633	20.684	29.949	151.050	146.046
Jan-00	39.384	(28.470)	10.914	14.764	6.187	31.866	13.017	18.849		
Feb-00	40.787	(28.470)	12.317	14.764	5.467	32.548	13.296	19.252		
Mar-00	43.783	(28.470)	15.313	14.764	5.475	35.552	14.523	21.029		
Apr-00	34.525	(28.470)	6.055	14.764	5.008	25.827	10.550	15.277		
May-00	41.219	(28.470)	12.749	14.764	5.367	32.881	13.432	19.449		
Jun-00	43.594	(28.470)	15.124	14.764	6.871	36.758	15.016	21.743		
Jul-00	46.789	(28.470)	18.319	14.764	7.068	40.150	16.401	23.749		
Aug-00	50.098	(28.470)	21.628	14.764	7.122	43.514	17.775	25.738		
Sep-00	45.257	(28.470)	16.787	14.764	6.247	37.798	15.440	22.357		
Oct-00	42.639	(28.470)	14.169	14.764	5.683	34.616	14.140	20.475		
Nov-00	42.770	(28.470)	14.300	14.764	5.711	34.774	14.205	20.569		
Dec-00	47.309	(28.470)	18.839	14.764	6.142	39.744	16.236	23.509	251.998	224.727
Jan-01	48.177	(28.470)	19.707	14.764	6.247	40.718	16.633	24.084		
Feb-01	12.343		12.343	14.764	5.716	32.823	13.408	19.415		
Mar-01	9.878		9.878	14.764	6.117	30.759	12.565	18.194		
Apr-01	6.507		6.507	14.764	5.903	27.174	11.100	16.073		
May-01	7.642		7.642	14.764	6.112	28.518	11.649	16.868		
Jun-01	5.145		5.145	14.764	7.969	27.878	11.388	16.490		
Jul-01	7.253		7.253	14.764	7.783	29.800	12.173	17.626		
Aug-01	2.717		2.717	14.764	8.905	26.386	10.778	15.607		
Sep-01	(0.089)		(0.089)	14.764	6.656	21.331	8.714	12.617		
Oct-01	(0.043)		(0.043)	14.764	6.535	21.256	8.683	12.573		
Nov-01	0.887	-	0.887	14.764	6.204	21.855	8.928	12.927		
Dec-01	0.273		0.273	14.764	6.561	21.598	8.823	12.775	195.250	160.599
Jan-02	(0.693)		(0.693)	17.285	6.561	23.154	9.458	13.695		
Feb-02	(0.429)		(0.429)	17.285	5.929	22.785	9.308	13.477		
Mar-02	(0.132)		(0.132)	17.285	6.291	23.444	9.577	13.867		
Apr-02	(0.332)		(0.332)	17.285	6.254	23.208	9.480	13.727		
May-02	(0.189)		(0.189)	17.285	6.264	23.360	9.543	13.817		
Jun-02	(3.665)		(3.665)	17.285	7.337	20.958	8.561	12.396		
Jul-02	(3.810)		(3.810)	17.285	8.855	22.330	9.122	13.208		
Aug-02	(23.684)		(23.684)	17.285	-	(6.399)	(2.614)	(3.785)		
Sep-02	(18.563)		(18.563)	17.285		(1.278)	(0.522)	(0.756)		
Oct-02	(13.565)		(13.565)	17.285		3.720	1.520	2.201		
Nov-02	(14.936)		(14.936)	17.285		2.349	0.960	1.390		
Dec-02	(15.266)		(15.266)	17.285		2.019	0.825	1.194	94.434	71.642
Jan-03	(13.639)		(13.639)	34.480		20.841	8.514	12.327		
Feb-03	(12.218)		(12.218)	34.480		22.262	9.094	13.168		
Mar-03	(12.951)		(12.951)	34.480		21.529	8.795	12.734		
Apr-03	(12.220)		(12.220)	34.480		22.260	9.093	13.167		
May-03	(12.264)		(12.264)	34.480		22.216	9.075	13.141		
Jun-03	(19.451)		(19.451)	34.480		15.029	6.139	8.890		
Jul-03	(22.479)		(22.479)	34.480		12.001	4.902	7.099	80.526	58.277
Total	$ 640.134	$ (370.110)	$ 270.024	$ 803.117	$ 234.137	$ 1,307.278	$ 534.023	$ 773.255		

Authorized Unsecuritized Stranded Cost Recovery	$ 661.292
	$ 540.000
Difference	$ 121.292
Revenue Level	$ 205.058

SCHEDULE RCK-D-9

ATTACHMENT-2

Schedule RCK-D-9
Updated through January 31, 2003

MTC Deferral Worksheet (millions)

	MTC Net Revenues from Customers	Carrying Cost Due to Delay in Securitization	Net MTC Revenues	Depreciation MTC	Retail Adder	Total Pre-tax MTC	Tax on MTC	After Tax MTC	Annual Sum	NPV of After-tax MTC @ 8.42%
Aug-99	61.321	-	61.321	-	8.201	69.522	28.400	41.122		
Sep-99	30.721	-	30.721	-	6.702	37.423	15.287	22.136		
Oct-99	44.044	-	44.044	-	6.277	50.321	20.556	29.765		
Nov-99	41.466	-	41.466	-	6.002	47.468	19.391	28.077		
Dec-99	44.224	-	44.224	-	6.409	50.633	20.684	29.949	151.050	146.046
Jan-00	39.384	(28.470)	10.914	14.764	6.187	31.866	13.017	18.849		
Feb-00	40.787	(28.470)	12.317	14.764	5.467	32.548	13.296	19.252		
Mar-00	43.783	(28.470)	15.313	14.764	5.475	35.552	14.523	21.029		
Apr-00	34.525	(28.470)	6.055	14.764	5.008	25.827	10.550	15.277		
May-00	41.219	(28.470)	12.749	14.764	5.367	32.881	13.432	19.449		
Jun-00	43.594	(28.470)	15.124	14.764	6.871	36.758	15.016	21.743		
Jul-00	46.789	(28.470)	18.319	14.764	7.068	40.150	16.401	23.749		
Aug-00	50.098	(28.470)	21.628	14.764	7.122	43.514	17.775	25.738		
Sep-00	45.257	(28.470)	16.787	14.764	6.247	37.798	15.440	22.357		
Oct-00	42.639	(28.470)	14.169	14.764	5.683	34.616	14.140	20.475		
Nov-00	42.770	(28.470)	14.300	14.764	5.711	34.774	14.205	20.569		
Dec-00	47.309	(28.470)	18.839	14.764	6.142	39.744	16.236	23.509	251.996	224.727
Jan-01	48.177	(28.470)	19.707	14.764	6.247	40.718	16.633	24.084		
Feb-01	12.343		12.343	14.764	5.716	32.823	13.408	19.415		
Mar-01	9.878		9.878	14.764	6.117	30.759	12.565	18.194		
Apr-01	6.507		6.507	14.764	5.903	27.174	11.100	16.073		
May-01	7.642		7.642	14.764	6.112	28.518	11.649	16.868		
Jun-01	5.145		5.145	14.764	7.969	27.878	11.388	16.490		
Jul-01	7.253		7.253	14.764	7.783	29.800	12.173	17.626		
Aug-01	2.717		2.717	14.764	8.905	26.386	10.778	15.607		
Sep-01	(0.089)		(0.089)	14.764	6.656	21.331	8.714	12.617		
Oct-01	(0.043)		(0.043)	14.764	6.535	21.256	8.683	12.573		
Nov-01	0.887		0.887	14.764	6.204	21.855	8.928	12.927		
Dec-01	0.273		0.273	14.764	6.561	21.598	8.823	12.775	195.250	160.599
Jan-02	(0.693)		(0.693)	17.285	6.561	23.154	9.458	13.695		
Feb-02	(0.429)		(0.429)	17.285	5.929	22.785	9.308	13.477		
Mar-02	(0.132)		(0.132)	17.285	6.291	23.444	9.577	13.867		
Apr-02	(0.332)		(0.332)	17.285	6.254	23.208	9.480	13.727		
May-02	(0.189)		(0.189)	17.285	6.264	23.360	9.543	13.817		
Jun-02	(3.665)		(3.665)	17.285	7.337	20.958	8.561	12.396		
Jul-02	(3.810)		(3.810)	17.285	8.855	22.330	9.122	13.208		
Aug-02	(18.553)		(18.553)	17.285	-	(1.268)	(0.518)	(0.750)		
Sep-02	(16.189)		(16.189)	17.285		1.096	0.448	0.648		
Oct-02	(16.372)		(16.372)	17.285		0.913	0.373	0.540		
Nov-02	(13.995)		(13.995)	17.285		3.290	1.344	1.946		
Dec-02	(15.391)		(15.391)	17.285		1.894	0.774	1.120	97.695	74.117
Jan-03	(16.546)		(16.546)	34.480		17.934	7.326	10.608		
Feb-03	(12.218)		(12.218)	34.480		22.262	9.094	13.168		
Mar-03	(12.951)		(12.951)	34.480		21.529	8.795	12.734		
Apr-03	(12.220)		(12.220)	34.480		22.260	9.093	13.167		
May-03	(12.264)		(12.264)	34.480		22.216	9.075	13.141		
Jun-03	(19.451)		(19.451)	34.480		15.029	6.139	8.890		
Jul-03	(22.479)		(22.479)	34.480		12.001	4.902	7.099	78.806	57.033
Total	$ 642.741	$ (370.110)	$ 272.631	$ 803.117	$ 234.137	$ 1,309.885	$ 535.088	$ 774.797		

Authorized Unsecuritized Stranded Cost Recovery	$ 662.522
	$ 540.000
Difference	$ 122.522
Revenue Level	$ 207.137

SCHEDULE RCK-D-9

ATTACHMENT-3

Response to Data Request S-DBINF-1
Page 10
Updated through July 31, 2003

MTC Deferral Worksheet ($-millions)

	MTC Net Revenues from Customers	Carrying Cost Due to Delay in Securitization	Net MTC Revenues	Depreciation MTC	Retail Adder	Total Pre-tax MTC	Tax on MTC	After Tax MTC	Annual Sum	NPV of After-tax MTC @ 8.42%
Aug-99	61 321	-	61 321	-	8 201	69 522	28 400	41 122		
Sep-99	30 721	-	30 721	-	6 702	37 423	15 287	22 136		
Oct-99	44 044	-	44 044	-	6 277	50 321	20 556	29 765		
Nov-99	41 466	-	41 466	-	6 002	47 468	19 391	28 077		
Dec-99	44 224	-	44 224	-	6 409	50 633	20 684	29 949	151 050	146 046
Jan-00	39 384	(28 470)	10 914	14 764	6 187	31 866	13 017	18 849		
Feb-00	40 787	(28 470)	12 317	14 764	5 467	32 548	13 296	19 252		
Mar-00	43 783	(28 470)	15 313	14 764	5 475	35 552	14 523	21 029		
Apr-00	34 525	(28 470)	6 055	14 764	5 008	25 827	10 550	15 277		
May-00	41 219	(28 470)	12 749	14 764	5 367	32 881	13 432	19 449		
Jun-00	43 594	(28 470)	15 124	14 764	6 871	36 758	15 016	21 743		
Jul-00	46 789	(28 470)	18 319	14 764	7 068	40 150	16 401	23 749		
Aug-00	50 098	(28 470)	21 628	14 764	7 122	43 514	17 775	25 738		
Sep-00	45 257	(28 470)	16 787	14 764	6 247	37 798	15 440	22 357		
Oct-00	42 639	(28 470)	14 169	14 764	5 683	34 616	14 141	20 475		
Nov-00	42 770	(28 470)	14 300	14 764	5 711	34 775	14 205	20 569		
Dec-00	47 309	(28 470)	18 839	14 764	6 142	39 745	16 236	23 509	251 996	224 727
Jan-01	48 177	(28 470)	19 707	14 764	6 247	40 718	16 633	24 085		
Feb-01	12 343		12 343	14 764	5 716	32 823	13 408	19 415		
Mar-01	9 878		9 878	14 764	6 117	30 759	12 565	18 194		
Apr-01	6 507		6 507	14 764	5 903	27 174	11 101	16 073		
May-01	7 642		7 642	14 764	6 112	28 518	11 650	16 868		
Jun-01	5 145		5 145	14 764	7 969	27 878	11 388	16 490		
Jul-01	7 253		7 253	14 764	7 783	29 800	12 173	17 627		
Aug-01	2 717		2 717	14 764	8 905	26 386	10 779	15 607		
Sep-01	(0 089)		(0 089)	14 764	6 656	21 331	8 714	12 617		
Oct-01	(0 043)		(0 043)	14 764	6 535	21 256	8 683	12 573		
Nov-01	0 887		0 887	14 764	6 204	21 855	8 928	12 927		
Dec-01	0 273		0 273	14 764	6 561	21 598	8 823	12 775	195 252	160 601
Jan-02	(0 693)		(0 693)	17 285	6 561	23 153	9 458	13 695		
Feb-02	(0 429)		(0 429)	17 285	5 929	22 785	9 308	13 477		
Mar-02	(0 132)		(0 132)	17 285	6 291	23 444	9 577	13 867		
Apr-02	(0 332)		(0 332)	17 285	6 254	23 207	9 480	13 727		
May-02	(0 189)		(0 189)	17 285	6 264	23 360	9 542	13 817		
Jun-02	(3 665)		(3 665)	17 285	7 337	20 957	8 561	12 396		
Jul-02	(3 810)		(3 810)	17 285	8 855	22 330	9 122	13 208		
Aug-02	(18 553)		(18 553)	17 285	-	(1 267)	(0 518)	(0 750)		
Sep-02	(16 189)		(16 189)	17 285	-	1 096	0 448	0 648		
Oct-02	(16 372)		(16 372)	17 285	-	0 913	0 373	0 540		
Nov-02	(13 995)		(13 995)	17 285	-	3 291	1 344	1 946		
Dec-02	(15 391)		(15 391)	17 285	-	1 894	0 774	1 120	97 694	74 115
Jan-03	(16 546)		(16 546)	34 480	-	17 934	7 326	10 608		
Feb-03	(19 275)		(19 275)	34 480	-	15 205	6 211	8 994		
Mar-03	(14 629)		(14 629)	34 480	-	19 851	8 109	11 742		
Apr-03	(13 629)		(13 629)	34 480	-	20 851	8 517	12 333		
May-03	(13 388)		(13 388)	34 480	-	21 092	8 616	12 476		
Jun-03	(18 692)		(18 692)	34 480	-	15 788	6 449	9 338		
Jul-03	(25 147)		(25 147)	34 480	-	9 333	3 813	5 521	71 011	51 391
Net present value										
										Recalculated
Total	$ 629.562	$ (370.110)	$ 259.452	$ 803.118	$ 234.137	$ 1,296.707	$ 529.705	$ 767.002		$ 656.881
Authorized Unsecuritized Stranded Cost Recovery										$ 540.000
Difference										$ 116.881
Revenue Level										$ 197.601

ATTACHMENT-4

Schedule RPA-1
Updated through July 31, 2003

PSEandG DEFERRAL CASE - PHASE II
NET PRESENT VALUE COMPARISON
$000

	After-Tax MTC Collections [Sch. RCK-D-9] [Actuals Thru 7/31/03]
Aug-99	$ 41,122
Sep-99	22,136
Oct-99	29,765
Nov-99	28,077
Dec-99	29,949
Jan-00	18,849
Feb-00	19,252
Mar-00	21,029
Apr-00	15,277
May-00	19,449
Jun-00	21,743
Jul-00	23,749
Aug-00	25,738
Sep-00	22,357
Oct-00	20,475
Nov-00	20,569
Dec-00	23,509
Jan-01	24,085
Feb-01	19,415
Mar-01	18,194
Apr-01	16,073
May-01	16,868
Jun-01	16,490
Jul-01	17,627
Aug-01	15,607
Sep-01	12,617
Oct-01	12,573
Nov-01	12,927
Dec-01	12,775
Jan-02	13,695
Feb-02	13,477
Mar-02	13,867
Apr-02	13,727
May-02	13,817
Jun-02	12,396
Jul-02	13,208
Aug-02	(750)
Sep-02	648
Oct-02	540
Nov-02	1,946
Dec-02	1,120
Jan-03	10,608
Feb-03	8,994
Mar-03	11,742
Apr-03	12,334
May-03	12,476
Jun-03	9,338
Jul-03	5,521
Total Collections	$ 767,000
NPV	$ 676,053
NPV - PSE&G Proposed	$ 656,881
NPV Difference [After-Tax]	$ 19,172
Revenue Factor	0.5915
NPV Diffence [Revenues]	$ 32,412

Annual Discount Rate of 8.42% / 12 = 0.70167% Monthly Discount Rate

Annually Discounted at Rate of 8.42%

ATTACHMENT-5

Schedule RPA-2

BPU Docket Nos. EX02060363
and EA02060366

Schedule RPA-2

PSEandG DEFERRAL CASE - PHASE II
TIMING OF COLLECTION OF NPV $540 MILLION DURING TRANSITION PERIOD
$000

I. BASED ON MONTHLY DISCOUNTING:

	After-Tax MTC Collections [Sch. RCK-D-9]	Monthly Dicount Factors Based on Annual Discount Rate of 8.42%	NPV After-Tax MTC Collections
Aug-99	$ 41,122	0.993	$ 40,834
Sep-99	22,136	0.986	21,826
Oct-99	29,765	0.979	29,140
Nov-99	28,077	0.972	27,291
Dec-99	29,949	0.966	28,931
Jan-00	18,849	0.959	18,076
Feb-00	19,252	0.952	18,328
Mar-00	21,029	0.946	19,893
Apr-00	15,277	0.939	14,345
May-00	19,449	0.932	18,126
Jun-00	21,743	0.926	20,134
Jul-00	23,749	0.920	21,849
Aug-00	25,738	0.913	23,499
Sep-00	22,357	0.907	20,278
Oct-00	20,475	0.900	18,428
Nov-00	20,569	0.894	18,389
Dec-00	23,509	0.888	20,876
Jan-01	24,084	0.882	21,242
Feb-01	19,415	0.876	17,008
Mar-01	18,194	0.869	15,811
Apr-01	16,073	0.863	13,871
May-01	16,868	0.857	14,456
Jun-01	16,490	0.851	14,033
Jul-01	17,626	0.846	14,912
Aug-01	15,607	0.840	13,110
Sep-01	12,617	0.834	10,523
Oct-01	12,573	0.828	10,410
Nov-01	12,927	0.822	10,626
Dec-01	4,636	0.816	3,783
Total NPV Collections			$ 540,026

II. BASED ON ANNUAL DISCOUNTING

	After-Tax MTC Collections [Sch. RCK-D-9]	Annual Dicount Factors Based on Annual Discount Rate of 8.42%	NPV After-Tax MTC Collections [Sch. RCK-D-9]
Aug 1999 - Dec 1999	$ 151,050	0.9669	$ 146,046
Jan 2000 - Dec 2000	251,996	0.8918	224,727
Jan 2001 - Dec 2001	195,250	0.8225	160,599
Jan-02	13,695	0.7587	10,390
Total NPVCollections			$ 541,762

ATTACHMENT-6

Schedule RPA-3
Updated through July 31, 2003

BPU Docket Nos. EX02060363
and EA02060366

PSEandG DEFERRAL CASE - PHASE II
OVER-COLLECTION AND INTEREST AFTER RECOVERY OF NPV $540 MILLION
$000

	Pre-Tax MTC Over-Collections [Sch. RCK-D-9] [Actuals Thru 7/31/03]	Cumulative Over-Collections	Average Monthly Balance	Interest Rate (1)	Interest (2)	Over-Collections Including Interest
Dec-01	$ 13,760 (3)	$ 13,760	$ 6,880	5.50%	$ 32	
Jan-02	23,153	36,913	25,337	5.50%	116	
Feb-02	22,785	59,698	48,306	5.50%	221	
Mar-02	23,444	83,142	71,420	5.50%	327	
Apr-02	23,207	106,349	94,746	5.50%	434	
May-02	23,360	129,709	118,029	5.50%	541	
Jun-02	20,957	150,666	140,188	5.50%	643	
Jul-02	22,330	172,996	161,831	5.50%	742	
Aug-02	(1,267)	171,729	172,363	4.64%	666	
Sep-02	1,096	172,825	172,277	4.64%	666	
Oct-02	913	173,738	173,282	4.64%	670	
Nov-02	3,291	177,029	175,384	4.64%	678	
Dec-02	1,894	178,923	177,976	4.64%	688	
Jan-03	17,934	196,857	187,890	4.64%	727	
Feb-03	15,205	212,062	204,460	4.64%	791	
Mar-03	19,851	231,913	221,988	4.64%	858	
Apr-03	20,851	252,764	242,339	4.64%	937	
May-03	21,092	273,856	263,310	4.64%	1,018	
Jun-03	15,788	289,644	281,750	4.64%	1,089	
Jul-03	9,333	298,977	294,311	4.64%	1,138	
Total	$ 298,977				$ 12,983	$ 311,960
PSE&G's Calculated Over-Collection	$ 197,601				$ -	$ 197,601
Over-Collection Difference	$ 101,376				$ 12,983	$ 114,359

Break-Out of Over-Collection Difference:

- Monthly vs. Annual NPV Discounting	$ 32,412	see RPA-1
- Non-NPV Discounting of MTC Collections After Full Recovery of NPV $540 million	$ 68,964	
- Interest	$ 12,983	
- Total	$ 114,359	

(1) Annual 7-year treasury note rate plus 60 basis points
(2) Average monthly balances times1/12th of annual interest rate
(3) Per RCK-D-9 and RPA-2 for December 2001: 12,775 - 4,636 = 8,139/12,775 = 63.71% x 21,598 = 13,760

Schedule RPA-3
Updated for Actuals Through 7/31/03

APPENDIX B

State of New Jersey
DIVISION OF THE RATEPAYER ADVOCATE
31 CLINTON STREET, 11TH FLOOR
P.O. BOX 46005
NEWARK NJ 07101

RICHARD J. CODEY
Acting Governor

SEEMA M. SINGH, ESQ.
Ratepayer Advocate and Director

June 28, 2005

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

Re: In the Matter of the Deferred Balances Audit of Public Service Electric & Gas Company
Phase II: August 2002 -July 2003
Docket Nos. EX02060363 and EA02060366

Dear Ms. Izzo:

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

The Ratepayer Advocate provides the within reply comments pursuant to the May 13, 2005 letter from the office of the Secretary of the Board of Public Utilities (Board or BPU) inviting interested parties to submit comments on the Phase II audit report of the Board's consultants, Mitchell & Titus, LLP and the Barrington-Wellesley Group, Incorporated (Auditors), concerning the deferred balances of Public Service Electric and Gas Company (PSE&G or Company). The only initial comments that the Ratepayer Advocate has received came from PSE&G. The Ratepayer Advocate incorporates by reference our June 13, 2005 initial comments in this letter and also provides this reply to the Company's June 13, 2005 initial

comments. Furthermore, on June 13, 2005 the Ratepayer Advocate sent to the parties a request concerning the provision of additional information to our office in order to facilitate and allow us to complete our review of this matter. Our office has not received any reply concerning our June 13 letter about being able to receive additional information that is not contained within the covers of the Phase II audit report. That matter should also be resolved before the Board closes the record concerning the Phase II audit report.

MARKET TRANSITION CHARGE (MTC) ISSUES

The Ratepayer Advocate has reviewed the June 13, 2005 initial comments by PSE&G concerning the six questions outlined in the May 13, 2005 letter from the office of the BPU Secretary, and we provide this reply. PSE&G objects to the Phase II audit report citing the Auditors' discussion concerning the "Unresolved Matter Between the BPU and PSE&G." *PSE&G initial comments, pages 1 and 2.* The Company's comments on this matter are completely inapposite and should be disregarded in their entirety. This unresolved matter is the subject of the six questions that the Board requested the parties to address in their initial comments and reply comments. Therefore, it is clear that the Board has already decided that not only should the discussion of this unresolved matter remain in the Phase II audit report, but that the record should remain open to complete the discussion of these issues after the parties have had sufficient time to be informed about them.

Background

As part of the restructuring agreement to transfer PSE&G's generating units to PSE&G's unregulated affiliate, PSEG Power, PSE&G received a cash advance of $540 million from PSEG Power toward the recovery of the generating units' stranded costs. This so-called "transfer premium" was to be used to reduce PSE&G's capitalization, and was to be repaid from the revenues collected by PSE&G from (1) its Market Transition Charge (MTC); (2) the amortization of its excess depreciation reserve; and (3) a 2 mil per kWh "retail adder" applied to the Basic Generation Service (BGS). If, at the end of the four-year Transition Period, these three revenue sources were not sufficient to fully repay the $540 million advance, the shortfall was to be absorbed by PSEG Power. If the $540 million were to be over-recovered, the excess revenue recovery was to be refunded to PSE&G's ratepayers by way of credits in the Societal Benefits Charge (SBC).

The Board's Restructuring Order of August 24, 1999 in Docket Nos. EO97070461, EO97070462, and EO97070463 (Restructuring Order) has the following language with regard to the above-described transfer premium:

> ...PSE&G shall be provided with the opportunity to recover $540 million of its unsecuritized generation stranded costs on a net present value (8.42% discount rate) net of tax basis over the Transition Period. This recovery is to be accomplished via a 2 mil per kwh retail adder, an explicit Market Transition Charge (MTC), exclusive of the NTC, as discussed in Attachment 2 to the PSE&G Stipulation, and the amount funded by the excess distribution depreciation reserve amortization. [page 118, paragraph 13]
>
> At the end of the Transition Period, the recovery of the $540 million will be reconciled to actual collections based on actual sales, the net present value of recovery from both the MTC, exclusive of the NTC, and collections from the 2.0 mil per kWh retail adder for customers retained on BGS, and the depreciation amortization. In the event the company fails to collect $540 million, it will be at risk for any such shortfall. In the event the

> company collects over $540 million, it shall use any such overrecovery to reduce the Company's SBC at the end of the Transition Period when the SBC is reset and shall in no event be retained by PSE&G or remitted to GENCO [PSEG Power] or otherwise utilized to recover unsecuritized generation related stranded costs. [page 119, paragraph 14]

In the Phase I Deferred Balances proceeding, BPU Docket No. ER02080604 (Phase I Proceeding), PSE&G's proposed reconciliation of the revenue received during the Transition Period for the recovery of the $540 million transfer premium was presented in the testimony of its witness Robert C. Krueger, Jr. Specifically, Mr. Krueger's original Schedule RCK-D-9 showed that, based on actual data through July 31, 2002 and projected data for the remainder of the Transition Period, PSE&G had determined that the reconciliation of the actual revenues received for the recovery of the $540 million indicated an over-recovery of $205.1 million as the amount to be refunded to PSE&G's ratepayers via the SBC (see Attachment-1 to these Reply Comments). PSE&G's initial comments dated June 13, 2005 apparently use an MTC over-recovery amount that was subsequently updated to reflect actual Transition Period data through January 31, 2003, which update increased the MTC over-recovery from $205.1 million to $207.1 million (see Attachment-2 to these Reply Comments).

PSE&G's proposed Transition Period over-recovery amounts of $205.1 million (original) and $207.1 million (updated) included an over-recovery reduction of approximately $370 million for the carrying costs associated with the delay in securitization from January 2000 through January 2001. In the Phase I Audit of PSE&G's Deferred Balances case, Docket No. ER02080604, the Auditors concluded that the inclusion in PSE&G's proposed MTC over-recovery determination of the $370 million securitization delay-related carrying costs had not been authorized by a Board order. The Ratepayer Advocate also took issue with this item and

recommended in that case that PSE&G's quantified Transition Period MTC over-recovery amount should be (1) increased by $328.1 million by completely removing the net present value of the $370 million carrying charges; or, alternatively (2) increased by $173.1 million by replacing PSE&G's proposed carrying cost rate with the rate on 7-year constant maturities Treasury notes plus 60 basis points.

In its May 13, 2005 letter accompanying the release of the PSE&G Electric Deferral Audit Report – Phase II, the Board asked interested parties to respond to six specific questions regarding PSE&G's determination of the MTC over-recovery. The Initial Comments containing the response to these six questions were due June 13, 2005. The Reply Comments are due by June 28, 2005. Both PSE&G and the Ratepayer Advocate issued their respective Initial Comments on June 13, 2005. For all of the reasons outlined in its Initial Comments, the Ratepayer Advocate believed that "the preferable procedure should be for PSE&G to file its initial comments on the various issues and to provide responses to discovery requests in order for other interested parties to be able to file meaningful reply comments by the June 28, 2005 deadline." *Ratepayer Advocate initial comments, page 1.* PSE&G did not provide any meaningful responses to the two discovery questions issued by the Ratepayer Advocate to the Company on June 7, 2005.

The Ratepayer Advocate's reply comments on the May 13, 2005 Board questions regarding the determination of the Company's determination of the MTC over-recovery follow below. The comments are slightly out of sequence in that the Ratepayer Advocate has chosen to answer Board question 4 prior to answering Board questions 2 and 3.

Question No. 1

How was the net present value of the MTC over-recovery due ratepayers determined by PSE&G and was it consistent with the determination of the net present value of the MTC recovery due PSEG Power? Please explain in detail, and provide supporting documentation.

Answer:

PSE&G determined the net present value (NPV) of the MTC over-recovery due ratepayers in the same way as it determined the NPV of the MTC recovery due PSEG Power. *PSE&G initial comments, pages 3-4.* The Company's specific calculation methodology for the updated NPV analysis of the Transition Period MTC collections is detailed in Attachment 2 to these reply comments which is Schedule RCK-D-9 from the Phase I Proceeding. As shown in Attachment-2, the Company first determined the after-tax MTC collections in each month of the 4-year Transition Period from August 1999 through July 2003. Next, the Company accumulated all monthly after-tax MTC collections for each calendar year in the Transition Period, and then applied to these annual calendar year MTC accumulations annual discount factors based on an after-tax annual discount rate of 8.42%. The 8.42% discount rate represents PSE&G's then-allowed overall rate of return (10.08%), expressed net of tax. The NPV results of this annual discounting process are summarized below:

Cumulative MTC Collections in Calendar Year ($million)	Annual Discount Factor Based on Annual Rate of 8.42%	NPV Cumulative MTC Collections in Calendar Year ($million)
1999 (5 mos.): $151.050	0.96687	$146.046
2000 (12 mos.): 251.996	0.89178	224.727
2001 (12 mos.): 195.250	0.82253	160.599
2002 (12 mos.): 97.695	0.75866	74.117
2003 (7 mos.): 78.805	0.72371	57.033
Total $774.796		$662.522

Thus, based on this annual discounting approach, the Company concluded that, during the entire Transition Period, it collected after-tax MTC revenues of $662.522 million on a NPV basis as of August 1999. Next, the Company subtracted from this total NPV amount the $540 million[1] transition premium owed to PSEG Power, thereby leaving an after-tax NPV amount of $122.552 million as the MTC over-recovery due ratepayers. As the final step, by using a revenue conversion factor of 0.5915,[2] the Company converted this after-tax MTC over-recovery amount of $122.552 million into a total over-recovered revenue amount of $207.137 million[3].

Question No. 4

In determining the net present value of the MTC recovery, should the discount rate have been applied monthly or annually? Please explain in detail with supporting documentation.

Answer:

It is the Ratepayer Advocate's position that, in determining the NPV of the MTC recovery, the discount rate should have been applied monthly rather than annually. The reason is quite simple.

First, it should be made clear that a discount factor used in a present value analysis represents a time value of money and, in this instance, represents the return presumed to be earned by PSE&G on the available cash flows from the MTC collections. The MTC revenues during the Transition Period were billed and collected by PSE&G on a monthly basis, with the monthly collections clearly shown on Schedule RCK-D-9 in the testimony of PSE&G witness, Mr. Krueger, in the Phase I Deferred Balances proceeding. Since the cash flows from the MTC collections became available to PSE&G on a monthly basis, PSE&G has been able to

[1] Similar to the amount of $662.522 million, the transition premium amount of $540 million is also stated on a NPV basis as of August 1999.
[2] Inverse of combined federal and state income tax rate of 0.4085.
[3] Calculation: $122.552 / 0.5915

immediately earn a return on these MTC revenues from the moment they were collected in each month. Applying the discount rate to the monthly MTC collections gives appropriate recognition to the fact that PSE&G has actually enjoyed the immediate returns on these monthly MTC collections during the Transition Period. The Company's proposed annual discounting approach assumes that PSE&G does not earn a return on its monthly MTC collections during the calendar year. Rather, it assumes that PSE&G will not start earning a return until all monthly MTC collections have been accumulated at the end of the calendar year. This assumption is wrong and completely inconsistent with financial reality.

The appropriate monthly discounting process to use is to take $1/12^{th}$ of the annual after-tax discount rate of 8.42% (equal to a converted monthly discount rate of 0.70167%) and apply this monthly discount rate to PSE&G's monthly after-tax MTC collections during the Transition Period. On Schedule RPA-1 in Attachment-3, the Ratepayer Advocate has calculated that the total Transition Period after-tax MTC collections of $774.796 million have a present value as of August 1999 of $681.766 million when discounted on a monthly basis using a monthly discount rate of 0.70167%. This after-tax NPV value of $681.766 million is $19.244 million higher than PSE&G's calculated after-tax NPV value of $662.522 million based on the Company's proposed annual discounting approach. Using the same revenue conversion factor of 0.5915, this higher after-tax value of $19.244 million translates into a higher MTC revenue over-recovery of $32.534 million. Thus, based on the monthly discounting approach, PSE&G's calculated MTC over-recovery of $207.137 million would be higher by $32.534 million, or $239.671 million.

PSE&G claims in its June 13, 2005 initial comments that its proposed use of the annual discounting approach is in accordance with the Board's Restructuring Order. Specifically, on page 9 of its initial comments, PSE&G states:

> A review of the language and context of the Board's Restructuring and Rate and Deferral Orders makes clear that, contrary to the Energy Staff's Position in the instant dispute, those Orders included:
>
> 1) a determination that the net present value calculation of the Company's MTC recovery would be on an annual, rather than monthly basis; ....

This PSE&G claim is based on its reading of the language on page 118, paragraph 13 of the Restructuring Order that "PSE&G shall be provided with the opportunity to recover $540 million of its unsecuritized generation stranded costs on a net present value (8.42% discount rate) net of tax basis over the Transition Period." Thus, since the Board's Order mentions an annual discount rate of 8.42%, PSE&G believes that, therefore, the Board meant to use the annual discounting approach in determining the NPV of the MTC collections. The Ratepayer Advocate submits that this Board language does not at all require, or even suggest, that all monthly MTC collection should be accumulated for each Transition Period calendar year and then discounted on an annual basis. The 8.42% rate was stated in the Order to indicate what the ***annualized*** rate should be in making NPV calculations with regard to the MTC collections and was not meant to require that the annual discounting method should be used. There is nothing unusual about converting an annualized earnings or discount rate to a monthly rate by dividing the annualized rate by twelve. And there is nothing unusual or unorthodox about applying such a monthly rate if cash flows are realized on a monthly basis rather than on an annual basis. As a matter of fact, this practice of converting an annual rate to a monthly rate (by taking $1/12^{th}$ of the annual rate) and applying the monthly rate to monthly cash flows rather than annual cash flows has been used by the Board in numerous regulatory matters involving interest or present value calculations.

For example, in many restructuring related matters, Board Orders have ruled that interest be calculated on under- or over-recovery balances based on the *annual* rate on 7-year constant

maturities Treasury notes plus 60 basis points. However, in making the interest calculations, the Board required that interest be calculated on monthly under- or over-recovery balances at a monthly interest rate equal to $1/12^{th}$ of the annual rate on 7-year constant maturities Treasury notes plus 60 basis points.

On page 8 of its June 13, 2005 initial comments, PSE&G states that recalculating the Company's MTC over-collection would be "inconsistent with the Restructuring Order." This claim is apparently based on the fact that the Restructuring Order does not specify the exact methodology of calculating the MTC over-recovery. In this regard, the Ratepayer Advocate notes that the previously discussed carrying charges on the delay of securitization that were allowed to be included in the determination of the MTC over-collection, and significantly reduced the MTC over-collection calculations, were also considered to be "inconsistent with the Restructuring Order" to the extent that the consideration of these carrying charges was not provided for in the Order. Thus, the Board has previously allowed MTC reconciliation-related calculation aspects that were not specifically covered in the Restructuring Order, if these calculation aspects were considered equitable and appropriately justified. The Board should do the same in this instance by re-calculating the MTC over-recovery based on the monthly discounting approach.

Question No. 2

How should the ratepayer MTC over-recovery have been booked during each year of the transition period, i.e., as an allocated portion of the estimated net present value of the over-recovery as of August 1, 1999, as determined and booked by PSE&G, or as the estimated over-recovery occurring in each year of the transition period, in that year's dollars?

Answer:

This question goes to the issue as to how much of the MTC recovery during the Transition Period should be discounted back to August 1, 1999 in the determination of the dollar value of the MTC over-recovery. PSE&G is of the position that all Transition Period MTC recoveries should be discounted. On the other hand, the Ratepayer Advocate believes that only the Transition Period MTC recovery amount needed to recover the $540 million transfer premium should be discounted back to August 1, 1999. Once the NPV amount of $540 million has been collected, any MTC revenues collected after that point in time should be treated as normal over-recovery that would receive the same treatment that has been prescribed by the Restructuring Order for other over- and under-recoveries incurred during the Transition Period. What this means is that these MTC over-recoveries should be deferred at undiscounted, nominal dollar values.

PSE&G's calculation methodology incorrectly discounts all MTC over-recoveries collected through July 2003 back to the NPV as of August 1, 1999, even though the ratepayer refunds for these MTC over-recoveries take place starting on August 1, 2003. This calculation method inappropriately assigns to PSE&G -- rather than to the ratepayers -- all earnings on the MTC over-recovery amount during the 4-year Transition Period from August 1, 1999 to August 1, 2003. Once enough MTC revenues have been collected that, on a discounted basis, would equal the $540 million transfer premium value as of August 1, 1999, it makes no sense, from either a sound financial or logical viewpoint, to continue to discount the subsequently collected MTC over-recoveries to a present value as of August 1, 1999 and then use that discounted value as the basis for the determination of the MTC over-recovery ratepayer refund starting on August 1, 2003.

On Schedule RPA-2 in Attachment-4, the Ratepayer Advocate has calculated that, based on the monthly discounting approach, the $540 million after-tax NPV transition premium is fully recovered through MTC collections from August 1999 until sometime in the month of December 2001. The bottom of Schedule RPA-2 also shows that, based on the annual discounting approach used by PSE&G, this full recovery point in time occurs one month later, in January 2002. All MTC collections after those months represent MTC over-recoveries for which there no longer is any need or reason to discount back to August 1999. As stated before, those over-recovered MTC collections should be deferred at undiscounted, nominal dollar values. The monthly undiscounted MTC recoveries collected after December 2001[4] and through July 2003 are shown in the first column of Schedule RPA-3 in Attachment-5 and amount to a total undiscounted pre-tax MTC over-recovery amount of $312.155 million. This is $105.018 million higher than the pre-tax MTC over-recovery amount of $207.137 million calculated via PSE&G's "total discounting" methodology. Of this $105.018 million pre-tax MTC over-recovery difference, $32.534 million is due to the use of the monthly (vs. annual) discounting calculation method (calculated on Schedule RPA-1). The remaining $72.484 million difference is due to the premise that all MTC collections after full recovery of the $540 million NPV transition premium be accrued at undiscounted, nominal dollar values, similar to the treatment prescribed by the Restructuring Order for other over- and under-recoveries incurred during the Transition Period.

The monthly undiscounted MTC recoveries collected after January 2002 (the month of full recovery of the $540 million NPV amount based on PSE&G's annual discounting approach) total approximately $298.395 million,[5] which is $91.258 million higher than the pre-tax MTC

[4] December 2001 is the month of full recovery of the $540 million NPV transfer premium based on the monthly discounting approach.

[5] Total pre-tax MTC over-recovery of $312.155 million less December 2001 pre-tax MTC over-recovery of $13.760 million.

over-recovery amount of $207.137 million calculated via PSE&G's "total discounting" methodology.

In its June 13, 2005 initial comments, PSE&G asserts that the Board's Restructuring Order included "a determination that discounting the MTC collections to its August 1, 1999 value should continue throughout the four year transition period, without regard to whether or not the Company was fully reimbursed..."[6] PSE&G bases this assertion on the following statement made in paragraph 14, page 119 of the Board's August 1999 Restructuring Order:

> At the end of the Transition Period, the recovery of the $540 million will be reconciled to actual collections based on actual sales, the net present value of recovery from both the MTC, exclusive of the NTC, and collections from the 2.0 mil per kWh retail adder for customers retained on BGS, and the depreciation amortization.

Based on the above-quoted Restructuring Order language, PSE&G concludes that "there were no requirements to book any ratepayer over collection on a monthly or annual basis..."[7] and that "it is clear that in issuing the Restructuring Order, the Board directed that MTC collections would be calculated via an annual discounting throughout the transition period..."[8] The Ratepayer Advocate disagrees with PSE&G's assertions and conclusions. Nowhere in the Restructuring Order does the Board require that *all* MTC collections in the Transition Period, including any potential MTC over-collections, must be discounted back to their August 1, 1999 value in the determination of the ratepayer refund of over-collections. Since the Restructuring Order is not specific on what exact MTC over-collection calculation method should be used, PSE&G has come up with its own "interpretation" of the Order, and has boldly concluded that the Board really meant to order that all Transition Period MTC collections, even the MTC over-

[6] PSE&G's 6/13/05 Comments, page 9, point 2).
[7] PSE&G's 6/13/05 Comments, page 4, Answer to Question 2.
[8] PSE&G's 6/13/05 Comments, last paragraph of page 10.

collections, should be discounted back to August 1, 1999 in determining the ratepayer refund amount. The Board Restructuring Order statement that "At the end of the Transition Period, the recovery of the $540 million will be reconciled to actual collections based on actual sales, the net present value of recovery from both the MTC, exclusive of the NTC, and collections from the 2.0 mil per kWh retail adder for customers retained on BGS, and the depreciation amortization" does not prescribe the reconciliation methodology that PSE&G has used.

On the contrary, the Ratepayer Advocate submits that this Board-ordered reconciliation process implied that present value discounting should be applied to all MTC collections required to pay back the August 1999 transfer premium of $540 million and that all Transition Period MTC collections after this point be booked and accrued at undiscounted, nominal values. Not only is this the correct reconciliation approach based on sound financial principles, it is also consistent with the reconciliation approach prescribed by the Restructuring Order for other Transition Period over- and under-recoveries. For example, any over- or under-recoveries for such Transition Period rates as PSE&G's Non-utility Generation Transition Charge (NTC), Social Programs, Decommissioning, and DSM rates were booked and deferred at undiscounted, nominal dollar values.

The premise that NPV discounting should be limited to just those MTC collections needed to fully recover the $540 million transfer premium as of August 1999 and not to the overcollected amounts after full recovery would appear to be supported by PSE&G's own statement in the third paragraph on page 8 of its June 13, 2005 initial comments that:

> In exchange for paying a "transfer premium" of $540 million, Genco [PSEG Power] received the right to collect market transition charge ("MTC") revenues during the Transition Period, but only until it was reimbursed the $540 million premium. Any collections above that figure would be retained by Public Service

to be refunded to customers after the end of the transition period....
[emphasis supplied]

Question No. 3

Should interest have been booked on the ratepayer MTC over-recovery occurring in each year of the transition period, and if so, what is the appropriate rate? If not, why not.

Answer:

The Ratepayer Advocate believes that interest should have been accrued, at a rate equal to the rate on 7-year constant maturities Treasury notes plus 60 basis points, on all cumulative monthly undiscounted (nominal value) MTC over-recovery balances booked after the point in time that the $540 million NPV amount has been fully recovered. From the moment PSE&G collects MTC over-recoveries that are due ratepayers, the earnings power of the deferred over-recovered MTC balances also belongs to the ratepayers and any earnings accrued on these deferred balances should be passed on to the ratepayers along with the deferred MTC over-recoveries themselves. The Ratepayer Advocate takes the reasonable position that, while it is appropriate to use a rate of 8.42% for discounting purposes in calculating the recovery of the $540 million NPV stranded cost amount, this 8.42% overall rate of return rate would no longer be appropriate to use as an earnings rate once the stranded costs are fully recovered. Instead, the earnings rate to be applied to the deferred MTC over-recovery balances accumulated after the recovery of the $540 million NPV stranded cost should be the rate on 7-year constant maturities Treasury notes plus 60 basis points, the Board-approved rate for accruing interest on deferred balances during the Transition Period. *Restructuring Order, pages 117 and 118.*

On Schedule RPA-3 in Attachment-5, the Ratepayer Advocate has calculated, in accordance with the above-described methodology, the total interest amount accrued on the average monthly deferred MTC over-recovery balances from December 2001 (the point in time

that the $540 million NPV amount was fully recovered based on the monthly discounting approach) through July 2003, the end of the Transition Period. As shown on this schedule, the calculations indicate total interest accruals of $13.193 million. If the Board agrees with the Ratepayer Advocate that interest should be accrued on all deferred MTC over-recovery balances and flowed through to the ratepayers, this increases the total ratepayer refund amount by that same amount, approximately $13.2 million.

Question No. 5

Is it appropriate to adjust the determination of the MTC recovery to reflect the fact that under IRS rulings and court decisions, monies properly belonging to ratepayers, such as fuel cost overrecoveries, are not taxable? See United States Tax Court decision, in Florida Progress Corporation and Subsidiaries v. Commissioner of Internal Revenue, No. 2961-97, June 30, 2000; affirmed Florida Progress Corp. and Subsidiaries, v. C.I.R., 348 F.3d 954 (11th Cir. Oct. 21, 2003) (No. 02-14910,02-14911). Please explain in detail, with supporting documentation.

Answer:

Based on its review of the above-referenced court ruling, it is the Ratepayer Advocate's understanding that this ruling is favorable to the utilities in that they decide that over-recovery balances to be refunded to customers are not taxable as income in the determination of the utilities' income tax liabilities. This, in turn, reduces the utilities' deferred tax liabilities and increases the utilities' accumulated deferred income tax balances that represent cost-free capital to the utilities. Thus, the Ratepayer Advocate is of the understanding that, as a result of these favorable court rulings, MTC over-recoveries during the Transition Period are not taxable,[9] and therefore reduce PSE&G's deferred tax liabilities and increase PSE&G's cost-free capital in the

[9] As previously discussed in these Reply Comments and shown on Schedule RPA-4, MTC over-recoveries did not start accruing until December 2001 (based on monthly discounting approach) or January 2002 (annual discounting approach). These dates fall after the June 30, 2000 date of the United States Tax Court ruling in Docket No. 2961-97.

form of accumulated deferred income taxes. It is the Ratepayer Advocate's position that any tax benefits resulting from the non-taxable status of MTC over-recoveries during the Transition Period should accrue to the ratepayers and should be incorporated in the determination of the total ratepayer refund amount from MTC over-recoveries. Unfortunately, the Ratepayer Advocate does not have the necessary data available to quantify the impact of these tax benefits on the determination of the total MTC over-recovery balance to be refunded to the ratepayers.

In answer to the above-stated Board question no. 5, PSE&G states in its June 13, 2005 initial comments (page 5) that "The cited tax court decision does not affect the Company's calculation of the MTC over collection." PSE&G does not further explain, or provide source documentation in support of, this position in its Comments. The May 13, 2005 BPU Secretary's letter required the Company to "explain in detail, with supporting documentation" its position on this issue, but PSE&G has completely failed to provide any explanation or supporting documentation in its initial comments.

As a result of the above-discussed information, including the Ratepayer Advocate's understanding of this tax issue, the Ratepayer Advocate recommends that the Board order PSE&G to provide the following information:

1. Any deferred tax "reversal" entries actually booked by PSE&G as a result of the cited tax court decisions, not only related to MTC over-recoveries, but also related to other Transition Period over-recoveries for, for example, NTC, Social Programs and Decommissioning rate components of the total SBC rate, as well as the exact timing and an explanation for the reasons of these tax reversal bookings;

2. Detailed explanations and relevant source documentation in support of PSE&G's claim that this tax issue does not affect the MTC over-recovery calculation; and
3. Calculations showing the impact of these tax benefits on the determination of the total MTC over-recovery balance to be refunded to the ratepayers under the assumption that the cited court decision *does* affect the amount of the MTC over-collection.

The Ratepayer Advocate requests that the Board permit our office and other parties to file additional comments on this issue when PSE&G has complied with the Board's direction on this issue.

Question No. 6

Are there other MTC quantification issues the Board should consider? Please list them and provide the reasons why the Board should consider them, with appropriate rationales and documentation.

Answer:

There are other issues that the Board should consider when determining how much the MTC over-recoveries should be and how and when it will be refunded to ratepayers. One of the issues is that the current record before the Board concerning the MTC over-recoveries in this Phase II audit review only has actual monthly data through January 31, 2003.[10] PSE&G's June 13, 2005 initial comments apparently use actual monthly data through January 31, 2003 and estimated monthly data through the balance of Year 4, *i.e.,* through July 31, 2003. *PSE&G initial comments, pages 12-13.* In order to provide a comparison using consistent data, the

[10] Page III-2 of the Phase II audit report contains a summary of the MTC over-recovery as of July 31, 2003, but is not broken out into monthly data.

Ratepayer Advocate's calculations attached to these reply comments are based on actual data through January 31, 2003 and PSE&G's estimates of the remaining MTC recoveries from February 1, 2003 through July 31, 2003. This data is contained in the record in the Phase I Proceeding.[11] The Ratepayer Advocate requests that the Board direct PSE&G to update Mr. Krueger's schedules concerning the MTC and other deferred balances recoveries on a monthly basis through the end of the fourth year of the Transition Period, i.e., July 31, 2003. Once that data is provided on a monthly basis, the Ratepayer Advocate can update its schedules to provide the correct MTC over-recoveries refund that is due to ratepayers. There are also other MTC issues that should be addressed as follows.

PSE&G complains about the Board's review of the MTC recovery calculation and alleges that this review is an exercise in impermissible "retroactive ratemaking." *PSE&G initial comments, page 6.* However, the concept of retroactive ratemaking more commonly applies to the utility's base rates rather than the deferred accounting that is applied to other non-base-rate recovery clauses such as PSE&G's deferred balances. Normally, when the Board sets the expenses that a utility may have the opportunity to recover in its base rates, the Board and any parties do not have the right to look back in time and match the actual base rate recoveries with the forecast items that the Board included in base rate recovery. On the contrary, when the Board directs that a particular rate recovery clause will receive deferred accounting treatment, the purpose of that treatment is to compare the eventual amounts recovered from customers to the allowed amounts that the Board previously ordered should be recovered, otherwise known as a "true-up" or "reconciliation" process. That is the process that we are engaged in presently. This

[11] The data in the Phase I Proceeding was updated with actual results through February 28, 2003, but PSE&G's June 13, 2005 initial comments apparently do not use that additional month of actual data. As stated above, the Ratepayer Advocate's reply comments will also use the data through January 31, 2003 to provide a comparison consistent with the Company's data in its June 13, 2005 initial comments.

process does not violate the principle of retroactive ratemaking and, therefore, the Board should disregard PSE&G's argument on this matter entirely.

In fact, as PSE&G itself admits, this true-up process was activated at the Company's own request when it formulated the Stipulation of its restructuring cases and included in that Stipulation the concept that once the $540 million premium was recovered from ratepayers, the Company would defer any over-recovery amount and refund it to ratepayers at a later time. *PSE&G initial comments, pages 8 and 10.* Therefore, the Company cannot now complain that the Board should not comply with this true-up process that the Company itself proposed and the Board approved in the restructuring dockets.

PSE&G's arguments concerning *res judicata* and collateral estoppel are akin to its argument concerning retroactive ratemaking and should also be disregarded. The Board is obviously not looking back at its previous orders in an attempt to rewrite them, but is only seeking to ensure that the utility has correctly applied the deferred accounting process to the MTC recovery and that ratepayers receive all the refund that is due to them. As a matter of fact, if the Board should adopt PSE&G's new arguments and denies ratepayers their full refund, then it is the Company itself that would have accomplished a rewriting of previous Board Orders. Obviously the Board should not permit that result.

The Company also argues that the Board Order in Phase I of PSE&G's Deferred Balances proceeding settled once and for all the MTC over-recovery amount that should be refunded to ratepayers. *PSE&G initial comments, page 12.* That argument overlooks the fact that Phase I of the Deferred Balances audit only formally covered the first three years of the Transition Period and specifically deferred a full accounting of Year 4 of the Transition Period until this Phase II review. Also, the record in the Phase I Proceeding did not contain actual data

through July 31, 2003 for the entire Year 4 of the Transition Period. Therefore, the Board Order in the Phase I Proceeding could not have resolved completely the MTC over-recovery issue. This Phase II audit process is the proceeding in which that reconciliation and correct calculation of the MTC over-recovery should be completed. When the Board issued its order in the Phase I audit, it could only have been issuing an order temporarily effective until the Phase II audit process was complete. PSE&G knew this fully well when the Phase I Order was issued and should not complain about the proper completion of this Phase II process now. The Company's arguments on this issue are clearly incorrect and should be denied.

PSE&G also complains that the Phase II audit report should not include the paragraph on page III-3 concerning the "Carrying Cost due to Delay in Securitization." *PSE&G initial comments, page 2.* The Company believes that the Auditors did not address this issue in the Phase II audit, but only in the Phase I audit. This complaint could be made about much of the background information in the Phase II audit report and, indeed, in most of the Company's June 13, 2005 initial comments. The Auditors included this information in a list of other background information that describes how the deferred balances reached their present state. It makes no sense for PSE&G to pick and choose which information among the other background information that it would not like to see mentioned in the Phase II audit report. PSE&G's complaint is completely unsupported in logic and should be denied. The information on the $370 million that PSE&G deducted from the MTC over-recovery that both the Auditors and our office contested is vital to understanding how the MTC deferred balance got to its present state and should remain in the Phase II audit report.

Further, it is entirely relevant to PSE&G's assertion on pages 4 to 5 in its June 13, 2005 initial comments that there should be no interest charged on any year's MTC over-recovery or

under-recovery. If PSE&G is correct about this lack of interest on the MTC recovery, then there is no basis for PSE&G to have deducted the $370 million from the MTC deferred balance for carrying costs due to the delay in securitization. The Ratepayer Advocate pointed out this discrepancy during the Phase I Proceeding and PSE&G contested our position. PSE&G should not now be allowed to posit a completely different argument now that the Phase I Proceeding has been decided. If PSE&G's argument that there should be no carrying charges on the MTC recovery is accepted, then the Board should also reverse the $370 million that PSE&G deducted from the MTC over-recovery due to ratepayers.[12]

NON-UTILITY GENERATION (NUG) CONTRACT COST RECOVERY AND RESTRUCTURING AND RENEGOTIATION

There are other issues that the Ratepayer Advocate believes would be fruitful for further examination and consideration by the parties and the BPU. These items are mentioned in the Phase II audit report and in the June 13, 2005 Ratepayer Advocate's initial comments. These issues relate to the Company's NUG contracts cost recovery and PSE&G's efforts to restructure and renegotiate its NUG contracts.

The first issue is mentioned on page VII-3 of the Phase II audit report and relates to a conceptual proposal that PSE&G received from a power marketer near the end of the Phase II audit period to undertake a comprehensive restructuring of the Company's entire remaining

[12] In the Phase I Proceeding, the Ratepayer Advocate's expert witness Robert Henkes calculated that the NPV of the $370 million would have been approximately $328.1 million. The Ratepayer Advocate also argued in the alternative that, if the Board should allow interest on the MTC recovery, it should deny PSE&G's use of its overall allowed rate of return as the interest rate (8.42% after tax) and should instead use the same interest rate the Board ordered for the NTC and SBC, which was the seven-year constant maturities Treasury rate at that time plus 60 basis points (approximately 6.7%) This correction would have increased the MTC over-recovery by a NPV of $173.1 million. *See the Ratepayer Advocate Initial Brief, pages 59-62, in the Phase I Proceeding.*

NUG contracts. The Phase II audit report notes that "[t]he Company did not pursue the proposal until after the Phase II period", but the report does not mention the outcome of PSE&G's pursuit of that proposal. The Ratepayer Advocate urges the Board to require PSE&G to provide the parties full information concerning the proposal received and detailed information concerning the Company's pursuit of that proposal and the current status of that proposal. The Ratepayer Advocate requests the ability to provide further comments concerning this issue after receiving such information.

The second issue concerns the Company's efforts to restructure and renegotiate the three NUG contracts with El Paso Merchant Energy Company (El Paso). On page VII-5, the Phase II audit report stated:

> When El Paso had liquidity problems in 2002, PSE&G approached El Paso to see if the latter's need for liquidity might make it amenable to buyouts of its NUG contracts. PSE&G's overtures to El Paso were met with interest. However, the liquidity problems resulted in high turnover in El Paso personnel, making it difficult for PSE&G to re-initiate restructuring discussions.

The Phase II audit report does not specify the outcome of these discussions with El Paso and whether or not the discussions are continuing. The Ratepayer Advocate urges the Board to require PSE&G to provide complete information concerning the discussions held with El Paso and to provide an update to the status of those discussions. The Ratepayer Advocate requests the ability to provide further comments concerning this issue after receiving such information.

The Phase II audit report also mentions on page V-3 an adjustment to add to the Non-Utility Generation Transition Charge (NTC) revenues recovered for the energy received from the St. Lawrence contract. PSE&G's initial comments do not discuss this matter and the Phase II audit report itself has scant information on this matter. In our initial comments dated June 13, 2005, the Ratepayer Advocate recommended that the Company address this issue in its initial

comments and that our office receive additional information as needed in order to review this issue. *Ratepayer Advocate initial comments, pages 3 and 4.* Perhaps the Company's reply comments will provide additional information on this issue and the Ratepayer Advocate can then supplement our filing with additional comments once we have received sufficient information concerning the revenues from the St. Lawrence contract.

The Phase II audit report discusses whether or not PSE&G is maximizing the value it could receive for the electric power from its NUG contracts. The items discussed on this issue include whether the Company should be monitoring the prices in PJM's day-ahead energy markets as well as the spot market and whether the Company should consider allocating the NUG contract energy to its BGS supply requirements rather than selling the output into the PJM markets. The Ratepayer Advocate believes that the Board should consider whether these issues might better be discussed in a more full manner and in a complete context in the Board's dockets on the BGS auctions. The Auditors' comments on this issue seem to discuss the matter only in the prospective mode, so that any change in how the NUG contract energy is treated would not affect the rate recovery of the Year 4 Transition Period Costs.

OTHER ISSUES

PSE&G apparently objects to the Auditors' citation of the Liberty Consulting Group audit of PSE&G concerning competitive services offerings and the Company's compliance with the BPU's affiliate relations standards. *PSE&G initial comments, page 2.* The utility concludes that no references should be made to prior or future affiliate standards audits. However, the Company does not state any reason for this objection. It does not seem objectionable to the Ratepayer Advocate that the Auditors include factual assertions about the Liberty audit, and we

believe the Board should overrule PSE&G's objections and allow this information to remain in the audit report.

PSEG also objects to the Auditors' inclusion of information concerning Jersey Central Power and Light Company (JCP&L) and Atlantic City Electric Company (ACE). *PSE&G initial comments, pages 2 and 3*. The Company's reasons for its objections are unpersuasive and do not lead to the conclusion that the information should not remain in the Phase II audit report. Furthermore, PSE&G incorrectly alleges that the last paragraph on page VII-8 of the Phase II report is "in conflict with Finding #5 on page VII-5 ...." Finding #5 says, "The company [sic] acted reasonably in seeking to maximize revenues from the resale of NUG power." However, the text that PSE&G finds objectionable also states that "the company [sic] was not unreasonable in continuing to eschew the day-ahead market even if it had monitored market prices." The Ratepayer Advocate does not see any conflict between the two sections of the Phase II audit report and believes that the Board should permit the text to remain in the report.

CONCLUSION

The Ratepayer Advocate respectfully urges the Board to adopt the conclusions contained in our initial and reply comments in this matter and to require PSE&G to supplement its filings with the additional information that is necessary to complete a full review of the Phase II audit report. After the Ratepayer Advocate and other interested parties have received the additional information from PSE&G, the Ratepayer Advocate respectfully urges the Board to provide additional time for our office and the other interested parties to file additional comments concerning the new information provided by PSE&G. We also request that the Board require PSE&G to provide responses to our earlier discovery requests as mentioned in our June 13, 2005

letter regarding the discovery process for our review of the Phase II audit report and responses to additional discovery as needed.

Respectfully submitted,

SEEMA M. SINGH
RATEPAYER ADVOCATE

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c: President Jeanne M. Fox
Commissioner Frederick F. Butler
Commissioner Connie O. Hughes
Commissioner Jack Alter
Service list (by hand delivery or US regular mail)

ATTACHMENT-1

MTC Deferral Work (millions)

	MTC Net Revenues from Customers	Carrying Cost Due to Delay in Securitization	Net MTC Revenues	Depreciation MTC	Retail Adder	Total Pre-tax MTC	Tax on MTC	After Tax MTC	Annual Sum	NPV of After-tax MTC @ 8.42%
Aug-99	61.321	-	61.321	-	8.201	69.522	28.400	41.122		
Sep-99	30.721	-	30.721	-	6.702	37.423	15.287	22.136		
Oct-99	44.044	-	44.044	-	6.277	50.321	20.556	29.765		
Nov-99	41.466	-	41.466	-	6.002	47.468	19.391	28.077		
Dec-99	44.224	-	44.224	-	6.409	50.633	20.684	29.949	151.050	146.046
Jan-00	39.384	(28.470)	10.914	14.764	6.187	31.866	13.017	18.849		
Feb-00	40.787	(28.470)	12.317	14.764	5.467	32.548	13.296	19.252		
Mar-00	43.783	(28.470)	15.313	14.764	5.475	35.552	14.523	21.029		
Apr-00	34.525	(28.470)	6.055	14.764	5.008	25.827	10.550	15.277		
May-00	41.219	(28.470)	12.749	14.764	5.367	32.881	13.432	19.449		
Jun-00	43.594	(28.470)	15.124	14.764	6.871	36.758	15.016	21.743		
Jul-00	46.789	(28.470)	18.319	14.764	7.068	40.150	16.401	23.749		
Aug-00	50.098	(28.470)	21.628	14.764	7.122	43.514	17.775	25.738		
Sep-00	45.257	(28.470)	16.787	14.764	6.247	37.798	15.440	22.357		
Oct-00	42.639	(28.470)	14.169	14.764	5.683	34.616	14.140	20.475		
Nov-00	42.770	(28.470)	14.300	14.764	5.711	34.774	14.205	20.569		
Dec-00	47.309	(28.470)	18.839	14.764	6.142	39.744	16.236	23.509	251.996	224.727
Jan-01	48.177	(28.470)	19.707	14.764	6.247	40.718	16.633	24.084		
Feb-01	12.343		12.343	14.764	5.716	32.823	13.408	19.415		
Mar-01	9.878		9.878	14.764	6.117	30.759	12.565	18.194		
Apr-01	6.507		6.507	14.764	5.903	27.174	11.100	16.073		
May-01	7.642		7.642	14.764	6.112	28.518	11.649	16.868		
Jun-01	5.145		5.145	14.764	7.969	27.878	11.388	16.490		
Jul-01	7.253		7.253	14.764	7.783	29.800	12.173	17.626		
Aug-01	2.717		2.717	14.764	8.905	26.386	10.778	15.607		
Sep-01	(0.089)		(0.089)	14.764	6.656	21.331	8.714	12.617		
Oct-01	(0.043)		(0.043)	14.764	6.535	21.256	8.683	12.573		
Nov-01	0.887	-	0.887	14.764	6.204	21.855	8.928	12.927		
Dec-01	0.273		0.273	14.764	6.581	21.598	8.823	12.775	195.250	160.599
Jan-02	(0.693)		(0.693)	17.285	6.561	23.154	9.458	13.695		
Feb-02	(0.429)		(0.429)	17.285	5.929	22.785	9.308	13.477		
Mar-02	(0.132)		(0.132)	17.285	6.291	23.444	9.577	13.867		
Apr-02	(0.332)		(0.332)	17.285	6.254	23.208	9.480	13.727		
May-02	(0.189)		(0.189)	17.285	6.264	23.360	9.543	13.817		
Jun-02	(3.665)		(3.665)	17.285	7.337	20.958	8.561	12.396		
Jul-02	(3.810)		(3.810)	17.285	8.855	22.330	9.122	13.208		
Aug-02	(23.684)		(23.684)	17.285	-	(6.399)	(2.614)	(3.785)		
Sep-02	(18.563)		(18.563)	17.285		(1.278)	(0.522)	(0.756)		
Oct-02	(13.565)		(13.565)	17.285		3.720	1.520	2.201		
Nov-02	(14.936)		(14.936)	17.285		2.349	0.960	1.390		
Dec-02	(15.266)		(15.266)	17.285		2.019	0.825	1.194	94.434	71.642
Jan-03	(13.639)		(13.639)	34.480		20.841	8.514	12.327		
Feb-03	(12.218)		(12.218)	34.480		22.262	9.094	13.168		
Mar-03	(12.951)		(12.951)	34.480		21.529	8.795	12.734		
Apr-03	(12.220)		(12.220)	34.480		22.260	9.093	13.167		
May-03	(12.264)		(12.264)	34.480		22.216	9.075	13.141		
Jun-03	(19.451)		(19.451)	34.480		15.029	6.139	8.890		
Jul-03	(22.479)		(22.479)	34.480		12.001	4.902	7.099	60.526	58.277
Total	$ 640.134	$ (370.110)	$ 270.024	$ 803.117	$ 234.137	$ 1,307.278	$ 534.023	$ 773.255		

Authorized Unsecuritized Stranded Cost Recovery	$ 661.292
	$ 540.000
Difference	$ 121.292
Revenue Level	$ 205.058

SCHEDULE RCK-D-9

ATTACHMENT-2

MTC Deferral Worksheet (millions)

	MTC Net Revenues from Customers	Carrying Cost Due to Delay in Securitization	Net MTC Revenues	Depreciation MTC	Retail Adder	Total Pre-tax MTC	Tax on MTC	After Tax MTC	Annual Sum	NPV of After-tax MTC @ 8.42%
Aug-99	61.321	-	61.321	-	8.201	69.522	28.400	41.122		
Sep-99	30.721	-	30.721	-	6.702	37.423	15.287	22.136		
Oct-99	44.044	-	44.044	-	6.277	50.321	20.556	29.765		
Nov-99	41.466	-	41.466	-	6.002	47.468	19.391	28.077		
Dec-99	44.224	-	44.224	-	6.409	50.633	20.684	29.949	151.050	146.046
Jan-00	39.384	(28.470)	10.914	14.764	6.187	31.866	13.017	18.849		
Feb-00	40.787	(28.470)	12.317	14.764	5.467	32.548	13.296	19.252		
Mar-00	43.783	(28.470)	15.313	14.764	5.475	35.552	14.523	21.029		
Apr-00	34.525	(28.470)	6.055	14.764	5.008	25.827	10.550	15.277		
May-00	41.219	(28.470)	12.749	14.764	5.367	32.881	13.432	19.449		
Jun-00	43.594	(28.470)	15.124	14.764	6.871	36.758	15.016	21.743		
Jul-00	46.789	(28.470)	18.319	14.764	7.068	40.150	16.401	23.749		
Aug-00	50.098	(28.470)	21.628	14.764	7.122	43.514	17.775	25.738		
Sep-00	45.257	(28.470)	16.787	14.764	6.247	37.798	15.440	22.357		
Oct-00	42.639	(28.470)	14.169	14.764	5.683	34.616	14.140	20.475		
Nov-00	42.770	(28.470)	14.300	14.764	5.711	34.774	14.205	20.569		
Dec-00	47.309	(28.470)	18.839	14.764	6.142	39.744	16.236	23.509	251.996	224.727
Jan-01	48.177	(28.470)	19.707	14.764	6.247	40.718	16.633	24.084		
Feb-01	12.343		12.343	14.764	5.716	32.823	13.408	19.415		
Mar-01	9.878		9.878	14.764	6.117	30.759	12.565	18.194		
Apr-01	6.507		6.507	14.764	5.903	27.174	11.100	16.073		
May-01	7.642		7.642	14.764	6.112	28.518	11.649	16.868		
Jun-01	5.145		5.145	14.764	7.969	27.878	11.388	16.490		
Jul-01	7.253		7.253	14.764	7.783	29.800	12.173	17.626		
Aug-01	2.717		2.717	14.764	8.905	26.386	10.778	15.607		
Sep-01	(0.089)		(0.089)	14.764	6.656	21.331	8.714	12.617		
Oct-01	(0.043)		(0.043)	14.764	6.535	21.256	8.683	12.573		
Nov-01	0.887		0.887	14.764	6.204	21.855	8.928	12.927		
Dec-01	0.273		0.273	14.764	6.561	21.598	8.823	12.775	195.250	160.599
Jan-02	(0.693)		(0.693)	17.285	6.561	23.154	9.458	13.695		
Feb-02	(0.429)		(0.429)	17.285	5.929	22.785	9.308	13.477		
Mar-02	(0.132)		(0.132)	17.285	6.291	23.444	9.577	13.867		
Apr-02	(0.332)		(0.332)	17.285	6.254	23.208	9.480	13.727		
May-02	(0.189)		(0.189)	17.285	6.264	23.360	9.543	13.817		
Jun-02	(3.665)		(3.665)	17.285	7.337	20.958	8.561	12.396		
Jul-02	(3.810)		(3.810)	17.285	8.855	22.330	9.122	13.208		
Aug-02	(18.553)		(18.553)	17.285	-	(1.268)	(0.518)	(0.750)		
Sep-02	(16.189)		(16.189)	17.285		1.096	0.448	0.648		
Oct-02	(16.372)		(16.372)	17.285		0.913	0.373	0.540		
Nov-02	(13.995)		(13.995)	17.285		3.290	1.344	1.946		
Dec-02	(15.391)		(15.391)	17.285		1.894	0.774	1.120	97.695	74.117
Jan-03	(16.546)		(16.546)	34.480		17.934	7.326	10.608		
Feb-03	(12.218)		(12.218)	34.480		22.262	9.094	13.168		
Mar-03	(12.951)		(12.951)	34.480		21.529	8.795	12.734		
Apr-03	(12.220)		(12.220)	34.480		22.260	9.093	13.167		
May-03	(12.264)		(12.264)	34.480		22.216	9.075	13.141		
Jun-03	(19.451)		(19.451)	34.480		15.029	6.139	8.890		
Jul-03	(22.479)		(22.479)	34.480		12.001	4.902	7.099	78.806	57.033
Total	**$ 642.741**	**$ (370.110)**	**$ 272.631**	**$ 803.117**	**$ 234.137**	**$ 1,309.885**	**$ 535.088**	**$ 774.797**		

Authorized Unsecuritized Stranded Cost Recovery	$ 662.522
	$ 540.000
Difference	$ 122.522
Revenue Level	$ 207.137

SCHEDULE RCK-D-9

ATTACHMENT-3

PSEandG DEFERRAL CASE - PHASE II
NET PRESENT VALUE COMPARISON
$000

	After-Tax MTC Collections [Sch. RCK-D-9]
Aug-99	$ 41,122
Sep-99	22,136
Oct-99	29,765
Nov-99	28,077
Dec-99	29,949
Jan-00	18,849
Feb-00	19,252
Mar-00	21,029
Apr-00	15,277
May-00	19,449
Jun-00	21,743
Jul-00	23,749
Aug-00	25,738
Sep-00	22,357
Oct-00	20,475
Nov-00	20,569
Dec-00	23,509
Jan-01	24,084
Feb-01	19,415
Mar-01	18,194
Apr-01	16,073
May-01	16,868
Jun-01	16,490
Jul-01	17,626
Aug-01	15,607
Sep-01	12,617
Oct-01	12,573
Nov-01	12,927
Dec-01	12,775
Jan-02	13,695
Feb-02	13,477
Mar-02	13,867
Apr-02	13,727
May-02	13,817
Jun-02	12,396
Jul-02	13,208
Aug-02	(750)
Sep-02	648
Oct-02	540
Nov-02	1,946
Dec-02	1,120
Jan-03	10,608
Feb-03	13,168
Mar-03	12,734
Apr-03	13,167
May-03	13,141
Jun-03	8,890
Jul-03	7,099
Total Collections	$ 774,792
NPV	$ 681,766
NPV - PSE&G Proposed	$ 662,522
NPV Difference [After-Tax]	$ 19,244
Revenue Factor	0.5915
NPV Diffence [Revenues]	$ 32,534

Annual Discount Rate of 8.42% / 12 = 0.70167% Monthly Discount Rate

Annually Discounted at Rate of 8.42%

ATTACHMENT-4

PSEandG DEFERRAL CASE - PHASE II
TIMING OF COLLECTION OF NPV $540 MILLION DURING TRANSITION PERIOD
$000

I. BASED ON MONTHLY DISCOUNTING:

	After-Tax MTC Collections [Sch. RCK-D-9]	Monthly Dicount Factors Based on Annual Discount Rate of 8.42%	NPV After-Tax MTC Collections
Aug-99	$ 41,122	0.993	$ 40,834
Sep-99	22,136	0.986	21,826
Oct-99	29,765	0.979	29,140
Nov-99	28,077	0.972	27,291
Dec-99	29,949	0.966	28,931
Jan-00	18,849	0.959	18,076
Feb-00	19,252	0.952	18,328
Mar-00	21,029	0.946	19,893
Apr-00	15,277	0.939	14,345
May-00	19,449	0.932	18,126
Jun-00	21,743	0.926	20,134
Jul-00	23,749	0.920	21,849
Aug-00	25,738	0.913	23,499
Sep-00	22,357	0.907	20,278
Oct-00	20,475	0.900	18,428
Nov-00	20,569	0.894	18,389
Dec-00	23,509	0.888	20,876
Jan-01	24,084	0.882	21,242
Feb-01	19,415	0.876	17,008
Mar-01	18,194	0.869	15,811
Apr-01	16,073	0.863	13,871
May-01	16,868	0.857	14,456
Jun-01	16,490	0.851	14,033
Jul-01	17,626	0.846	14,912
Aug-01	15,607	0.840	13,110
Sep-01	12,617	0.834	10,523
Oct-01	12,573	0.828	10,410
Nov-01	12,927	0.822	10,626
Dec-01	4,636	0.816	3,783
Total NPV Collections			$ 540,026

II. BASED ON ANNUAL DISCOUNTING

	After-Tax MTC Collections [Sch. RCK-D-9]	Annual Dicount Factors Based on Annual Discount Rate of 8.42%	NPV After-Tax MTC Collections [Sch. RCK-D-9]
Aug 1999 - Dec 1999	$ 151,050	0.9669	$ 146,046
Jan 2000 - Dec 2000	251,996	0.8918	224,727
Jan 2001 - Dec 2001	195,250	0.8225	160,599
Jan-02	13,695	0.7587	10,390
Total NPVCollections			$ 541,762

ATTACHMENT-5

BPU Docket Nos. EX02060363
and EA02060366

PSEandG DEFERRAL CASE - PHASE II
OVER-COLLECTION AND INTEREST AFTER RECOVERY OF NPV $540 MILLION
$000

	Pre-Tax MTC Over-Collections [Sch. RCK-D-9]	Cumulative Over-Collections	Average Monthly Balance	Interest Rate (1)	Interest (2)	Over-Collections Including Interest
Dec-01	$ 13,760 (3)	$ 13,760	$ 6,880	5.50%	$ 32	
Jan-02	23,154	36,914	25,337	5.50%	116	
Feb-02	22,785	59,699	48,307	5.50%	221	
Mar-02	23,444	83,143	71,421	5.50%	327	
Apr-02	23,208	106,351	94,747	5.50%	434	
May-02	23,360	129,711	118,031	5.50%	541	
Jun-02	20,958	150,669	140,190	5.50%	643	
Jul-02	22,330	172,999	161,834	5.50%	742	
Aug-02	(1,268)	171,731	172,365	4.64%	666	
Sep-02	1,096	172,827	172,279	4.64%	666	
Oct-02	913	173,740	173,284	4.64%	670	
Nov-02	3,290	177,030	175,385	4.64%	678	
Dec-02	1,894	178,924	177,977	4.64%	688	
Jan-03	17,934	196,858	187,891	4.64%	727	
Feb-03	22,262	219,120	207,989	4.64%	804	
Mar-03	21,529	240,649	229,885	4.64%	889	
Apr-03	22,260	262,909	251,779	4.64%	974	
May-03	22,216	285,125	274,017	4.64%	1,060	
Jun-03	15,029	300,154	292,640	4.64%	1,132	
Jul-03	12,001	312,155	306,155	4.64%	1,184	
Total	$ 312,155				$ 13,193	$ 325,348
PSE&G's Calculated Over-Collection	$ 207,137				$ -	$ 207,137
Over-Collection Difference	$ 105,018				$ 13,193	$ 118,211

Break-Out of Over-Collection Difference:

- Monthly vs. Annual NPV Discounting	$ 32,534	see RPA-1
- Non-NPV Discounting of MTC Collections After Full Recovery of NPV $540 million	$ 72,484	
- Interest	$ 13,193	
- Total	$ 118,211	

(1) Annual 7-year treasury note rate plus 60 basis points
(2) Average monthly balances times1/12th of annual interest rate
(3) Per RCK-D-9 and RPA-2 for December 2001: 12,775 - 4,636 = 8,139/12,775 = 63.71% x 21,598 = 13,760

I/M/O the Deferred Balances Audit of
Public Service Electric & Gas Company
Phase II: August 2002 - July 2003

BPU Dkt. No. EX02060363 and
EA02060366

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APPENDIX C

State of New Jersey
DIVISION OF THE RATEPAYER ADVOCATE
31 CLINTON STREET, 11TH FLOOR
P.O. BOX 46005
NEWARK NJ 07101

RICHARD J. CODEY
Acting Governor

SEEMA M. SINGH, ESQ.
Ratepayer Advocate and Director

June 13, 2005

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

Re: In the Matter of the Deferred Balances Audit of Public Service Electric & Gas Company
Phase II: August 2002 -July 2003
Docket Nos. EX02060363 and EA02060366

Dear Secretary Izzo:

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

The Ratepayer Advocate provides the within comments pursuant to the May 13, 2005 letter from the office of the Secretary of the Board of Public Utilities (Board or BPU) inviting interested parties to submit comments on the Phase II audit report of the Board's consultants, Mitchell & Titus, LLP and the Barrington-Wellesley Group, Incorporated (Auditors), concerning the deferred balances of Public Service Electric and Gas Company (PSE&G). The May 13, 2005 letter invited comments on all issues including the issue mentioned on page I-6 of the Phase II audit report concerning the Market Transition Charge (MTC). More specifically, the Board requested the parties to respond to six questions concerning PSE&G's determination of the MTC overrecovery. At page I-6, the Phase II audit report noted that:

> BPU Staff has raised questions with respect to the reconciliation method PSE&G employed in calculating the over-recovery of $540 million of unsecuritized stranded costs by its MTC and other charges during the Transition Period, which in accordance with paragraph 14 of the EMP Order is to be refunded to ratepayers through the SBC. It is PSE&G's position that all MTC issues were fully litigated and resolved in the EMP Proceeding of 1998-1999 and the Deferral Proceeding of 2002, that the methodology for calculating the MTC reconciliation has not changed since the Board made its restructuring Final Decision in 1999. Discussions between Staff and PSE&G to resolve these questions are continuing, and if a resolution cannot be achieved, a Board proceeding may be instituted to consider the issues raised by Staff.

The Auditors do not state specifically what the issue is in the above paragraph. However, the six questions contained in the May 13, 2005 letter provide additional guidance on this issue. Despite this guidance, the Ratepayer Advocate finds it difficult to provide any initial comments on these issues without further additional information other than what is contained in the audit report. The Ratepayer Advocate believes that the preferable procedure should be for PSE&G to file its initial comments on the various issues and to provide responses to discovery requests in order for other interested parties to be able to file meaningful reply comments by the June 28, 2005 deadline.

One of the difficulties in providing any meaningful initial comments is that the audit report contains mainly brief recitations of the Auditors' conclusions and findings without much detail on the background information that led them to these findings and conclusions. There are citations to interviews with utility employees and discovery responses presumably provided by PSE&G to the Auditors concerning their report. However, the background documents containing the specific information are not attached, in all probability because they are voluminous. As noted in the audit overview (page I-1), the Auditors were engaged on October 2, 2002 to perform the audit of PSE&G's deferred balances. The Phase II audit report itself is

dated March 11, 2005. Thus, the entire audit took over twenty-nine months to complete. The Phase I audit report was completed on or about December 16, 2002. Although it is uncertain how long the Auditors needed to complete the Phase II audit, it probably took a large part of the balance of time from the December 16, 2002 Phase I audit report to the March 11, 2005 Phase II audit report (approximately twenty-six months), whereas other interested parties have had only a few weeks to absorb the Phase II audit report and provide initial comments.

The executive summary of the Phase II audit report (page I-3) states that as of July 31, 2003, the PSE&G deferred balances for the Non-utility Transition Charge (NTC), the Societal Benefits Charge (SBC), and the MTC were overcollected by approximately $373.5 million. There was also an underrecovery of approximately $234.7 million for the Basic Generation Service (BGS).[1] Clearly these are significant amounts which need to be carefully reviewed by the other interested parties including the Ratepayer Advocate, as well as the BPU. In addition, the questions concerning the MTC overrecovery determination indicate possible additional overrecoveries that have not been identified by PSE&G and which should be returned to ratepayers if they in fact have not been previously reported by the utility. PSE&G should in its initial comments provide the other interested parties with a specific discussion of the issues between the BPU Staff and the utility concerning the MTC overrecovery and any undercounting of the overrecovery that should be returned to ratepayers.

There are other issues also brought out in the Phase II audit report that should be addressed by PSE&G in its initial comments and which the other interested parties including our office should have the opportunity to include in our reply comments, once we have

[1] PSE&G has requested to securitize the remaining BGS underrecovery for Year Four of the transition period in a separate open docket. *I/M/O the Petition of Public Service Electric & Gas Company for a Bondable Stranded Cost Rate Order in Accordance with N.J.S.A. 48:3-49 et seq. to Recover Its Basic Generation Service,* Docket No. EF03070532.

received the additional needed information. These issues include, but are not limited to, the following: the St. Lawrence adjustment which covers additional revenues from the sale of the St. Lawrence contract energy that was somehow not included in the NTC from August 1999 to May 2003[2]; whether or not PSE&G is successfully maximizing the value it receives for the electric power from the NUG contracts; and the utility's efforts to renegotiate and restructure its remaining NUG contracts.

The Ratepayer Advocate believes that once PSE&G has provided the necessary additional information to complete a comprehensive review of the audit report's issues, then all other interested parties will be in a better position to provide our reply comments by the June 28, 2005 deadline. The Ratepayer Advocate respectfully thanks the Board for this opportunity to provide our initial comments.

Respectfully submitted,

SEEMA M. SINGH
RATEPAYER ADVOCATE

By: Badrhn M. Ubushin

Badrhn M. Ubushin, Esq.
Deputy Ratepayer Advocate

c: President Jeanne M. Fox
Commissioner Frederick F. Butler
Commissioner Connie O. Hughes
Commissioner Jack Alter
Service list (by US regular mail)

[2] According to the audit report (page V-3), PSE&G did include the costs of the saint Lawrence contract in the NTC for this period.

I/M/O the Deferred Balances Audit of
Public Service Electric & Gas Company
Phase II: August 2002 - July 2003

BPU Dkt. No. EX02060363 and
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APPENDIX D

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PSEG

June 13, 2005

In The Matter of the Audit of
Public Service Electric and Gas Company's
Deferral Balances – Phase II
BPU Docket Nos. EX02060363 & EA02060366

Kristi Izzo, Secretary
Board of Public Utilities
Two Gateway Center
Newark, New Jersey 07102

Dear Ms. Izzo:

In response to (1) the March 11, 2005 Electric Deferral Audit Report – Phase II, prepared by Mitchell & Titus (M&T) and Barrington-Wellesley Group, Inc. and released by the Board on May 13, 2005, and (2) the letter from Carmen Diaz, Acting Secretary of the Board, dated May 13, 2005, inviting the parties to submit comments on the Market Transition Charge (MTC") issue mentioned in the Audit Report, Public Service Electric and Gas Company (PSE&G, the Company) submits the following comments:

Audit Report – Phase II of Deferral Balances for Public Service Electric and Gas Company

- Chapter I – Executive Summary, page I-6. Please correct the date of the Independent Accountants' Report from November 26, 2003 to March 11, 2005.
- Chapter I – Executive Summary, page I-6. The Company objects to including the statement under the heading "Market Transition Charge ('MTC'), Unresolved Matter Between the BPU and PSE&G" in the Audit Report, as it is not the opinion of the Auditors or related to their audit Findings. It is inappropriate for the Auditors Report to make an "Observation" with regard to this issue raised by the NJ BPU Energy Staff. Its inclusion is contrary to the independence of the NJBPU's audit process, and it is contrary to the Board's standard practice (and is contrary to law, as discussed further below) to mix the work and findings of the external independent auditors with the positions of the NJBPU's Energy Division on a matter that has been the subject of, and resolved through, prior litigation. See

my letter to the NJBPU, dated October 21, 2004 (attached). The Company recommends that the statement be deleted from the Audit Report.

- If the statement remains in the Audit Report, please include the following statements under the heading "Market Transition Charge ('MTC'), Unresolved Matter Between the BPU and PSE&G", consistent with the Auditor's Opinion in the Independent Accountants' Report:
  - In response to the Board Energy Staff's concerns, Public Service has noted that all MTC issues were fully litigated and resolved in the EMP Proceeding of 1998-1999 and the Deferral Proceeding of 2002, that the methodology for calculating the MTC reconciliation has not changed since the Board issued its restructuring Final Decision on August 24, 1999, and that methodology has been thoroughly tested in the 2002 Deferral Audit process and the Deferral proceeding. With regard to the audit process, Public Service has pointed out that Mitchell & Titus issued a certified opinion in its Phase I audit, dated December 16, 2002, covering the first three years of the transition period, and finding the Company to be in compliance with Board Orders regarding the recovery of the MTC.
  - The final sentence on page I-6 can remain, but the date should be fixed: "As noted in the Independent Accountants' Report dated March 11, 2005, PSE&G complied, in all material respects, with the Board Orders regarding the deferred balances for Phase II."

- Chapter III – MTC Deferral, page III-3. Please remove the paragraph "Carrying Cost due to the Delay in Securitization".
  - The Delay in Securitization was not an issue addressed by the Deferral Auditors in Phase II. The costs associated with the Delay in Securitization were addressed by the Deferral Auditors in the 2002 Phase I Report and approved by Board Order dated April 22, 2004 in Docket No. ER02080604.
- Chapter VI – BGS Procurement Procedures, page VI-7. Please remove the paragraphs that reference the Liberty Audit of January 1, 2001 through June 30, 2002, and "the next competitive services audit" for the period August 1, 2002 through July 31, 2003.
  - The Deferral Audit – Phase II included a Scope of work designed by the Board for the Deferral Auditors for a review and opinion on the deferred balances for the PSE&G Transition Period – Phase II. No references should be made to prior or future Affiliate Standards Reports.
- Chapter VII – NUG Mitigation, page VII-8. Please remove the last paragraph on page VII-8, the entire page VII-9 and the 1st paragraph and Exhibit on page VII-10.

- The information presented on the above-indicated pages references data apparently extracted from the JCP&L and Atlantic City deferral audits. These utilities have different NUG contracts with different customers than PSE&G. These utilities also operate and sell power in a very different zonal area of New Jersey and PJM. PSE&G and its NUG power should not be compared on a prospective basis (after receiving and complying with specific PSE&G Board Orders) to other New Jersey utilities that have different Board Orders.associated with NUG power and mitigation efforts.
- The Company also notes that the last paragraph on page VII-8 is in conflict with Finding #5 on page VII-5, which states that the "company acted reasonably in seeking to maximize revenues from the resale of NUG power."
- The information presented was not discussed or presented to PSE&G during the Phase II fieldwork, but rather during the Report preparation process in the release of the Draft Deferral Audit Report – Phase II.

- Chapter VII – NUG Mitigation, page VII-12. Please remove the Second Bullet that starts "Atlantic City.....".
  - The information presented is not associated with PSE&G, or in accordance with the PSE&G NUG NJBPU Board Orders.
- Independent Accountants' Report – Attachment II, Page 1 of 4, the seventh line item from the bottom should read "Market Transition Charge ("MTC") (see Note 2)" [NOT "Note 1"].

MTC Over-Recovery

In Response to the May 13, 2005 NJBPU Energy Staff Questions on PSE&G's determination of the MTC over-recovery, PSE&G offers the following:

Question - 1

How was the net present value of the MTC over-recovery due ratepayers determined by PSE&G and was it consistent with the determination of the net present value of the MTC recovery due PSEG Power? Please explain in detail, and provide supporting documentation.

Answer:

The net present value of the MTC over-recovery due ratepayers was calculated in accordance with the NJBPU Board Order in Docket Nos. EO97070461, EO97070462 and EO97070463 as shown on Attachment 1. The net present value of the MTC due to PSEG

Power was calculated on the same basis. The MTC over-recovery due ratepayers was approved by the NJBPU in Docket No. ER02080604, dated April 22, 2004.

Question - 2

How should the ratepayer MTC over-recovery have been booked during each year of the transition period, i.e., as an allocated portion of the estimated net present value of the over-recovery as of August 1, 1999, as determined and booked by PSE&G, or as the estimated over-recovery occurring in each year of the transition period, in that year's dollars?

Answer:

The Stipulation in the restructuring proceeding provided that the MTC will be reconciled "At the end of the transition period..." (page 11, paragraph 14). (See also paragraph 14, page 119, of the August 1999 Order). There were no requirements to book any ratepayer over collection on a monthly or annual basis. This methodology was reviewed in the Energy Restructuring Proceeding (EMP) before the NJBPU in Docket Nos. EO97070461, EO97070462 and EO97070463.

Question - 3

Should interest have been booked on the ratepayer MTC over-recovery occurring in each year of the transition period, and if so, what is the appropriate rate? If not, why not.

Answer:

In accordance with the Final Decision and Order, Docket Nos. EO97070461, EO97070462 and EO97070463, no interest was provided for and none should be booked on the MTC over- or under-recovery in any year of the transition period. The language associated with the MTC, Order page 105, included the following: "At the end of the Transition Period, the recovery of the $540 million will be reconciled with actual collections as set forth herein, with PSE&G being at risk for any shortfall and customers receiving the benefit of any over-recovery via a credit of such excess amount to the SBC. We find this mechanism to be consistent with the provisions of section 13 of the Act, N.J.S.A. 48:3-61, which require that we afford the utility the opportunity, but not a guarantee, for recovery of generation-related stranded costs, and that (with specific reference to subsection 13(g) of the Act, N.J.S.A. 48:3-61(g)), we reconcile stranded cost recoveries to ensure that the utility will not collect in excess of its stranded costs."

Note that the Final Decision and Order provided for interest on over or under recovered SBC and NTC costs and specifically stated that requirement – see paragraph (6), page 116 of August 1999 Order and paragraph (9). No such requirement was stated in regard to the MTC.

Question - 4

In determining the net present value of the MTC recovery, should the discount rate have been applied monthly or annually? Please explain in detail with supporting documentation.

Answer:

As discussed further below, the MTC discount rate should be applied on an annual basis in accordance with the Board Order in Docket Nos. EO97070461, EO97070462 and EO97070463. In accordance with that Final Decision and Order, page 118, PSE&G shall be provided with the opportunity to recover up to $540 million of its unsecuritized generation stranded costs on a net present value (8.42% discount rate) net of tax over the Transition Period.

Question - 5

Is it appropriate to adjust the determination of the MTC recovery to reflect the fact that under IRS rulings and court decisions, monies properly belonging to ratepayers, such as fuel cost overrecoveries, are not taxable? See United States Tax Court decision, in Florida Progress Corporation and Subsidiaries v. Commissioner of Internal Revenue, No. 2961-97, June 30, 2000; affirmed Florida Progress Corp. and Subsidiaries, v. C.I.R., 348 F.3d 954 (11th Cir.Oct.21 , 2003) (No.02-14910,02-14911). Please explain in detail, with supporting documentation.

Answer:

The cited tax court decision does not affect the Company's calculation of the MTC over collection.

Question - 6

Are there other MTC quantification issues the Board should consider? Please list them and provide the reasons why the Board should consider them, with appropriate rationales and documentation.

Answer:

The Board should consider the following MTC quantification issues:

As the Company has explained several times, including in my letter dated October 21, 2004 submitted herewith, Board Staff's attempt to modify the methodology for reconciliation of the Company's recovery of $540 million of unsecuritized stranded costs is an improper attempt to re-litigate issues that have been previously decided by the Board, apparently based on Staff's reflection several years after-the-fact that the Board's resolution of this issue was somehow "inequitable."

The Company strenuously objects to these efforts, which are nothing more than an improper attempt to substantially revise one element of the comprehensive resolution of the electric restructuring proceeding, while leaving the other, interrelated elements unchanged. This "single issue" approach is inconsistent with the Board's own previously stated view of the interrelated nature of the restructuring, and improperly ignores the numerous ratepayer benefits already provided, and costs to the Company already imposed, under the Board's Restructuring Order.

> Staff's efforts are barred on several legal grounds. First, modification of the MTC reconciliation methodology at this stage would violate the well-settled prohibition against retroactive ratemaking, as it would impermissibly require Public Service to refund revenues already collected pursuant to lawfully established rates. Secondly, Staff's proposal would alter the terms of two final and comprehensive Board Orders (the August 1999 "Restructuring Order" and the April 2004 "Rate and Deferral Order"), and is therefore barred by the doctrines of res judicata and collateral estoppel. Where, as here, a Board decision resolves a contested proceeding, in which a subsequently aggrieved party expended substantial resources, and all parties (1) were afforded due process and substantial opportunity to be heard, and (2) had every right to appeal, and several parties in fact did appeal, a detailed resolution to the Appellate Division, the Board, at the staff's behest may not simply "change its mind" and modify important details of that resolution with impunity. Finally, the Board may not rely on its statutory authority to engage in management audits as a means to overcome the foregoing principles. The purpose of audits under Title 48 is to evaluate a utility's "operating procedures and . . . internal workings". Such audits may not be used as a pretext for selectively altering prior comprehensive rate decisions that included many interrelated piece-parts, that were based on a fully developed record and due process, and on which the parties have relied.

Introduction – The Board May Not Attempt To Unravel, At This Late Date, Its Comprehensive Restructuring Order

When various parties challenged the Restructuring Order in the appellate courts, the Board consistently, and successfully, highlighted the comprehensive nature of the process underlying that Order, as well as the Order itself:

> The BPU's [Restructuring] Order was issued after a five-year process to restructure the electric industry in New Jersey in order to lower energy costs and provide increased energy choices to New Jersey consumers . . . . The process included 20 days of evidentiary hearings on PSE&G's fact-specific unbundling and stranded cost issues . . . and an additional 20 days of hearings . . . on the more generic restructuring issues. Over 40 parties intervened in these proceedings and over 20 parties filed testimony. . . . After the close of hearings, the parties engaged in settlement discussions, which led to the submission . . . of two alternative non-unanimous settlement proposals, followed by the opportunity to submit comments thereupon. . . . The 126-page [Restructuring] Order contains detailed, interrelated findings supported by a vast and highly technical record, which allowed the BPU to bring the complex case before it to a fair and timely conclusion . . . ."
>
> * * * *
>
> [I]t must be emphasized that [the Restructuring Order] was designed as a comprehensive, integrated package, resolving all the outstanding issues in the case via interrelated findings whose combined effects were carefully weighed by the BPU to achieve a fair and balanced resolution of this complex matter, consistent with applicable law and supported by a detailed record. Since so many of the elements of the BPU's decision are inextricably intertwined, the economic impact of individual findings of the BPU must be evaluated in the full context of the entire decision.[1]

Among the numerous "intertwined" elements were several items benefiting ratepayers, at the expense of Public Service. Commencing August 1, 1999 and

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[1] See I/M/O Public Service Electric and Gas Company's Rate Unbundling, Stranded Costs, and Restructuring Filings, Supreme Court of New Jersey, Docket No. 49,690, Brief in Opposition to Petition for Certification on Behalf of Respondent New Jersey Board of Public Utilities (May 26, 2000), at 1-2, and Supplemental Brief on Behalf of Respondent New Jersey Board of Public Utilities (September 20, 2000), at 1.

during the first four years of competition (the "transition period"), Public Service took on the sole responsibility to provide safe, adequate and reliable electric service to its 1.9 million customers, at a pre determined energy rate, while providing immediate rate reductions to all customers. During the transition period the rate decreases under the Restructuring Order would aggregate approximately $1.4 billion. These rate reductions were ordered without any determination that they were supported by specific cost justifications, which would have been required if traditional rate regulation principles had been followed.

The impact on the Company of the Board's valuation of Public Service's generating assets was also considerable. On June 30, 1999, Public Service was required to write off $1.149 billion -- more than a year's earnings -- producing its first annual loss since its incorporation in 1924.

There were also significant economic impacts due to the conditions imposed in the transfer of the Company's generation assets to a competitive affiliate, known as a "Genco." In exchange for paying a "transfer premium" of $540 million, Genco received the right to collect market transition charge ("MTC") revenues during the Transition Period, but only until it was reimbursed the $540 million premium. Any collections above that figure would be retained by Public Service to be refunded to customers after the end of the transition period, while the Company was at risk for any underrecovery. Genco was also obliged to contract with the utility for a three-year period during which it would supply energy for basic generation service ("BGS") at a fixed price equal to the BGS rates established by the Board in the Restructuring Order, guaranteeing that there would be no deferred undercollected energy costs at the end of that period. It should be noted that the other three (3) electric utilities in New Jersey had significant deferred undercollected energy costs for that three-year period. Thus, risks previously borne by customers for increased fuel and wholesale energy purchases, and for generation plant performance, were, after issuance of the Restructuring Order, to be borne by Genco. This benefit saved PSE&G customers hundreds of millions of dollars.

It would be inconsistent with the Restructuring Order, as well as simply inequitable, for the Board as suggested by the Staff's Energy Director at this late date to reopen the restructuring proceeding for the sole purpose of recalculating the Company's MTC over-collection, while leaving the rate reductions and the Company's transition period BGS obligations (and countless other elements)

unchanged.[2] As discussed further below, all parties in interest were or should have been well aware of the method of calculation embodied in the Restructuring Order, and as also described below, that methodology was confirmed in the subsequent deferral proceeding. No parties objected to that methodology at any time. There is no principled basis to depart from that methodology now.

The MTC Reconciliation Methodology Has Been Established By The Board

A review of the language and context of the Board's Restructuring and Rate and Deferral Orders makes clear that, contrary to the Energy Staff's position in the instant dispute, those Orders included:

1) a determination that the net present value calculation of the Company's MTC recovery would be on an annual, rather than monthly, basis;

2) a determination that discounting the MTC collection to its August 1, 1999 value should continue throughout the four year transition period, without regard to whether or not the Company was fully reimbursed; and

3) No requirement that interest would be payable on MTC under- or over-recoveries.

This reconciliation methodology was clearly outlined in the Restructuring Order, which has been upheld on appeal, and then detailed in the Rate and Deferral Order, which is final and non-appealable.

The Restructuring Order adopted with certain modifications the stipulation ("Stipulation") submitted by the Company and certain other parties on March 17, 1999, resolving the stranded cost/restructuring proceeding. On April 15, 1999 I submitted a "Summary of Stranded Cost Collection and Genco Valuation" to the Board's Chief of Staff in order to more fully explain the Stipulation. See Attachment 2. That summary stated that PSE&G would have an opportunity to collect its unsecuritized stranded costs through the combination of an explicit MTC, an amortization of the distribution depreciation reserve and a BGS retail adder of 2 mills. Id. The summary, provided to Staff in April 1999, also included an attached schedule demonstrating the reconciliation methodology and making

[2] Of course, it would be simply impossible to "re-do" many aspects of the Restructuring Order at this point in time. For example, how could Genco be compensated for having taken on the risk of MTC underrecovery, or the risk of the fixed price BGS Contract?

clear that the elements of the unsecuritized stranded cost recovery would each be discounted to present value at August 1, 1999 at the end of each year, at a discount rate of 8.42%. There was no suggestion in the summary that interest would accrue on any under or over-recoveries, or that the discount rate would be applied on anything other than a yearly basis. Id.

The Restructuring Order indicated that the reconciliation of MTC collections to the Board's permitted recovery would be conducted in the same manner that had been proposed by Public Service, et al, in its Stipulation. That is, this recovery of the $540 million of unsecuritized stranded costs would "be accomplished via a 2 mill per kwh retail adder, an explicit Market Transition Charge ("MTC"), . . . and the amount funded by the excess distribution depreciation reserve amortization," and that recovery would be reconciled "on a net present value (8.42% discount rate) net of tax basis over the Transition Period." Restructuring Order, at 118. See also id., at 117 ("the Company will be provided with an opportunity . . . to recover up to $540 million of its unsecuritized net-of-tax generation related stranded costs on a present value basis . . . ."); id., at 119 ("[t]he discount rate used in these present value calculations will be based on the same cost of capital/discount rate [8.42%] used to calculate securitization savings on Attachment 1 to the PSE&G Stipulation", which reflected an annual discounting).

Further, as noted above, "[a]t the end of the Transition Period, the recovery of the $540 million will be reconciled with actual collections as set forth herein, with PSE&G being at risk for any shortfall and customers receiving the benefit of any overrecovery via a credit of such excess amount . . . ." Restructuring Order, at 107. While the Restructuring Order did not require interest on over- or under-recovery of the MTC/unsecuritized stranded costs, the Board was clear that interest would apply to certain other deferred balances, specifically the Non-Utility Transition and Societal Benefits charge balances. See Restructuring Order, at 116 (interest on under- or over recovered SBC balances), 116-17 (interest on NTC balances).

Thus, it is clear that in issuing the Restructuring Order, the Board directed that MTC collections would be calculated via an annual discounting throughout the transition period, and that no interest would accrue on any MTC under- or over-recoveries. This resolution reflects the give-and-take among adverse parties that is embodied in the Public Service Stipulation and the Board's Restructuring Order. In particular, Public Service agreed that it would not be compensated at all for under-recovered stranded costs, and in exchange for that agreement, the Stipulation provided that in the event there was an over-recovery, it would be

returned to ratepayers, but that no interest would accrue and the total collections would be calculated based on annual discounting.

This interpretation was subsequently confirmed during the Board's resolution of the Company's 2002-2003 electric base rate case and deferred balance proceeding. During the case, the Company's deferred MTC collections were fully investigated.

In that proceeding the Company sponsored the testimony of Robert Krueger in support of its MTC reconciliation schedule. Mr. Krueger's original "MTC Deferral Worksheet" was introduced as part of Exhibit PS-DEF-1, and is attached hereto as Attachment 1. That worksheet made clear that Public Service discounted total MTC collections annually, at 8.42%. There was no indication, on that worksheet or anywhere else in Mr. Krueger's testimony, that MTC recovery would be subject to interest on under- or over-recoveries at any time. The schedule and testimony of Mr. Krueger was subjected to audit, discovery, and cross-examination. Public Service presented the identical MTC schedule consistently throughout the proceeding and both phases of the deferral audit, as it was updated with actual data as time progressed.

The Staff and the parties had a full opportunity to investigate the reconciliation methodology. The RPA specifically asked why Public Service discounted MTC revenues collected during the transition period, and asked for the monthly interest rate and compounding assumptions used in Mr. Krueger's schedule. Public Service explained that its reconciliation method was supported by the Restructuring Order and with the exception of a single issue that is not relevant here, no party articulated any challenges to this method. The Board also retained an auditor, Mitchell & Titus LLC ("Mitchell & Titus") to perform an independent audit of the Company's electric restructuring deferred balance incurred through July 2003. In the auditors' "Phase I" report, covering the period through July 31, 2002, the auditors determined that PSE&G had complied in all material respects with the Board Orders governing deferred balances, including the MTC balance, which was "fairly stated, in all material respects."[3]

On June 6, 2003, Public Service and several other parties submitted a settlement to ALJ McGill ("Settlement") proposing, in the Board's words, "to resolve all issues pending in the base rate and deferral proceedings, ..." Rate and Deferral Order, at 6; see also Settlement at 4 (the parties "stipulate the following findings, conclusions and determinations for purposes of a full, final and complete

[3] See Deferral Proceeding, Exh. S-DEF-2, at IV-3.

resolution of the issues raised in these proceedings"). With regard to deferral case issues,

> [t]he Settlement provides for a $238.4 million reduction to the Company's SBC/NTC revenues for a period of 29 months effective for service rendered on and after August 1, 2003, simultaneously with the new electric distribution base rates discussed [elsewhere in the Rate and Deferral Order]. Rate and Deferral Order, at 14.

The portion of this over collection to be returned to ratepayers attributable to the MTC (an amount of $207.137 million as set forth in Mr. Krueger's updated submission (see Attachment 3.) was increased under the Settlement by a total of $48 million versus the Company's litigated position, in recognition of the parties' positions with respect to the MTC carrying costs due to the delay in securitization, and the transfer of certain nuclear decommissioning funds.[4] All parties, including the Board Staff, had a full opportunity to review the methodology used to quantify the MTC recovery in the proceeding and in the Stipulation.

On July 31, 2003, the Board issued its Summary Order adopting the proposed Settlement, with several modifications. The Summary Order was "issued for the purpose of implementing new rates for Public Service . . . on August 1, 2003, consistent with the requirements of the Electric Discount and Energy Competition Act ("EDECA"), N.J.S.A. 48:3-49 et seq., and the Board Orders implementing EDECA." Rate and Deferral Order, at 2.[5]

The various "modifications" to the Settlement that the Board found necessary did not include any changes whatsoever to the proposed MTC reconciliation methodology or calculation. In accordance with the Restructuring Order, the over recovered MTC was to be returned to customers through the SBC. The "just and reasonable rates" approved in the Rate and Deferral Order included a reduction in the SBC of $202.1 million, including "a refund of the Company's over-recovered Market Transition Charge deferred balance of $105.4 million" per year over the ensuing 29 months. Rate and Deferral Order, at 28. This figure reflects the amount approved in the Public Service Settlement, which in turn reflects the figure in Mr. Krueger's schedule.[6]

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4 These latter issues are not relevant for the present purpose of this brief.

5 The complete Rate and Deferral Order was actually not issued until April 22, 2004, and superseded the earlier Summary Order.

6 Specifically, Mr. Krueger's updated schedule (see Attachment 3) quantified the MTC over collection at $207.137 million. This amount, when combined with the $48 million increase in the over collection agreed to

Reconsideration Of The MTC Reconciliation Methodology Would Result In Impermissible Retroactive Ratemaking

In its April 22, 2004 Rate and Deferral Order, the Board determined that the terms thereof "ensure[ ] the provision of safe, adequate and proper service at just and reasonable rates." Rate and Deferral Order, at 29-30. Among the many piece parts embodied in that Order was the MTC reconciliation methodology proposed by Public Service, incorporated into the Public Service Settlement, and unchallenged by the parties (including Board Staff). The Staff's apparent attempt to undo that methodology long after the Rate and Deferral Order became final and unappealable is contrary to the well-settled prohibition against retroactive ratemaking.

"Generally, retroactive rate making occurs when a utility is permitted to recover an additional charge for past losses, or when a utility is required to refund revenues collected, pursuant to then lawfully established rates." I/M/O Petition of Elizabethtown Water Co., 107 N.J. 440, 448 (1987)(quoting Chesapeake and Potomac Tel. Co. v. Public Serv. Comm'n of West Virginia, 300 S.E.2d 607, 619 (W.Va. 1982)(emphasis added)).[7] The Company's MTC over-recovery was collected during the transition period, pursuant to what have been determined, in both the Restructuring Order and the Rate and Deferral Order, to be lawful rates. Staff now appears to be attempting to modify the reconciliation methodology in a manner that would require Public Service to refund more money to ratepayers than provided for under the Restructuring Order or the Rate and Deferral Order. Staff's position, if adopted by the Board, would impermissibly require Public Service to refund revenues in violation of the prohibition against retroactive ratemaking.

There are strong public policy arguments against the Staff's efforts. In re New Jersey Power & Light Co., 15 N.J. 82, 92-93 (1954), which specifically overruled a prior decision permitting retroactive ratemaking, the court struck down a

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by the settling parties, results in an over collection of $255.137 million. The rate reduction associated with the return of this over collection over 29 months, as provided for in the Settlement and in the Rate and Deferral Order, results in an annual rate reduction of $105.4 million.

7 See also State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Serv. Comm'n, 585 S.W.2d 41, 59 (Mo. 1979)(retroactive ratemaking is "the setting of rates which permit a utility to recover past losses or which require it to refund excess profits")(emphasis added); South Carolina Elec. and Gas Co. v. Public Serv. Comm'n, 272 S.E.2d 793, 795 (1980)("The Commission has no more authority to require a refund of monies collected under a lawful rate than it would have to determine that the rate previously fixed and approved was unreasonably low, and that the customers would thus pay the difference to the utility").

ratemaking methodology that would "require[ ] the Board to look both forward and backward in rate-making when the orderly processes of rate-making are necessarily present and prospective if rate-making is to be effective" (emphasis added). The court condemned that approach as "inconsistent with the businesslike processes of rate-making that have received the approval of this court." Similarly in Elizabethtown Water, the court stated that "allowing the BPU to retroactively order a refund to consumers every time the utility earns more than its rate of return [could] potential[ly] disrupt[ ] the stability of the marketplace" and undermine investor confidence. Elizabethtown Water, 107 N.J. at 461.

In this case, modifying the MTC reconciliation at this stage would cause substantial confusion and negatively impact investor confidence and shareholder value.

Staff's Proposal, Which Would Alter the Terms of Two Final and Comprehensive Board Orders, is Barred by the Doctrines of Res Judicata and Collateral Estoppel

It is well-settled that principles such as res judicata and collateral estoppel apply not only to parties in courts of law, but also in administrative tribunals and agency hearings. See, e.g., Hackensack v. Winner, 162 N.J. Super. 1, 24 (1978)(citations omitted). Res judicata, for example, "bars a party from relitigating a second time what was previously fairly litigated and determined finally." Id., at 27.[8]

"The application of res judicata to adjudicative decisions of administrative agencies, . . . rests on policy considerations such as 'finality and repose; prevention of needless litigation; avoidance of duplication; reduction of unnecessary burdens of time and expenses; elimination of conflicts, confusion and uncertainty; and basic fairness." Bressman, supra, 131 N.J. at 526-27 (citation omitted).

These policy considerations clearly prohibit Staff's attempt to "redo" the equities (as Staff sees them) of the Restructuring Order and the Rate and Deferral Order. The evidence in the EMP proceeding and the deferral proceeding was exhaustively developed and carefully evaluated, and all parties had ample opportunity to take

[8] See also Bressman v. Gash, 131 N.J. 517, 526-27 ("[a]s a general rule, an adjudicative decision of an administrative agency 'should be accorded the same finality that is accorded the judgment of a court")(citing Restatement (Second) of Judgments § 83 comment b (1982); Kenneth C. Davis, 4 Administrative Law Treatise § 21.9 (2d ed. 1983)("Davis"))

part in those proceedings. Staff's ongoing efforts to "take another bite" regarding this single issue is tantamount to an attempt by the Company to recover from ratepayers the full market value of energy provided during the first three years of the Transition Period. Staff's attempt to unravel the Restructuring Order should be rejected. See, e.g., Winner, supra, 162 N.J. Super. at 30 (striking results of second proceeding where "[t]he parties were adequately represented by counsel" in the first proceeding and "were not restricted in their proofs and the witnesses . . . available," and it was not "even suggested that the parties did not understand the finality of [the first] unappealed determination").[9]

The Staff May Not Rely On The "Phase II Audit" To Overcome The Proscription Of Retroactive Ratemaking Or Principles of Res Judicata And Collateral Estoppel

The purpose of Mitchell & Titus' "Phase I" and "Phase II" audits was to review "deferred balance accounts, transactions, and supporting calculations for the Transition Period." The Board did not direct, and could not have directed, its auditors to suggest methodological modifications to any aspects of its prior rate Orders.[10] Indeed, the audits of Public Service that have occurred to date have never sought to change an ongoing methodology, but have been solely confined to determining if the Company was following Board Orders, and whether its calculations were correct. As I have previously explained to the Staff, "no audit, in this Company's history, has indicated that the Company's methodology was correct, but in retrospect, inequitable." Oct. 21 letter, at 2.[11]

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[9] See also Mancuso v. Borough of North Arlington, 203 N.J. Super. 427, 432-33 (Sup. Ct. Law Div. 1985)(applying res judicata and collateral estoppel where the agency had conducted a full adversarial proceeding, and where plaintiff "was afforded the opportunity to conduct discovery, present witnesses, introduce evidence and conduct cross-examination; "[t]he basic considerations of speed, expertise, impartiality and judicial economy underlying our administrative process have been satisfied by the prior administrative proceeding"); I/M/O Crown/Vista Energy Project, 279 N.J. Super. 74, 88 (App. Div. 1994)(declining further review of Board Orders that appellants did not appeal from; "[w]e reject appellant's untimely attempt to collaterally attack the BPU's prior declaratory rulings").

[10] While the auditors were authorized to review the "prudence" of the Company's deferred costs, that authorization was limited to a prudency review of the BGS procurement practices of those utilities that had divested their generation assets. See Mitchell & Titus proposal (Sept. 5, 2002), at 1-10 through 1-11.

[11] As noted in that Oct. 21 letter, "This is most troubling in that this attempt is not the result of independent audit findings but the Energy Division's desire to rebalance equities that have long been settled by Board decisions and orders. . . . [T]he issues raised by the Energy Division were clearly reviewed and litigated in the Deferral case which was resolved by settlement and a final Board Order of July 2003." (See Attachment 4)

Staff's efforts to "rebalance" the equities of prior rate Orders is not only inconsistent with the scope of the auditor's charge in this case, but is actually inconsistent with the scope of the Board's statutory authority to audit utilities at all. N.J.S.A. 48:2-16.4 provides in relevant part as follows:

> The Board of Public Utilities shall establish procedures to provide for management audits to be performed on a regular or irregular schedule on **all or any portion of the operating procedures and any other internal workings** of every gas or electric utility subject to its jurisdiction. . . . The results of each audit shall be filed with the board and shall be open to public inspection. Upon completion and review of an audit, if the person or firm performing or supervising the audit determines that **any of the operating procedures or any other internal workings** of the affected utility are inefficient, improvident, unreasonable, negligent or an abuse of discretion, the board may, after notice and opportunity for a hearing, order the affected public utility to adopt such new or altered practices and procedures as the board shall find to be necessary to promote efficient and adequate service to meet the public convenience and necessity. All reasonable and proper costs and expenses, as determined by the board, of complying with any order of the board pursuant to this act shall be recognized by the board for all purposes as proper business expenses of the affected utility. . . . (emphasis added)

Staff's apparent view that the deferral audit may support a modification of the Board's prior rate Orders (as distinct from a modification of the Company's procedures or "internal workings") would be outside the proper bounds of a management audit.

Very truly yours,

C Jeanne M. Fox, President
Frederick F. Butler, Commissioner
Connie O. Hughes, Commissioner
Jack Alter, Commissioner
Michael Gallagher, Executive Director
W. P. Szymanski, Director-Division of Audits
Nusha Wyner, Director Energy Division

ATTACHMENT 1

	MTC Net Revenues from Customers	Carrying Cost Due to Delay in Securitization	Net MTC Revenues	Depreciation MTC	Rate	Total Pre-tax MTC	Tax on MTC	After Tax MTC	Annual Sum	NPV of After-tax MTC @ 8.42%
Aug-99	61 321	-	61 321	-	8 201	69.522	28.400	41 122		
Sep-99	30.721	-	30 721	-	6 702	37.423	15.287	22.136		
Oct-99	44 044	-	44 044	-	8 277	50 321	20.556	29.765		
Nov-99	41.466	-	41.466	-	6.002	47.466	19.391	28.077		
Dec-99	44.224	-	44.224	-	8 409	50.633	20.684	29.949	151.050	146.046
Jan-00	39.384	(28.470)	10 914	14 764	6 187	31.868	13.017	18.849		
Feb-00	40.787	(28.470)	12.317	14 764	5.467	32.548	13.296	19.252		
Mar-00	43.783	(28 470)	15.313	14 764	5.475	35.552	14.523	21.029		
Apr-00	34.525	(28 470)	6 055	14 764	5.008	25.827	10.550	15.277		
May-00	41 219	(28.470)	12 749	14.764	5.367	32.681	13.432	19.449		
Jun-00	43 594	(28.470)	15 124	14.764	6 871	36.756	15.016	21.743		
Jul-00	46.789	(28 470)	18 319	14 764	7.068	40 150	16.401	23 749		
Aug-00	50.098	(28 470)	21.628	14 764	7.122	43.514	17.775	25.738		
Sep-00	45.257	(28 470)	16 787	14.764	6 247	37.798	15.440	22.357		
Oct-00	42 639	(28 470)	14 169	14 764	5 683	34.616	14.140	20.475		
Nov-00	42 770	(28 470)	14.300	14 764	5 711	34.774	14 205	20.569		
Dec-00	47 309	(28 470)	18.839	14.764	6.142	39.744	16.236	23.509	251.996	224.727
Jan-01	46 177	(28 470)	19 707	14.764	6 247	40.718	16.633	24.084		
Feb-01	12 343		12.343	14 764	5 716	32 823	13 408	19.415		
Mar-01	9.878		9 878	14.764	6 117	30 759	12 565	18.194		
Apr-01	6 507		6 507	14 764	5 903	27 174	11 100	16.073		
May-01	7.642		7.842	14 764	6 112	28 518	11.649	16.868		
Jun-01	5.145		5 145	14 764	7 969	27 878	11.388	16.490		
Jul-01	7.253		7.253	14 764	7 763	29 800	12.173	17.626		
Aug-01	2.717		2 717	14 764	8.905	26.388	10.778	15.607		
Sep-01	(0.089)		(0 089)	14 764	6 658	21.331	8.714	12.617		
Oct-01	(0 043)		(0.043)	14 764	6 535	21.256	8.683	12.573		
Nov-01	0.887		0 887	14.764	6 204	21.855	8.928	12.927		
Dec-01	0.273		0.273	14 764	6.561	21.598	8.823	12.775	195.250	160.599
Jan-02	(0.693)		(0.693)	17.285	6.581	23.154	9.458	13.695		
Feb-02	(0.429)		(0.429)	17.285	5.929	22 785	9.308	13.477		
Mar-02	(0.132)		(0.132)	17 285	6.291	23 444	9.577	13.867		
Apr-02	(0.332)		(0 332)	17 285	6.254	23.208	9.480	13.727		
May-02	(0.189)		(0.189)	17.285	6.264	23.360	9.543	13.817		
Jun-02	(3.665)		(3.665)	17.285	7.337	20.958	8.561	12 396		
Jul-02	(3.810)		(3 810)	17 285	8.855	22.330	9.122	13.208		
Aug-02	(23.684)		(23.684)	17 285	-	(6.399)	(2 614)	(3 785)		
Sep-02	(18.563)		(18 563)	17 285		(1 278)	(0.522)	(0.756)		
Oct-02	(13.565)		(13.565)	17 285		3.720	1.520	2.201		
Nov-02	(14.936)		(14.936)	17.285		2.349	0 960	1.390		
Dec-02	(15.266)		(15.266)	17.285		2.019	0.825	1 194	94.434	71.642
Jan-03	(13.639)		(13.639)	34 480		20.841	8.514	12.327		
Feb-03	(12.218)		(12.218)	34 480		22.262	9.094	13.168		
Mar-03	(12.951)		(12.951)	34.480		21.529	8 795	12.734		
Apr-03	(12.220)		(12.220)	34 480		22.260	9 093	13.167		
May-03	(12.264)		(12 264)	34 480		22.218	9.075	13 141		
Jun-03	(19.451)		(19 451)	34 480		15.029	6 139	8.890		
Jul-03	(22.479)		(22.479)	34 480		12.001	4.902	7.099	80.526	58.277
Total	$ 840.134	$ (370.110)	$ 270.024	$ 803.117	$ 234.137	$ 1,307.278	$ 534.023	$ 773.255		
Authorized Unsecuritized Stranded Cost Recovery										$ 661.292
Difference										$ 540.000
Revenue Level										$ 121.292
										$ 205.058

SCHEDULE RCK-D-9

ATTACHMENT 2

Public Service
Electric and Gas
Company

Francis E. Delany, Jr.
Vice President and
Corporate Rate Counsel

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Mailing Address: P.O. Box 570 Newark, NJ 07101

April 15, 1999

Elizabeth Murray
Chief of Staff
Board of Public Utilities
Two Gateway Center
Newark, New Jersey 07102

Dear Ms. Murray:

Pursuant to your oral request on Tuesday, enclosed please find our response entitled "Summary of Stranded Cost Collection and Genco Valuation." It is intended to be an explanation of the Stipulation filed on March 17. Hopefully it will be of assistance to your understanding of the document. As I have offered on previous occasions, we are available to meet with you or your Staff to further discuss these issues.

Very truly yours,

C Mark Musser
Robert Chilton

SUMMARY OF STRANDED COST COLLECTION AND GENCO VALUATION

- PSE&G filed for $3.873 billion (after-tax NPV) of generation related stranded costs, comprised of an after-tax investment value of $5.068 billion and a market value of $1.195 billion (after-tax NPV).

- The Stipulation of PSE&G, et al (¶ 10) finds generation stranded costs at $3.300 billion (after-tax NPV), comprised of an after-tax investment value of $5.068 billion and a $0.573 billion increase in market value from $1.195 billion (after-tax NPV) to $1.768 billion (after-tax NPV).

- The Stipulation further states (¶ 10) that from this $3.300 billion (after-tax NPV) of stranded costs PSE&G has an opportunity to collect no more than $3.075 billion (after-tax NPV). The $3.075 billion is comprised of a recovery of stranded costs through the securitization process (¶ 11 & 12) of $2.475 billion (after-tax NPV) with an opportunity to collect up to $600 million (after-tax NPV) in unsecuritized stranded costs through the combination of an explicit MTC, an amortization of the distribution depreciation reserve and a BGS retail adder of 2 mils (¶ 13 & 14). Any collection of the three components in excess of the $600 million (after-tax NPV) will be returned to customers at the conclusion of the transition period through the SBC (¶ 14).

- The reduction in stranded costs from $3.873 billion (after-tax NPV) to no more than a maximum collection of $3.075 billion (after-tax NPV) is an amount ($.798 billion after-tax NPV) that will not be paid for by customers.

- As mentioned previously the Stipulation provides (¶ 13 & 14) PSE&G with an opportunity to collect up to $600 million (after-tax NPV) in unsecuritized stranded costs through the combination of an explicit MTC, an amortization of the distribution depreciation reserve and a BGS retail adder of 2 mils.
  - The explicit MTC is the residual rate component in the unbundled tariffs. The explicit MTC is the rate that remains after the rate decrease and other rate components [Transmission & Distribution, Societal Benefits Charge, Non-Utility Generation Transition Charge, Securitization Transition Charge and Basic Generation Service (BGS)/Shopping Credit] are accounted for. The explicit MTC begins as a positive value but turns and remains negative as the rate discount reaches 8.25% (beginning in August, 1, 2001). Over the four year transition period it is estimated to accumulate $49 million (after-tax NPV) of unsecuritized stranded cost recovery (see attached schedule).
  - The distribution depreciation reserve represents the amortization of the excess reserve and provides a source of unsecuritized stranded cost recovery while maintaining the rate discounts and shopping credits agreed to in the Stipulation. The revenue reduction resulting from the amortization provides $377 million (after-tax NPV) of unsecuritized stranded cost recovery (see attached schedule).

- The BGS retail adder of 2 mils provides unsecuritized stranded cost recovery for every kWh that remains on BGS. Therefore, the amount of unsecuritized stranded cost recovery that will result from this component is uncertain. If the percentage of customers that leave BGS is 20%, 50% and 80%, unsecuritized stranded cost collection (after-tax NPV) will equal $92 million, $57 million and $23 million, respectively (see attached schedule--50% level).

- Genco will pay the utility $2.368 billion (Attachment 4 of the Stipulation), the economic value of the generation plant of $1.768 billion plus $600 million. The $600 million represents the consideration Genco will receive over time for its agreement to provide reliability and price stability to the uncertain BGS load during the transition period pursuant to the BGS contract between PSE&G and Genco.[1]

- The BGS contract between PSE&G and Genco will provide for the following:
  1. Genco **will provide** the full requirements service for energy and capacity (i.e., electricity) needed by PSE&G to supply customers BGS, at a fixed price.
  2. Genco **will receive** payment for providing the BGS in an amount equal to PSE&G's BGS price times the energy consumed by BGS customers and an amount for price stability provided by the Genco's combustion turbines. The amount provided for price stability will be the amount collected for unsecuritized stranded costs, for which customers are only responsible for up to $600 million (after-tax NPV).
  3. Genco will maintain its generating capacity as a capacity resource within the PJM market during the transition period.

- The utility will be collecting up to $600 million (after-tax NPV) of unsecuritized stranded costs as set forth above. Thus, utility customers will only be paying what the Board found appropriate as the unsecuritized portion of stranded costs.

- Pursuant to the BGS contract, and in order to insure availability and reliability during the term of the BGS contract, at fixed prices, the utility has agreed to pay to the Genco the BGS rate plus the revenues collected from customers over the transition period for the unsecuritized stranded assets up to $600 million.

- Thus, the utility customers are indifferent, and the utility has the $600 million cash up front available to refinance PSE&G.

- Any shortfall in the collection of the $600 million (after-tax NPV) of unsecuritized stranded costs (e.g. from lower sales, customers purchasing generation service from third party suppliers) will be the Genco's--not the utility's--risk. If 50% of customers leave, the Genco is estimated to receive only $483 million (after-tax NPV) from the utility (see attached schedule). If zero customers leave, the Genco is estimated to receive approximately $541 million (after-tax NPV). Under all circumstances, the Genco pays the utility $600 million,

[1] The $2.4 billion transfer value will be increased for the book value of assets that were not subject to the stranded cost analysis. Items such as inventories of materials and supplies and fuel will be transferred to and paid for by Genco at their book value.

customers will probably pay less than $600 million but are guaranteed to pay no more than $600 million

- Should the utility collect more (e.g. higher sales) than $600 million (after-tax NPV) the excess will be used to reduce customer rates.

ACCOUNTING

ASSET IMPAIRMENT AND WRITE-DOWN

- Pursuant to accounting requirements and adoption of the Stipulation, PSE&G will be required to account for its generation assets under an impairment accounting test. This test will require a write-down of the asset values. Any net difference between the write-down resulting from the accounting impairment test and the regulatory asset established from the securitization authorization, will be reflected as a loss on PSE&G's income statement.

GENCO TRANSFER

GENCO'S BOOKS

- As mentioned previously Genco will pay PSE&G $2.368 billion ($1.768 billion economic value of generating plant plus $.600 billion consideration for Genco's rights under the BGS contract) in cash for the generation related assets[1].

- The difference between the cash payment of $2.368 billion and the net book value established via the impairment test will be recorded in an "intangible asset" account.

- The intangible asset will be amortized, reducing Genco's earnings over the life of the generating assets.

- Payments received from PSE&G for the BGS contract will be considered revenues to Genco.

- In summary, immediately after the transfer, Genco will have assets on its balance sheet equal to the cash paid of $2.368 billion[1] split between plant values as determined in the impairment test and the difference being accounted for as an intangible asset. Both asset categories (physical and intangible) will be depreciated/amortized to lower income over the life of the generating assets.

PSE&G's BOOKS

- As mentioned previously PSE&G will receive from Genco $2.368 billion in cash for the generation related assets[1].

- The difference between the cash receipt of $2.368 billion and the asset value remaining after the impairment test will be recorded in a "deferred credit"--below-the-line--account, and does not impact customer rate-setting in the future.

[1] The $2.4 billion transfer value will be increased for the book value of assets that were not subject to the stranded cost analysis. Items such as inventories of materials and supplies and fuel will be transferred to and paid for by Genco at their book value

- The deferred credit will be amortized to below-the-line income over the life of the generating assets and hence, in the consolidated financial statements of Enterprise, will offset Genco's treatment of the intangible asset. Accounting rules require this treatment to avoid inter-company transactions from creating earnings or expense.

- In summary, immediately after the transfer PSE&G will have cash on its balance sheet equal to the amount received from Genco of $2.368 billion.[1] and will remove from its books the plant values after reflection of the impairment test. The difference will be accounted for as a deferred credit and will be amortized to below-the-line-income over the life of the generating assets.

[1] The $2.4 billion transfer value will be increased for the book value of assets that were not subject to the stranded cost analysis. Items such as inventories of materials and supplies and fuel will be transferred to and paid for by Genco at their book value.

Ui .CURITIZED STRANDED COST RECOVERY

(THOUSANDS OF $)

Explicit MTC Recovery

Year	Net MTC Ex. SUT	Depre. Adj.	MTC w/out Depre.Adj.	Effective Period	Period Recovery	Recovery Year	After Tax	PV @ 8.42% Aug. 1, 1999
1999	538,019		538,019	8/1/99-12/31/99	224,175	224,175	132,599	128,207
2000	49,398		49,398	1/1/00-12/31/00	49,398	49,398	29,219	26,057
2001a	37,043		37,043	1/1/01-7/31/01	21,608			
2001b	(12,358)		(12,358)	8/1/01-12/31/01	(5,149)	16,459	9,736	8,008
2002a	(19,468)		(19,468)	1/1/02-7/31/02	(11,356)			
2002b	(248,062)		(248,062)	8/1/02-12/31/02	(103,359)	(114,716)	(67,854)	(51,478)
2003	(246,146)		(246,146)	1/1/03-7/31/03	(143,585)	(143,585)	(84,931)	(61,465)
						31,731	18,769	***49,329***

Distribution Depreciation Amortization

		Depre.Adj.					
1999			8/1/99-12/31/99	-	-	-	-
2000	177,138	177,138	1/1/00-12/31/00	177,138	177,138	104,777	93,439
2001a	177,146	177,146	1/1/01-7/31/01	103,335			
2001b	177,146	177,146	8/1/01-12/31/01	73,811	177,146	104,782	86,186
2002a	191,339	191,339	1/1/02-7/31/02	111,614			
2002b	191,339	191,339	8/1/02-12/31/02	79,725	191,339	113,177	85,862
2003	446,329	446,329	1/1/03-7/31/03	260,359	260,359	154,002	111,452
					805,982	476,738	***376,940***

Retail Adder

	Retl Adder	billing determ.	With 50% Load Loss					
1999	0.2	39,075,401	36,864	8/1/99-12/31/99	15,360	15,360	9,085	8,784
2000	0.2	39,595,990	37,355	1/1/00-12/31/00	37,355	37,355	22,095	19,704
2001a	0.2	40,045,551	37,779	1/1/01-7/31/01	22,038			
2001b	0.2	40,045,551	37,779	8/1/01-12/31/01	15,741	37,779	22,346	18,380
2002a	0.2	40,563,793	38,268	1/1/02-7/31/02	22,323	22,323	13,204	10,360
2002b	0.2	40,563,793	38,268		-	-	-	-
2003	0.2	40,968,789	38,650		-	-	-	-
						112,816	66,731	***57,230***
						GRAND TOTAL		*483,499*

ATTACHMENT 3

MTC Deferral Worksheet (Millions)

	MTC Net Revenues from Customers	Carrying Cost Due to Delay In Securitization	Net MTC Revenues	Depreciation MTC	Retail	Total Pre-tax MTC	Tax on MTC	After Tax MTC	Annual Sum	NPV of After-tax MTC @ 8.42%
Aug-99	61.321	-	61.321	-	8.201	69.522	28.400	41.122		
Sep-99	30.721	-	30.721	-	6.702	37.423	15.287	22.136		
Oct-99	44.044	-	44.044	-	6.277	50.321	20.556	29.765		
Nov-99	41.466	-	41.466	-	6.002	47.468	19.391	28.077		
Dec-99	44.224	-	44.224	-	6.409	50.633	20.684	29.949	151.050	146.046
Jan-00	39.384	(28.470)	10.914	14.764	6.187	31.866	13.017	18.849		
Feb-00	40.787	(28.470)	12.317	14.764	5.467	32.548	13.296	19.252		
Mar-00	43.783	(28.470)	15.313	14.764	5.475	35.552	14.523	21.029		
Apr-00	34.525	(28.470)	6.055	14.764	5.008	25.827	10.550	15.277		
May-00	41.219	(28.470)	12.749	14.764	5.367	32.881	13.432	19.449		
Jun-00	43.594	(28.470)	15.124	14.764	6.871	36.758	15.016	21.743		
Jul-00	46.789	(28.470)	18.319	14.764	7.068	40.150	16.401	23.749		
Aug-00	50.098	(28.470)	21.628	14.764	7.122	43.514	17.775	25.738		
Sep-00	45.257	(28.470)	16.787	14.764	6.247	37.798	15.440	22.357		
Oct-00	42.639	(28.470)	14.169	14.764	5.683	34.616	14.140	20.475		
Nov-00	42.770	(28.470)	14.300	14.764	5.711	34.774	14.205	20.569		
Dec-00	47.309	(28.470)	18.839	14.764	6.142	39.744	16.236	23.509	251.996	224.727
Jan-01	48.177	(28.470)	19.707	14.764	6.247	40.718	16.633	24.084		
Feb-01	12.343		12.343	14.764	5.716	32.823	13.408	19.415		
Mar-01	9.878		9.878	14.764	6.117	30.759	12.565	18.194		
Apr-01	6.507		6.507	14.764	5.903	27.174	11.100	16.073		
May-01	7.642		7.642	14.764	6.112	28.518	11.649	16.868		
Jun-01	5.145		5.145	14.764	7.969	27.878	11.388	16.490		
Jul-01	7.253		7.253	14.764	7.783	29.800	12.173	17.626		
Aug-01	2.717		2.717	14.764	8.905	26.386	10.778	15.607		
Sep-01	(0.089)		(0.089)	14.764	6.656	21.331	8.714	12.617		
Oct-01	(0.043)		(0.043)	14.764	6.535	21.256	8.683	12.573		
Nov-01	0.887		0.887	14.764	6.204	21.855	8.928	12.927		
Dec-01	0.273		0.273	14.764	6.561	21.598	8.823	12.775	195.250	160.599
Jan-02	(0.693)		(0.693)	17.285	6.561	23.154	9.458	13.695		
Feb-02	(0.429)		(0.429)	17.285	5.929	22.785	9.308	13.477		
Mar-02	(0.132)		(0.132)	17.285	6.291	23.444	9.577	13.867		
Apr-02	(0.332)		(0.332)	17.285	6.254	23.208	9.480	13.727		
May-02	(0.189)		(0.189)	17.285	6.264	23.360	9.543	13.817		
Jun-02	(3.665)		(3.665)	17.285	7.337	20.958	8.561	12.396		
Jul-02	(3.810)		(3.810)	17.285	8.855	22.330	9.122	13.208		
Aug-02	(18.553)		(18.553)	17.285	-	(1.268)	(0.518)	(0.750)		
Sep-02	(16.189)		(16.189)	17.285		1.096	0.448	0.648		
Oct-02	(16.372)		(16.372)	17.285		0.913	0.373	0.540		
Nov-02	(13.995)		(13.995)	17.285		3.290	1.344	1.946		
Dec-02	(15.391)		(15.391)	17.285		1.894	0.774	1.120	97.695	74.117
Jan-03	(16.546)		(16.546)	34.480		17.934	7.326	10.608		
Feb-03	(12.218)		(12.218)	34.480		22.262	9.094	13.168		
Mar-03	(12.951)		(12.951)	34.480		21.529	8.795	12.734		
Apr-03	(12.220)		(12.220)	34.480		22.260	9.093	13.167		
May-03	(12.264)		(12.264)	34.480		22.216	9.075	13.141		
Jun-03	(19.451)		(19.451)	34.480		15.029	6.139	8.890		
Jul-03	(22.479)		(22.479)	34.480		12.001	4.902	7.099	78.806	57.033
Total	$ 642.741	$ (370.110)	$ 272.631	$ 803.117	$ 234.137	$ 1,309.885	$ 535.088	$ 774.797		
Authorized Unsecuritized Stranded Cost Recovery										$ 662.522
Difference										$ 540.000
Revenue Level										$ 122.522
										$ 207.137

SCHEDULE RCK-D-9

ATTACHMENT 4

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PSEG

October 21, 2004

In the Matter of the Audit of
Public Service Electric and Gas Company
Deferred Balances
BPU Docket No. EX02060363 & EA02060366

Walter Szymanski, Director
Division of Audits
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102

Dear Director Szymanski:

On October19, 2004, Public Service Electric and Gas Company (Public Service, the Company) met with you and members of your Staff, the Director of the Energy Division, Nusha Wyner, her consultant, Larry Gentieu (Energy Division) and Helene Wallenstein, Deputy Attorney General. The Company assumes that DAG Wallenstein is advising Staff on the audit, and that a separate DAG will be assigned as Board advisor since she has indicated her agreement with Director Wyner's position, as noted below. Also in attendance were Christopher Brown and Dionne Johnson from the Mitchell and Titus accounting firm (M&T). The Company, in a letter dated October 1, 2004, had requested that a meeting be held to address a series of discovery requests that were propounded by Mr. Gentieu on behalf of Staff starting in April of 2004 and continuing through October. These requests were repetitive in nature, and in the Company's opinion, were not bringing closure to the audit process despite the fact that the M&T draft audit report has been in final form and with the Audit Staff since last Spring.

Director Wyner and Mr. Gentieu outlined several areas of concern. The most troubling to the Company was the questions posed surrounding the methodology utilized in the MTC reconciliation. The Company representatives took Director Wyner and Mr. Gentieu through documents starting with the EMP Settlement of March 1999, an April 15, 1999 letter and attachments in response to a request by the then BPU Chief of Staff, outlining the Settlement from that case and detailing the methodology and treatment of the MTC agreed to by the Parties, and the Initial Decision and Board Order in the Unbundling, Stranded Costs and Restructuring Case dated April 21, 1999. The Company also reviewed questions propounded by Mr. Gentieu, and Company responses dated April 7, 2004, September 8, 2004, and two responses dated October 1, 2004. In each of these documents the Company clearly detailed the methodology and treatment of the MTC.

The Company indicated to Director Wyner, and the documents show, that we were not deviating from the Board Orders. Director Wyner and Mr. Gentieu indicated that they agreed that the Company was following the methodology detailed in the various documents, but that in retrospect the outcome did not seem equitable to them. They supported this assertion by the fact that in a completely separate case (Securitization Order of 1999), the Company was permitted to recover hedged interest costs associated with the delay of the securitization resulting from the appeal brought by the Ratepayer Advocate. Since this issue is not a matter detailed in the audit report, and occurred in a separate case which is long closed, it has no relevance in this audit, and was not the subject of M&T's review.

A discussion followed wherein the Company representatives detailed the various discovery responses that were part of the Electric Base Rate and Deferral Case litigated during 2002 and 2003, and concluded by the Board Order dated July 9, 2003. In that case the calculations and methodology of the MTC were reviewed, and Company witnesses addressed all questions and issues raised. Also, on December 16, 2002 M&T issued a certified opinion to the BPU regarding the Phase I Audit which covered the first three years of the transition period. In that opinion no exceptions were identified or disclosed regarding non-compliance with the Board Order or the recording/recovery of the Deferral MTC. The Board made no changes to the Company's calculations.

The Energy Staff acknowledged that these were indeed the facts, however, in their opinion there was no bar to them waiting until the current audit, since they consider this audit to be the end of the issue. DAG Wallenstein concurred with this interpretation. The Company indicated that the Company audits that have occurred have never sought to change an ongoing methodology, but have been solely confined to determining if the Company was following Board Orders, and whether the calculations were correct. No audit, in this Company's history, has indicated that the Company's methodology was correct, but in retrospect, inequitable. This is most troubling in that this attempt is not the result of independent audit findings but the Energy Division's desire to rebalance equities that have long been settled by Board decisions and orders. As mentioned previously, the issues raised currently by the Energy Division were clearly reviewed and litigated in the Deferral case which was resolved by settlement and a final Board Order of July 2003.

After consideration of the substance and process discussed at Tuesday's meeting, the Company has determined it will not file a position in response to the MTC reconciliation issues raised by the Director of the Energy Division. It is apparent from the detailed conversations that these issues rest solely with the Energy Division and are not a finding of the independent auditors, M&T. These issues therefore have no place in the independent audit report. Inclusion of these issues in the audit report would be an abuse and manipulation of the independent audit process. It is the Company's opinion that if

the Energy Division continues to pursue these issues, given their substantial financial effect on the Company, that the Company should be afforded appropriate due process in the form of testimony and hearings, to adequately challenge any formal assertions of the Energy Division.

As the Company representative stated at the meeting, the Energy Division is attempting to change the methodology for the reconciliation of the $540 million of unsecuritized stranded cost recovery is an attempt to re-litigate issues that have been previously decided by Board Order. As we indicated, the Company's utilization of a discount rate of 8.42% and associated annual compounding period was consistently applied throughout the restructuring proceeding, was approved by the Board's Order in the Restructuring Proceeding, and was reviewed and unchallenged during the Deferral Proceeding. Similarly, the treatment of interest in the reconciliation process was pursuant to the Board's Order in the Restructuring Proceeding and was raised and unchallenged during the Deferral Proceeding. Furthermore, the Energy Division Director's attempt to modify the reconciliation process and calculations is not similar or analogous to the adjustment litigated in the Deferral Proceeding related to the delay in securitization.

Based upon the foregoing, the Company requests that M&T issue their long delayed independent report detailing their audit conclusions, and if the Energy Division continues to request that the Company's methodology be retroactively changed by the Board, a contested case be commenced. Finally, since Director Wyner was an attorney for the Ratepayer Advocate during the EMP process and litigation, and the Ratepayer Advocate had opposed the PSE&G settlement and was party to an appeal of the Board's Order, she should be excluded from any further involvement in the Audit process or in issues related to the EMP proceeding where she participated as a counsel for the Ratepayer Advocate.

Very truly yours,

Francis E. Delany

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PUBLIC SERVICE ELECTRIC AND GAS COMPANY
DEFERRAL AUDIT MTC
BPU DOCKET NO. EX02060363 AND EA02060366

BPU

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