

**STATE OF NEW JERSEY  
BOARD OF PUBLIC UTILITIES**

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

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**EXCEPTIONS TO THE INITIAL DECISION  
ON BEHALF OF THE  
DIVISION OF RATE COUNSEL**

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## INTRODUCTION

The Division of Rate Counsel (“Rate Counsel”) has received the Initial Decision dated January 8, 2015 in the above referenced matter and files these exceptions to the conclusions of the Administrative Law Judge (“ALJ”) finding that Jersey Central Power and Light Company (“JCP&L or the Company”) should implement a reduction in annual revenues of \$107,489,352. *I.D.*, p. 113.<sup>1</sup> Rate Counsel respectfully urges the Board of Public Utilities (“Board or BPU”) to adopt the Initial Decision except for those portions of the Initial Decision discussed below. Rate Counsel will not repeat here the arguments and conclusions contained in our testimony, initial brief and reply brief filed below but incorporate them by reference as if fully set forth herein. Rate Counsel believes that the record evidence in this proceeding fully supports our recommendations.

## STATEMENT OF THE FACTS AND PROCEDURAL HISTORY

Rate Counsel agrees with the Procedural History contained in the Initial Decision up to the paragraph listing the evidentiary hearings and provides the following as a supplement and an update of the events that have occurred thereafter:

On the final day of hearings, a briefing schedule was set with initial briefs due on January 17, 2014 and reply briefs on February 14, 2014. The filing dates were later modified to January 27, 2014 and February 24, 2014, respectively.

In response to the ALJ’s directive and Board Staff’s request during an April 17, 2014 conference call, Rate Counsel and the Company filed letters on April 22, 2014 identifying the

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<sup>1</sup> In this brief Rate Counsel refers to the Initial Decision as *ID*, Rate Counsel’s Initial Brief and Reply Brief as *RCIB*; *RCRB*, Petitioner’s Initial Brief and Reply Brief as *PIB*; *PRB*, Board Staff’s Initial Brief as *SIB*, Gerdau Initial and Reply Briefs as *GIB*, *GRB*.

portions of the evidentiary record that relate to the amortization period and appropriate carrying charge to be applied to the recovery of the 2011 Major Storm costs. In that letter, Rate Counsel also requested that the ALJ close the record and issue an initial decision. Additionally, the Company requested, and then filed, supplemental schedules reflecting updated revenue requirements schedules for the Board-approved 2011 Major Storm Costs.

On May 6, 2014, Staff acknowledged review of the parties submissions and notified the ALJ that the record contains sufficient information. On May 12, 2014, Board Staff filed updated schedules reflecting the settlement in the Major Storm Events proceeding.

By letter dated May 21, 2014, Rate Counsel renewed its request that the record be declared closed and asked that the matter be concluded expeditiously. On that same day, JCP&L filed a letter pointing out two errors in Board Staff's May 12, 2014 updated schedules. By letter dated June 11, 2014, the Staff filed its revised updated schedules.

On June 20, 2014, JCP&L advised the ALJ of the BPU's generic proceeding to review the applicability and calculation of a consolidated tax adjustment and requested that the ALJ take official notice of the Board's notice. Rate Counsel and Board Staff filed response letters objecting to the Company's request. On June 30, 2014, the ALJ denied the Company's request and advised that the record was closed.

On July 24, 2014, Rate Counsel filed a motion and letter brief requesting that the Board direct that effective August 1, 2014 JCP&L's rates be considered provisional and subject to refund pending a final order. Walmart, Gerdau and AARP parties filed letters in support of Rate Counsel's motion. JCP&L and PSEG filed letters in opposition.

On August 14, 2014 and for a second time on September 26, 2014 the ALJ requested and was granted an extension of time to file the Initial Decision. The new due date was set for

November 13, 2014. Shortly before the filing due date was set to expire, the ALJ requested a third extension.

On November 18, 2014, Rate Counsel filed a letter renewing its request that the Board grant its July 24, 2014 Motion, deny the ALJ's request for an additional forty-five day extension and require that the ALJ file the Initial Decision by December 1, 2014. Walmart and AARP subsequently filed letters in support and JCP&L filed a letter in opposition.

On November 21, 2014, the Board granted a third extension until January 9, 2015. The Initial Decision was filed on January 8, 2015. Written exceptions to the Initial Decision are due on February 5, 2015 and written replies are due on February 19, 2015.

On January 12, 2015, Rate Counsel filed a subsequent letter advising the Board that the Initial Decision recommended a rate decrease and again requesting that the Board decide Rate Counsel's July 24, 2014 motion. On January 13, 2015 JCP&L filed a response requesting that Rate Counsel's Motion be denied.

## ARGUMENT

### POINT I

**JCP&L SHOULD NOT BENEFIT FROM THE DELAY IN THIS PROCEEDING AND SHOULD BE HELD TO THE SAME CONSOLIDATED INCOME TAX RATEMAKING TREATMENT THAT ALL UTILITIES WERE HELD TO IN 2011, THE TEST YEAR IN THIS BASE RATE CASE.**

Judge McGill declined to make a Consolidated Tax Adjustment (“CTA”) to the Company’s rate base in this proceeding. In doing so, the ALJ relied upon the Board’s direction in its December 12, 2014 Order which provided:

In pending rate cases where the record has been closed, the Board shall, following an initial decision by the Office of Administrative Law, reopen the record for the limited purpose of adding the calculation of the CTA as modified by this Order while providing all parties with the opportunity to comment.

In the Matter of the Board’s Review of the Applicability and Calculation of a Consolidated Tax Adjustment, BPU Docket No. EO12121072, Order of Clarification Modifying The Board’s Current Consoldated (sic) Tax Adjustment Policy, (12/12/ 2014).

At the time JCP&L filed this base rate case, the Board’s “Rockland methodology” was the CTA methodology used for all utilities filing base rate cases in that time period. Not only was the test year in this matter concluded well before the BPU determined to modify its CTA calculation, the case was fully tried and the record created before any policy changes were made public. There is absolutely no evidence in the record to support a different calculation, nor is there any basis to apply a different rule for JCP&L than other companies whose rate cases were litigated or settled between 2011 and 2014. JCP&L is not entitled to special treatment caused only by the repeated delays in this proceeding.

Accordingly, the Board should, without further delay, implement the significant rate reduction that is due to JCP&L's ratepayers. That rate reduction should include full credit for the only CTA that was introduced into the record during the evidentiary hearings before Judge McGill, the \$511.66 million rate base adjustment recommended by Rate Counsel.

JCP&L in this proceeding merely contended that the Board should not make any CTA. *ID*, p. 17. ALJ McGill found this position not helpful and noted that JCP&L's "position is directly contrary to the judicial and regulatory precedents in regard to consolidated tax savings as set forth above. It follows that JCP&L's contention opposing any consolidated tax adjustment cannot be accepted in this proceeding." *ID*, pp. 17-18. Judge McGill also noted that "JCP&L's witness did not quantify any of the alleged flaws in Rate Counsel's proposed consolidated tax adjustment, and therefore, his testimony will not serve as a basis for any modifications." *ID*, p. 18. Judge McGill however declined to recommend a CTA, suggesting a deferral of any implementation of a CTA to a Phase II proceeding after completion of the 2013 Generic CTA proceeding. *ID*, pp. 18-19.

Rate Counsel maintains that application of any new CTA policy must await the Company's next base rate case with the opportunity to file testimony and cross examine witnesses. If a Phase II is to be considered, the rate reduction owed to ratepayers since 2011 should go into effect utilizing the Rockland methodology until such time as the Phase II is completed. In order to ensure just and reasonable rates in a timely manner, the Board should establish new base rates based on the evidence in this proceeding and then convene another proceeding – either a base rate case or a Phase II - to potentially re-set base rates based on a revised CTA methodology.

The only evidence in this proceeding that complies with New Jersey law and Board precedent is the testimony of Rate Counsel witness Andrea Crane. Ms. Crane calculated a CTA based on the Board's "Rockland methodology," the methodology in force at the time of the Company's filing. In their Initial Brief, Board Staff agreed with Ms. Crane calculation and supported Rate Counsel's CTA. Subsequently, on January 30, 2015, Board Staff circulated a revised CTA calculation based on methodology set forth in the Board's December 17, 2014 Order in BPU Dkt. No. EO12121072. Rate Counsel will address this subsequent filing in Rate Counsel's Reply Exception.

This base rate case dates back to a 2011 test year, a time well before the Board issued the 2013 Generic CTA Order. In 2011, all New Jersey utilities that participated in a consolidated tax filing were subject to the CTA methodology then in effect, the same methodology used by Rate Counsel in calculating its recommended CTA in this proceeding. The Board should reject the ALJ's decision to make no adjustment for consolidated tax filings until a Phase II proceeding. Instead, the Board should adopt the CTA in evidence, the CTA calculated by Rate Counsel witness Crane, a rate base reduction of \$511.66 million. *RC-13*, Sch. ACC-1. JCP&L should be held to the Board practices and policies in effect at the time of the rate case filing and should not be allowed to benefit from the excessive delays encountered in reaching an initial decision in this case. To allow JCP&L to continue to collect excessive rates would be unfair to JCP&L's ratepayers who have been denied just and reasonable rates for many years.

## POINT II

### **THE BOARD SHOULD RECOGNIZE THAT ALL NON-CASH ITEMS SHOULD BE EXCLUDED FROM THE CASH WORKING CAPITAL CALCULATION AND ADOPT RATE COUNSEL'S PROPOSED CASH WORKING CAPITAL ALLOWANCE OF \$76.5 MILLION.**

Cash working capital (“CWC”) is an element of rate base and can be defined as monies advanced by either investors or ratepayers to cover expenses associated with the provision of service to the public during the period of time between the payment of those expenses and the Company’s collection of revenues from customers. In this proceeding, the Company’s proposed rate base adjustment of \$138,138,683 for CWC was calculated based upon the results of a lead/lag study.<sup>2</sup>

Rate Counsel’s witness David Peterson recommended several adjustments to the Company’s lead/lag analysis. These recommended adjustments would reduce JCP&L’s distribution CWC requirement by \$61,654,653 to \$76,484,029. The ALJ properly adopted Rate Counsel’s adjustments for the expense lead days for Federal Income Tax payments and rejected the Company’s calculation based on the “grossly distorted results in 2011.” *ID*, p. 6. Judge McGill also found that Rate Counsel’s recommended removal of deferred income taxes from the lead/lag study was reasonable and should be approved by the Board. However, Judge McGill included the items discussed below.

Rate Counsel’s position to exclude non-cash items from an allowance for CWC is reasonable, based upon careful consideration of the underlying purpose for granting the Company an allowance for CWC, that is to compensate investors for investor supplied funds, if

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<sup>2</sup> A lead/lag study measures the difference between when the Company receives revenue for the provision of service and when the Company pays for the costs of providing service.

any, used for the day to day cash needs of the utility. Rate Counsel therefore asks that the following adjustment also be made.

### **1. Non-Cash Depreciation Expense and Amortization Expense.**

A rate base allowance for CWC is intended to compensate investors for investor-supplied funds, if any, used to finance the day to day operating needs of the utility. *RC152*, p.14. In his Initial Decision, ALJ McGill adopted the position of the Company and Board Staff and found that both depreciation expense and regulatory debits and credits should be included in the lead/lag study with a zero lag. *ID*, p. 11. The ALJ was persuaded by prior BPU precedent assigning a zero lag to depreciation expense and to the amortization of owned nuclear fuel. *ID*, p. 10 citing I/M/O the Petition of Public Service Electric and Gas Company for an Increase in Rates, Docket No. ER85121163 (April 6, 1987). The cited 1987 Board decision was based on the rationale that each dollar of expense recovered in rates reflects the return of a dollar of investor-supplied funds and as such belongs to investors.

Ownership of the funds is not the proper consideration for determining if an expense should be included in CWC. Indeed, all revenues become the property of the investors once service is provided. The real issue in determining a CWC allowance is how much investor-supplied capital (or how much ratepayer capital) is needed to meet the utility's day-to-day operating expenses. Cash outlays by investors **during the test year** are appropriately included in a CWC allowance. Non-cash expenses do not create a need for cash to be supplied by investors (or by ratepayers) during the lead/lag study period and thus should not be included. *RC-152*, p.14.

There is no argument that depreciation expense does not involve a cash outlay by investors *during the test year*. Indeed, at the evidentiary hearings, the Company's witness testified that, for financial reporting purposes, depreciation expense is recorded as a **cash inflow, or a source of cash to the Company**; not a cash outflow or requirement for cash. *T129:L2-3* (October 210, 2013). Similarly, JCP&L's regulatory debits include various amortizations of costs incurred prior to the 2011 test year. As with depreciation expense, the cash transactions associated with these amortizations took place in years prior to the 2011 study period. Thus, as with depreciation, there is no continuing need for investor-supplied capital to wind down the remaining accounting write-off of costs incurred in prior years.

Rate Counsel recognizes that its recommended position on this issue is not compliant with prior BPU precedent but believes that its position is correct and urges its adoption by the Board. Cash working capital reflects the need for investor-supplied funds to meet the day to day expenses of operations that arise from the timing differences between when JCP&L must expend money to pay the expenses of operation and when revenues for utility service are received by the utility. *RC-4*, p.15. Only those items for which actual out-of-pocket cash expenditures are made should be included in the Company's CWC lead-lag calculation. Rate Counsel therefore recommends that the Board reconsider its current policy on this issue and exclude depreciation and amortization expenses from the lead-lag study for purposes of determining the Company's appropriate CWC allowance in this case. *RC-4, Sch. ACC-7*. As the expenses that relate to depreciation and amortization simply do not represent or require cash outlays by JCP&L investors, a properly conducted lead/lag study should exclude these non-cash expenses. *RC-152*, p.15. The Board should therefore reject the ALJ's finding on this issue.

## **2. Return on Invested Capital and Interest on Long Term Debt.**

ALJ McGill adopted JCP&L's position that the return on common equity and the interest on long term debt should be included in the lead/lag study with a zero payment lag. The ALJ found persuasive JCP&L's argument that interest on long term debt and the return on common equity are earned and become the property of investors at the time service is rendered. The Company stated in its Initial Brief:

In an unbroken line of decisions, the Board has held that return of, and return on, all invested capital, including interest on long-term debt, dividends on preferred stock and the return on common equity capital, are earned and become the property of the utility's investors at the time that service is rendered. Because such returns are not actually received by investors until the related revenue is collected from customers, the Board has repeatedly held that such returns must be included in the lead-lag study with a zero payment lag in order to compensate investors for that delay. *PIB*, pp. 52-53.

As discussed above, ownership of earnings is not the issue. In a lead-lag analysis, the utility's ownership of revenues is not a relevant consideration because all utility revenues are owned by the utility. Rather, the only relevant consideration in a lead-lag study is the timing of the receipt of revenues vis-à-vis the timing of the utility's cash outlays.

By using a zero day expense lead, JCP&L is acting as if investors are compensated on a daily basis. This is incorrect. Regardless of when the utility collects revenues from ratepayers, common equity investors do not receive a "return" until the Company declares and pays a dividend or until a stockholder sells his stock. This is the mechanism by which the common shareholder is compensated in the real world. Similarly, long term debt holders are not compensated on a daily basis. There are contractual requirements associated with long term debt interest payments that obligate JCP&L to make specified payments on certain dates (i.e., semi-annually). The utility's cash transaction associated with the return on investment lies within these instances; not when the Company receives payment from ratepayers.

Thus, the Board should reject the ALJ's finding on this issue. The Company is under no contractual obligation to make dividend payments to shareholders before collecting the corresponding revenue. Further, it is incorrect to assume that debt-holders are being compensated on a daily basis. The Board should adopt Rate Counsel's recommended adjustment for equity returns and long-term debt expense which reduces JCP&L's CWC requirement by approximately \$26.5 million.

### **3. Cash Working Capital Conclusion.**

Rate Counsel respectfully requests that in establishing an allowance for CWC, the Board should recognize that ownership of earnings is irrelevant; and that the only relevant factor in measuring a utility's CWC requirement is the relationship between the receipt of revenues from customers and JCP&L's cash payments to employees, vendors, and investors. The Board should reject the ALJ's approval of JCP&L's inclusion of non-cash items into its CWC allowance and adopt a positive lead/lag study CWC requirement of approximately \$76,484,029. *RC-152, Sch. DEP-2*. This is approximately \$61,654,653 less than the CWC requirement of approximately \$138,138,683 claimed by JCP&L.

### POINT III

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

##### **1. The ALJ Recognized that JCP&L's Suffers From Poor Performance But Fails to Apply a More Stringent Standard Based on the Company's Performance Between 2007 to 2011 in This Case.**

Rate Counsel argued in its initial and reply brief in the instant case that JCP&L has suffered from poor reliability for quite some time. When the Company was ordered to file the present base rate case, the Board cited to the Morristown Underground Fire and the Company's response to Hurricane Irene as examples of reliability problems that troubled the Board. In that Order, the Board stated that that issue of whether the Company has maintained a sufficient level of investment in infrastructure to be able to provide safe adequate and proper service should to be addressed in the base rate case. See, I/M/O The Petition of Rate Counsel Requesting a Board Order Directing Jersey Central Power And Light Company To File a Base Rate Case Petition and Establishing a Test Year Of 2010, BPU Dkt. No. EO11090528, Order, (7/31/12) p. 12. In his decision, Judge McGill stated that the Company is in compliance with the Board's reliability performance standards. *ID*, p. 106. However he also noted that "It is noteworthy that at the public hearings, customers and public officials seemed to be more concerned about service problems than the proposed rate increase." *ID*, p. 6. The ALJ agrees with Rate Counsel that the Board's current standard based on 2002 to 2006 SAIFI and CAIDI is unreasonably low. In adopting Rate Counsel's argument that JCP&L's performance using 2002 to 2006 should not be used for future evaluations the Initial Decision stated:

Rate Counsel's argument is persuasive. The results for SAIFI and CAIDI for 2002 to 2006 reflect a period of poor performance with respect to service reliability. It is unreasonable to use those results as the standard for future evaluation of service reliability. The SAIFI and CAIDI figures for JCP&L for 2007 to 2011 would constitute a more reasonable standard for evaluation of the Company reliability performance in the future. *ID*, p. 107.

Rate Counsel agrees with the ALJ that setting the bar using JCP&L's performance during 2002 to 2006 sets the bar too low for JCP&L. However, the Initial Decision refused to apply Rate Counsel's recommendation to establish an improvement plan with specific deadlines and consequences if reliability does not improve. Rate Counsel believes that the Board has the jurisdiction to apply a more stringent standard now if it believes that the minimum reliability standard is not sufficient to encourage JCP&L to perform better. New Jersey Statutes expressly require JCP&L, as a public utility, to provide safe adequate and proper service at just and reasonable rates. N.J.S.A. 48:2-21 and N.J.S.A. 48:2-23. The Board sets a minimum reliability level which each electric public utility must meet but by no means is this the only measure at the Board's disposal to ensure reliable service. Therefore Rate Counsel respectfully requests that the Board acknowledge JCP&L's poor performance and specifically order the Company to establish an improvement plan with specific deadlines and consequences, such as a reduction of its return on equity, if reliability does not improve. JCP&L's customers have suffered from poor reliability too long and should be provided a remedy immediately.

## **2. JCP&L's CAIDI and SAIFI with Major Events Should be Compiled and Reported to the Board in the Company's Annual System Reliability Report.**

Currently JCP&L reports CAIDI and SAIFI without Major Events in its Annual System Reliability Report.<sup>3</sup> Under the Board's regulation, there is a separate reporting requirement for

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<sup>3</sup> New Jersey defines Major Events as events beyond the control of the Company which affect at least 10% of an EDC's electric customers in any one service area or operating area. N.J.A.C. 14:5-1.2

Major Events which is due to the Board within 15 business days after the end of a Major Event. Major Events Reports are therefore submitted piecemeal on a per event basis. N.J.A.C. 14:5-8.8. In rejecting Rate Counsel's request that JCP&L maintain and report CAIDIs and SAIFIs with and without Major Events the Initial Decision noted that "2011 and 2012 are totally out of proportion to the figures with major storms excluded and cannot serve as a basis for comparison. It is more useful to evaluate the results for each major storm on an individual basis." *ID*, p. 107.

The Initial Decision misses the point. First, Rate Counsel did not recommend that the reporting of CAIDI and SAIFI with Major Event take the place of the Major Storm Reports. Rate Counsel believes that the Major Storm Reports provide valuable information to the regulators on the remediation measures taken by the utilities during and after Major Events. However, As Rate Counsel expert witness Mr. Peter Lanzolatta pointed out:

The SAIFI and CAIDI index reporting, benchmark standards, and minimum reliability levels specified in the Board's regulations, which exclude major events, are addressing less than one-third of the total customer interruptions that occurred in the central area in 2012. This shows that the Board should consider the Company's annual reliability data both with and without the inclusion of major events. By looking at major events as isolated incidents, the Board is not getting a complete picture of the overall reliability of the Company. In order to do this the Company should report CAIDIs and SAIFIs with and without major storms annually in their annual systems performance report. Currently, the Company does not report the CAIDI and SAIFI numbers including major events in its annual system report.

*RC-87 p. 15 lines 3-12.*

There is no question that JCP&L reporting to the Board its CAIDI and SAIFI with Major Events can be valuable in years when so many days out of the year fall in the Major Event category and the Company keeps this data in the normal course of business and is therefore not overly burdensome. As stated in our initial brief, it may have made sense in the past to exclude major event days from the CAIDI and SAIFI reporting requirement when only a handful of days

out of the year represented major event days. However with such an exponential increase in major event days in recent years, inclusion of major event days in the Annually System Performance Report would allow the Board to obtain a clear understanding of how the utility is performing in all types of conditions. The Initial Decision suggests that 2011 and 2012 storm numbers may be an anomaly and not to be relied on however, as the chart below shows, 2008 and 2010 also recorded a large number of Major Event Days.

Number of Major Events Days by Year

Table 1<sup>4</sup>

Year	MEDs <sup>5</sup>
2004	4
2005	9
2006	13
2007	10
2008	40
2009	22
2010	56
2011	62

*RC-87, p.8.*

Putting 2011 and 2012 data aside, weather-related exclusion has grown from 4 days in 2004 to 56 days in 2010. While there will no doubt be fluctuations in the number of major event days, reporting of major event days in the Annually System Performance Report will help the Board to obtain a clear understanding of how the utility is performing in all types of conditions.

Therefore, JCP&L should be required to include in its annual system reliability report the Company’s CAIDI and SAIFI both including and excluding major events.

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<sup>4</sup> Data taken from Figure III.3 from Cummings Direct Testimony, page 22.

<sup>5</sup> “MED” means major event days.

## POINT IV

### THE ALJ ERRED IN CONCLUDING THAT A RETURN ON EQUITY OF 9.75% IS REASONABLE.

The ALJ found that a Return on Equity (“ROE”) of 9.75 percent is fair and reasonable notwithstanding the fact that this ROE is the same as that granted JCP&L in its last base rate case in 2005.<sup>6</sup> Since that time the cost of capital has declined precipitously, as Rate Counsel witness Matthew Kahal testified.<sup>7</sup> Even the ALJ noted that a 9.75 percent ROE today is “better” for the Company than when it was awarded in its last base rate case. *ID*, p. 30. Furthermore, a combination of the revenue, cost and rate of return components established in JCP&L’s last base rate case undoubtedly led to the Company’s overearning. The evidence presented in this case shows that JCP&L’s ROE is ripe for a downward adjustment, and the 9.25 percent ROE recommended by Rate Counsel is fair and reasonable and fully supported by evidence in the record. In the instant case, Rate Counsel respectfully submits that the Board has the opportunity and obligation to review the evidence in the record supporting the parties’ respective ROE positions and award a ROE for JCP&L more reflective of current market conditions.

By adopting the same ROE as that awarded in 2005, the Initial Decision effectively dismisses the unmistakable capital trends relevant to the determination of the ROE. Mr. Kahal presented ample evidence which shows that capital costs have declined between 2005 and 2013. See RCIB, p. 38; *RC-111*, p. 10 and Schedule MIK-2; and *RC-113*. Specifically, Mr. Kahal presented capital cost trends from 2002 through calendar year 2012, using such benchmarks as the annualized inflation rate, 10-year Treasury yields, 3-month Treasury bill yields, and Moody’s

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<sup>6</sup> See I/M/O the Petition of JCP&L, BPU Dkt. No. ER02080506 et al., Final Order, (6/1/05) (“2005 JCP&L Base Rate Case Order”).

<sup>7</sup> *RC-111*, p. 10 and Schedule MIK-2; and *RC-113*.

single A and triple B yields on long-term utility bonds. *RC-111*, Schedule MIK-2; and *RC-113*.

Mr. Kahal found that “while there is some fluctuation, these data series show a general declining trend in capital costs.” *RC-111*, p. 10, ln. 8-9. More specifically, Mr. Kahal found:

For example, in the very early part of this 10-year period, utility bond yields averaged about 7 to 8 percent, with 10-year Treasury yields of 4 to 5 percent. By 2011, single A utility bond yields had fallen to an average of 5.1 percent, with 10-year Treasury yields declining to an average of 2.8 percent. Within the past year (i.e., calendar 2012 into early 2013), Treasury and utility long-term bond rates have declined even further to near or below the lowest levels in many decades. For the past three years, short-term Treasury rates have been close to zero, with three-month Treasury bills averaging about 0.1 percent.<sup>8</sup>

In short, the overwhelming evidence shows that capital costs have declined since JCP&L’s last base rate case. Mr. Kahal further testified on the relevance of this downward trend in long-term interest rates:

[U]tility cost of equity and cost of debt need not move together precisely in lock step or necessarily in the short run. The economic forces mentioned above (and Fed policy) that lead to lower interest rates also tend to exert downward pressure on the utility cost of equity.<sup>9</sup>

In light of the evidence presented in the instant case, an award of the same ROE of 9.75 percent granted in the Company’s last base rate case in 2005 would greatly overstate investor requirements, which would be unreasonable. In contrast, Mr. Kahal’s recommended ROE of 9.25 percent reflects recent capital cost trends. Mr. Kahal incorporated recent utility stock market data in his analysis which incorporates these trends. See *RC-111*, p. 14.

Furthermore, there is convincing analytical evidence in the record which supports an award of less than 9.75 percent. Mr. Kahal utilized DCF analyses using several proxy groups, as well as a CAPM check, to arrive at his 9.25 percent ROE recommendation. In addition to Mr. Kahal’s analysis, the various analyses entered into the record by Gerdau’s witness O’Donnell

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<sup>8</sup> *RC-111*, p. 10, ln. 9-17.

<sup>9</sup> *RC-111*, p. 12, ln. 22-25.

also support an ROE of far less than 9.75 percent. Gerdau's witness utilized the DCF and Comparable Earnings methods and recommended an ROE of 8.9 percent. *Gerdau-1*. In addition, Mr. Kahal found that even another iteration of Ms. Ahern's DCF analysis using different data inputs and proxy companies produced results which supported Mr. Kahal's 9.25 percent recommendation. Mr. Kahal found that Ms. Ahern's updated DCF analysis presented in her rebuttal testimony, using her proxy companies and eliminating her unwarranted data adders, resulted in an ROE figure of "around 9 percent." *T129:L13-14* (October 4, 2013). This comports with Mr. Kahal's DCF results, where he computed a range of 8.4 to 9.5 percent for JCP&L's ROE. *RC-111*, p. 7. This also comports with Gerdau witness O'Donnell's ROE study results, which yielded a range of 8.1 to 9.0 percent. *See GIB*, pp. 28-29; *Gerdau-1*, p.18.

Finally, Staff's recommended ROE of 9.75 percent- which was adopted by the ALJ - is based on weak evidence. First, in support of its recommended 9.75 percent ROE position, Staff relied on an ROE which were established as but one provision of a stipulation of settlement resolving a recent Atlantic City Electric ("ACE") base rate case as well as the ROE awards in recent unidentified water base rate cases. *SIB*, p. 22. With respect to the ACE base rate case, Rate Counsel notes that settlements by their very nature involve compromises and trade-offs by the litigating parties among a range of issues, so it is entirely reasonable to assume that a different ROE might have been awarded if any of the cited cases were fully litigated. Second, rather than a study specific to JCP&L based on market data, Staff bases its ROE recommendation on average regulatory commission ROE awards compiled by SNL Financial. *SIB*, p. 22. Third, while Staff acknowledges lower treasury yields, it paradoxically admits that the 9.75 percent ROE it recommends is "from the Company's perspective, ...better than the same ROE the Company was awarded in its last rate case" *SIB*, p. 22. In short, the ample

evidence in the record supports a fair ROE award for JCP&L far lower than Staff's recommendation, which was adopted in the ID. *ID*, p. 31.

## POINT V

### **MAJOR STORM PERFORMANCE AND CUSTOMER SERVICE ISSUES ARE PROPERLY ADDRESSED IN A BASE RATE CASE PROCEEDING.**

In the instant proceeding Rate Counsel expressed concerns about JCP&L's customer service issues in two broad areas: 1) JCP&L's performance during the Major Storms in 2011 and 2012 including Hurricane Irene, Sandy and October Storm ("Major Storm Performance"); and 2) JCP&L's day to day customer service performance including billing and customer care practices ("Customer Service"). *RCIB*, pp.139-152.

In his initial decision, the ALJ rejected Rate Counsel's concerns with respect to both JCP&L's performance during Major Storms and Customer Service issues stating that he agreed with the Company's position that these types of issues are normally addressed in proceedings other than a base rate case:

The Company's argument is persuasive. While all aspects of service provided by a public utility are important, the concerns raised by Rate Counsel are not sufficiently serious to impact the determinations as to the revenue requirement. Rate Counsel's concerns in regard to operations should be addressed in another proceeding. *ID*, p. 112

The ALJ's conclusion that Rate Counsel's concerns should be addressed in another proceeding is contrary to law and Board precedent. *ID*, p. 112. The Board clearly regulates utilities' customer service in a base rate case. In re Valley Rd. Sewerage Co., 285 N.J. Super. 202, 209-210 (App. Div. 1995), aff'd, 154 N.J. 224 (1998). In that case, the Appellate Division found that the Board's ratemaking duty includes evaluating "the caliber of the utility's operation and service" as well as its rates. Id. The practice of reviewing customer service issues in a base rate case has also been exercised by the Board in a recent Atlantic Electric base rate case, where

the Board Ordered a Phase II of the base rate case to specifically focus on the reliability and customer service issues of Atlantic. I/M/O the Petition of Atlantic City Electric Company for Approval of Amendments to Its Tariff to Provide for an Increase in Rates and Charges for Electric Service Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and for other Appropriate Relief, Docket No. ERO9080664, Order Approving Stipulation (5/16/11) (“Atlantic Base Rate Case”).

Moreover the ALJ’s decision that Customer Service issues “should be addressed in another proceeding” was based on a factually incorrect conclusion and without foundation. *ID*, p. 112. In support of his finding the ALJ relied on the Company’s position that:

The concerns raised by Mr. Colton are normally addressed in proceedings other than a base rate case and do not suggest any circumstances approaching the type of conditions that have impacted rate determinations. *ID*, p. 112.

It must be noted that the Company did not argue that Customer Service issues are improperly addressed in this base rate case.<sup>10</sup> The Prehearing Order entered in this matter expressly included “service concerns” among the issues to be resolved. OAL Dkt. No. PUC 16310-12, BPU Dkt. No. ER12111052, Prehearing Order (March 7, 2013), p. 2. The Initial Decision itself recognized that “service concerns are an integral part of this proceeding.” *ID*, p. 6. Service issues were addressed by Rate Counsel in its prefiled testimony, rebutted by the Company in its rebuttal testimony and fully covered during the course of testimony at the hearing. At no point did the Company or the ALJ state that these service issues were outside the scope of the proceeding.

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<sup>10</sup> The Company did argue that the Major Storm Performance is outside the scope of this proceeding but did not argue, in its initial or reply briefs that billing and other customer issues was improperly presented in this proceeding.

Based upon the Orders in this proceeding, all parties clearly had the expectation that service issues would be addressed. Indeed, based upon prior rate cases, service was undoubtedly to be addressed. The conclusion in the Initial Decision that customer service “operations should be addressed in another proceeding” is contrary not only to Board precedent but also to the prior clear understanding of the parties.

Furthermore, the Board’s remedies for poor performance are not limited to financial penalties as the initial decision seems to indicate. *ID*, p. 112. The Initial Decision’s determination that Rate Counsel’s concerns “do not suggest any circumstances approaching the type of conditions that have impacted rate determination” unnecessarily limits the Board’s jurisdiction. As in the Atlantic Base Rate Case, the Board has the jurisdiction to Order other remedies such as conducting expanded surveys for customer satisfaction; increasing the frequency of meetings with Staff and Rate Counsel regarding customer complaints, and monitoring customer calls technology. Atlantic Base Rate Case Order p. 4.

Therefore as supported by the record and discussed fully in Rate Counsel’s post-hearing briefs, the Board should order JCP&L to: a) offer reasonable deferred payment agreements; b) provide clear and believable disconnection notices; and c) promptly and effectively resolve customer payment disputes to improve its credit and collection problem.

Similarly with respect to the Storm Performance issues, it is without question that the Board reviews JCP&L’s response to Major Storms in a base rate case. Nevertheless the Company argued in its initial and reply briefs that addressing Major Storm performance in the base rate case was duplicative and more appropriate for review and consideration in the context of another proceeding such as a generic statewide rulemaking proceeding. *PIB* p. 201. The Company’s position ignored the Board’s own directive to the municipalities served by JCP&L

that the base rate case proceeding was the correct venue for the municipalities to address finances and operations of the Company during the 2011 and 2012 storms. For example, in a January 7, 2013 letter addressed to Mayor David Fried of Robbinsville Township from the Secretary of the Board of Public Utilities, the Board directed the Township to file comments or petition to intervene in this JCP&L base rate proceeding at the OAL and to “present complaints or concerns with JCP&L’s storm response practices.”<sup>11</sup> Therefore it was certainly contemplated by the Board’s Secretary that Major Storms performance would be properly addressed in this base rate case.

The Board itself has already found that the Company’s customer service deteriorated over the past few years, with particularly bad service during the storm events of 2011 and 2012. *RC-72*, p. 6, line 17 to p. 7, line 8, citing *RC-62* & *RC-64*. The many ratepayers and elected officials who testified at the public hearings in Freehold and Morristown also would likely disagree with the ALJ’s conclusion that service issues were not “sufficiently serious.” It is undisputed that JCP&L’s communications with local government officials suffered serious breakdowns during storm events, *RC-62*; *RC-64*; *RC-63*; *RC-72*, p. 6, line 19 to p. 7, line 5, and “a recurring complaint by elected officials was an inability to communicate with JCP&L.” *RC-64*, p. 221; see also *RC-72*, p. 6, line 23 to p. 7, line 3. The Company’s massive communication failures during successive system-wide blackouts demonstrate that its service was not safe, adequate or proper an unfortunate fact that is well within the jurisdiction of the Board to remedy.<sup>12</sup>

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<sup>11</sup> Rate Counsel requests that the Board take judicial notice of its own letter to Robbinsville Township dated January 7, 2013 attached hereto as Exhibit A.

<sup>12</sup> Indeed, the ALJ noted that, “at the public hearings, customers and public officials seemed to be more concerned about service problems than the proposed rate increase.” *ID*, p. 6.

Therefore as supported by the record and discussed fully in Rate Counsel's post-hearing briefs, the Board should order the following measures to address JCP&L's Storm Performance issues:

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

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

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

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

## **CONCLUSION**

For all the reasons set forth herein, Rate Counsel respectfully urges the Board to adopt the Initial Decision except for those portions discussed above. Rate Counsel believes that the record evidence in this proceeding fully supports our recommendations.

# **EXHIBIT A**



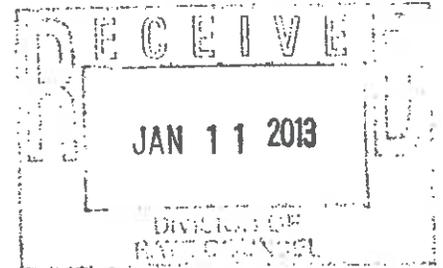
Chris Christie  
Governor

Kim Guadagno  
Lt. Governor

**State of New Jersey**  
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KRISTI IZZO  
Secretary of the Board  
Tel. # (609) 292-1599

January 7, 2013



David Fried, Mayor  
Robbinsville Township  
1 Washington Boulevard  
2<sup>nd</sup> Floor – Suite 5  
Robbinsville, NJ 08691

Re: Township of Robbinsville Appeal for Generic Proceeding Investigating  
Jersey Central Power & Light (JCP&L) and its Parent Company First Energy  
Company

Dear Mayor Fried:

Thank you for your letter of December 12, 2012 requesting that the New Jersey Board of Public Utilities ("BPU" or "the Board") begin an investigation of the response to Hurricane Sandy of Jersey Central Power & Light ("JCP&L" or "Company"), and its parent company, First Energy Company.

As you may know, since the date of your letter, the Board began a series of hearings in locations around the State, at which members of the public and elected officials are encouraged to testify as to the response, preparedness and performance of the four electric distribution companies ("EDCs") relating to Sandy. JCP&L was the focus of two of the first three hearings, held in Basking Ridge and Hopatcong. A third hearing will be held in JCP&L's service territory later this month or next month.

In addition, the Board recently ordered JCP&L to file a base-rate case, through which the Board will conduct a full review of the Company's finances and operations<sup>1</sup>. On December 1, 2012, JCP&L filed with the Board a rate-base rate under BPU Docket No. ER012111052. The Board sent the JCP&L filing to the Office of Administrative Law ("OAL") for review in December 2012. Administrative Law Judge Richard McGill has been assigned to this case under OAL Docket PUC1631-12. Robbinsville Township is welcome to file comments or petition to intervene in this case before OAL and to present complaints or concerns concerning JCP&L's storm response practices.

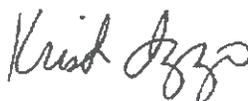
<sup>1</sup> See Order In Re Petition of Rate Counsel Requesting a Board Order Directing Jersey Central Power and Light to File a Base Rate Case Petition and Establishing a Test Year of 2010. BPU Docket EO11090528.

Several of the New Jersey utilities are permitted to seek cost recovery from major events through rates under prior Board-approved orders. In general, the companies are allowed to defer the costs of these events on their books until their next base-rate case, in which they can request compensation for those costs prudently incurred. In JCP&L's current base rate case, referred to above, the Company is using this mechanism to recover costs incurred as a result of responding to Hurricane Irene and the October snowstorm in 2011. Please note that the mere filing for recovery of such costs does not guarantee recovery, as all of these charges will be carefully considered by Board staff and other parties to the case before OAL.

The Board will soon consider the recommendations for future action for JCP&L, as well as the other EDCs, made by Board staff, and listed in the Emergency Preparedness Partnership report of August 2012. A formal order is expected in early 2013. In the meantime, the EDCs have voluntarily implemented many of these recommendations.

Andrea Garzón-Sarmentero is the Legal Specialist handling the JCP&L rate case for Board Staff. If you have additional questions, please contact Andrea directly at 609-292-1496.

Sincerely,



Kristi Izzo  
Secretary of the Board

/ac

C William Dressel - New Jersey State League of Municipalities  
Stefanie A. Brand, Esq., Director - New Jersey Rate Counsel  
Robert M. Hanna, President - New Jersey Board of Public Utilities  
Jeanne M. Fox, Commissioner - New Jersey Board of Public Utilities  
Nicholas Asselta, Commissioner - New Jersey Board of Public Utilities  
Joseph L. Fiordaliso, Commissioner - New Jersey Board of Public Utilities  
Mary-Ann Holden, Commissioner - New Jersey Board of Public Utilities  
Tricia Caliguire, Chief Counsel - New Jersey Board of Public Utilities  
Andrea Garzón-Sarmentero, Legal Specialist