BEFORE THE STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE PETITION OF)	
PUBLIC SERVICE ELECTRIC AND GAS)	
COMPANY FOR APPROVAL OF ITS)	
ENERGY EFFICIENCY 2017 PROGRAM))	**BPU DOCKET NO. EO17030196**
AND RECOVERY OF ASSOCIATED COSTS)	
("EE 2017 PROGRAM"))	

DIRECT TESTIMONY OF ROBERT J. HENKES ON BEHALF OF THE STATE OF NEW JERSEY DIVISION OF RATE COUNSEL

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IN THE MATTER OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY FOR APPROVAL OF ITS ENERGY EFFICIENCY 2017 PROGRAM AND RECOVERY OF ASSOCIATED COSTS ("EE 2017 PROGRAM")

BPU DOCKET NO. EO17030196

DIRECT TESTIMONY OF ROBERT J. HENKES

TABLE OF CONTENTS

I. STATEMENT OF QUALIFICATIONS

Q. WOULD YOU STATE YOUR NAME AND ADDRESS?

A. My name is Robert J. Henkes and my business address is 7 Sunset Road, Old Greenwich, Connecticut 06870.

Q. WHAT IS YOUR PRESENT OCCUPATION?

A. I am Principal and founder of Henkes Consulting, a financial consulting firm that specializes in utility regulation.

Q. WHAT IS YOUR REGULATORY EXPERIENCE?

A. I have prepared and presented numerous testimonies in rate proceedings involving electric, gas, telephone, water and wastewater companies in jurisdictions nationwide including Arkansas, Delaware, District of Columbia, Georgia, Kentucky, Maryland, New Jersey, New Mexico, Pennsylvania, Vermont, the U.S. Virgin Islands and before the Federal Energy Regulatory Commission.

Q. WHAT OTHER PROFESSIONAL EXPERIENCE HAVE YOU HAD?

A. Prior to founding Henkes Consulting in 1999, I was a Principal of The Georgetown Consulting Group, Inc. for over 20 years. At Georgetown Consulting, I performed the same type of consulting services as I am currently rendering through Henkes Consulting. Prior to my association with Georgetown Consulting, I was employed by the American Can

Company as Manager of Financial Controls. Before joining the American Can Company, I was employed by the management consulting division of Touche Ross & Company (now Deloitte & Touche) for over six years. At Touche Ross, my experience, in addition to regulatory work, included numerous projects in a wide variety of industries and financial disciplines such as cash flow projections, bonding feasibility, capital and profit forecasting, and the design and implementation of accounting and budgetary reporting and control systems.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I hold a Bachelor degree in Management Science received from the Netherlands School of Business, The Netherlands in 1966; a Bachelor of Arts degree received from the University of Puget Sound, Tacoma, Washington in 1971; and an MBA degree in Finance received from Michigan State University, East Lansing, Michigan in 1973. I have also completed the CPA program of the New York University Graduate School of Business.

II. SCOPE AND PURPOSE OF TESTIMONY

Q. WHAT IS THE SCOPE AND PURPOSE OF THIS TESTIMONY?

A. On March 3, 2017, Public Service Electric & Gas Company ("PSE&G" or "Company") filed a Petition with the Board of Public Utilities ("Board" or "BPU") to continue the current PSE&G Energy Efficiency Economic Extension II ("EEE") Program offerings with certain modifications; establish a residential energy efficiency ("EE") offering that includes a deployment of Smart Thermostats, and a pilot for Data Analytics; and recover costs associated with the programs described herein (collectively referred to as the EE 2017 Program) through a new component of the Company's electric and gas Green Programs Recovery Charge ("GPRC"). PSE&G proposes to invest up to $74 million in EE 2017 Program Investment, as well as $21.9 million for a fixed administrative allowance and $2.7 million in IT system expenditures. Thus, the total cost recovery requested in this filing is $98.6 million.

Henkes Consulting was engaged by the New Jersey Division of Rate Counsel ("Rate Counsel") to conduct a review and analysis of the filing and present recommendations to the Board with regard to the issue areas of revenue requirements and cost recovery. Ezra D. Hausman, Ph.D. is also filing testimony on behalf of Rate Counsel in this proceeding regarding program design issues.

In developing this testimony, I have reviewed and analyzed the revenue requirement and cost recovery aspects of PSE&G's Petition, the testimonies of PSE&G witnesses Courtney McCormick and Stephen Swetz, PSE&G's responses to initial and follow-up data requests submitted by Rate Counsel and BPU Staff; and other relevant documents and data.

III. SUMMARY OF RECOMMENDATIONS

Q. MR. HENKES, PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

A. Based on my review and analysis of the revenue requirement and cost recovery aspects of the previously referenced EE 2017 Program filing material and other related documents and data, I am making the following recommendations to the Board:

1) The Company's proposed rate recovery for a non-reconcilable fixed foregone distribution contribution (lost revenue) claim of $7.67 million should be disallowed by the Board;
2) The weighted average cost of capital ("WACC") of 7.0142% (pre-tax 10.4618%) PSE&G proposes to use in the revenue requirement determination of the EE 2017 Program investment costs should be reduced to a corrected and updated WACC rate of 6.9673% (pre-tax 10.4149%);
3) The Company's proposed non-reconcilable fixed administrative cost level of $14.2 million should be reduced to, and capped at, $7.4 million, which is equivalent to 10% of the total EE 2017 Program investment; and
4) The revenue requirement of the EE 2017 Program should be reduced by 100% of the cost offsets generated by the sub-programs, including not only PJM Capacity

Market net auction proceeds, but also any net revenues to be derived from the proposed new Smart Thermostat and Residential Data Analytics sub-programs

These recommendations should be considered in conjunction with the recommendations made by Rate Counsel witness, Ezra Hausman, and would only apply in the event the Board approves any or all of the Company's proposed EE 2017 sub-programs.

IV. CASE OVERVIEW

Q. PLEASE PROVIDE AN OVERVIEW OF THIS CASE.

A. In this filing, PSE&G's proposed EE 2017 Program represents a continuation of three energy efficiency programs that have previously been approved by the Board. Specifically, by Order dated July 16, 2009, the Board approved a Stipulation that authorized PSE&G to implement its initial EEE Program with a program investment of up to $166 million ("2009 Initial EEE Program").[1] Then, on July 14, 2011 the Board approved a Stipulation providing for a $95 million extension of the three energy efficiency sub-programs (Multifamily Housing; Direct Install; and Hospital Efficiency) that were approved in the 2009 Initial EEE Filing ("EEE Extension Program").[2] Next, on April 16, 2015, the Board approved a Stipulation for another $95 million extension of the three energy efficiency sub-

[1] BPU Dkt. No. EO09010058.
[2] BPU Dkt. No. EO11010030.

programs approved in the EEE Extension II Program Order ("EEE Extension II Program").[3]

In the instant EE 2017 Program filing, the Company is not only requesting a further extension of these three EE sub-programs but also the addition of two new residential efficiency offerings that includes the deployment of Smart Thermostats and a pilot for Data Analytics. The total program investment of the EE 2017 Program is $74 million. In addition, the Company is requesting authorization to recover $2.7 million in IT System Enhancement costs and a Fixed Administrative Allowance of $21.9 million, consisting of $14.2 million in administrative costs and $7.67 million in Foregone Distribution Contributions (Lost Revenues). As shown in Table 1 below, this results in a total EE 2017 Program expenditure of $98.6 million:

Table 1 – Total EE 2017 Program Costs

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	($Millions)[4]
Multifamily Housing Sub-Program	$20.00
Direct Install Sub-Program	15.00
Hospital Efficiency Sub-Program	25.00
Smart Thermostat Sub-Program	11.50
Residential Data Analytics Sub-Program	2.50
Program Investment	**74.00**
Fixed Administrative Allowance:	
- Administrative Costs	14.20
- Lost Revenues	7.67
IT System Enhancement Costs	2.70
Total EE 2017 Expenditures	**$98.57**

Q. HOW DOES PSE&G PROPOSE TO DETERMINE THE COST RECOVERY OF THE EE 2017 PROGRAM?

[3] BPU Dkt. No. EO14080897.
[4] Petition, para. 31, p.12 and response to RCR-A-8.

A. The $74 million EE 2017 Program Investments are proposed to be treated as a regulatory asset and amortized over 7 years. The $2.7 million capitalized IT System Enhancement costs are proposed to be amortized over a 5-year period. These respective amortization periods are consistent with the 7- and 5-year amortization periods approved by the Board in the prior EEE Extension II Program proceeding. As shown on page 3 of Mr. Swetz's direct testimony, the monthly revenue requirement would be calculated as follows:

*Revenue Requirements = (Cost of Capital * Net Investment) + Amortization + Fixed Administration Allowance – Program Investment Repayments – Cost Offsets + Tax Adjustments*

Net investment represents the net balance of the program investments and capitalized IT costs, less the associated accumulated amortization and accumulated deferred income taxes.

The Cost of Capital is PSE&G's overall weighted average cost of capital (WACC). PSE&G has proposed that the initial cost of capital for the Program be set at 7.0142%, resulting in a pre-tax cost of capital of 10.4618%. Petition, Schedule SS-EE17-2.

The proposed $14.2 million Administrative Costs include costs for program administration, marketing, training, program management, inspections, evaluations and quality assurance/quality control. Petition, para. 31, pp. 11-12.

The proposed cost claim for Foregone Distribution Contributions (Lost Revenues) is based on the energy savings estimated to be generated from the implementation of the sub-programs. The Company's estimated Lost Revenue amount of $7.67 million is based on 10% of the total $76.7 million costs for the Program Investment and IT System Enhancement. Petition, para. 31, pp.11-12.

Program Investment Repayments include that portion of the project costs that is repaid by participants based on the terms of each program. These repayments are credited back to the revenue requirement and used to reduce the costs that would otherwise be borne by the ratepayers.

Program Cost Offsets represent revenues (net of costs) that may be generated as a result of the implementation of the 5 proposed sub-programs. All such net revenues will be credited to the ratepayers by reducing the Program's revenue requirement. Examples of such Cost Offsets could be net proceeds from bids into PJM's capacity market auctions or net revenues/cost reductions derived from the implementation of the newly proposed Smart Thermostat and Residential Data Analytics sub-programs. In this proceeding, PSE&G has not reflected any of such Program Cost Offsets.

V. DISCUSSION OF ISSUES

1. Foregone Distribution Contributions (Lost Revenues)

Q. PLEASE BRIEFLY SUMMARIZE PSE&G'S PROPOSED POSITION WITH REGARD TO FOREGONE DISTRIBUTION CONTRIBUTIONS, ALSO REFERRED TO AS LOST REVENUES.

A. In the current EE 2017 Program filing, PSE&G is requesting rate recovery for a $21.9 million Fixed Administrative Allowance, consisting of $14.2 million in administrative costs (including administration, marketing, training, program management, inspections, evaluations and quality assurance/quality control efforts) and $7.67 million in foregone distribution contributions (lost revenues) associated with the energy savings generated from the implementation of the sub-programs. Petition, para.31, pp. 11-12. While these lost revenues are estimated to be approximately $11 million over 5 years, PSE&G has proposed to cap these costs at $7.67 million which is equal to 10% of the total program investment of $76.7 million ($74 million for total Program Investment, plus $2.7 million for IT System Enhancement costs). Petition, para. 31, p. 12.

Q. HAS THE COMPANY MADE A CLAIM IN THIS PROCEEDING THAT ITS PROPOSED REQUEST FOR LOST REVENUE RATE RECOVERY IS CONSISTENT WITH WHAT WAS APPROVED BY THE BOARD IN THE COMPANY'S PRIOR EEE EXTENSION II FILING IN DOCKET NO. EO14080897?

A. Yes. This claim is made on page 5, lines 15-18 of Mr. Swetz's testimony where he states: "Consistent with the approval of the EEE Extension II Program, the Company is seeking to recover a fixed administrative allowance, which will be comprised of the administrative costs to run the Program and foregone distribution margins associated with the energy savings from the Program." When PSE&G was asked in RCR-A-7 where and how the Board approved rate recovery for lost revenues in its 4/16/15 Board Order in Docket No. EO14080897, the Company stated in its response:

> "Included within the fixed administrative allowance [of $12 million] authorized in the Order were dollars associated with foregone distribution margins. The Company is seeking a fixed administrative allowance in this proceeding consistent with the approval of the EEE Extension II Program.

> The fixed administrative allowance allows the Company to recover foregone distribution margins to the extent its administrative costs are less than the fixed administrative allowance."

The claim in the above-referenced RCR-A-7 response is simply not supported by the facts.

As shown in the EEE Extension II Order dated April 16, 2015, while PSE&G had proposed administrative expenses of $13.7 million, the Board eventually approved a fixed and capped administrative expense level of $12 million and – as is indicated in the table on page 4 of the EEE Extension II Order - this capped cost allowance was stipulated as including the costs for program administration, marketing, training, program management, inspections, evaluations, measurements and verification, and quality assurance/quality control, and did not include a separate allowance for lost revenues. In fact, as confirmed by PSE&G in its response to RCR-A-22, the Company had made a separate proposal in the EEE Extension II filing to charge a so-called Participation Fee – equal to 1.5% of the project costs – to allow the Company to recover lost revenues associated with the EEE Extension II program, but this Participation Fee was not approved by the Board in that proceeding. Nowhere in its EEE Extension II program petition or in its supporting testimonies did the Company claim that its requested administrative expenses of $13.7 million included another claim for lost revenues. Since the Board reduced the requested $13.7 million administrative charge to $12.0 million, it seems quite logical that this reduced charge also did not include a lost revenues allowance. Furthermore, nowhere else in either the Stipulation or the Board Order in this EEE Extension II case are there any indications or is there any language showing that lost revenue recovery was allowed.

It is my understanding that the parties came to a stipulated agreement that a fixed administrative allowance capped at $12 million would be allowed to be recovered, and that if more than $12 million would be spent, this would not be charged to the ratepayers, and if less than $12 million would be spent, this could be retained by the Company. PSE&G's argument introduced in this case is that, to the extent that actual administrative costs are less than $12 million, the difference is to be considered lost revenue recovery for ratemaking purposes. This argument should be summarily rejected, as that was never agreed to by the parties or approved by the Board in the EEE Extension II case.

Q. WERE LOST REVENUE RECOVERIES APPROVED BY THE BOARD IN THE TWO ENERGY EFFICIENCY PROCEEDINGS PRIOR TO THE EEE EXTENSION II CASE, I.E, IN THE 2009 INITIAL EEE AND THE 2011 EEE EXTENSION FILINGS?

A. No. Based on my review, it is my understanding that no rate recovery for lost revenues was approved by the Board in these two prior EEE proceedings as lost revenues were not proposed and therefore not at issue in those cases.

Q. DO YOU BELIEVE THAT THE CLAIMED LOST REVENUE CHARGE OF $7.67 MILLION IS KNOWN AND MEASURABLE AT THIS POINT?

A. No. This charge can certainly not be characterized as known and measurable at this time. It is based on estimates and assumptions of factors and events that are solely related to energy efficiency programs being implemented in the next 5 years. However, there are numerous non-energy efficiency factors and events that could impact PSE&G's utility earnings over the next 5 years, and those factors are not incorporated in the estimation analysis. Thus, this estimation exercise is speculative and could result in very inaccurate results. This is particularly relevant given that, while the cost vs cost recovery projections for the Program Investments and IT System Enhancement are eventually reconciled, a similar reconciliation is not proposed for the projected lost revenue charge as part of the proposed Fixed Administrative Allowance.

Q. DO YOU BELIEVE THAT PSE&G'S PROPOSED $7.67 MILLION CLAIM FOR LOST REVENUES RATE RECOVERY SHOULD BE ALLOWED FOR RATEMAKING PURPOSES IN THIS CASE?

A. No. I recommend that the Company's proposed rate recovery for estimated lost revenues of $7.67 million be disallowed by the Board. This recommendation is based on the following arguments:

- The Company's claim that lost revenue recovery was allowed by the Board in its prior 2014/15 EEE Extension II filing is incorrect. There is no evidence whatsoever in the Stipulation or the Board Order in that case stating, or even suggesting, that the capped administrative expenses of $12 million allowed to be collected included lost revenue costs.
- The Board has never allowed lost revenue recovery in any of PSE&G's other predecessor energy efficiency proceedings.

- PSE&G's estimated lost revenues are arbitrary, speculative, potentially inaccurate and based on numerous factors that are unknown and unquantifiable at this time and are not proposed to be reconciled with actual results.
- The BPU has traditionally relied on base rate case proceedings as the appropriate forum and mechanism for determining pro forma sales levels; and PSE&G has not proven that it is necessary or appropriate for the Board to deviate from this practice.

2. <u>Rate Of Return</u>

Q. PLEASE DESCRIBE THE WEIGHTED AVERAGE COST OF CAPITAL ("WACC") PSE&G PROPOSES TO USE IN THE REVENUE REQUIREMENT DETERMINATION OF THE EE 2017 PROGRAM INVESTMENT COSTS.

A. As described in the testimony of Mr. Swetz, the Company has proposed that the initial cost of capital for the Program be based on the capital structure, equity cost rate and "Other Capital" cost rate approved by the Board in the Solar 4 All Extension II filing in Docket No. EO16050412, which was the latest GPRC program approved for PSE&G by the Board on November 30, 2016. Petition, Attach. 2, p. 4. The Company further proposes that any change in the WACC authorized by the Board in a subsequent PSE&G electric, gas or combined base rate case will then be reflected in the appropriate corresponding subsequent monthly revenue requirement calculations. Filing Schedule SS-EE17-2 shows that this proposed initial WACC rate is 7.0142%, which is equivalent to a pre-tax WACC of 10.4618%:

Table 2 - PSE&G's Proposed WACC

	Ratio	Cost	Weighted Cost	Pre-Tax Converter	Pre-Tax Cost of Capital
Other Capital	48.80%	4.1439%	2.0222%		2.0222%
Common Equity	51.20	9.7500	4.9920	59.15% [5]	8.4396
Total	100.0%		7.0142%		10.4618%

Q. IS THERE AN ISSUE WITH REGARD TO THIS INITIAL WACC RATE PROPOSED BY PSE&G?

A. Yes. As shown in the response to RCR-A-13 (attached), the "Other Capital" component of the WACC rate approved in the Solar 4 All Extension II filing amounts to 4.0931%, representing the weighted cost of the Company's embedded cost of debt rate and customer deposit cost rate. The same response also shows that (1) PSE&G inappropriately disregarded the customer deposit component of the Other Capital in the calculation of its proposed weighted Other Capital cost rate of 4.1439%, and (2) an update of the Other Capital cost rate calculation based on actual data as of the more recent date of March 31, 2017 indicates a weighted cost rate of 4.0478%.

Q. WHAT INITIAL WACC RATE DO YOU RECOMMEND SHOULD BE USED FOR THE EE 2017 PROGRAM REVENUE REQUIREMENT CALCULATION?

A. While I take no exception to the use of the proposed capital structure and ROE rate of 9.75% until revised in a subsequent rate case, I recommend that the Other Capital cost rate be changed from 4.1439% to the corrected and updated rate of 4.0478%. In support of this recommendation I note that in its response to RCR-A-25 (attached), PSE&G admits that it

[5] 1 minus composite income tax rate of 40.85% is 59.15%, equivalent to a multiplier of 1.6906.

inadvertently omitted customer deposits from the Other Capital cost rate calculation and that, if the same method to calculate the Other Capital cost rate as was approved in the Solar 4 All Extension II filing with updated long-term debt and customer deposit rates were used, it would result in a rate of 4.0478%.

Q. HAVE YOU CALCULATED THE RECOMMENDED INITIAL WACC RATE WITH THE INCLUSION OF THE RECOMMENDED OTHER CAPITAL COST RATE OF 4.0478%?

A. Yes. As shown in Table 3 below, the recommended initial WACC rate to be used to calculate the EE 2017 Program revenue requirement should be 6.9673%, which is equivalent to a pre-tax WACC of 10.4149%:

Table 3 – Recommended WACC

	Ratio	Cost	Weighted Cost	Pre-Tax Converter	Pre-Tax Cost of Capital
Other Capital	48.80%	4.0478%	1.9753%		1.9753%
Common Equity	51.20	9.7500	4.9920	59.15%	8.4396
Total	100.0%		6.9673%		10.4149%

3. Administrative Costs

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSAL WITH REGARD TO THE FIXED ADMINISTRATIVE ALLOWANCE.

A. In this filing, PSE&G is requesting a fixed level of rate recovery for a $21.9 million administrative cost allowance, consisting of $14.2 million for administrative costs and approximately $7.7 million for forgone distribution contributions (lost revenues). Petition, para. 32, pp. 11-12. Earlier in this testimony, I already discussed my recommended position with regard to the requested rate recovery of the fixed amount of lost revenues of $7.7 million. I will now discuss my recommended position regarding the proposed $14.2 million fixed administrative cost component, consisting of program administration, marketing, training, program management, inspections, evaluations and quality assurance/quality control efforts. But before I do so, I summarize in Table 4 below PSE&G's administrative cost experiences in its most recent 3 predecessor EEE filings (which can be found in the responses to RCR-A-15 and RCR-A-20) as compared to the proposals in the instant proceeding:

Table 4 – Administrative & Program Investment Costs

($ millions)

	2009 EEE	2011 EEE Ext	2014 EEE Ext II	2017 EE
Admin Costs				
Approved	24.00	8.00	12.00	14.20 (proj)
Actual	15.00	7.80	4.90	
Actual Program Inv.	161.50	94.90	32.90	74.00 (proj)
Actual Cost/Act. Inv.	9.3%	8.2%	14.9%	19.20% (proj)

Table 4 not only indicates that the actual administrative costs have historically been lower than the approved cost levels, it also shows that the actual administrative costs as a percentage of the actual program investment costs in the prior 2009, 2011 and 2014 EEE programs averaged approximately 9.6%. By contrast, PSE&G's proposed administrative costs of $14.2 million in the instant proceeding are 19.2% of the proposed program investment cost level of $74 million.

Thus, it is evident that the Company's actual administrative costs historically have consistently been lower than both the filed and approved administrative costs, and the proposed 19.2% ratio of administrative costs to program investment costs for the proposed EE 2017 Program is substantially out of line with the historical average of 9.6%. These facts leave me to conclude that the estimated administrative cost allowance of $14.2 million is unreasonably high.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THE THIS ISSUE?

A. Based on the previously discussed findings and conclusions, I recommend that the Company's administrative cost allowance be reduced to, and capped at, 10% of the total program investment level, which would be a cost level of $7.4 million.

4. Rate Treatment Of Program Cost Offsets

Q. HAS THE COMPANY IN THIS PROCEEDING REFLECTED ANY PROJECTED COST OFFSETS TO BE GENERATED BY THE PROGRAM INVESTMENTS TO REDUCE THE REVENUE REQUIREMENT OF THE PROPOSED EE 2017 PROGRAM?

A. No, it has not. One example of such cost offsets would be capacity revenues (net of associated auction costs) derived from bidding of EE 2017 sub-program in the PJM RPM Capacity Market Auctions to the extent eligible. In PSE&G's prior EEE Extension II Program filing, the Company did include a certain projected level of capacity revenues. In Table 5 below, I have listed the actual capacity revenues derived from reductions in electric usage that were booked by PSE&G as a result of the Company's 3 prior EEE Programs:[6]

Table 5 – Actual Capacity Revenues

	2009 EEE	2011 EEE Ext	2014 EEE Ext II
2012	$ 4,703		
2013	476,587		
2014	912,493	$ 175,812	
2015	602,462	202,184	
2016	182,022	242,343	$ 0

[6] See response to RCR-A-24

As shown in Table 5, while the most recent 2014 EEE Extension II Program has not generated any auction capacity revenues, fairly substantial capacity revenues were realized as a result of electric usage reductions from the 2009 EEE and 2011 EEE Extension Programs.

Q. WHAT ARE THE REASONS WHY PSE&G HAS NOT REFLECTED ANY PROJECTED AUCTION CAPACITY REVENUES ASSOCIATED WITH THE EE 2017 PROGRAM IN THIS CASE?

A. As described in more detail in the testimony of Ms. McCormick, PSE&G has not assumed any capacity revenues from PJM's RPM Capacity Market Auctions because of significantly changed PJM performance rules and the performance risk to customers. In this regard, the response to RCR-A-24 states more specifically: "With a significantly reduced amount of EE resources to bid, increased measurement and verification costs, and a lower amount of EE resources to spread fixed costs, it was determined that there was too great of a risk that the costs to participate in the [PJM Capacity Market] auction would exceed the revenues generated and that this would have a negative impact on ratepayers by increasing the cost of the program, rather than affording a credit that lowers the overall cost of the program."

Q. HAVE THERE BEEN RECENT CHANGES IN THE PJM CAPACITY MARKET THAT MAY IMPROVE THE BIDDING ELIGIBILITY?

A. Yes. In its response to RCR-A-24, PSE&G stated in this regard:

> "… since the time of the 2017 EE filing, the capacity market rules have changed. The rules in place right now include an ability for EE resources to be bid as "summer-period capacity performance resource," which may provide a better opportunity to cost effectively participate in the capacity market. PSE&G intends to monitor the capacity market rules and make a final determination as to its participation in the market prior to the completion of the first projects."

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE RATE TREATMENT OF ANY COST OFFSETS GENERATED BY THE PROPOSED EE 2017 PROGRAM PROJECTS?

A. It is my recommendation that 100% of any net revenues generated by the proposed EE 2017 program projects be flowed back to the ratepayers by treating these net revenues as reductions to the EE 2017 Program revenue requirements. It is my understanding that, at least with regard to capacity revenues, PSE&G agrees with this position as evidenced by its commitment stated on page 16 of the Petition and page 6 of Mr. Swetz's testimony that "All [PJM Capacity Market] auction proceeds, net of the costs associated with participation in the RPM auctions, will be credited to ratepayers." PSE&G should be obligated to advocate and pursue PJM policies which work to offset program costs to the benefit of its ratepayers.

Q. COULD COST OFFSETS GENERATED BY THE PROPOSED EE 2017 PROGRAM PROJECTS INCLUDE NET REVENUES AND OTHER COST OFFSETS FROM SOURCES OTHER THAN THE PJM CAPACITY MARKET AUCTION PROCEEDS?

A. Yes. As part of the proposed EE 2017 Program, the Company has requested rate recovery of the revenue requirements associated with two new sub-programs: the Smart Thermostat and the Residential Data Analytics sub-programs. To the extent that these two sub-programs generate any incremental net revenues, 100% of such revenues must similarly be treated as offsets to the sub-programs' revenue requirements.

Furthermore, if the Company obtains funds or credits - including rebates, tax credits and other incentives - related to any of the Board-approved EE 2017 sub-programs through any federal, state or municipal action, such proceeds must also be fully used to the benefit of ratepayers by offsetting the revenue requirements of the proposed EE 2017 Program.

VI. CONCLUSIONS

Q. WOULD YOU PLEASE SUMMARIZE YOUR CONCLUSIONS?

A. Based my review and analysis as explained above, the Board should adopt the following recommendations:

1) The Company's proposed rate recovery for a non-reconcilable fixed foregone distribution contribution (lost revenue) claim of $7.67 million should be disallowed by the Board;
2) The weighted average cost of capital ("WACC") of 7.0142% (pre-tax 10.4618%) PSE&G proposes to use in the revenue requirement determination of the EE 2017 Program investment costs should be reduced to a corrected and updated WACC rate of 6.9673% (pre-tax 10.4149%) until revised in a subsequent rate case;

3) The Company’s proposed non-reconcilable fixed administrative cost level of $14.2 million should be reduced to, and capped at, $7.4 million, which is equivalent to 10% of the total EE 2017 Program investment; and
4) The revenue requirement of the EE 2017 Program should be reduced by 100% of the cost offsets generated by the sub-programs, including not only PJM Capacity Market net auction proceeds, but also any net revenues to be derived from the proposed new Smart Thermostat and Residential Data Analytics sub-programs.

Q. MR. HENKES, DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does at this time. Rate Counsel reserves its right to present supplemental testimony based on any updated and/or new information.