STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE PETITION OF ATLANTIC CITY ELECTRIC COMPANY FOR APPROVAL OF CERTAIN ENERGY INFRASTRUCTURE INVESTMENTS AND APPROVAL OF COST RECOVERY FOR SUCH PROJECTS AND RELATED TARIFF MODIFICATIONS ASSOCIATED THEREWITH PURSUANT TO N.J.S.A 48:2-21 AND N.J.S.A. 48:2-21.1	)))))))))))	**BPU DOCKET No. EO11100650**

DIRECT TESTIMONY OF ANDREA CRANE ON BEHALF OF THE DIVISION OF RATE COUNSEL

STEFANIE A. BRAND
DIRECTOR, DIVISION OF RATE COUNSEL

DIVISION OF RATE COUNSEL
31 Clinton Street, 11th Floor
P. O. Box 46005
Newark, New Jersey 07101
Phone: 973-648-2690
Email: njratepayer@rpa.state.nj.us

FILED: FEBRUARY 28, 2012

TABLE OF CONTENTS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Andrea C. Crane and my business address is 90 Grove Street, Suite 211, Ridgefield, Connecticut 06877. (Mailing Address: PO Box 810, Georgetown, Connecticut 06829)

Q. By whom are you employed and in what capacity?

A. I am President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and undertake various studies relating to utility rates and regulatory policy. I have held several positions of increasing responsibility since I joined The Columbia Group, Inc. in January 1989.

Q. Please summarize your professional experience in the utility industry.

A. Prior to my association with The Columbia Group, Inc., I held the position of Economic Policy and Analysis Staff Manager for GTE Service Corporation, from December 1987 to January 1989. From June 1982 to September 1987, I was employed by various Bell Atlantic (now Verizon) subsidiaries. While at Bell Atlantic, I held assignments in the Product Management, Treasury, and Regulatory Departments.

Q. Have you previously testified in regulatory proceedings?

A. Yes, since joining The Columbia Group, Inc., I have testified in over 350 regulatory proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Hawaii, Kansas, Kentucky, Maryland, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Vermont, Washington, West Virginia and the District of Columbia. These proceedings involved electric, gas, water, wastewater, telephone, solid waste, cable television, and navigation utilities. A list of dockets in which I have filed testimony since January 2008 is included in Appendix A.

Q. What is your educational background?

A. I received a Master of Business Administration degree, with a concentration in Finance, from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a B.A. in Chemistry from Temple University.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. On October 19, 2011, the Atlantic City Electric Company ("ACE" or "Company") filed a Petition with the New Jersey Board of Public Utilities ("BPU" or "Board") seeking to implement an Infrastructure Investment Program ("IIP-2") surcharge to recover costs associated with non-revenue producing, reliability projects between base rate cases. The Columbia Group, Inc. was engaged by the Division of Rate Counsel ("Rate Counsel") to review the Company's Petition and to provide recommendations to the BPU regarding the Company's proposed IIP-2 surcharge. My testimony addresses policy and cost recovery issues. Charles Salamone is also filing testimony on behalf of Rate Counsel addressing the specific projects proposed in the Company's filing.

III. SUMMARY OF CONCLUSIONS

Q. What are your conclusions concerning ACE's proposal?

A. Based on my analysis of the Company's filing, my review of responses to data requests and other documentation in this case, and my experience in the area of utility ratemaking, my conclusions and recommendations are as follows:

- Ensuring reliability is a basic responsibility of any electric company pursuant to its obligation to provide safe and reliable utility service.
- The Company has not demonstrated that any change from the traditional method of recovering reliability-related expenditures is either necessary or desirable.
- The Company's proposal would dilute its responsibility for managing its reliability projects.
- The Company has not shown that there are any net benefits to ratepayers of its proposed IIP-2 surcharge.
- The proposed surcharge would reduce shareholder risk, transfer risk from shareholders to ratepayers, and increase shareholders' return on equity.

- The Company's proposal results in single-issue ratemaking and has not been justified on either financial or operational grounds.
- The Company's proposed IIP-2 surcharge should be rejected by the BPU.

IV. DISCUSSION OF THE ISSUES

A. Background of the Filing

Q. Please provide a brief history of ACE's initial infrastructure investment program.

A. On January 30, 2009, ACE filed a Petition requesting BPU approval for an initial infrastructure investment program ("IIP-1") whereby the Company agreed to accelerate spending for certain of its planned infrastructure capital projects.[1] The Company's proposal was filed in response to a directive issued by then Governor Jon Corzine on October 16, 2008 and the subsequent Energy Master Plan ("EMP") issued on October 22, 2008. The Governor's directive and the EMP encouraged the state's electric and gas utilities to accelerate the existing schedule for planned capital improvements in an effort to create jobs and strengthen the New Jersey economy. In its Petition, ACE proposed to undertake in 2009 and 2010 certain planned capital projects that were originally scheduled to be undertaken in 2011-2013. The Company's Petition included 21 projects at a total projected cost of $46.355 million.

Pursuant to a Stipulation executed in April 2009, the parties agreed that ACE

[1] I/M/O the Petition of Atlantic City Electric Company for Approval of Certain Energy Infrastructure Investments and Approval of Cost Recovery for Such Projects and Related Tariff Modifications Associated Therewith Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, BPU Docket Nos. EO09010049 and EO09010054, Jan. 30, 2009.

should accelerate 16 projects, for a total cost of $27.613 million. The Company projected that 92 new jobs would result from implementation of the IIP-1. The parties also agreed on a cost recovery mechanism that permitted the Company to implement an IIP-1 surcharge to recover the annual revenue requirement associated with the return on investment and depreciation expense for the approved projects. The IIP-1 surcharge was based on projected capital expenditures and was subject to an annual true-up. The parties agreed that the return on investment would be based on the return approved in the Company's most recent base rate case. They also agreed that interest would be applied to monthly over-recovered or under-recovered balances, based on the Company's short-term debt rate. The Stipulation among the parties was approved by the BPU on April 28, 2009.

Q. Has the IIP-1 been completed?

A. Yes, it has. The IIP-1 has been completed and the resulting expenditures are being reviewed as part of the Company's pending base rate case. Actual expenditures for IIP-1 were approximately $29.625 million and the Company claims that 59 jobs were created.

Q. Please provide a brief summary of the Company's IIP-2 proposal in this case.

A. On October 18, 2011, ACE filed a Petition with the BPU that the Company stated was an "extension" of its IIP-1 program. In its filing, ACE proposed to implement a new surcharge, the IIP-2 surcharge, that would "provide for near simultaneous cost recovery, outside of a base rate proceeding, for reliability related capital investments."[2] Pursuant to ACE's proposal, the Company would recover costs related to all reliability-related capital projects, except for emergency and storm restoration costs, through the surcharge. The Company is proposing to implement this surcharge for a three-year period, covering calendar years 2012-2014. ACE is proposing a cost recovery mechanism for its associated costs that calculates an annual revenue requirement in a manner similar to the formula used for the IIP-1 program. However, in this case, the Company is proposing that interest on over-recoveries or under-recoveries be based on the two-year Treasury rate plus 60 basis points instead of on the short-term debt rate approved for IIP-1. In addition, ACE is proposing to change the way in which its revenue requirement is allocated among customer classes.

Q. How much is the Company seeking to recover in this case?

A. The Company originally requested authorization for a three-year program totaling $244.3 million. The initial filing included a request to implement an initial IIP-2 surcharge designed to recover $3,896,324 in 2012. Because of a revision in its 2012 estimated spending, ACE subsequently updated its filing to include total capital expenditures of $238.2 million. In addition, the Company notified the parties that its initial filing contained an error in the calculation of depreciation expense. Thus, the revised filing is based on a 2012 revenue requirement of $612,655. For 2013 and 2014, the Company's

[2] Testimony of Anthony J. Kamerick, October 17, 2011, page 4.

revised claim results in annual revenue requirements of $8,621,908 and $19,001,718 respectively.[3]

Q. Does the Company's proposal represent a second phase of the IIP-1 that has been in place since 2009, as alleged by Dr. Lowry on page 3 of his testimony?

A. No, it does not. While the Company is attempting to frame its proposal as simply a continuation of the IIP-1 program, the fact is that this program is very different from the program approved in IIP-1. The prior program was necessitated by a state directive, while no such directive exists in this case. IIP-1 was part of a statewide effort to use utility construction programs as a mechanism to stimulate the New Jersey economy and to reduce unemployment in the state. While the unemployment rate is still high and the economy is still sluggish, there is no indication that the current administration views utility spending as the appropriate mechanism to stimulate economic growth. Moreover, while accelerated spending for capital programs may create some new jobs, it also requires ratepayers to pay significantly higher rates during a time when many ratepayers can ill afford these rate increases.

Perhaps more importantly, IIP-1 was an incremental program, designed to provide extraordinary rate recovery for projects that were being accelerated for a specific purpose. Under IIP-1, the remaining capital costs of the Company continued to be recovered through traditional ratemaking mechanisms. However, in this case, the

[3] Response to RCR-A-IIP2-12.

Company is proposing that all reliability projects be recovered through its IIP-2 surcharge. This is a significant departure from the spirit and mechanics of IIP-1. Furthermore, there are at least two primary differences in the cost recovery mechanism proposed for the IIP-2 surcharge relative to the mechanism proposed for the IIP-1 surcharge. First, the Company is proposing to apply interest on over-recoveries and under-recoveries at the 2 year Treasury Rate plus sixty basis points, instead of at the short-term debt rate. Second, the Company is proposing to change the manner in which its revenue requirement is allocated among customer classes. Both of these modifications can increase costs to residential customers, as discussed in more detail below. Therefore, while the Company attempts to frame its Petition as nothing more than an extension of a previously-approved program, such is not the case.

B. Need for Accelerated Recovery

Q. What is the rationale given by the Company for its proposed IIP-2?

A. The Company claims that its IIP-2 projects are "designed to improve the reliability of the ACE operating area, support the economy of southern New Jersey and work toward the retention and creation of employment in the State." [4] However, given the emphasis in the Company's testimony on attrition and earnings, in my opinion the Company's proposal is primarily an attempt to improve the Company's financial condition. Mr. Kamerick indicates in his testimony that "[g]rowth in distribution rate base costs are outpacing the

[4] Testimony of William M. Gausman, Oct. 17, 2011, page 3.

growth in distribution revenues" and he goes on to state that "[a]pproval of IIP-2 will improve, but not totally resolve, the Company's opportunity to earn its authorized return, while at the same time significantly enhancing system reliability for our customers."[5]

Company witness Lowry testifies that:

> [i]n order for ACE to increase its reliability capex, rate cases would need to be annual or even more frequent, involving high regulatory cost and the distraction of senior management from their basic business. These frequent rate cases would nonetheless not afford the Company a fair chance to earn its allowed rate of return. . . . Expedited recovery of IIP-2 capex costs would encourage investment and construction sector employment, alleviate attrition, and avoid higher capital market costs. Less frequent rate cases would lower regulatory costs and encourage better operating performance."[6]

Thus, while the Company discusses the need to increase its spending for reliability programs, it appears that the IIP-2 proposal is primarily driven by the desire to enhance its cash flow between base rate case filings.

Q. Has the Company demonstrated that this IIP-2 program is necessary in order to continue to provide safe and reliable utility service to New Jersey ratepayers?

A. No, it has not. ACE has not identified any specific safety or reliability concerns that would necessitate a program of this type. Moreover, reliability is not a new concept. Ensuring reliability is an integral part of managing any electric utility. The regulatory compact provides that in exchange for being granted a monopoly franchise area, a utility will provide safe and reliable utility service at reasonable rates. The obligation to provide

[5] Kamerick testimony, page 5.
[6] Testimony of Mark Newton Lowry, October 17, 2011, page 4..

safe and reliable service is a cornerstone of the utility's obligations. Thus, the concept of undertaking expenditures that promote reliability is not new or novel. Rather, this is a fundamental obligation of any regulated electric company.

Q. Is the Company basing its proposal on any new federal or state regulations relating to reliability?

A. No, it is not. The Company is not contending that there are any new federal or state mandates that would change the Company's obligations with regard to reliability. The utility has always had, and continues to have, an obligation to operate its business reliably. This has not changed.

Q. Has the Company already made commitments to increase its reliability spending?

A. Yes, it has. In the Stipulation in Phase Two of its last base rate case, ACE agreed to undertake reliability spending of $145 million over a five-year period, for an annual expenditure of $29 million.[7] In this case, the Company is proposing to increase that by $50.4 million per year for three years, resulting in annual expenditures of $79.4 million over the 2012-2014 period. However, instead of recovering these reliability costs through the traditional rate case process, as envisioned when the Stipulation in the last case was executed, ACE is now seeking to abandon traditional regulatory mechanisms and accelerate recovery of <u>all</u> reliability projects between base rate cases. A new

[7] Response to RCR-ER-IIP2-4.

ratemaking mechanism was not envisioned when ACE made these reliability commitments. It is disingenuous for the Company to attempt now to change the recovery mechanism that was in place for reliability projects at the time the Company agreed to increase its reliability expenditures.

Q. Has ACE demonstrated that an IIP-2 surcharge is necessary to meet its obligations with regard to reliability?

A. No, it has not. ACE has not shown that there are reliability issues that would necessitate abandonment of the traditional ratemaking process. In response to RCR-A-IIP2-15, ACE stated that,

> The Company is not contending that system reliability will decline if the Petition is not approved. The Company's IIP-2 Petition is premised upon (a) the need to improve overall system reliability through increased expenditures on non-revenue producing reliability infrastructure projects, (b) to reduce earnings attrition associated with the need to raise capital to support the increased level of reliability spending, and (c) to provide further economic stimulus for the benefit of the State's economy.

ACE gave a similar response when asked if its system will be unsafe unless the IIP-2 surcharge is approved.[8]

As currently structured, the proposed program is clearly an accelerated <u>recovery</u> program. The Company's proposed surcharge is not based on incremental expenditures, but rather is based on recovering all reliability spending, excluding emergency and storm restoration costs, through a surcharge mechanism. Thus, while the Company claims that

[8] Response to RCR-A-IIP2-16.

its proposed IIP-2 surcharge will improve reliability, it is proposing to change the manner in which it recovers all reliability costs, and not just those incremental costs over and above its previous commitments.

In addition, as currently proposed, the IIP-2 is an alternative cost recovery mechanism that will require ratepayers to pay for certain costs earlier than they would under traditional ratemaking. Not only does the proposed IIP-2 accelerate recovery of costs that would not otherwise be recoverable until the Company filed a new base rate case, but in addition the Company's proposal further accelerates recovery by requiring ratepayers to pay not only for actual capital expenditures, but for projected expenditures as well. The Company is proposing that each year, the IIP-2 surcharge would be established based on projected costs for the upcoming year, subject to true-up. Thus, each time the surcharge is reset, ratepayers would be required to begin to pay for plant that is not yet in-service and which will not be in-service until, on average, six months later.

Q. If the BPU found that there was a reliability problem that required increased expenditures and if it further found that the Company could not meet these expenditures within the traditional ratemaking mechanism, what would you recommend?

A. If there was a critical issue of safety or reliability that mandated expenditures that would jeopardize the Company's financial integrity, then I would recommend that the BPU develop an alternative ratemaking methodology just for those incremental expenditures that the Company could not finance through traditional ratemaking mechanisms. A key feature of the IIP-1 program was that it was designed to achieve a specific policy goal and the special ratemaking treatment used for the program was limited to incremental expenditures associated with achieving that goal. Neither of these factors is present here.

ACE has not identified any specific reliability issues that necessitate a departure from traditional ratemaking approaches. Nor has the Company proposed any measurement metrics that would be used to evaluate the effectiveness of any such program. It does not appear that ACE's proposal is being driven by specific reliability concerns. Instead, the Company is proposing a wholesale change in the manner in which a significant portion of its capital expenditures would be recovered.

C. <u>Impact on Ratepayers</u>

Q. Have you examined the impact of the Company's proposal on both ratepayers and shareholders?

A. Yes, I have. As currently structured, the Company's proposal provides no net benefits to ratepayers, while shareholders will benefit from accelerated recovery and reduced risk.

Q. Has ACE undertaken a cost / benefit analysis to determine if ratepayers would benefit from an accelerated recovery mechanism?

A. No, it has not. ACE has not provided any documentation to suggest that the benefit to ratepayers from enhanced reliability will offset the burden of having to pay increased rates through the IIP-2 surcharge. Thus, ACE is requesting that the IIP-2 surcharge be approved without any evidence that the benefits to ratepayers will exceed the incremental costs. The Company should be required to justify its proposal before receiving BPU approval, not afterwards.

Pursuant to the current ratemaking mechanism, plant additions are only included in rate base, and therefore in utility rates, once the plant is completed and placed into service. Between general base rate cases, plant that is booked to utility plant-in-service is not reflected in utility rates until the Company's next base rate case.

However, under the Company's proposal, ratepayers will bear higher costs sooner, as a result of the IIP-2. Pursuant to the IIP-2 mechanism, ratepayers will pay an additional surcharge each year. Moreover, these charges will include not only plant that has been completed to date, but also plant that is projected to be completed over the upcoming twelve months. From a financial perspective, these are serious detriments to ratepayers.

Q. Has the Company included any potential cost savings in its revenue requirement relating to reliability improvements?

A. No, it has not. Thus, the Company has not demonstrated that there are any cost savings that would provide a net benefit to ratepayers if the IIP-2 is adopted.

Q. Could the IIP-2 surcharge impact the process currently used by ACE to prioritize capital expenditures?

A. Yes, it could. In a perfect world, utilities would have infinite funds for reliability improvements and service would always be 100% reliable. However, we know that in the real world capital is limited and achieving 100% reliability is not a cost-effective option. Therefore, ACE must allocate its resources accordingly. One of my concerns is that the IIP-2 program could reduce the Company's incentive to make reliability expenditures based on identified need, and instead could provide an incentive to spend up to a pre-approved, arbitrary allowance, knowing that shareholders will earn a return on any such expenditures and that recovery of such expenditures is guaranteed.

More importantly, if the Company's proposal is adopted, ratepayers could pay significantly more than they might have otherwise paid. In these tough economic times, putting an additional burden on ratepayers is unwise. Assuming that the IIP-2 program creates an incentive for the Company to maximize its expenditures, ratepayers are worse off under the proposed surcharge because they would pay higher rates than they would under a traditional ratemaking approach, and they would be required to begin payment earlier.

At the present time, ACE must manage its business in such a way as to provide safe and reliable utility service at reasonable rates. Part of managing that business is evaluating the costs of providing safe and reliable utility service and of prioritizing those costs. A significant and integral component of utility service, i.e., certain reliability projects, should not be viewed in isolation.

Under the present regulatory mechanism, ACE has to prioritize not only its total expenditures, but also the expenditures earmarked for reliability projects. Therefore, the Company must make choices about how much to spend and how to spend it, while meeting its mandate to provide safe and reliable utility service. If the Company believes that certain capital expenditures will be recovered on a guaranteed dollar-for-dollar basis, ACE will have much less incentive to prioritize. Instead of undertaking reliability projects for which a specific need has been identified, ACE may be more inclined to undertake reliability projects in lower priority categories more rapidly, resulting in unnecessary expenditures and higher rates for ratepayers. The process to determine which reliability projects should be replaced would likely become less defined, since there would be less incentive to prioritize funds earmarked for reliability.

Q. **Has the Company proposed a measurement and evaluation method to evaluate the IIP-2, in the event that it is adopted?**

A. No, it has not. ACE claims that the IIP-2 will improve reliability but no measurement or performance standards have been proposed by the Company to evaluate the potential benefits of accelerating reliability projects. Nor has the Company proposed any measurement or evaluative criteria to assist the parties in determining, after the fact, whether the IIP-2 has been successful. This lack of measurement and evaluative criteria is another indication that the IIP-2 is being driven by financial considerations instead of by reliability concerns.

Q. Please comment on the Company's claim that this proposal only includes plant that is non-revenue producing?

A. While the projects included in the IIP-2 surcharge may not result in additional customers or additional usage by existing customers, "new revenue" is generated by every new project recovered from ratepayers. This is because two of the major components of a utility's revenue requirement are return on investment and depreciation. Both of these components increase with every $1 of capital invested by the Company. Thus, it is not accurate to state that no revenue will be generated by the program. Moreover, under the Company's proposal, ratepayers will begin to pay this revenue sooner than they would under the traditional ratemaking mechanism. This is because under a traditional ratemaking approach, the Company would not begin to recover incremental return and depreciation expense until its next general base rate case. However, under the IIP-2, this recovery will begin prior to the expenditures even having been made.

Q. Would the Company's proposal to implement an IIP-2 surcharge shift additional risk onto ratepayers?

A. Yes, it would. The Company's proposed mechanism would shift risk from shareholders, where it properly belongs, to ratepayers without any commensurate reduction in the

Company's return on equity. In addition, the Company's proposal would result in single-issue ratemaking and could result in a rate increase even if the Company is earning its authorized rate of return.

Permitting these costs to be recovered between base rate cases will also reduce the Company's incentive to control and manage these costs. If the Company is required to file a base rate case to recover these costs, it is likely to work harder to keep costs down between base rate cases by investing in the most efficient projects and by managing construction of such projects effectively. The IIP-2 surcharge rider also results in rate uncertainty for ratepayers. Rate stability can be especially important to residential and small commercial customers.

D. <u>Impact on Shareholders</u>

Q. What is the impact on shareholders of the Company's proposed IIP-2?

A. Contrary to economic theory and good ratemaking practice, the proposed IIP-2 program will increase shareholder return while significantly reducing shareholder risk. Shareholder return is directly proportional to the amount of investment made by the utility. Since shareholders benefit from every investment dollar that is spent by a utility, the proposed IIP-2 will increase overall return to shareholders and accelerate recovery of that return.

In addition, the IIP-2 will reduce shareholder risk, in two ways. First, since the IIP-2 surcharge will accelerate recovery, shareholders will no longer have to wait for a general base rate case to receive a return on this investment. Nor will shareholders have to wait for a general base rate case in order to begin recovery of depreciation associated with the investment. Second, given the true-up mechanism included in the IIP-2, recovery of and on this investment is guaranteed between base rate case proceedings. Under traditional ratemaking, shareholders are awarded a risk-adjusted return on equity and given the opportunity, but not a guarantee, to earn this return. Under the true-up mechanism proposed by ACE, shareholders would be guaranteed to recover both the return <u>on</u> this investment as well as the return <u>of</u> this investment as long as these costs were being recovered through the IIP-2 surcharge.

Q. What impact does the Company's proposal have on shareholder return?

A. In spite of the fact that the IIP-2 will reduce shareholder risk, and will transfer that risk to ratepayers, the Company has not proposed any reduction to the cost of equity to be paid by ratepayers. As stated earlier, ACE is proposing that the return authorized in the most recent base rate case be used to calculate the IIP-2 tariff rate. However, since this return will be accelerated, the impact to shareholders in an increase in the earned return on equity between base rate cases. Thus, the IIP-2 surcharge mechanism provides exactly the wrong movement in return on equity that one would expect, given the significant reduction in shareholder risk.

E. Single-Issue Ratemaking

Q. Does the Company's proposal result in single-issue ratemaking?

A. Absolutely. The Company's proposal clearly constitutes single issue ratemaking since it proposes to increase rates for one component of the ratemaking equation without consideration of the overall revenue requirement or revenue levels being earned by ACE. Single-issue ratemaking violates the regulatory principle that all components of a utility's ratemaking equation be considered when new rate are established.

Moreover, in this case, there is no compelling reason for deviating from traditional ratemaking practice and permitting single-issue ratemaking, other than the Company's request to accelerate recovery to shareholders. The need to provide safe and reliable service is not an extraordinary circumstance. Nor it is a new circumstance. Rather, this requirement is a basic tenet of monopoly utility service.

Single-issue ratemaking has generally been considered an extraordinary ratemaking treatment used to resolve a specific and well-defined problem. Single-issue ratemaking can be used to address extraordinary operational issues or serious financial concerns. However, in this case, there is no evidence that the utility system is unsafe, or is on the verge of becoming unsafe. In fact, the Company acknowledges that the IIP-2 program is not necessary to maintain either its current level of reliability or safety.

Moreover, the Company has not demonstrated that its financial condition warrants an accelerated recovery mechanism. There is no evidence that ACE has had difficulty attracting the capital necessary to make the reliability improvements that have been made to date. ACE has not provided any evidence that it has had, or will have, difficulty attracting capital if the IIP-2 is not approved. In addition, there is no indication that it will delay filing for future rate increases if the IIP-2 surcharge is approved. Thus, ACE has not demonstrated that its financial integrity would be jeopardized if the IIP-2 proposal is rejected by the Commission. In this case, there is no evidence that either operational issues or financial issues necessitate implementation of a new accelerated recovery mechanism for reliability projects.

Q. Please comment on Mr. Lowry's testimony at paged 22-24 that other states have adopted similar mechanisms.

A. First, I agree with Mr. Lowry that the use of single-issue ratemaking is expanding. In an attempt to shift risk from ratepayers to shareholders, utilities are becoming more aggressive in attempting to establish surcharges that result in dollar-for-dollar recovery of various expenditures. However, I caution the BPU to view lists of other states that have adopted infrastructure investment clauses or other single-issue ratemaking mechanisms with caution.

For example, as acknowledged by Mr. Lowry, such mechanisms are more common for gas utilities than for electric utilities. This is because gas utilities are perceived as having greater safety concerns than electric utilities. In many cases, surcharge mechanisms are the result of legislative mandates, particularly with regard to gas pipeline safety issues. Thus, the existence of surcharges in other states should be viewed cautiously be regulators. In addition, there are no facts in this case that would suggest that the BPU should deviate from its general policy against single-issue ratemaking with regard to reliability projects.

F. <u>Policy Recommendations</u>

Q. Should the Commission approve the Company's request for an IIP-2 surcharge?

A. No, it should not. Reliability is an integral part of the Company's responsibility and should be recovered through traditional ratemaking mechanisms. ACE has not demonstrated that an IIP-2 surcharge is necessary in order to provide safe and reliable utility service. ACE's proposal attempts to carve out a new ratemaking mechanism for one of its most basic obligations, i.e., to ensure reliability.

The IIP-2 surcharge proposal is not intended to meet a specific objective, nor is it necessary to protect the Company's financial integrity. Capital spending for reliability projects should be handled like any other investment that is required to provide safe and reliable utility service and recovered through a general rate case proceeding. Between base rate cases, the risk of recovery should be on shareholders, who are given a premium return on equity for taking on such risk. The Company does not begin to recover other types of investment until it files for new base rates and investment in reliability projects should be given the same regulatory treatment. Requiring the Company to recover these costs in a base rate case also provides a better forum for Rate Counsel, Staff, and other interveners to review these costs and to determine whether the costs are just and reasonable.

Q. If this proposal is approved, will the BPU likely face additional requests for trackers from ACE and other utilities?

A. Yes, it will. In fact, it should be noted that the BPU may face additional requests for trackers even if the IIP-2 surcharge proposal is denied. What began for most utilities as a mechanism to recover volatile fuel costs in the 1970s, has expanded to include recovery of not only certain operating expenses but also recovery of capital costs, including cost of equity. Moreover, the proliferation of these mechanisms seems to have accelerated over the past few years, as the economy has weakened and companies have attempted to further insulate their income from volatility. Even though shareholders receive a generous risk-adjusted, return on equity award, utilities have become even more aggressive in seeking to transfer that risk from shareholders to ratepayers, without any commensurate reduction in return on equity. At the current pace, utility regulation will become nothing more than a reimbursement system, with utilities submitting a financial report each year and ratepayers writing a check. The basic principles of risk and reward, as well as providing incentives for effective management, are being eroded by tracker mechanisms that relieve the utility from risk and uncertainty, without any commensurate benefit to ratepayers.

Q. If the IIP-2 is not approved, will the Company continue to operate a safe and reliable electric system?

A. Yes, it will. As stated earlier, ACE has indicated that it will continue to maintain a safe and reliable system regardless of whether or not the IIP-2 surcharge is approved.

Q. Given your concerns with the IIP-2, what do you recommend?

A. I recommend that the BPU reject the Company's proposal to accelerate recovery of its reliability program costs. The IIP-2 proposal results in single-issue ratemaking, provides a disincentive for utility management to control costs, and shifts risk from shareholders to ratepayers. The IIP-2 surcharge will only put a further (and unnecessary) financial burden on ratepayers. Investment in reliability projects should be treated no differently from other investment that is necessary to provide safe and reliable utility service, and should be recovered only through a general base rate case where all parties can undertake a thorough review of the costs. Accordingly, the Company’s request for the IIP-2 should be denied.

G. <u>Other Issues</u>

Q. In addition to your policy concerns about the IIP-2 surcharge, do you also have concerns about the mechanics of the proposal?

A. Yes, I do. If the BPU approves a surcharge mechanism for the Company’s reliability costs, I am recommending three revisions to the cost recovery mechanism proposed by

ACE. First, given the risk-free nature of the IIP-2 surcharge, if the BPU approves the surcharge then I recommend that the Company's return on investment be calculated based on a return that is no greater than its embedded cost of debt. Since ACE will be assured of recovery of these costs as long as they remain in the surcharge, there is no reason to provide shareholders with a premium return that reflects increased risk, including the risk of recovery, when shareholders will not actually be exposed to this risk.

Second, ACE is proposing to apply interest on over-recoveries and under-recoveries based on the 2 year Treasury rate plus 60 basis points, which is significantly higher than the short-term debt rate used for IIP-1. According to the Company's response to RCR-A-IIP2-2, ACE's short-term debt rate is approximately 0.35% while the current rate for 2 year Treasuries plus 60 basis points is 0.91%[9]. Since ACE finances any cash flow shortfalls with short-term debt, the short-term debt rate is the appropriate rate for calculating interest on monthly deferrals.

Third, ACE is proposing to allocate its revenue requirement associated with these projects based on the allocation of its distribution revenue. This would result in 92% of these costs being allocated to residential customers. If the IIP-2 is approved, I recommend that the costs be allocated based on an energy allocator (kwh). This is the allocator used for the IIP-1 program. Moreover, since these costs relate to the reliability of energy distribution, it is appropriate to allocate these costs based on the energy usage of each rate class used in the last base rate case. This would reduce the allocation to the

[9] Based on the February 21, 2012 Treasury rate as reported by the Federal Reserve.

residential class to approximately 43.6%. While I recommend that the IIP-2 be rejected by the BPU, if the BPU approves the program then, at a minimum, these three modifications should be made.

Q. Does this complete your testimony?

A. Yes, it does.

APPENDIX A

The Columbia Group, Inc., Testimonies of Andrea C. Crane

Company	Utility	State	Docket	Date	Topic	On Behalf Of
Atlantic City Electric Company	E	New Jersey	EO11110650	2/12	Infrastructure Investment Program (IIP-2)	Division of Rate Counsel
Chesapeake Utilities Corporation	G	Delaware	11-384F	2/12	Gas Service Rates	Division of the Public Advocate
New Jersey American Water Co.	W/WW	New Jersey	WR11070460	1/12	Consolidated Income Taxes Cash Working Capital	Division of Rate Counsel
Westar Energy, Inc.	E	Kansas	12-WSEE-112-RTS	1/12	Revenue Requirements Cost of Capital	Citizens' Utility Ratepayer Board
Puget Sound Energy, Inc.	E/G	Washington	UE-111048 UG-111049	12/11	Conservation Incentive Program and Others	Public Counsel
Puget Sound Energy, Inc.	G	Washington	UG-110723	10/11	Pipeline Replacement Tracker	Public Counsel
Empire District Electric Company	E	Kansas	11-EPDE-856-RTS	10/11	Revenue Requirements	Citizens' Utility Ratepayer Board
Comcast Cable	C	New Jersey	CR11030116-117	9/11	Forms 1240 and 1205	Division of Rate Counsel
Artesian Water Company	W	Delaware	11-207	9/11	Revenue Requirements Cost of Capital	Division of the Public Advocate
Kansas City Power & Light Company	E	Kansas	10-KCPE-415-RTS (Remand)	7/11	Rate Case Costs	Citizens' Utility Ratepayer Board
Midwest Energy, Inc.	G	Kansas	11-MDWE-609-RTS	7/11	Revenue Requirements	Citizens' Utility Ratepayer Board
Kansas City Power & Light Company	E	Kansas	11-KCPE-581-PRE	6/11	Pre-Determination of Ratemaking Principles	Citizens' Utility Ratepayer Board
United Water Delaware, Inc.	W	Delaware	10-421	5/11	Revenue Requirements Cost of Capital	Division of the Public Advocate
Mid-Kansas Electric Company	E	Kansas	11-MKEE-439-RTS	4/11	Revenue Requirements	Citizens' Utility Ratepayer Board
South Jersey Gas Company	G	New Jersey	GR10060378-79	3/11	BGSS / CIP	Division of Rate Counsel
Chesapeake Utilities Corporation	G	Delaware	10-296F	3/11	Gas Service Rates	Division of the Public Advocate
Westar Energy, Inc.	E	Kansas	11-WSEE-377-PRE	2/11	Pre-Determination of Wind Investment	Citizens' Utility Ratepayer Board
Delmarva Power and Light Company	G	Delaware	10-295F	2/11	Gas Cost Rates	Attorney General
Delmarva Power and Light Company	G	Delaware	10-237	10/10	Revenue Requirements Cost of Capital	Division of the Public Advocate
Pawtucket Water Supply Board	W	Rhode Island	4171	7/10	Revenue Requirements	Division of Public Utilities and Carriers
New Jersey Natural Gas Company	G	New Jersey	GR10030225	7/10	RGGI Programs and Cost Recovery	Division of Rate Counsel
Kansas City Power & Light Company	E	Kansas	10-KCPE-415-RTS	6/10	Revenue Requirements Cost of Capital	Citizens' Utility Ratepayer Board
Atmos Energy Corp.	G	Kansas	10-ATMG-495-RTS	6/10	Revenue Requirements Cost of Capital	Citizens' Utility Ratepayer Board

The Columbia Group, Inc., Testimonies of Andrea C. Crane

Company	Utility	State	Docket	Date	Topic	On Behalf Of
Empire District Electric Company	E	Kansas	10-EPDE-314-RTS	3/10	Revenue Requirements Cost of Capital	Citizens' Utility Ratepayer Board
Delmarva Power and Light Company	E	Delaware	09-414 and 09-276T	2/10	Cost of Capital Rate Design Policy Issues	Division of the Public Advocate
Delmarva Power and Light Company	G	Delaware	09-385F	2/10	Gas Cost Rates	Division of the Public Advocate
Chesapeake Utilities Corporation	G	Delaware	09-398F	1/10	Gas Service Rates	Division of the Public Advocate
Public Service Electric and Gas Company	E	New Jersey	ER09020113	11/09	Societal Benefit Charge Non-Utility Generation Charge	Division of Rate Counsel
Delmarva Power and Light Company	G	Delaware	09-277T	11/09	Rate Design	Division of the Public Advocate
Public Service Electric and Gas Company	E/G	New Jersey	GR09050422	11/09	Revenue Requirements	Division of Rate Counsel
Mid-Kansas Electric Company	E	Kansas	09-MKEE-969-RTS	10/09	Revenue Requirements	Citizens' Utility Ratepayer Board
Westar Energy, Inc.	E	Kansas	09-WSEE-925-RTS	9/09	Revenue Requirements	Citizens' Utility Ratepayer Board
Jersey Central Power and Light Co.	E	New Jersey	EO08050326 EO08080542	8/09	Demand Response Programs	Division of Rate Counsel
Public Service Electric and Gas Company	E	New Jersey	EO09030249	7/09	Solar Loan II Program	Division of Rate Counsel
Midwest Energy, Inc.	E	Kansas	09-MDWE-792-RTS	7/09	Revenue Requirements	Citizens' Utility Ratepayer Board
Westar Energy and KG&E	E	Kansas	09-WSEE-641-GIE	6/09	Rate Consolidation	Citizens' Utility Ratepayer Board
United Water Delaware, Inc.	W	Delaware	09-60	6/09	Cost of Capital	Division of the Public Advocate
Rockland Electric Company	E	New Jersey	GO09020097	6/09	SREC-Based Financing Program	Division of Rate Counsel
Tidewater Utilities, Inc.	W	Delaware	09-29	6/09	Revenue Requirements Cost of Capital	Division of the Public Advocate
Chesapeake Utilities Corporation	G	Delaware	08-269F	3/09	Gas Service Rates	Division of the Public Advocate
Delmarva Power and Light Company	G	Delaware	08-266F	2/09	Gas Cost Rates	Division of the Public Advocate
Kansas City Power & Light Company	E	Kansas	09-KCPE-246-RTS	2/09	Revenue Requirements Cost of Capital	Citizens' Utility Ratepayer Board
Jersey Central Power and Light Co.	E	New Jersey	EO08090840	1/09	Solar Financing Program	Division of Rate Counsel
Atlantic City Electric Company	E	New Jersey	EO06100744 EO08100875	1/09	Solar Financing Program	Division of Rate Counsel
West Virginia-American Water Company	W	West Virginia	08-0900-W-42T	11/08	Revenue Requirements	The Consumer Advocate Division of the PSC

The Columbia Group, Inc., Testimonies of Andrea C. Crane

Company	Utility	State	Docket	Date	Topic	On Behalf Of
Westar Energy, Inc.	E	Kansas	08-WSEE-1041-RTS	9/08	Revenue Requirements Cost of Capital	Citizens' Utility Ratepayer Board
Artesian Water Company	W	Delaware	08-96	9/08	Cost of Capital, Revenue, New Headquarters	Division of the Public Advocate
Comcast Cable	C	New Jersey	CR08020113	9/08	Form 1205 Equipment & Installation Rates	Division of Rate Counsel
Pawtucket Water Supply Board	W	Rhode Island	3945	7/08	Revenue Requirements	Division of Public Utilities and Carriers
New Jersey American Water Co.	W/WW	New Jersey	WR08010020	7/08	Consolidated Income Taxes	Division of Rate Counsel
New Jersey Natural Gas Company	G	New Jersey	GR07110889	5/08	Revenue Requirements	Division of Rate Counsel
Kansas Electric Power Cooperative, Inc.	E	Kansas	08-KEPE-597-RTS	5/08	Revenue Requirements Cost of Capital	Citizens' Utility Ratepayer Board
Public Service Electric and Gas Company	E	New Jersey	EX02060363 EA02060366	5/08	Deferred Balances Audit	Division of Rate Counsel
Cablevision Systems Corporation	C	New Jersey	CR07110894, et al.	5/08	Forms 1240 and 1205	Division of Rate Counsel
Midwest Energy, Inc.	E	Kansas	08-MDWE-594-RTS	5/08	Revenue Requirements Cost of Capital	Citizens' Utility Ratepayer Board
Chesapeake Utilities Corporation	G	Delaware	07-246F	4/08	Gas Service Rates	Division of the Public Advocate
Comcast Cable	C	New Jersey	CR07100717-946	3/08	Form 1240	Division of Rate Counsel
Generic Commission Investigation	G	New Mexico	07-00340-UT	3/08	Weather Normalization	New Mexico Office of Attorney General
Southwestern Public Service Company	E	New Mexico	07-00319-UT	3/08	Revenue Requirements Cost of Capital	New Mexico Office of Attorney General
Delmarva Power and Light Company	G	Delaware	07-239F	2/08	Gas Cost Rates	Division of the Public Advocate
Atmos Energy Corp.	G	Kansas	08-ATMG-280-RTS	1/08	Revenue Requirements Cost of Capital	Citizens' Utility Ratepayer Board