STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

I/M/O THE PETITION OF ATLANTIC CITY ELECTRIC COMPANY FOR APPROVAL OF AN INFRASTRUCTURE INVESTMENT PROGRAM, AND RELATED COST RECOVERY MECHANISM, PURSUANT TO N.J.A.C. 14:3-2A.1 *et. seq.*	)))))))	**BPU DOCKET NO. EO18020196**

DIRECT TESTIMONY OF DAVID E. PETERSON ON BEHALF OF THE DIVISION OF RATE COUNSEL

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is David E. Peterson. I am a Senior Consultant employed by Chesapeake Regulatory Consultants, Inc. ("CRC"). Our business address is 1698 Saefern Way, Annapolis, Maryland 21401-6529. I maintain an office in Dunkirk, Maryland.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE IN THE PUBLIC UTILITY FIELD?

A. I graduated with a Bachelor of Science degree in Economics from South Dakota State University in May of 1977. In 1983, I received a Master's degree in Business Administration from the University of South Dakota. My graduate program included accounting and public utility courses at the University of Maryland.

In September 1977, I joined the Staff of the Fixed Utilities Division of the South Dakota Public Utilities Commission as a rate analyst. My responsibilities at the South Dakota Commission included analyzing and testifying on ratemaking matters arising in rate proceedings involving electric, gas and telephone utilities.

Since leaving the South Dakota Commission in 1980, I have continued performing cost of service and revenue requirement analyses as a consultant. In December 1980, I joined the public utility consulting firm of Hess & Lim, Inc. I remained with that firm until August 1991, when I joined CRC. Over the years, I have analyzed filings by electric, natural gas, propane, telephone, water, wastewater, and steam utilities in connection with utility rate and certificate proceedings before federal and state regulatory commissions. A copy of my curriculum vitae is provided in Appendix A attached to my testimony.

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN PUBLIC UTILITY RATE PROCEEDINGS?

A. Yes. I have presented testimony in 167 other proceedings before the state regulatory commissions in Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Indiana, Kansas, Maine, Maryland, Montana, Nevada, New Jersey, New Mexico, New York, Pennsylvania, South Dakota, West Virginia, and Wyoming, and before the Federal Energy Regulatory Commission. Collectively, my testimonies have addressed the following topics: the appropriate test year, rate base, revenues, expenses, depreciation, taxes, capital structure, capital costs, rate of return, cost allocation, rate design, life-cycle analyses, affiliate transactions, mergers, acquisitions, and cost-tracking procedures.

In addition, I testified twice before the Energy Subcommittee of the Delaware House of Representatives on the issues of consolidated tax savings and tax normalization. Also, I have presented seminars on public utility regulation, revenues requirements, cost allocation, rate design, consolidated tax savings, income tax normalization and other ratemaking issues to the Delaware Public Service Commission, to the Commissioners and Staff of the Washington Utilities and Transportation Commission, and to the Colorado Office of Consumer Counsel.

II. SUMMARY

Q. HAVE YOU TESTIFIED IN OTHER PROCEEDINGS BEFORE THE NEW JERSEY BOARD OF PUBLIC UTILITIES ("BOARD")?

A. Yes, I have. I have submitted testimony in the following proceedings before the Board:

Utility	Docket No.
South Jersey Gas Company	GR8704329
	GR03050413
	GR03080683
	GR10010035
New Jersey-American Water Company	WR88070639
	WR91081399J
	WR92090906J
	WR94030059
	WR95040165
	WR98010015
	WR03070511
	WR06030257
	WR17090985
ACE/Delmarva Merger	EM97020103
Atlantic City Electric Company	ER03020110
	ER11080469
	ER17030308
FirstEnergy/GPU Merger (JCP&L)	EM00110870
Jersey Central Power & Light	ER02080506
	ER05121018
	ER12111052
	EM14060581
	EM15060733
Rockland Electric Company	ER02100724
	ER06060483

	ER09080668
Public Service Electric and Gas	EM00040253
	GR09050422
	GO12030188
	ER18010029
	GR18010030
Exelon/PSE&G Merger	EM05020106
Exelon/Pepco Holdings Merger	EM14060581
Conectiv/Pepco Merger (ACE)	EM01050308
Elizabethtown Gas Company	GR02040245
	GR09030195
The Southern Company/AGL Resources	GM15101196
United Water New Jersey, Inc.	WR07020135
United Water Toms River	WR15020269
New Jersey Natural Gas Company	GR07110889

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. My appearance in this proceeding is on behalf of the Division of Rate Counsel ("Rate Counsel").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I was asked by Rate Counsel to review and to analyze the Petition, testimonies and exhibits filed by Atlantic City Electric Company ("ACE" or "the Company") in support of its request to implement an Infrastructure Investment Program ("IIP") and related cost recovery mechanism pursuant to N.J.A.C. 14:3-2A.1 *et seq.* Specifically, I was asked to review and to comment on the formula to be used in ACE's proposed IIP cost recovery mechanism and the allocation of IIP-related cost responsibility to the various rate classes and rate schedules within each rate class. Therefore, the purpose of my testimony is to present the results of my analyses and my recommendations regarding ACE's proposed IIP cost recovery mechanism to Your Honor and the Board.

Q. ARE YOU FAMILIAR WITH ACE'S RATE DESIGN PROPOSALS IN THIS PROCEEDING?

A. Yes, I am. Mr. Joseph F. Janocha presents ACE's IIP-related revenue requirements, cost allocation and rate design proposals through his Direct Testimony. I have carefully reviewed Mr. Janocha's Direct Testimony. I also reviewed the Company's responses to Rate Counsel's data requests relating to the issues that I address in my testimony.

Q. BEFORE DISCUSSING YOUR SPECIFIC FINDINGS AND RECOMMENDATIONS, PLEASE SUMMARIZE ACE'S REQUESTS IN THIS PROCEEDING.

A. On February 28, 2018, Atlantic City Electric Company ("ACE" or "the Company") filed a Petition seeking approval from the New Jersey Board of Public Utilities ("Board") for an Infrastructure Investment Program ("IIP") and related cost recovery. The Board recently adopted regulations, codified in <u>N.J.A.C.</u> 14:3-2A.1 *et seq*, allowing New Jersey utilities to request approval for IIP's for accelerated cost recovery of qualifying investments made to enhance system safety, reliability, and/or resiliency.

The Board's IIP regulations allow utilities to seek accelerated cost recovery for qualifying projects to the extent they exceed the utility's "baseline" spending for utility plant and facilities that enhance safety, reliability, and/or resiliency. While utilities may request accelerated cost recovery on either an annual or semi-annual basis, qualifying IIP projects must be in-service before new rates are implemented. Each IIP request also must seek recovery for at least 10 percent of the overall program costs. IIP costs are to be recovered through a special rate rider and will include a return allowance on net investment in qualifying projects and an allowance for depreciation. IIP rates are provisional and subject to refund, however, in that prudence for IIP projects will be examined in the context of future base rate proceedings.

ACE's IIP proposal includes approximately $338.2 million of projects to be completed during the period 2019 through 2022. This amount is over and above its claimed "baseline" spending of $240 million for the same four-year period, or $60 million annually, and is in addition to the $55.8 million previously approved by the Board in ACE's *PowerAhead* program. Each of ACE's proposed IIP projects fall into one of five broad categories, which include: Targeted Reliability Improvements, Distribution Automation/Telecommunications, Infrastructure Renewal, Emergency, and Facilities. ACE claims that none of these projects are revenue producing. It also claims that its proposed IIP rates will have a less than 1 percent per year rate impact on total electric bills for its New Jersey customers.

Q. ARE THE CATEGORIES OF PROJECTS PROPOSED IN THE IIP NEW OR UNUSUAL?

A. No. Each of the five broad categories of ACE's proposed IIP, if prudently designed and constructed or purchased, represent elements of ACE's pre-existing public service obligation to its customers. That is, each element is part of the Company's existing obligation to deliver safe, adequate and reliable service to its customers at the lowest reasonable cost. Therefore, the new rules governing IIP filings did not create the need for the projects that ACE is proposing in its IIP. That need already existed and was already part of the Company's service obligation to its customers. In that sense, there is nothing unique about the projects that ACE has identified in its IIP, except that those are the projects that ACE has singled out for accelerated cost recovery, outside of the traditional base rate proceeding.

Q. DOES SINGLING OUT THE IIP INVESTMENTS FOR COST RECOVERY THROUGH A NEW RATE RIDER CONFER ANY BENEFITS ON ACE AND ITS INVESTORS THAT ARE NOT AVAILABLE FROM ACE'S OTHER RATE BASE INVESTMENTS THAT ARE ALSO PART OF THE COMPANY'S PUBLIC SERVICE OBLIGATION?

A. Yes, it does. Projects deemed eligible for ACE's IIP will be guaranteed accelerated cost recovery, unlike ACE's other non-IIP investments. This is significant because ACE proposes that nearly 54 percent of its distribution plant construction budget over the period 2019 through 2022 be classified under the IIP and receive guaranteed accelerated cost recovery.

Moreover, despite guaranteed accelerated cost recovery, which should reduce investment risk considerably, which Rate Counsel's witness Dr. Marlon Griffing addresses in his testimony, ACE is requesting a return allowance for IIP investments that is the same rate of return authorized by the Board for ACE's non-IIP rate base investments. Using the same rate of return for both IIP and non-IIP investments gives ACE a significant incentive to get as much of its capital expansion projects included in its IIP and, thereby, create a windfall for ACE's investors. This incentive probably explains why ACE proposes that nearly 54 percent of its distribution construction budget be included in its IIP.

Finally, the IIP procedure is a form of single-issue ratemaking of which the Board should be very cautious to be led down that path. The IIP procedure permits a guaranteed increase in ACE's distribution rates to reflect certain plant additions made during a certain time period while ignoring all other changes (both increases and decreases) in ACE's costs occurring during the same time period. The "test period" concept is a fundamental ratemaking principle that has been used for decades to fairly measure a utility's revenue requirement. The IIP procedure, however, turns the test period concept on its head by ignoring all factors that influence a utilities cost of service except for a one-sided return allowance and a depreciation expense allowance on IIP investments. Such a one-sided procedure is cannot accurately or fairly measure a utility's revenue requirement.

Moreover, the fact that these rates are "provisional, subject to refund" does not fully protect ACE's ratepayers from ultimately paying unjust or unreasonable rates. The time elapsed between the roll-in of provisional rates and subsequent prudency review in a base rate case can range up to five years. Refunding to customers rates found to be unreasonable after several years, already a difficult task, can be further complicated by subsequent (every six month) rate increases. Indeed, the difficulty in returning over-payments makes it less likely that costs allowed under the IIP roll-ins will be found imprudent in a base rate case. Thus, the Board should be especially conservative when approving IIP programs that extend over several years.

Q. WHAT ARE ACE'S SPECIFIC PROPOSALS RELATING TO IIP-RELATED REVENUE REQUIREMENTS, COST ALLOCATION AND RATE DESIGN?

A. ACE's revenue requirement, cost allocation and rate design proposals are presented through the Direct Testimony of Joseph F. Janocha. Mr. Janocha proposes to collect ACE's IIP-related costs through a separate tariff rider, Rider IIP, which is to be calculated on a semi-annual basis and become effective 60 days after ACE's periodic IIP filings. Each filing is to reflect actual plant-in-service IIP-related closings during the six months prior to the filing and for each filing ACE is required to seek recovery of at least 10 percent of its overall IIP expenditures. Mr. Janocha's proposed semi-annual revenue requirement includes a return allowance and a depreciation expense allowance on actual plant closings. ACE's proposed IIP "rate base" includes the Company's actual IIP construction-related costs, including engineering, design, construction, property acquisition, labor, materials, and AFUDC, less accumulated depreciation and deferred taxes. Construction work in progress will not be included in the periodic IIP rate base. ACE proposes a rate of return allowance based on the Company's most recent approved rate of return – 7.60%. Similarly, depreciation rates to be applied to IIP plant investment will reflect depreciation rates previously approved by the Board. The income tax consequences associated with IIP plant investment will reflect the requirements of the Tax Cuts and Jobs Act ("TCJA") of 2017, including a 21% federal income tax rate, Modified Accelerated Cost Recovery System depreciation and no bonus depreciation.

Mr. Janocha proposes to allocate the Company's IIP revenue requirement to each class on the basis of current rate class specific levels of non-customer-related distribution revenues (i.e. total class revenues minus revenues collected through the monthly customer charge) approved by the Board in ACE's most recent base rate proceeding.

For rate schedules RS, MGS Secondary, MGS Primary, and DDC, the IIP rate will be designed as a volumetric (i.e., $/kWh) charge. For rate schedules AGS Secondary, AGS Primary, and TGS, the IIP rate will be designed as a demand charge (i.e., per kW) applicable to the customers' maximum monthly demand. For the street lighting classes, the IIP rate will be calculated as a per lamp charge.

Mr. Janocha estimates that ACE's IIP filings will have the following rate impacts on residential customers:

	$/Month	% of Total Bill
2019	$0.72	0.53%
2020	$1.34	0.98%
2021	$1.68	1.22%
2022	$0.67	0.49%
2023	$0.41	0.30%

Q. DO YOU TAKE ISSUE WITH ANY OF MR. JANOCHA'S REVENUE REQUIREMENT, COST ALLOCATION OR RATE DESIGN PROPOSALS?

A. Yes, I do. I have no problem with Mr. Janocha's proposed allocation of the IIP revenue requirement to the classes. His proposed non-customer charge revenue basis preserves the relative class revenue responsibilities, as a percentage of total distribution revenue, that were established in ACE's last base rate proceeding. Mr. Janocha's proposal to adjust volumetric rates for residential customers also is reasonable, in that IIP investments will not result in an increase in monthly service charges.

There is one revenue requirement issue that Mr. Janocha failed to address in his Direct Testimony, however. On page 11 of his Schedule (JFJ)-1, Mr. Janocha shows his projection of plant retirements that result from IIP investments. Yet, nowhere in his testimony or in his illustration of the development of IIP revenue requirements does Mr. Janocha explain whether and how plant retirements should be included in the IIP revenue requirement determination. Plant that has been retired and removed from service is no longer used and useful to ratepayers. Yet, not recognizing a credit for retired plant-related costs in the IIP revenue requirement calculation will allow ACE to continue to earn a return allowance and a depreciation expense allowance on plant that is no longer in service. This over-recovery of costs will continue until ACE's next base rate proceeding. Therefore, investment-related costs (both the remaining net plant in service and the depreciation expense) on IIP-related plant retirements should be recognized in the IIP revenue requirement formula as an offset to ACE's IIP periodic revenue requirement.

Q. WHAT IS YOUR SPECIFIC RECOMMENDATION REGARDING ACE'S PROPOSED IIP REVENUE REQUIREMENT FORMULA?

A. I recommend that for each semi-annual filing, actual IIP-related plant retirements during the prior six months be credited to ACE's IIP rate base and the associated depreciation expense be removed in determining the semi-annual IIP revenue requirement.

Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes, it does.

APPENDIX A

STATEMENT OF EDUCATION AND EXPERIENCE
FOR
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Mr. Peterson is employed as a public utility rate consultant by Chesapeake Regulatory Consultants, Inc. Mr. Peterson has over thirty-nine years of experience analyzing regulated public utility ratemaking and service matters including three years as a member of a state regulatory commission staff and thirty-six years as a consultant. Mr. Peterson specializes in utility revenue requirement and cost of service analyses. He has presented testimony in more than 160 proceedings before twenty state regulatory commissions, the Delaware House Energy Subcommittee, and the Federal Energy Regulatory Commission. Utilities addressed in Mr. Peterson's analyses and testimonies have included electric, natural gas, propane, telephone, water, steam and sewer companies.

EMPLOYMENT

1991 - Present	Senior Consultant Chesapeake Regulatory Consultants, Inc. Annapolis, Maryland
1980 - 1991	Consultant Hess & Lim, Inc. Greenbelt, Maryland
1977 - 1980	Rate Analyst South Dakota Public Utilities Commission Pierre, South Dakota
1977	Research Assistant Economics Department South Dakota State University Brookings, South Dakota

As a rate analyst and consultant, Mr. Peterson has served a diverse group of public utility consumers and governmental agencies on utility ratemaking and service-related issues. Clients have included state regulatory commissions and their staffs, consumer advocate agencies of state governments, federal agencies, municipalities, privately owned, municipally owned and cooperatively owned utilities, civic organizations, and industrial consumers.

EDUCATION

December 1983	Master of Business Administration University of South Dakota Vermillion, South Dakota
May 1977	Bachelor of Science Degree in Economics South Dakota State University Brookings, South Dakota

EXPERT TESTIMONY

Among the issues that Mr. Peterson has addressed in testimony are the appropriate test year, construction work in progress, cash working capital lead/lag studies, rate base, excess capacity, revenues, expenses, depreciation, income taxes, capital structure, rate of return, cost allocation, rate design, customer service charges, flexible rates, life-cycle analyses, cost tracking procedures, affiliate transactions, mergers, acquisitions and the consequences of industry restructuring. Mr. Peterson has presented testimony to the following regulatory bodies.

Alabama Public Service Commission
Arkansas Public Service Commission
California Public Utilities Commission
Colorado Public Utilities Commission
Connecticut Public Utilities Control Authority

Delaware Public Service Commission
Indiana Public Service Commission
Kansas State Corporation Commission
Maine Public Utilities Commission
Maryland Public Service Commission

Montana Public Service Commission
Nevada Public Service Commission
New Jersey Board of Public Utilities
New Mexico Public Service Commission
New York Dept. of Environmental Protection

New York Public Service Commission
Pennsylvania Public Utility Commission
South Dakota Public Utilities Commission
West Virginia Public Service Commission
Wyoming Public Service Commission

Delaware House of Representatives (Energy Subcommittee)
Federal Energy Regulatory Commission

In addition, Mr. Peterson has presented several utility training seminars, including the following:

Consolidated Tax Savings and Income Tax Normalization
Presented to Delaware Public Service Commission 2006

Public Utility Ratemaking Principles
Presented to Washington Utilities and Transportation Commission 2011

Electric Cost Allocation and Rate Design
Presented to Colorado Office of Consumer Counsel 2012

Public Utility Revenue Requirements
Presented to Delaware Public Service Commission 2012

Electric Cost Allocation and Rate Design
Presented to Delaware Public Service Commission 2013