BEFORE THE STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE RATES AND :
CHARGES OF JERSEY CENTRAL :
POWER AND LIGHT COMPANY : BPU Dkt. No.: ______________

CERTIFICATION OF ROBERT J. HENKES

ROBERT J. HENKES, of full age, hereby certifies:

Qualifications

1. My name is Robert J. Henkes and my business address is 7 Sunset Road, Old Greenwich, Connecticut, 06870. I am Principal and founder of Henkes Consulting, a financial consulting firm that specializes in utility regulation. I am submitting this affidavit on behalf of the New Jersey Division of Rate Counsel.

2. Prior to founding Henkes Consulting in 1999, I spent 20 years as a Principal of The Georgetown Consulting Group, Inc., performing the same type of regulatory consulting services that I am currently rendering through Henkes Consulting.

3. During the course of my regulatory work, I have prepared and presented numerous testimonies in regulatory proceedings involving electric, gas, telephone, water and wastewater utilities 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.

4. 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.

Introduction

5. Rate Counsel is concerned that, under its current base rates, Jersey Central Power & Light Company ("JCP&L" or the "Company") is earning a return in excess of what may be considered within the "zone of reasonableness," i.e., a return so high that the rates are not just and reasonable.

6. As a result, I was engaged by Rate Counsel to conduct a review of JCP&L's recent earnings. My review is based on the most recent financial and other relevant documents pertaining to JCP&L that are publicly available at this time. Specifically, I reviewed JCP&L's 2009 and 2010 FERC Form 1[1], as well as the BPU's Final Order (agenda date 7/25/03) and Phase II Order (agenda date 5/25/05), including the related Stipulations of Settlements, pertaining to JCP&L's most recent completed base rate case, BPU Docket No. ER02080506.

7. The results of my review are summarized on the attached Schedules RJH-1 through RJH-3. The earnings review data summarized on Schedules RJH-1 through RJH-3 reflect JCP&L's earnings status for calendar year 2010, the most recent 12-month period for which JCP&L-specific public financial information is available. It is important to note that these results are for <u>*JCP&L's total electric operations*</u>, including production, transmission and distribution operations. This is because it is not possible to determine, from the FERC Form 1 financial data, segregated earnings results for Distribution Delivery operations only. As will be discussed in more detail later on, it should also be noted that I have had to make certain estimates in my earnings review because actual information was not available, and these estimates may turn out to be less than fully accurate. However, even if there are some potential inaccuracies in the analysis results, I do not believe that the correction for these potential inaccuracies will change the overall conclusions of my earnings review.

<u>Review Summary</u>

8. My review indicates that JCP&L's actual 2010 return on rate base for its total electric operations amounts to 12.37% which is substantially in excess of JCP&L's adjusted BPU-authorized return on rate base of 8.75%, or JCP&L's more updated return on rate base requirement of 8.59%. The calculations in support of these return on rate base numbers are shown on the attached Schedule RJH-1.

9. JCP&L's actual 2010 return on rate base for its total electric operations of 12.37% is also substantially in excess of the "zone of reasonableness" when compared to the current BPU-authorized return on rate base rates of 8.21% for Public Service Electric & Gas Company; 8.21% for South Jersey Gas Company; 7.76% for New Jersey Natural Gas Company; and 7.64% for Elizabethtown Gas Company. JCP&L's actual 2010 return on its total electric operations is also in excess of the Board's overall allowed returns on the distribution operations of Rockland Electric Company, 8.21%, and Atlantic City Electric Company, 8.69%.

10. As will be explained in more detail in my discussion below of Schedule RJH-1, the potential current overearnings range for JCP&L's total electric operations is approximately $86 to $90 million which, on a tax-grossed up basis, is equivalent to a revenue requirement excess range of approximately $146 to $152 million.

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[1] I understand that, for New Jersey's electric utilities, the FERC Form 1 also serves as the Annual Report to the BPU.

Discussion of Schedules RJH-1, RJH-2, and RJH-3

Below, I will discuss Schedule RJH-1 through RJH-3 in reverse order.

Schedule RJH-3 – 2010 Net Operating Income

11, The information on Schedule RJH-3 shows the actual 2010 Net Utility Operating Income for JCP&L's total electric operations. This information is reported on page 114 of JCP&L's 2010 FERC Form 1. The financial data shown on Schedule RJH-3 represent the Company's actual per books Net Utility Operating Income that has not been adjusted for any annualization, normalization or BPU ratemaking adjustments.

12. As shown on Schedule RJH-3, line 13, JCP&L's unadjusted actual per books net operating income in calendar year 2010 for the total electric operations amounts to $294.716 million.

Schedule RJH-2 – 2010 Average Rate Base

13. The information on Schedule RJH-2 shows JCP&L's actual December 31, 2009, December 31, 2010 and Average 2010 rate base balances. The Average 2010 rate base balances in the third column of Schedule RJH-2 are determined by dividing the sum of the actual December 31, 2009 and actual December 31, 2010 rate base balances by two.

14. The rate base components shown on Schedule RJH-2 reflect generally accepted rate base principles and are generally consistent with the rate base components approved by the Board in its Final Order (agenda date 7/25/03) regarding JCP&L's most recent base rate case, BPU Docket No. ER02080506, specifically on "Schedule Board-2" attached to the Final Order.

15. Footnotes (1) through (13) on Schedule RJH-2 show the source documentation for each of the reflected rate base components. As is evident from these footnotes, almost all of the source documentation comes from JCP&L's 2009 and 2010 FERC Form 1.

16. The following qualifications should be noted with regard to the rate base components shown on Schedule RJH-2:

- The Account 282 ADIT Property balances on line 5 may not be completely accurate, as I have reflected the entire balances reported in the FERC Form 1, however, these balance may include ADIT items that may not properly be treated as a rate base deduction for ratemaking purposes. There are not enough details available in the FERC Form 1 to make these distinctions.
- Schedule Board-2 attached to the Final Order in BPU Docket No. ER02080506 shows that the Board reduced rate base by certain net-of-tax operating reserves. I do not know what these operating reserves were, but have assumed them to be the

Company's Account 228.2 – Accumulated Provision for Injuries & Damages. See Schedule RJH-2, line 9 and footnote (8).

- The rate base balances for Materials and Supplies and Prepayments should really reflect the 13-month average balances for these accounts in 2010. However, since such 13-month average balances were not available, I have determined the average 2010 balances by averaging the actual 12/31/09 and 12/31/10 balances.
- There is no detailed lead/lag study available to determine the Company's current Cash Working Capital ("CWC") requirement. For that reason, I had no other choice then to approximate the Company's CWC requirement using the so-called "1/8th method" as a guidance. This method assumes that a utility's CWC requirement is equal to 1/8th of its total O&M expenses. As shown on Schedule RJH-3, line 4, JCP&L's 2010 O&M expenses amount to $2,070,000,000 and 1/8th of that would suggest a CWC requirement of $258.750 million. To be conservative, I increased this CWC estimate from $258.750 million to $350 million. This is shown on Schedule RJH-2, line 14. I have done so because in JCP&L's 2002 base rate case, Docket No. ER02080506, the Board approved a lead/lag study-determined CWC requirement of $241 million which may have grown considering that 8 years have passed between the 2002 test year in the last base rate case and calendar year 2010.
- In the Company's prior base rate case, BPU Docket No. ER02080506, the Board reduced JCP&L's rate base by approximately $37 million to reflect the tax benefits from the Company's participation in a consolidated income tax filing.[2] I have increased this to an estimated balance of $75 million to reflect the fact that 8 years worth of additional tax benefits have accumulated between 2002 and 2010.

17. Schedule RJH-2, line 17 shows that, with the qualification noted above, I have determined that the Company's total electric average 2010 rate base amounts to $2,382.751 million.

<u>Schedule RJH-1– 2010 Achieved Overall Rate Of Return And Associated Overearnings</u>

18. As shown on Schedule RJH-1, lines 1 through 3, dividing the 2010 Net Operating Income number of $294.716 million derived on Schedule RJH-3 into the average 2010 Rate Base of $2,382.751 million derived on Schedule RJH-2 produces an actual achieved overall rate of return rate of **<u>12.37%.</u>**

    This rate of return rate of 12.37% is substantially higher than the current BPU-authorized return on rate base rates of 8.21% for Public Service Electric & Gas Company; 8.21% for South Jersey Gas Company; 7.76% for New Jersey Natural Gas Company; and 7.64% for Elizabethtown Gas Company. JCP&L's actual 2010 return on its total electric operations is also in excess of the Board's allowed returns on the distribution operations of Rockland Electric Company, 8.21%, and Atlantic City Electric Company, 8.69%.

[2] This is shown on "Schedule Board-2", line16 attached to the Final Order in Docket No. ER02080506.

19. Schedule RJH-1, line 4 shows that JCP&L's currently authorized overall rate of return - as set by the Board in the Phase II Order of JCP&L's 2002 base rate case, Docket No. ER02080506 – is **8.50%**. In footnote (1) of Schedule RJH-1, I show the capital structure ratios (46% common equity and 54% preferred stock and long-term debt) and capital cost rates (9.75% ROE and 7.45% for preferred stock and long-term debt) underlying this BPU-authorized overall weighted rate of return of 8.50%.

20. On Schedule RJH-1, line 5 and footnote (2), I show that the BPU-authorized overall ROR of 8.50% in 2002 would increase to **8.75%** when one maintains the BPU-approved capital structure ratios of 46% common equity and 54% preferred and long-term debt with a cost rate of 7.43%, but replaces the ROE rate of 9.75% found reasonable by the Board in 2003 with an ROE rate of 10.30% recently used by the Board for the utilities under its jurisdiction.

21. On Schedule RJH-1, line 6 and footnote (3), I show that, if one assumes a more conservative equity/debt ratio of 55%/45%, an ROE rate of 10.30% and a reduced debt cost of 6.50%, the resultant overall rate of return requirement is **8.59%.** Thus, even if one assumes a conservative equity ratio of 55% with an ROE rate of 10.30%, but a lower debt cost rate of 6.50% (to reflect probable refinancings since 2002), this produces an overall rate of return requirement of 8.59%, which is even lower than the indicated overall rate of return requirement of 8.75% based on the overall ROR parameters authorized by the Board in 2002 with an updated ROE rate of 10.30%.

22. Schedule RJH-1, line 7 shows that the calculated 2010 achieved rate of return of 12.37% on line 3 is 3.62% in excess of JCP&L's BPU-authorized rate of return using the more updated ROE rate of 10.30%, resulting in the updated overall rate of return of 8.75% (line 5). I have referred to this as Scenario I.

23. Schedule RJH-1, line 8 shows that the calculated 2010 achieved rate of return of 12.37% on line 3 is 3.78% in excess of JCP&L's indicated overall rate of return requirement of 8.59% (line 6) based on the hypothetical capital structure ratio of 55% equity/45% debt, an ROE rate of 10.30% and an assumed debt rate of 6.50%. I have referred to this as Scenario II.

24. Schedule RJH-1, lines 9 and 10 show that the Scenario I excess rate of return earnings are $86.225 million which, on a tax-grossed up basis, indicates a revenue requirement excess of $145.773 million.

25. Schedule RJH-1, lines 11 and 12 show that the Scenario II excess rate of return earnings are $90.038 million which, on a tax-grossed up basis, indicates a revenue requirement excess of $152.218 million.

26. In summary, the results on Schedule RJH-1 indicate that JCP&L's total electric operations may currently be in a substantial overearnings position based on a comparison of the Company's actual 2010 earnings rate with JCP&L's adjusted BPU-authorized rate

of return, JCP&L's more updated rate of return requirement, and the current BPU-authorized rates of return of New Jersey's other electric and gas utilities.

I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

Robert J. Henkes

Dated: September 6, 2011

JERSEY CENTRAL POWER AND LIGHT COMPANY
2011 EARNINGS REVIEW OF TOTAL ELECTRIC OPERATIONS
2010 ACHIEVED OVERALL RATE OF RETURN AND ASSOCIATED OVEREARNINGS
$000's

1. 2010 Average Rate Base	$ 2,382,751	Sch. RJH-2	
2. 2010 Net Operating Income	294,716	Sch. RJH-3	
3. 2010 Achieved Overall Rate of Return (ROR)	12.37%		
4. JCP&L's Currently Authorized ROR, Including ROE Rate of 9.75%	8.50%	(1)	
5. JCP&L's Currently Authorized ROR, but with ROE Rate of 10.30%	8.75%	(2)	
6. JCP&L's ROR with More Conservative Capital Structure and Reduced Debt Cost Rate	8.59%	(3)	
7. Excess of 2010 Achieved ROR over Currently Authorized ROR with ROE Rate of 10.30% - Scenario I	3.62%	L3 - L5	
8. Excess of 2010 Achieved ROR over ROR with More Conservative Capital Structure and Reduced Debt Cost Rate - Scenario II	3.78%	L3 - L6	
9. Excess ROR Earnings in 2010 - Scenario I	$ 86,225	L1 x L7	
10. Scenario I Earnings Excess Grossed up for Income Taxes	$ 145,773	L9 x 1.6906	(4)
11. Excess ROR Earnings in 2010 - Scenario II	$ 90,038	L1 x L8	
12. Scenario II Earnings Excess Grossed up for Income Taxes	$ 152,218	L11 x 1.6906	

(1) Per BPU Decision and Order Adopting Stipulations of Settlements Approving Phase II Rate Increase and Resolving Motion and Cross Motion for Reconsideration, Docket No. ER02080506:

Common Equity (allowed in ER02080506)	46.00%	9.75%	4.49%
Preferred Stock and LT Debt (allowed in ER02080506)	54.00%	7.43%	4.01%
Total	100.00%		8.50%

(2) Per BPU Decision and Order in footnote (1) above, but with ROE increased to 10.3%:

Common Equity (with ROE rate changed to 10.3%)	46.00%	10.30%	4.74%
Preferred Stock and Long-term Debt	54.00%	7.43%	4.01%
Total	100.00%		8.75%

(3) Using hypothetical capital structure with increased equity ratio and estimated decreased debt cost (to reflect probable refinancings since 2002) - As shown below, this would still produce a lower ROR than the 8.75% in footnote (2):

Common Equity	55.00%	10.30%	5.67%
Preferred Stock and Long-term Debt	45.00%	6.50%	2.93%
Total	100.00%		8.59%

(4) Composite federal and state income tax rate = 40.85% = after-tax factor of 59.15%. Tax gross-up rate is 1/.5915 or 1.6906

JERSEY CENTRAL POWER AND LIGHT COMPANY
2011 EARNINGS REVIEW OF TOTAL ELECTRIC OPERATIONS
2010 AVERAGE RATE BASE
$000's

	12/31/2010 Balance (A)	12/31/2009 Balance (B)		Average 2010 Balance [A+B]/2
1. Electric Utility Plant in Service	$ 4,549,026	$ 4,449,796	(1)	$ 4,499,411
2. Plant Held for Future Use	13,716	13,682	(2)	13,699
3. Total Electric Utility Plant	4,562,742	4,463,478		4,513,110
Deductions:				
4. Accumulated Depreciation	(1,807,091)	(1,767,819)	(3)	(1,787,455)
5. ADIT Property - Account 282	(649,959)	(579,047)	(4)	(614,503)
6. Customer Advances (Net of Tax)	(10,573)	(8,810)	(5)	(9,692)
7. Customer Deposits	(23,385)	(23,636)	(6)	(23,511)
8. Unamortized Loss/ (Gain) on Reacquired Debt (Net of Tax)	12,173	13,148	(7)	12,661
9. Operating Reserves (Net of Tax)	(5,525)	(5,350)	(8)	(5,438)
10. Contributions in Aid of Construction	(3,023)	(1,362)	(9)	(2,193)
11. Total Net Deductions	(2,487,383)	(2,372,876)		(2,430,130)
Additions:				
12. Materials & Supplies	-	2,059	(10)	1,030
13. Prepayments	11,898	35,583	(11)	23,741
14. Cash Working Capital	350,000	350,000	(12)	350,000
15. Total Additions	361,898	387,642		374,770
16. Consolidated Tax Savings	(75,000)	(75,000)	(13)	(75,000)
17. Total Net Rate Base	$ 2,362,257	$ 2,403,244		$ 2,382,751

(1) 2010 and 2009 FERC Forms 1, page 200, line 8
(2) 2010 and 2009 FERC Forms 1, page 200, line 9
(3) 2010 FERC Form 1, page 110, line 5.
(4) 2010 FERC Form 1, page 113, line 63.
(5) 2010 FERC Form 1, page 113, line 56:
- 2010: $17,875,000 x .5919 (after-tax factor) = $10,573,000
- 2009: $14,895,000 x .5919 (after-tax factor) = $8,810,000

(6) 2010 FERC Form 1, page 112, line 41.
(7) 2010 FERC Form 1, page 111, line 81 and page 113, line 61:
- 2010: ($21,870,000 - $1,290,000) x .5919 (after-tax factor) = $12,173,000
- 2009: ($23,950,000 - $1,721,000) x .5919 (after-tax factor) = $13,148,000

(8) 2010 FERC Form 1, page 112, line 28 (Acct 228.2 - Accumulated Provision for Injuries & Damages):
- 2010: $9,341,000 x .5919 (after-tax factor) = $5,525000
- 2009: $9,044,000 x .5919 (after-tax factor) = $5,350,0000

(9) 2010 FERC Form 1, page 269, line 16.
(10) 2010 FERC Form 1, page 110, lines 45 and 48
(11) 2010 FERC Form 1, page 111, line 57.
(12) Based on 1/8th of 2010 O&M expenses: $2,070,059,000 / 8 = $258,757,000, further increased to $350,000,000
(13) BPU-ordered CIT rate base adjustment in Dkt. ER02080506 was $40 million (2002). Estimated balance in 2010 is $75 million

Sch. RJH-3

JERSEY CENTRAL POWER AND LIGHT COMPANY
2011 EARNINGS REVIEW OF TOTAL ELECTRIC OPERATIONS
2010 NET OPERATING INCOME
$000's

	Actual 2010
Operating Revenues:	
1. Sales of Electricity Revenues	$ 2,916,958
2. Other Operating Revenues	56,628
3. Total Operating Revenues	2,973,586
Operating Expenses:	
4. O&M Expenses	2,070,059
5. Depreciation Expenses	123,237
6. Amortization Expenses	5,602
7. Regulatory Debits (Acct. 407.3)	300,150
8. Regulatory Credits (Acct. 407.4)	(35,099)
9. Taxes Other Than Income Taxes	65,401
10. Total Operating Expenses	2,529,350
11. Operating Income Before Income Taxes	444,236
12. Income Taxes	149,520
13. Net Utility Operating Income	$ 294,716

SOURCE: 2010 FERC Form 1, page 114