BEFORE THE STATE OF NEW JERSEY
OFFICE OF ADMINISTRATIVE LAW
BOARD OF PUBLIC UTILITIES

I/M/O THE JOINT PETITION OF PUBLIC	**)**	
SERVICE ELECTRIC AND GAS COMPANY	**)**	**BPU DKT. NO. EM05020106**
AND EXELON CORPORATION FOR	**)**	**OAL DKT. NO.PUC-1874-05**
APPROVAL OF A CHANGE IN CONTROL	**)**	
OF PUBLIC SERVICE ELECTRIC AND GAS	**)**	
COMPANY AND RELATED AUTHORIZATIONS	**)**	

SURREBUTTAL TESTIMONY OF ROBERT J. HENKES ON BEHALF OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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Q. PLEASE 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. ARE YOU THE SAME ROBERT J. HENKES WHO SUBMITTED DIRECT TESTIMONY ON NOVEMBER 28, 2005?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF THIS SURREBUTTAL TESTIMONY?

A. The purpose of this surrebuttal testimony is to respond to (1) the rebuttal testimony of the Joint Petitioners' witness William Arndt concerning the allocation of net merger savings between PSE&G's electric and gas businesses; and (2) the rebuttal testimony of the Joint Petitioners' witness Kathryn Houtsma concerning Regulatory Asset versus deferred accounting treatment for certain pension and OPEB costs recognized under the proposed purchase method of accounting.

Q. DO YOU AGREE WITH MR. ARNDT'S STATEMENT IN HIS REBUTTAL TESTIMONY AT PAGE 35 THAT YOUR RECOMMENDED ALLOCATION BASED ON A HISTORIC NON-FUEL O&M ALLOCATOR OF 58.5% ELECTRIC TO 41.5% GAS IS FACTUALLY INCORRECT?

A. No, I do not. Throughout his synergy study, all merger savings and associated costs to achieve that could not be directly assigned were allocated by Mr. Arndt using allocation ratios based on historical non-fuel O&M costs. As discussed on pages 45 through 50 of

Mr. Arndt's direct testimony, this historical non-fuel O&M allocation method was used in the allocation process for each "Tier" (I through IV) in the study, including Tier III in which the net merger savings for PSE&G's electric and gas businesses were allocated. In response to data request RAR-ALLOC-3(b), in which Mr. Arndt was asked to provide a copy of the study and all other relevant source documentation in support of his assumed 62% electric and 38% gas historic non-fuel O&M expense ratios for the allocation of net merger savings between PSE&G's electric and gas businesses, Mr. Arndt stated the following:

> Attached is a worksheet which shows the summary of net non-fuel O&M expenses and allocation ratios for the year 2003, which is the historical year used in the synergy study.

The attached worksheet showed the following annual electric and gas allocators based on PSE&G's historic non-fuel O&M expense ratios:

	Electric	Gas
2000	76.5%	23.5%
2001	81.3%	18.7%
2002	69.9%	30.1%
2003	61.4%	38.6%
2004	58.5%	41.5%

Based on this information, I have recommended that the electric and gas allocation ratios to be used for purposes of allocating net merger savings to PSE&G's electric and gas businesses should be 58.5%/41.5%. I made this recommendation because the 2004 non-fuel O&M expense ratios are the most recent ratios available at this time.

Subsequently, Mr. Arndt submitted an updated response to RAR-ALLOC-3 in which he showed the same historic non-fuel O&M expense ratios, but adjusted to remove the "amortization of various fuel clauses that were not deleted from the total O&M costs." This updated RAR-ALLOC-3 response indicated adjusted non-fuel electric/gas O&M ratios of 62.1%/37.9% for the year 2004. Apparently, Mr. Arndt is now relying on this updated information to justify his use of the 62%/38% electric/gas allocation ratios for the Tier III net merger savings allocation between PSE&G's electric and gas businesses.

Based on my review of this updated RAR-ALLOC-3 response, I concluded that the adjusted historic non-fuel electric/gas O&M ratios presented in this updated response should not be relied upon in the determination of the appropriate electric/gas allocation ratios for the Tier III net merger savings allocation between PSE&G's electric and gas businesses. There are several reasons for that. First, while Mr. Arndt states that the adjustments to the historic non-fuel O&M ratios involve the removal of "amortizations of various fuel clauses that were not deleted from the total O&M costs," this is incorrect. As is clearly shown on page 2 of the updated response to RAR-ALLOC-3, most of the adjustments made by Mr. Arndt involve non-fuel MTC, DSM and SBC-related O&M expense adjustments. Second, it is my understanding that the historic non-fuel O&M expense ratios used by Mr. Arndt in allocating Tier I, II, III (for regulated PECO) and IV net merger savings are based on "pure," unadjusted non-fuel O&M expenses. I believe it is inconsistent and inappropriate to use adjusted non-fuel O&M expense ratios for PSE&G's Tier III net merger savings allocations while using "pure" unadjusted non-fuel O&M expense ratios for net merger savings allocations in all other areas of Mr. Arndt's synergy study. Finally, I find it curious that Mr. Arndt first stated that the electric/gas historic non-fuel O&M expense ratios used by him for the allocation of net merger savings between

PSE&G's electric and gas businesses are based on the unadjusted non-fuel O&M ratios for the year 2003, "the historical year used in the synergy study,"[1] but then subsequently argued that these ratios should be based on adjusted non-fuel O&M expense data for the year 2004.

Q. COULD YOU COMMENT ON THE STATEMENTS MADE BY MS. HOUTSMA ON PAGE 11 OF HER REBUTTAL TESTIMONY REGARDING YOUR RECOMMENDATION TO USE DEFERRAL ACCOUNTING RATHER THAN THE CREATION OF A REGULATORY ASSET FOR THE PENSION AND OTHER POST-EMPLOYMENT BENEFIT COSTS RESULTING FROM THE FAIR MARKET VALUATION UNDER THE PROPOSED PURCHASE METHOD OF ACCOUNTING?

A. Yes. As described by Ms. Houtsma, starting on line 16 of page 11 of her rebuttal testimony, the Joint Petitioners are now requesting the Board to incorporate in its merger Order a proposed ordering paragraph presented in her Exhibit KMH-2 which will to "provide PSE&G the ability to defer these costs."[2] The proposed ordering paragraph in Exhibit KMH-2 contains virtually the same language as used by the Board in the NUI/AGL merger in permitting Elizabethtown Gas Company ("ETG"), NUI's utility subsidiary, to establish a *deferral account* for the pension and Other Post-Employment Benefit ("OPEB") costs (referred to in Ms. Houtsma's testimony as "PBOPs") resulting from the merger's fair market valuation rather than allowing ETG to create a Regulatory Asset for these costs.

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[1] Response to RAR-ALLOC-3(b).
[2] Houtsma rebuttal testimony, page 11, lines 23-24.

Thus, based on my reading of page 11, lines 11-24 of Ms. Houtsma's rebuttal testimony, it is my understanding that Ms. Houtsma agrees with my recommended deferral accounting approach as long as the Board incorporates in its eventual merger Order the ordering paragraph provided in rebuttal Exhibit KMH-2. If this understanding is not correct, then I would continue to urge the Board to use deferral accounting rather than creating a Regulatory Asset for the pension and OPEB costs resulting from the fair market valuation under the proposed purchase method of accounting, similar to the approach the Board followed in its order approving the NUI/AGL merger. This deferral accounting approach should be accompanied by a Board ordering paragraph such as the one presented in Exhibit KMH-2.

Q. DO YOU HAVE ANY ADDITIONAL COMMENTS REGARDING MS. HOUTSMA'S REBUTTAL TESTIMONY?

A. Yes. Ms. Houtsma's rebuttal testimony only addresses the Company's (apparently) newly proposed deferred accounting approach for the pension and OPEB costs resulting from the fair market valuation and does not mention whether the Company is now proposing a similar deferral accounting approach for the third-party debt and BGS/BGSS costs resulting from the fair market valuation under the purchase method of accounting. As I recommended in my direct testimony, the Board should use the same type of deferral accounting approach for the third-party debt and BGS/BGSS costs resulting from the fair market valuation as for the previously described pension and OPEB costs. This recommended deferral accounting approach should also be accompanied by a Board ordering paragraph structured along the same lines as the one presented in Exhibit KMH-2 concerning the pension and OPEB costs.

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

A. Yes, it does.