March 19, 2004

VIA HAND DELIVERY

The Honorable Kristi Izzo, Secretary
New Jersey Board of Public Utilities
Two Gateway Center
Newark, New Jersey 07102

RE: I/M/O Regulations of Extensions of Service;
Proposed Amendments: *N.J.A.C.* 14:3-1.1 and 6.2; 14:18-3.2, 6.2 and 11.2;
Proposed Repeals and New Rules: *N.J.A.C.* 14:3-8; 14:5-4; 14:10-3;
Proposed Repeals: *N.J.A.C.* 14:10-1.1 and 4
BPU Docket No. AX03120973
Proposal Number PRN 2004-34

Dear Secretary Izzo:

Please accept this letter in lieu of a more formal submission regarding the proposed amendments and new rules cited above, as a follow up to the remarks made by the Ratepayer Advocate at the March 2, 2004, public hearing held by the Board in the above-captioned matter. Enclosed are an original and ten copies; please date stamp one copy as "filed" and return it to the courier. Thank you for your consideration and attention to this matter.

Background

On January 20, 2004, the Board of Public Utilities ("BPU" or "Board") proposed changes to certain parts of the *N.J.A.C.* regarding the rules for extensions of utility service. The Board proposed: amendments to *N.J.A.C.* 14:311.1 and 6.2 and 14:18-3.2, 6.2 and 11.2; new rules, i.e. *N.J.A.C.* 14:3-10; repeals and new rules, i.e. *N.J.A.C.* 14:3-8, 14:5-4 and 14:10-3; and a repeal of *N.J.A.C.* 14:10-1.1 and 4, under the authority granted to the Board under *N.J.S.A.* 48:21-13, 48:2-16, 48:2-27, 48:2-23, 48:5A-36 and 48:5A-10. The stated goal of the proposed changes is "to ensure that the Board's programs reflect the Smart Growth policy goals of the State."[1] The amendments, repeals and new rules will govern the responsibility borne by regulated entities for the costs of certain investments in infrastructure, based on whether the development served by the infrastructure is in an area designated for growth under the State Development and Redevelopment Plan ("State Plan"). The proposed amendments and new rules replace various existing rules governing extensions of service with one consolidated, comprehensive set of new extension rules that reflect the State's Smart Growth policies for addressing the problems of "sprawl development." In addition, the new rules include a proposed Pilot Program for encouraging development in certain targeted areas, called the Targeted Revitalization Incentive Program ("TRIP"). The Board has provided a 60-day comment period regarding these proposed amendments, repeals and new rules, which expires on March 20, 2004.

On March 2, 2004, the Board held a public hearing on the proposed changes. Representatives of various regulated utility companies, trade associations and advocacy groups, including the Ratepayer Advocate, testified on the record at the hearing. All parties who testified indicated their intention to file more substantive, written comments by the end of the comment period.

Analysis and Recommendations

CHAPTER 3 – SUBCHAPTER 1: Definitions

This subchapter is proposed to be amended by the addition of two definitions to *N.J.A.C.* 14:3-1.1: "regulated entity" and "regulated service." The Ratepayer Advocate takes no exception to these proposed amendments.

CHAPTER 3 - SUBCHAPTER 6: Records

Various amendments are proposed to be made to *N.J.A.C.* 14:3-6.2 requiring each utility to keep detailed records of its expenditures on extensions to infrastructure. These records must be kept by Planning Area and must be made available to Board Staff for inspection upon request. These proposed amendments will allow the Board Staff to track how and where extensions are made in relation to areas designated for growth under the State Plan, and to determine if infrastructure investments comply with the proposed rules. The Ratepayer Advocate takes no exception to these proposed amendments but

[1] 36 *N.J.R.* 276, Summary.

notes that these records should be made available to the Ratepayer Advocate as well as Board Staff within a reasonable amount of time upon request.

CHAPTER 3 – SUBCHAPTER 8: Extensions To Provide Regulated Services

The Board proposes that Subchapter 8, Suggested Formulae for Extension of Utility Service, be repealed and replaced by proposed new Subchapter 8 rules and formulae. The Proposed new Subchapter 8 is designed to change the regulatory landscape so as to reduce incentives to development in areas not designated for growth under the State Plan, and to encourage development in designated growth areas. The new Subchapter 8 sets forth differing cost requirements and responsibilities for where and when a utility may bear the cost of constructing an extension. These cost requirements and responsibilities differ depending on whether the customer served by the extension is located in an area not designated for growth, a designated growth area, or a Smart Growth Infrastructure Incentive Program (SGIIP) area[2]:

- Extensions in Areas Not Designated for Growth (see *N.J.A.C.* 14:3-8.6)

  For extensions in areas not designated for growth, the proposed rules phase out, over a 3-year period, the utility's authority to pay for or contribute to the cost of extensions. This 3-year phase-out period will start with the effective date of this proposed rulemaking and end sometime in 2007. During this 3-year phase-out period, the utility may choose to (1) not contribute to an extension, or (2) contribute in accordance with a phase-out scheme. After the 3-year phase-out period, the utility is prohibited from paying for or contributing financially to an extension. This also means that the utility can no longer claim the cost of this infrastructure for ratemaking purposes, thereby reducing the revenue requirement to the general ratepayer body of the utility. The new rules are, therefore, designed to eventually make the developer, business, or individual pick up the entire cost of construction of the necessary infrastructure to serve the development in the area not designated for growth. It places the entire financial burden for new utility lines serving new sprawl development on those who build the sprawl development, rather than on ratepayers and regulated entities. Thus, while the new rules will have a negative impact on the applicants for extensions of utility service for developments in areas not designated for growth, it will have a positive impact on the across-the-board ratepayers of the utility due to a reduced growth in the utility's rate base. For all of these reasons, the

[2] The new rules in Subchapter 8 do not apply to an extension covered by a Targeted Revitalization Incentive Program (TRIP), which is separately governed by new Subchapter 10, *N.J.A.C.* 14:3.10.

Ratepayer Advocate supports the proposed new Subchapter 8 new rules regarding extensions in areas not designated for growth.

- <u>Extensions in Designated Growth Areas (see *N.J.A.C.* 14:3-8.7)</u>

  For extensions in designated growth areas, the proposed rules generally provide that: (1) the utility bears the entire cost of the infrastructure or, under certain circumstances, may require a reduced level of deposits from applicants; or (2) the utility and applicant can come to an agreement on the costs distribution; or (3) the parties can use a cost sharing formula, either by petition to the BPU or without BPU intervention, that allows the applicant to receive deposit refunds from the utility in a much more accelerated fashion than is currently the case. For example, while the annual deposit refund from the utility to the customer is currently equal to about five (5) times the customer's annual revenues, under the proposed rules this annual refund amount is increased to ten (10) times the customer's annual revenues. The new rules for extensions in designated growth areas are, therefore, designed to ensure that applicants (developers, businesses, individuals) who build in designated growth areas will have to provide less (or no) money up front, while getting reimbursed for this upfront cost much faster than is the current practice. The new benefits accruing to the applicants of extensions in designated growth areas are essentially "funded" by – initially - the utility and – ultimately – the ratepayers. This is because the utility will end up with more rate base investment and lesser availability of Customer Advances (which are treated as rate base deductions). While the utility will initially bear the responsibility for these added costs, as soon as the Board allows these additional costs in rates, the ratepayers will ultimately be made responsible. Nevertheless, the Ratepayer Advocate supports these proposed new rules regarding extensions in designated growth areas. We believe that these extra costs are well worth the societal benefits that would be derived from a migration back to inner cities and other older urban and suburban areas and away from sprawl development. However, these added costs will still be subject to regulatory scrutiny through the base rate case, and must be prudently incurred by the utility. Furthermore, the utility bears the burden of proof regarding the reasonableness, prudence, and accuracy of the claimed program costs. The Ratepayer Advocate's support of the proposed new rules should not be construed as a "blanket" approval of all of these costs for ratemaking purposes.

- <u>Extensions in Smart Growth Infrastructure Incentive Program ("SGIIP")Areas (see *N.J.A.C.* 14:3-8.12)</u>

  Proposed *N.J.A.C.* 14:3-8.12 establishes the Smart Growth Infrastructure Incentive Program (SGIIP) under which program a utility may either make a mutual agreement with the applicant for the distribution of the cost of an extension, or apply the suggested formula set forth at *N.J.A.C.* 14:3-8.10 or 8.11. However, if the suggested formulae are used under a SGIIP, the utility may either (1) refund the applicant's deposit at double the usual rate (at an annual rate of 20 times the customers revenues rather than the already accelerated annual rate of 10 times the customers' revenues); or (2) refund deposits received from applicants at a rate higher than twice the suggested formula (i.e., at a rate higher than 20 times the customers' revenues); or (3) not charge the applicant for infrastructure extensions. In addition, a SGIIP authorizes the utility to include the cost of necessary relocations of infrastructure, and expansions of infrastructure to serve new customers, in the costs covered by the SGIIP.

The rules give the following definition for what can be considered a SGIIP area:

> "A SGIIP area is any area in a municipality that is located in planning area 1 for which the municipality has obtained appropriate formal sanction from the Office of State Planning." (see top of 2nd column of 36 *N.J.R.* 288).

There does not appear to be a clear distinction between a SGIIP Area and a Designated Growth Area in the new rules. The new rules (see middle of 1st column of 36 *N.J.R.* 283) have the following definition for Designated Growth Area:

> "Designated Growth Area means an area depicted on the New Jersey State Planning Commission State Plan Policy Map as:
> 1. Planning Area 1 (PA-1);
> 2. Planning Area 2 (PA-2);
> 3. A designated center; or
> 4. An area identified for growth as a result of a final petition for either initial or advanced plan endorsement that has been approved by the State Planning Commission pursuant to *N.J.A.C.* 5:85-7"

Looking at the above two definitions, it would seem that the SGIIP Area definition (PA-1 area for which appropriate formal sanction has been obtained from the Office of State Planning) is already subsumed in the Designated Growth Area definition. The question is: what is the key distinction between areas that fall under Designated Growth areas (and which are therefore subject to the new rules and deposit refund formulas in *N.J.A.C.* 14:3-8.7) and areas that can be designated SGIIP areas (and which are therefore subject to the new rules and deposit refund formula in *N.J.A.C.* 14:3-8.12)? We believe that the proposed rules need more clarification regarding this distinction.

The Ratepayer Advocate notes the statement in the new rules that the "intent of this SGIIP program is to provide an additional incentive to develop in the areas of the State that have gone through the initial plan endorsement process, and that the utility would receive the benefit of new customers in areas that would not have been feasible to build in formerly." The utilities will undoubtedly argue that they will incur higher costs under this SGIIP program and that they should not be expected to absorb these higher costs until the point that these costs can be recognized in rates through their next base rate case. They may therefore argue for similar rate treatment of SGIIP program costs as the new rules have proposed for TRIP investment. While it may be true that the utilities would incur the higher costs associated with this program, they will also be provided with the opportunity to acquire incremental revenues from new customers that would otherwise not have been feasible. These incremental revenues would serve to offset the revenue requirement associated with the higher utility costs of the SGIIP program. This is an issue that will need to be explored further as empirical data accumulates during future utility base rate cases. As the Ratepayer Advocate will describe further below, the TRIP program needs to be narrowly tailored and include only those specific investments that further the purpose of the program.

CHAPTER 3 – SUBCHAPTER 10: Targeted Revitalization Infrastructure Program ("TRIP")

Subchapter 10 provides for a Targeted Revitalization Incentive Program ("TRIP") under which the Board will authorize infrastructure projects on a pilot basis.

The rules (in the 2nd column of 36 *N.J.R.* 281) state that "the TRIP pilot will provide significant economic benefit to regulated utilities and municipalities for which the Board approves participation, in that it will allow them to recover certain infrastructure costs in targeted growth areas through a special charge, outside of a rate case." Through the proposed TRIP rate mechanism, the utility will receive a guaranteed, dollar-for-dollar reconcilable return on, and return of, its TRIP-eligible investment with none of the usual regulatory lag that is experienced under the traditional base rate recovery mechanism.

The Ratepayer Advocate is generally opposed to "automatic adjustment clause" rate mechanisms similar to what is being proposed for the TRIP rate mechanism. Among the many reasons the Ratepayer Advocate adheres to this position, the most important reason is that such a mechanism represents inappropriate single-issue ratemaking. In addition, it is a well-known ratemaking principle that utilities are not *guaranteed* a return on investment in utility plant. Rather, the ratemaking process entitles the utility to no more than a *reasonable opportunity* to earn a fair rate of return. The automatic adjustment clause rate mechanism would enable the utility to earn a reconcilable, guaranteed rate of return on a portion of the Company's rate base. Clearly, this removes the risk the utility may face in its efforts to satisfy its investors desire for a return on their investment in TRIP-related plant. Another problem with automatic adjustment clauses is that they could allow utilities to earn in excess of their authorized rate of return. In summary, the Ratepayer Advocate is not in favor of automatic adjustment clauses. However, in order not to stand in the way of the State's Smart Growth program objectives, the Ratepayer Advocate would consider the a reasonable, narrowly defined TRIP rate mechanism, but only if certain minimum requirements are met. Most of these minimum requirements have been appropriately addressed in the proposed Subchapter 10 rules. Below, we will address each of the key Subchapter 10 rules of the proposed TRIP mechanism and provide comments where required.

***N.J.A.C.* 14:3-10.1**

This part of Subchapter 10 presents the purpose, scope and general provisions of the TRIP.

N.J.A.C. 14:3-10.1 (d) (1) and (2) sets forth the proposed rules regarding eligibility of costs recoverable under a TRIP. The rules only allow TRIP recovery for (1) investments within the TRIP area that have a service capacity no greater than is needed to serve the TRIP area, and/or (2) extensions designed, constructed and used solely to provide service to customers located in a TRIP area and have a service capacity no greater than is needed to serve the TRIP area. If the infrastructure so constructed is capable of serving additional customers beyond the TRIP area, the utility should only be able to use the TRIP to pay for the explicitly defined portion of infrastructure necessary to serve the TRIP area. Any infrastructure constructed beyond that necessary to serve the TRIP area would be covered by the standard provisions for extensions at *N.J.A.C.* 14:3-8. The Ratepayer Advocate has consistently argued that the type of investments to be included in the TRIP mechanism should be limited to infrastructure investment that is physically located within the pre-determined TRIP area in order to avoid potential misuse of the TRIP mechanism by the utilities. The Ratepayer Advocate takes no exception to the TRIP eligibility rules discussed above as long as the Board commits to ensure no misuse of the TRIP mechanism occurs.

Another important proposed rule which the Ratepayer Advocate supports is *N.J.A.C.* 14:3-10.1 (e) which states that the Board requires frequent and detailed monitoring and reporting of the TRIP-eligible construction and associated construction expenditures during all phases of the TRIP, in order to ensure prudent investment and compliance with the TRIP rules. After all, the utilities receive significant benefits from the proposed TRIP mechanism. In exchange, the utilities should be required to pass a rigorous "test" to justify TRIP recoverability for its investments.

***N.J.A.C.* 14:3-10.2**

This part of Subchapter 10 sets forth the various requirements of Board approval for a TRIP. All of the rules listed under *N.J.A.C.* 14:3-10.2 are consistent with, and almost fully reflect, the positions taken by the Ratepayer Advocate in terms of the minimum requirements for a TRIP mechanism that should be required by the Board under the assumption that a TRIP mechanism will be implemented. For example, the proposed rules require that (1) TRIP investments should only concern infrastructure necessary to serve *new* developments and must exclude infrastructure serving *existing* customers; (2) TRIP investment should only concern infrastructure that *expands* capacity and service to *increase* potential number of customers served and must exclude *replacement* and/or *rehabilitation* of infrastructure that is fully depreciated; (3) TRIP-eligible costs must exclude *promotional* and *regulatory* expenses and the *cost of removal* of existing fully depreciated infrastructure.

As properly addressed in the above-summarized proposed rules, it is important that the TRIP mechanism not be used by utilities to recover investments that the utilities would have had to make anyway absent the Smart Growth program in order to fulfill their franchise requirement of providing safe and adequate service, such as replacement and/or rehabilitation-related construction. The TRIP mechanism should also not be used to recover such operating expenses as promotional, legal, consultants and regulatory expenses. The utilities' base rates already include a certain level of annual allowances for such operating expenses and it would be difficult, if not impossible, to accurately determine to what extent the TRIP related promotional and regulatory expenses are truly incremental to the similar expenses that are already built into the utilities' base rates. Moreover, we believe that such TRIP related operating expenses should be the responsibility of the stockholders in exchange for the utilities receiving the benefits of a fully-reconcilable cost recovery mechanism outside the context of a base rate case proceeding that allows the utilities to recover their costs much sooner than under the traditional base rate recovery process. It should be recognized that there are no clearly identifiable benefits to the ratepayers flowing from the proposed TRIP mechanism, and the entire cost burden associated with the TRIP falls on the ratepayers. In other words, the ratepayers are expected to fund, on an accelerated and guaranteed basis, all of the TRIP-eligible costs through the use of a fully reconcilable "automatic adjustment clause" rate recovery mechanism. In addition, the Customer Advances (eventually reclassified to Contributions in Aid of Construction) that are normally contributed by developers will be waived under the proposed TRIP mechanism. This also means additional costs to be funded by the ratepayers because it will result in a higher rate base and higher depreciation expenses. The ratepayers should not be further burdened through the inclusion of various operating expenses in the TRIP. There should be a balancing of interests between ratepayers and shareholders and one way to accomplish this is to have the stockholders absorb any truly incremental operating expenses associated with the TRIP mechanism. This would be particularly appropriate in light of the facts that (a) the TRIP investments concern infrastructure for *new* customers and *expanded* capacity, (b) these TRIP investments can be expected to generate incremental margins; and (c) the proposed rules do not require that such incremental margins be used as an offset to the TRIP revenue requirement. Therefore, the utilities' stockholders will have the opportunity to retain any of such incremental margins. Such incremental margins could be used to offset any claimed TRIP related incremental operating expenses.

The intention of the rules is to limit the TRIP-eligible recoverable costs to the return *on* (financing costs) and the return *of* (depreciation) TRIP investment and that there should be no other costs in the TRIP. However, this intention is not entirely clear from the rules specified in *N.J.A.C.* 14:3-10.2 (d). These rules prohibit the inclusion of promotional expenses and "costs incurred in order to comply with requirements, for example, legal fees, or costs for preparation of petitions and filings…" The rules in *N.J.A.C.* 14:3-10.2 (d) should first have an all-encompassing statement that no operating costs whatsoever (whether promotional or regulatory or maintenance related, security related, etc.) should be included in the TRIP and then be more specific by giving the examples of promotional and regulatory expenses in *N.J.A.C.* 14:3-10.2 (d) (4) and (5).

Another important rule under *N.J.A.C.* 14:3-10.2 is that Board approval of any particular TRIP petition is only valid for a one-year period and is based on a utility-prepared and Board-reviewed one-year workplan containing detailed information regarding the type and location of TRIP infrastructure construction with detailed breakdowns of associated estimated costs. Thus, the TRIP is not proposed to be a permanent rate recovery mechanism the existence of which will have automatic "staying power" until challenged in a general base rate proceeding or through other (intermediate) Board action. Rather, the proposal is that the existence of the TRIP mechanism will only be approved by the Board on a year-by-year basis, and if the Board decides that a utility's TRIP no longer appropriately serves the State's Smart Growth objectives, it has the right to terminate the particular TRIP mechanism upon a 3-month notice period. This rule is consistent with the position of the Ratepayer Advocate.

***N.J.A.C.* 14:3-10.3**

As proposed, *N.J.A.C.* 14:3-10.3 sets forth the rules for annual TRIP adjustment petitions by the utilities. The proposed rules in *N.J.A.C.* 14:3-10.3 (a) through (d) are comprehensive, complete, and consistent with what the Ratepayer Advocate considers the minimum requirements for annual TRIP adjustment petitions.

***N.J.A.C.* 14:3-10.4**

N.J.A.C. 14:3-10.4 covers the rules for termination of a TRIP charge and termination of a TRIP pilot. As previously stated, the Ratepayer Advocate's position is that there should be a "sunset provision" for the TRIP mechanism. In other words, the TRIP rate recovery mechanism should be a temporary mechanism (hence the term "pilot program") that will sunset after a specified number of years and will not automatically revert into a permanent rate mechanism at the expiration of the pilot program. This concern is appropriately addressed in the proposed rules at *N.J.A.C.* 14:3-10.4 (d) where the rules state that if the Board has not adopted a permanent TRIP to replace the pilot within 5 years after initial approval of a utility's TRIP pilot, the utility must stop initiating infrastructure investments under the TRIP, and the Ratepayer Advocate supports those proposed rules. The Ratepayer Advocate also agrees with the proposed rules in *N.J.A.C.* 14:3-10.4 (a) (1) and (2) that the TRIP charge should cease at the earlier of the times that (1) the infrastructure covered by the TRIP charge is fully depreciated; or (2) at the conclusion of the next rate case for the particular utility. However, the rules in *N.J.A.C.* 14:3-10.4 (a) may not be as complete as the Board intended, and should be examined in light of the subsequent rule in *N.J.A.C.* 14:3-10.5 (d) (3) requiring that "The TRIP charge shall not allow a regulated entity to earn in excess of its allowed return on common equity…" The Ratepayer Advocate questions whether it is the intention of the rules that the TRIP charge cease at the time that it is determined that the TRIP charge has caused the utility to over-earn, or do the rules envision that any intermittent over-earnings be accrued during the particular TRIP period and then credited against the TRIP charge for the next TRIP period? If the rules envision the first alternative treatment (cessation of

TRIP charge) then this potential TRIP termination clause should also be included in *N.J.A.C.* 14:3-10.4 (a).

The Ratepayer Advocate respectfully suggests that the wording in *N.J.A.C.* 14:3-10.4 (c) is incomplete, and to fully reflect the apparent intent of the Board in that subsection, the sentence should read as follows: "(c) If the Board finds at any time that a regulated entity is not in compliance with the TRIP as approved, or if development patterns, economic trends, or other trends relevant to the prudence of the planned and prospective development being served by infrastructure constructed under the TRIP *arise or are otherwise brought to the attention of the Board* (italics represent added text), the Board may cancel the TRIP approval upon three months notice to the regulated entity. The Ratepayer Advocate recommends that relevant trends should be examined as part of the Board's routine, regular review of the utility's TRIP program implementation and costs.

***N.J.A.C.* 14:3-10.5**

N.J.A.C. 14:3-10.5 covers the rules for the calculation of a TRIP charge as well as the limitations imposed on the TRIP charge. The proposed rules specify that the TRIP charge may only include (1) an appropriate *return on* eligible TRIP investments that have been offset by associated accumulated depreciation and accumulated deferred income taxes; and (2) an appropriate *return of* eligible TRIP investments in the form of depreciation expenses. Specifically, the rule in *N.J.A.C.* 14:3-10.5 (b) (1) states with regard to the rate of return requirement:

> (b) (1) A return on eligible TRIP investments, offset by accumulated depreciation and accumulated deferred income taxes, and adjusted for taxes. The return shall be set at the regulated entity's current cost of debt, adjusted for taxes. The current cost of debt shall be determined by the Board based on economic conditions prevailing during the Board's review of the petition for approval of the TRIP charge.

The requirement that the eligible TRIP investment be offset with associated accumulated depreciation and accumulated deferred income taxes in the calculation of the allowable rate of return component of the TRIP charge is consistent with, and fully reflects, the Ratepayer Advocate's position on this matter.

The same can be said for the proposed requirement that the rate of return in the TRIP charge be limited to the utility's cost of debt. Because the TRIP mechanism allows for dollar-for-dollar recovery of eligible TRIP investment through a reconcilable rate mechanism outside the context of a general rate case without any significant regulatory lag, the allowed rate of return should exclude a return on equity

("ROE"), i.e., there should be no "profit" element built into the return on investment requirement in the TRIP charge. The ROE cost should also be excluded from the overall TRIP return number in order to approximate some semblance of "cost sharing" between the ratepayers and the stockholders of the TRIP rate mechanism. Excluding a profit element from the TRIP mechanism is also consistent with the Board's past and present policy on other cost adjustment rate clauses.

Some questions become readily apparent when reading the above rule in *N.J.A.C.* 14:3-10.5 (b) (1). First, the rule should be more specific as to what exactly is meant by the term "adjusted for taxes." This sentence should mean that in determining the TRIP charge, the tax benefits from the tax deductibility of the cost of debt must be taken into account. However, since the proposed rate of return is limited to the cost of debt (and excludes the non-tax deductible return elements of equity), the (somewhat confusing term) "adjusted for taxes" should not be included in the rules at all. A return on investment in the form of the cost of debt does not have to be adjusted for taxes just as the second TRIP charge component, depreciation expense, does not have to be adjusted for taxes.[3]

Second, the proposed rule in *N.J.A.C.* 14:3-10.5 (b) (1) should specify what *types of debt* should make up the overall rate of return to be used in the determination of the TRIP charge. The Board should clarify whether the debt intended to be used in this rule is solely Long Term Debt, solely Short Term Debt, or a combination of Long Term and Short Term Debt and, if the latter, what would be the suggested ratios for the Long Term and Short Term Debt capital components?

With regard to the depreciation expense component to be included in the TRIP charge, the rule in *N.J.A.C.* 14:3-10.5 (b) (2) states:

> (b) (2) Recovery of depreciation expense on the eligible investments, calculated using the regulated entity's current overall composite depreciation rate. The current overall composite depreciation rate shall be determined by the Board based on economic conditions prevailing during the Board's review of the petition for approval of the TRIP charge.

It is the Ratepayer Advocate's position that the depreciation expenses to be included in the TRIP charge should reflect current actual per books depreciation rates for the utility rather than some hypothetical "incentive depreciation rate." It would appear that this is also the intent of the rules in *N.J.A.C.* 14:3-10.5 (b) (2) which require that the depreciation expense in the TRIP charge be based on the utility's "current overall composite depreciation rate." However, the next sentence in *N.J.A.C.* 14:3-10.5 (b) (2) introduces some confusion on this matter. What is really meant by the statement that the

[3] For that reason, the rules in *N.J.A.C.* 14:3-10.5 (b) (2) do not include the requirement that the depreciation expenses included in the TRIP charge be "adjusted for taxes." For example, it is unclear whether the Board intends the cost of debt adjustment in the phrase "adjusted for taxes" means "after tax" or "net of tax."

overall composite depreciation rate should be "based on economic conditions prevailing during the Board's review of the petition for approval of the TRIP charge?" This should be further clarified in the proposed rules. Other required clarifications are whether the "overall composite depreciation rate" should be the dollar-weighted result of (1) the application of the then-current Board-approved depreciation rates to the utility's total plant in service balance during the most recent rate proceeding; or (2) the application of the then-current Board-approved depreciation rates to the utility's total plant in service balance during the particular TRIP period at issue; or (3) the application of the then-current Board-approved depreciation rates to the utility's specific TRIP-eligible plant investment types in the particular TRIP period at issue. It would appear that the best basis for the depreciation expense calculation in the TRIP is the overall composite depreciation rate determination in accordance with the method described under alternative (3) above.

The rules in *N.J.A.C.* 14:3-10.5 (c) require that the investments includable in the TRIP charge reflect actual expenditures made by the utility that can be verified by all parties prior to inclusion for recovery in the TRIP charge. This is appropriate and the Ratepayer Advocate supports this requirement.

N.J.A.C. 14:3-10.5 (d) (3) requires the following limitation:

> The TRIP charge shall not allow a regulated entity to earn in excess of its allowed return on common equity, as determined by the Board in the most recent base rate case for that regulated entity. Amounts not recoverable under this paragraph shall not be deferred.

The above requirement raises the following questions:

First, as discussed previously, there is the question as to whether it is the intention of the rules that the TRIP charge cease at the time that it is determined that the TRIP charge has caused the utility to over-earn, or whether the rules envision that any over-earnings be accrued during the particular TRIP period and then credited against the TRIP charge for the next TRIP period. Since it is really not feasible to perform any earnings test measurements and make any required TRIP charge changes *during* a TRIP period, we presume that the earnings test be performed either (a) on a retro-active basis at the *end* of a TRIP period at the same time as the TRIP charge reconciliation takes place; or (b) at the beginning of a TRIP period prior to the decision as to whether an appropriate TRIP charge should be in effect during the prospective TRIP period. The advantage of the retroactive earnings test under the approach described in (a) above is that it would be based on actual earnings data. If, under this approach, the earnings test indicates that the utility earned in excess of its authorized return on equity (measured with the inclusion of the TRIP recoverable costs and TRIP revenues) during the TRIP period, then the extent of over-earnings should be calculated and used as an offset against the TRIP charge for the next TRIP period. Alternatively, with this rule, the Board may have envisioned performing the earnings test at the *beginning* of a TRIP period as described in (b) above and not implement a TRIP charge if this earnings test indicates that the utility is projected to earn in excess of its authorized ROE (measured with the inclusion of the TRIP recoverable costs and TRIP revenues) during the TRIP period. While this approach has the advantage that there will be no TRIP charge during the TRIP period, the disadvantage is that the earnings test is solely based on projected earnings data for the TRIP period. We believe that these uncertainties need to be clarified in the rules.

A related question concerns the treatment of TRIP related over-earnings. If a utility TRIP program is over-earning, and is terminated, the Ratepayer Advocate recommends that the over-earnings be returned immediately to ratepayers. While the Ratepayer Advocate is not recommending that the Board try to tailor the rules to cover every conceivable circumstance, there should be mechanisms in place to protect ratepayers from paying any money to the utility without the appropriate review and regulatory oversight.

Second, the rules do not specify *how* the earnings test should be conducted and measured. For example, the ROE earnings measurement should not be based on simply dividing a utility's net income available for common stock, as reported for book purposes, into the utility's per books common stock balance during the TRIP period. Rather, the earnings test should reflect a meaningful test based on net income and common equity data that have been appropriately adjusted for Board ratemaking policies and adjustments.

N.J.A.C. 14:3-10.5 (d) (4) requires the following limitation:

> The TRIP charge shall not be set at a level that results in a charge to residential customers that is greater than one percent of the average bill of a typical residential customer for that regulated entity.

This proposed rule fully reflects the Ratepayer Advocate's position that there should be a TRIP rate cap. For example, in the NJNG TRIP filing discussions, we took the position that there should be a TRIP rate cap and that this cap should not exceed 2.75% of firm gas revenues. NJNG and most other utilities that have currently filed a TRIP petition have proposed the TRIP rate cap to be around 5% of their annual sales revenues.

The utilities will undoubtedly be vigorously arguing for a higher percentage than the proposed 1% and come up with illustrations showing why this limitation will render the TRIP mechanism ineffective. Indeed, several utility representatives made comments to that effect during the public hearing on March 2. For the program to be properly evaluated, the TRIP should be funded at the lowest level possible that still makes the TRIP goals achievable. Unless or until the utilities demonstrate that the proposed 1% cap substantially interferes with the goals of TRIP, the Board should proceed with caution on any type of guaranteed return program such as this, and adhere to the 1% cap during the TRIP pilot program.

Finally, we note that while the proposed rules in *N.J.A.C.* 14:3-10.5 prescribe what types of costs may be included and what limitations are applicable in the calculation of the TRIP charge, there is no mention made of the *support* requirement for the TRIP charge calculation. We believe that somewhere under *N.J.A.C.* 14:3-10.5 there ought to be a general requirement stating that the TRIP charge calculations should be supported with actual source documentation, detailed financial analyses, and other relevant information showing all assumptions and calculations. All of this supporting financial information should be presented in such a way as to allow intervening parties in TRIP proceedings to verify all TRIP charge claims, earnings test results, and TRIP rate cap. Furthermore, there should be adequate provision for notice to interested parties, including the Ratepayer Advocate. Having specific, detailed filing requirements for the TRIP petition request would help to reduce the time needed to review these filings.

Telecommunications and Cable Television

The impact of the proposed rule changes on the rates charged by telecommunications companies and cable television providers is unclear. The statement made by the representative of the New Jersey Cable and Telecommunications Association at the public hearing raised the argument that telecommunications companies are not subject to rate-base, rate-of-return regulation, and therefore do not recover certain specific costs covered by the rule changes through cost recovery tariffs. While this argument is largely true, there may be some unanticipated impacts on the way telecommunications and cable companies approach their business models under the new rules. Furthermore, cable service is primarily governed by Federal law, and the Form 1235 is used to apportion upgrade costs to and among customers. Upgrades are not the same as an extension of service into an unserved area within a franchise. The only cable rates regulated by the BPU (rates that are not regulated exclusively by the Federal Communications Commission) are the basic service tier rates, and equipment and installation costs. Cable companies seek adjustments to these rates by filing a Form 1240 or 1205. The Ratepayer Advocate would like to reserve its right to submit further comments on the specific impacts of the proposed rule changes on the rates charged by telecommunications and cable companies as the issue matures and those companies begin to submit rate filings that include (or do not include) changes in rates attributable to the proposed rule changes.

Conclusion

The Ratepayer Advocate commends the BPU for its commitment to protecting New Jersey's vital natural resources by proposing new rules, and changes to the existing rules, regarding extensions of utility infrastructure. Placing a greater burden on those seeking to build in areas that are environmentally sensitive is sound public policy. The provision of safe, adequate and proper utility service should be extended to anyone who seeks it, but it can and should be done in a responsible manner and at a cost that properly reflects the needs and values of all New Jersey residents. The proposed rule changes will change the regulatory landscape and reverse the incentives that now exist to develop in non-Smart Growth areas, and provide new incentives to encourage development and redevelopment in designated growth areas.

The Ratepayer Advocate thanks the Board for the opportunity to comment on the proposed amendments to the New Jersey Administrative Code. The Ratepayer Advocate looks forward to reviewing the comments of other interested parties, and continuing the productive dialogue initiated by the Board in this proceeding. The Ratepayer Advocate also looks forward to working with all stakeholders to ensure that all residents and businesses benefit from the enhanced quality of life that these rules should bring to New Jersey.

Respectfully submitted,
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RATEPAYER ADVOCATE

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