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

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| **I/M/O THE PETITION OF ATLANTIC CITY** | **)** |
| **ELECTRIC COMPANY d/b/a CONECTIV** | **) BPU DOCKET NO. ER02080510** |
| **POWER DELIVERY FOR APPROVAL OF** | **) OAL DOCKET NO. PUC 06917-02** |
| **AMENDMENTS TO ITS TARIFF TO** | **)** |
| **PROVIDE FOR AN INCREASE IN RATES** | **)** |
| **FOR ELECTRIC SERVICE** | **)** |

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# REPLY BRIEF OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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# I. INTRODUCTION

The Initial Briefs filed in this proceeding reflect the vast differences between the positions of Atlantic Electric Company ("Atlantic" or "Company") and the Ratepayer Advocate as representative of New Jersey's electric energy consumers. Atlantic is seeking to recover a Deferred Balance of $176.4 million to be amortized over four years and to establish rates for its Market Transition Charge ("MTC"), Net Non-Utility Generation Charge ("NNC") and Societal Benefits Charge ("SBC"). The Ratepayer Advocate contends that the Company's Deferral Balance is inflated and is based on unreasonable and imprudent expenditures which should be disallowed. The Ratepayer Advocate's recommended adjustments to the Company's proposal are set forth in detail in the Ratepayer Advocate's testimony and Initial Brief and will not be repeated here. This Reply Brief will highlight the differing approaches taken by the Company and the Ratepayer Advocate and will respond to selected issues raised in the Initial Briefs filed by the Company, the Staff of the Board of Public Utilities ("Staff"), the Staff's Auditors, and the New Jersey Large Energy Users Coalition ("NJLEUC")[1].

These are difficult times. The Electric Discount and Energy Competition Act ('EDECA"), *N.J.S.A.* 48:3-49 *et. seq.* mandated a new environment in the utility industry, with the restructuring of the electric utilities and competition in a deregulated marketplace. The Transition Period was a time when the utilities should have developed plans and programs to continue the rate reductions ordered by EDECA, or at least to minimize the burden of energy costs for New Jersey residents and businesses. Atlantic did just the opposite: The Company failed to develop a plan for purchasing supply and capacity; failed to utilize its owned generation facilities to minimize costs to consumers, failed to use hedging and other financial instruments to stabilize, and hopefully to minimize, costs, and failed to comply with Board Orders that would have provided guidance in these areas.

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[1] The parties' briefs will be denoted as follows:
Atlantic Initial Brief - PIB;
Ratepayer Advocate Initial Brief - RAIB;
Staff Initial Brief - SIB;
Auditors' Reports - AUD-1 and AUD-2;
NJLEUC Initial Brief - LEIB.

The determination of Your Honor and the Board in this matter should reflect a fair balance of the interests of the Company's shareholders, the rate paying public and the State as a whole. The Company's proposal reflects only the interests of its shareholders many of whom do not live in New Jersey, and may also include the interests of Atlantic's new out-of-state owners. The Ratepayer Advocate's proposal would allow the Company to recover only prudently incurred costs, which would reward shareholders to the extent that the Company acted prudently and reasonably, and would reduce the cost of the Deferred Balance to New Jersey's ratepayers to the extent that they did not act prudently.

## II. DEFERRAL ACCOUNTS

### A. The Board Should Accept the Ratepayer Advocate's Recommended Additional Credit to Ratepayers for Interest on LEAC over-recoveries in the Amount of $1,993,000.

In its Initial Brief Atlantic argued that the starting point of the Deferral Account should be the LEAC over-recovery balance (credit) of $50.002 million. PIB at 10. The Ratepayer Advocate has argued that the Company failed to properly calculate interest due to ratepayers from the LEAC over-recovery and that the starting credit balance was understated by $1,993,000. RAIB at 6. On Page 11 of its Initial Brief, the Company takes exception to Ms. Crane's testimony wherein she stated that allowance of interest expense on balances was "one-way." *Id*. The Company dismissed Ms. Crane's testimony "that is how the LEAC regulations work." T650; PIB at 11. However, Board policy has traditionally allowed ratepayers to receive interest on utility over-recoveries while rejecting utilities' receiving interest on their under-recoveries. RAIB at 7; *N.J.A.C* 14:3-14. The imposition of one-way interest is appropriate because the Company would have the incentive to take greater care in projecting commodity costs. Moreover, the utilities received a tremendous benefit (and tremendous risk reduction) when the Board granted them the right to implement LEACs in the first place, guaranteeing them dollar-for-dollar recovery of prudently incurred fuel costs.

The Company also argues that the extended time period over which the over-recovery developed was a factor which should have limited the over-recovered balance to the Company's requested amount. As the Ratepayer Advocate argued in its Initial Brief, the Board, not the Company, has the discretion to determine whether the true-up period should be extended beyond twelve months. RAIB at 8, *N.J.A.C.* 14:3-14 (a).

Atlantic also argues that the Ratepayer Advocate recommends that "the calculation of interest on the LEAC balances should be done using net-of-tax balances." PIB at 12. This is incorrect. The Ratepayer Advocate's net-of-tax adjustment has been applied only to the balances accrued during the transition period; the Ratepayer Advocate is not attempting to change the regulations under which the LEAC balances are calculated. RAIB at 21.

Staff also disputes the Company's interest calculation. In its Initial Brief, Staff proposes that during both the accrual and recovery periods, interest on Atlantic's deferred balances be accrued "net of tax". SIB at 42. Staff plans to apply this methodology, illustrated in Appendix SIB-1, to the recovery of Atlantic's deferred balance over the recovery period. *Id.*

Atlantic's initial LEAC credit to offset the Deferred Balance should be increased by $1,993,000. The beginning balance should be a total credit of $51,995,000.

**B. Atlantic's Actions Concerning BGS Were Imprudent, Resulting in Excessive Costs. The Board Should Adopt the Disallowances Recommended by the Ratepayer Advocate, Board Staff, and the NJLEUC.**

**1. Energy**

In its Initial Brief, the Company asserts that its deferral was created "due to the fact that the costs exceeded the revenues received by the Company to provide BGS." PIB at13. Such a deferral always happens when costs exceed revenues. Unfortunately, the Company fails to adequately explain why this situation developed. The Ratepayer Advocate, Board Staff, the Board's Auditors, and NJLEUC all have demonstrated, through testimony and documentation, that the reason for the Company's large deferral balance was the Company's flawed and imprudent BGS procurement procedures. RIB at 11; SIB at 41; LEIB at 16.

**2. Procurement**

### a. Energy and Capacity

On pages 13 through 16 of its Initial Brief, the Company itemizes each of its RFPs during the Transition Period, in an attempt to justify the Company's procurement procedures. However, this recitation merely highlights Atlantic's failure to develop an overall plan for BGS procurement. The Company issued four RFPs during the 1999 through 2001 period, each with totally different criteria, setting forth totally different procurement needs. *AUD-2* at VII-6, Ex. VII-4; RAIB at 14. It was only after the Board issued its Order reprimanding the Company for its failure to comply with the Final Order, declaring that the Company had come to the Board with "unclean hands", and stating that the Company was at risk of not recovering its procurement costs that the Company developed some semblance of a procurement strategy. *J-2* at 3. The Company states, possibly by way of apology, that "the Company may have started down the avenue a few months late, but it took the same avenue [Ms. Crane] identifies." PIB at 16. On the contrary, Atlantic took a very different road, one which led to massive excess energy costs, and should not be permitted to pass these costs through to ratepayers. Atlantic is projecting a total BGS deferral of $72,512,000 by the end of the transition period. P-12; Sched. HAC-10 updated, p. 2 of 2.

The Ratepayer Advocate viewed the Company's actions in a much broader context, one which demonstrates the confusion and lack of planning which characterized the Company's procurement policies. As Ratepayer Advocate witness Andrea Crane testified:

> What I'm looking at is over the period of the entire three years of the transition period... were your actions reasonable from beginning to the end... There are other choices that the Company could have made earlier on... They could have investigated having their affiliate provide service... They could have investigated parting contracts with their fossil fuel facilities, which perhaps would have sped up that regulatory process with regard to the approval of the fossil plants. They could have investigated further hedging opportunities.
>
> So they could have taken a host of actions that would have resulted in them [*sic*] being in a position by July and August of not facing a $78 million deferral.
>
> You didn't do that. So by the time you found yourself where you were going into the summer months...I don't have any problem with the decision that you made at that point to accept the bids that you did. Again, my disallowance is not focused on the specific RFP that you might have put out at one point in time and whether you made the right

> or wrong decision in response to that proposal, it's based on the totality of management's actions during this process.

[T:713-15 to 715-19; SIB at 40-41].

Staff concurs with the Ratepayer Advocate's position, stating that "on the whole, [the Company] could have done a much better job of BGS procurement than it did." SIB at 40-41. Staff further noted, "Of the options the Company did not avail itself of, Staff views not having negotiating a parting contract with the purchaser of its nuclear units to have been the one having the most impact." SIB at 40.

As a result of the Company's improper and imprudent procedures, Atlantic's BGS deferred balance should be reduced by $49,523,000 to $31,989,000. RAIB at 11-12. Staff agrees with the Ratepayer Advocate's third party purchase and excess capacity adjustments which were proposed in the Ratepayer Advocate's Initial Brief. SIB at 42.

### b. Excess Capacity

The Auditors recognized that during the RFP period from January 2000 through May 2000, the Company was a net seller of energy. RAIB at 21, T929:L25-T930:L5. The Company entered into bilateral contracts for 370 MW during the RFP, sold capacity in the PJM daily and monthly markets, and still had excess capacity for 4 of the 5 months between January and May. RAIB at 21; *AUD-2,* Exhibit VII-19; T929:L29-T930:L5; T930-L14.

Because of this accumulation of excess capacity, the Ratepayer Advocate recommended, as part of its BGS disallowance, $3.4 million in capacity costs for the period April 2001 through May 2002. The Company opposes this disallowance as arbitrary and capricious on the ground that Ms. Crane's proposal "involved no independent judgment of prudence or market prices with respect to either capacity or the sales of capacity." PIB at 20. The Company also objected to Ms. Crane's comparison of the average price of capacity purchased in the month with the average price of capacity sold in the month. PIB at-21. Contrary to the Company's allegation, Ms. Crane's comparison methodology is appropriate. It provides a quantifiable result which demonstrates the Company's imprudent activities. Moreover, as the Ratepayer Advocate has explained in its Initial Brief, the

Ratepayer Advocate and its witness, Ms. Crane, reviewed the Company's BGS program, energy and capacity, in its totality, not as to individual actions. T715:L13-19**.**

Staff also used a quantifiable methodology. In Appendices SIB-2 and SIB-3. Staff performed "benchmark" analyses to quantify the financial impact of the Company's performance. SIB at 41. Staff priced the Company's discretionary purchases during the first three years of the transition period at the estimated PJM price of energy and capacity. *Id.* In its brief, Staff shows that the actual cost of the Company's PJM and other contracts purchases during this period was $518.8 million, whereas the cost of purchasing the same amount of energy and capacity from PJM would have been $353.5 million - a difference of $165.3 million. SIB at 41. On a unit cost basis, the average actual cost of the Company's discretionary purchases was $72.38 per MWh, as compared to $49.32 per MWh if purchased from PJM. *Id.* at 42.

In addition, Staff compared the cost of the Company's discretionary purchases to the cost of such purchases incurred by JCP&L and Rockland Electric Company over the first three years of the transition period. Appendix SIB-3. As SIB-3 shows, the average cost of JCP&L's discretionary purchases was $49.58 per MWh and Rockland's was $55.68 per MWh. Staff concludes that "[i]f Atlantic had been able to achieve these rates, its procurement costs would have been lower by $163 million, and $122 million, respectively." *Id.* at 42. Staff then concluded, "Given this poor performance, Staff agrees with both the third party purchase and excess capacity adjustments proposed by the Ratepayer Advocate." *Id.*

Therefore, Your Honor and the Board should accept the Ratepayer Advocate's and Staff's recommendations and allow the Company to recover $31.989 million in BGS deferral costs, not the $72.512 million requested.

### 3. Atlantic's Claim for BGS Administrative Costs Should Be Disallowed.

Atlantic begins its argument regarding BGS administrative costs by stating that the existence of these costs "cannot reasonably be questioned." PIB at 25. The Ratepayer Advocate agrees that BGS administrative costs may exist; the issue is whether the Company should be permitted to collect them.

As established in the Ratepayer Advocate's Initial Brief, the Company has failed to prove that its claimed administrative expenses should be recovered. Accordingly, Your Honor and the Board should reject the Company's claim for BGS Administrative Costs.

The Board's Auditors have also recommended disallowances of certain costs. They found that the Company's first three RFPs were flawed; consequently, all administrative costs, including outside contractors and legal expenses, relating to these RFPs should be disallowed. RAIB at 23; *AUD-2* at VI-6. The Auditors further recommend that BGS merchant support costs included in the BGS without Board Order be disallowed. *AUD-2* at II-5; RAIB at 23.

The Company argues that the costs associated with the three RFPS filed with the Board and related activities should be recoverable. PIB at 27. However, given the dismal results of the Company's RFPs and procurement strategies, these ancillary costs should not be permitted.

**C. The Board Should Adopt the Ratepayer Advocate's Calculation for Atlantic's Market Transition Charge**

**1. New NUG Charge Deferrals**

This issue is addressed in Section III below.

**2. To Be Divested Generation**

**a. Cash Working Capital**

In its Initial Brief the Company argues that the Company's investors are entitled to earn an allowance for Cash Working Capital based on its "to-be-divested generation" revenue requirement. PIB at 29. The Company should not be permitted such an allowance. Atlantic already receives a return on these funds through the monthly interest it receives on its deferred balance. RAIB at 25. Moreover, the Company is permitted to collect interest at the rate of 13%, which is far above the current short-or long-term treasury rates. This interest rate is likely higher than the Company's cost of capital. Given that Atlantic has earned this high interest rate on these facilities, permitting the Company to collect additional moneys is a windfall for shareholders and yet another financial burden on Atlantic's ratepayers.

The Company's "taking" argument is without merit. The to-be-divested generation units are currently in rate base, and the Company is collecting the Board-Ordered rate of return on those facilities. Permitting the Company an allowance for cash working capital in addition to an extremely generous 13% pre-tax return is surely excessive and an unnecessary burden on ratepayers.

**b. The Company's 20% excess supply resulting from erroneous calculations regarding its BGS auction needs should be disapproved.**

Despite explicit plans to divest its fossil fuel units, Atlantic failed to do so in a reasonable and timely manner. Indeed, the Company displayed the same poor judgement in divesting its generation assets as it did in procuring BGS. For example, in the proposed sale of the "to-be-divested" units to NRG, the Company failed to negotiate parting contracts. LEIB at 26. The Ratepayer Advocate objected to the lack of a parting contract, and the Company subsequently amended the agreement with NRG. *Id.* However, the petition remained pending for a significant period of time as a result of a number of outstanding issues. One such issue was the failure of the Company to negotiate an agreement with NRG that properly reflected the full market value of the NJ fossil units because the allocation of the sale price of several in state and out of state units did not reflect a reasonable allocation and ultimately, the agreement fell through as it was "no longer appropriate due to the passage of time." *IMO Petition of ACE Regarding the Sale of Certain Fossil Generation Assets,* Docket No. EM00020106 (Order dated February 20, 2002), at 5. The Company's actions, or lack thereof, to reallocate the proceeds contributed to the delay and ultimate termination of the sale with NRG. It also resulted in Atlantic's having 20% more capacity than it needed.

At the time of the auction, the Company optimistically planned that its fossil generation units would have been sold by the time a significant amount of BGS was needed. Consequently, it purchased 80% of its projected supply through the auction. That supply, plus the 20% supply from the NUGs, and the 20% supply from the unsold generation units resulted in the Company's possessing 120% of its BGS needs. If the Company had been more responsive to Board encouragement and more effective in its planning, it would not have had excess capacity. Given the Company's counterproductive activities, the Company should not recover the costs of the extra 20% capacity. The Company alleges that it plans to sell its excess supply into the open market and credit revenues to customers. PIB at 35. However, given the Company's past history of selling under market and outside the PJM grid, it is uncertain if ratepayers will be made whole. Therefore, the Company's above market to-be-divested monthly generation costs should be excluded from the MTC.[2]

### 3. Your Honor and the The Board Should Disallow Atlantic's Transition-Related Costs as Imprudent.

The Ratepayer Advocate has recommended disallowance of 100% of Atlantic's transition costs on the ground that the Company failed to provide adequate documentation to prove that the costs were (1) related to the transition period; and (2) prudently incurred. RAIB at 29-30. Atlantic disputes Ms. Crane's testimony regarding the proposed disallowance, citing Company witness Morgan's litany of costs allegedly incurred by the Company for the transition to competition. PIB at 37. Mr. Morgan cited outside contractors, internal labor, enhancement of computer systems and other expenses. *Id.* Unfortunately, the Company failed to provide adequate documentation for all these costs. On Sept. 20, 2002, the Ratepayer Advocate sent discovery requesting a breakdown of the amount, the purpose, and the date of each expenditure. RAIB at 30; T644:L22-25. On December 23, the Company finally responded, providing a list of broad categories, but failing to provide specific data such as invoices or requests for proposals for obtaining contractors. Id.; T645:L6-10. As Ms. Crane stated in her testimony: "[y]ou can't ask for several million dollars of costs without providing some support for those dollars." *Id.*

T646:L11-13.

The Company believes it can ask for and recover those costs. The Company dismisses Ms.

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[2] It should be noted that on February 5, 2003 the Board solicited comments from the Company and the Ratepayer Advocate as to whether the ratemaking treatment accorded the B.L. England facility during the transition period should be prospectively modified. The Board specifically questioned whether the 13% pre-tax return allowed on plant investment could be justified. *I/M/O Atlantic City Electric Company-Rate Unbundling, Stranded Cost and Restructuring Filings,* Docket Nos. EO97070455-457 (Order issued February 5, 2003) ("SIB-4").

Crane's position, stating, "[d]isallowing millions of dollars of actual costs is not a reasonable penalty for an alleged failure to provide an adequate discovery response." PIB at 38. The Company does not seem to understand that the discovery process is not an unnecessary exercise, but is rather the basis of establishing whether a utility has demonstrated prudency in its actions. A failure to provide sufficient documentation to satisfy the prudency standard demands disallowance of the funds in question. Since the Company has failed to provide the necessary support for its transition expenses, those expenses should be disallowed.

Staff agrees with the Ratepayer Advocate that the Company has not sustained its burden of proof regarding transition costs. Staff contends that Atlantic has not fully met the reasonableness and verification tests set forth in the Board's Final Order for the recovery of the Company's claimed restructuring-related costs. SIB at 20. Regarding disallowance of the costs, Staff proposes additional review in Atlantic's recently filed base rate case. *Id.* This, in Staff's view, would allow the Company to provide additional support for its positions. *Id.* at 21. The Ratepayer Advocate disagrees with Staff's proposal. This amounts to a second bite at the apple. The Company has had more than sufficient time to provide documentation to support its position, but has failed to do so. Continuing this proceeding for additional review gives the Company another opportunity to justify unjustifiable costs, and does a significant disservice to the Company's ratepayers.

All transition costs should be disallowed by Your Honor and the Board in this proceeding.

**4. The Company failed to provide adequate documentation for its consolidated billing costs arising from the customer account services proceeding; those expenditures should therefore be disallowed.**

In its Initial Brief the Ratepayer Advocate recommended that the Company's consolidated billing costs should be disallowed because of Atlantic's failure to document those costs properly. RAIB at 31. In its brief the Company attempted to fill this void by citing to the rebuttal testimony of Company witness Herbert Chalk. PIB at 41. The Company alleges that Mr. Chalk's testimony adequately described the work done to comply with the Board Order and claims that this testimony was sufficient to establish that the costs were incurred and should be recoverable. *Id.* Atlantic states that "while separate invoices from the contractors whose bills comprise 99% of the costs could be pored over, that is not generally required as a precondition to inclusion in rates." PIB at 42. Testifying in rebuttal or writing in a brief that requested discoverable material is now available for the parties' review is not the kind of discovery and document production envisioned by the law. The Company should have provided the documentation during the discovery period at the time when these documents were requested. Contrary to the Company's claim, Atlantic has provided no documentation to support that it has incurred any Market Development Fund costs, nor has it provided testimony regarding the reasonableness of its consolidated billing costs. RAIB at 31.

The Ratepayer Advocate has opposed the Company's proposed four-year amortization of customer account service costs as contrary to Board Order. *Id* at 31. The Company has conceded that it will "acquiesce" to the Ratepayer Advocate's demand for a two-year amortization of these costs. PIB at 43. It is gracious of the Company to "acquiesce", particularly since the Board has ordered the Company to use a two-year recovery period. *J-3* at Attachment E, at 2(c).

Since no support for these costs has been provided, the Ratepayer Advocate recommends that no part of the $1.2 million in over-collected GR&FT funds be applied to this account and that the entire amount of consolidated billing costs be disallowed. RAIB at 32.

## III. NET NON-UTILITY GENERATION CHARGE ("NNC")

### A. All Costs of the Logan Arbitration Should Be Disallowed Pending Resolution of the Matter and Board Approval of Costs.

The Ratepayer Advocate has recommended eliminating all costs of the Logan arbitration because the matter is still unresolved. RAIB at 34. The Company has admitted that even after the arbitration there have been disputes that have prevented resolution of the matter. PIB at 47; Ex. P-8 at 23-24. In its Initial Brief the Company has ignored the critical element in the Ratepayer Advocate opposition – the fact that the case is not yet resolved and expenses are still accruing. The Board has frequently deferred review of litigation expenses until such matter is resolved. For example, New Jersey utilities recover costs from their remediation of contaminated manufactured gas plants through Remediation Adjustment Clauses. *I/M/O Petition of Elizabethtown Gas Company to Revise Its*

*Remediation Adjustment Clause Factor*, Docket No.GR00080548 (Order Adopting Stipulation and Initial Decision dated March 7, 2002), at 2; *I/M/O Petition of South Jersey Gas Company to Change the Level of Its Remediation Adjustment Clause*, Docket No GR97070551 and GR98080545 (Order Adopting Stipulation dated September 30, 1999) at 3; *I/M/O Petition of New Jersey Natural Gas Company for an Annual Review and Approval of Its LGAC, et seq.*, Docket Nos. GR9801014-17 (Order Adopting Initial Decision and Stipulation dated July 7, 1999) at 4. Each company has sued its insurance carriers for recovery under their policies. *Id.* Litigation in these cases continued for years. In each case the parties agreed to continue to accrue their litigation expenses until final resolution of the suits, at which time the Ratepayer Advocate and Board Staff would have the opportunity to review the expenses incurred. *Id.* The Board has approved this methodology for the companies. *Id.*

The Logan matter is similar to the RAC litigation cases. The Company has incurred expenses as a result of arbitration and wishes to recover those costs in this proceeding. However, since issues relating to the matter are still in dispute, there has been no final resolution of the case. Pursuant to the existing Board policy regarding ongoing litigation, the Ratepayer Advocate recommends that the $2,477,000 in Logan arbitration costs be eliminated from the Company's deferred balance. These costs should be considered for recovery only when the litigation is resolved and the parties can evaluate whether the costs were justified in light of the overall financial benefit to ratepayers. RAIB at 34-35.

Staff concurs with the Ratepayer Advocate's position. SIB at 43. Staff noted that the Company had included in the NNC the costs incurred in the ongoing Logan dispute. *Id.* It noted that the Company believes it may ultimately recover approximately $3 million; however, Staff supports the Ratepayer Advocate's recommendation that all Logan litigation costs be eliminated from the NNC balance and considered for recovery only when the litigation is resolved and its net effect on ratepayers can be assessed. SIB at 44.

## IV. SOCIETAL BENEFITS CHARGE ("SBC")

### A. Starting Balance

The Ratepayer Advocate does not dispute that the Company's starting SBC balance in 1999 was $9.071 million, nor does Board Staff. PIB at 48; SIB at 48. The Company has projected changes to that balance which will increase the total deferred SBC balance to $21.108 million. RAIB at 35. For the period from August 1999 through July 2003, the Company projected a cumulative Demand Side Management ("DSM") under-recovery deferral of $1.386 million, a cumulative deferred under-recovery of $7.798 million in the Uncollectible Account; and an over-recovery of $30.293 million in the Nuclear Decommissioning Deferral account. Sched. HACR-14 at 1-3.

The Ratepayer Advocate recommends that all deferred balances and credits attributable to the SBC and accrued during the transition period be netted out and the remaining SBC credit due to ratepayers because of the large nuclear decommissioning overcollection should be refunded to customers over one year starting August 1, 2003. *Id.* at 36.

The NJLEUC did not address any SBC issues in its Initial Brief, but reserved its right to address SBC issues in its reply. LEIB at 38.

### B. Universal Service Fund ("USF")

On March 20, 2003 the Board approved the establishment of a permanent USF to begin on July 1 of this year. *I/M/O the Establishment of a Universal Service Fund*, Docket No. EX00020091 (Agenda date March 2003, Item 2C). The first year of the USF program will be funded with an expected $30,000,000 plus administrative and start-up costs. Implementation of the USF awaits final Board Order.

In its Initial Brief the Company stated that it was waiting for the issuance of the USF Order to initiate a permanent USF program. PIB at 48. The Company further stated that it might revise its request based on the Board Order. *Id.* The Ratepayer Advocate reserves the right to comment on the Company's program, based on the terms of the Order.

Regardless of the permanent Board-ordered USF, there remains an interim USF program which must be funded for 2002. The Ratepayer Advocate recommends that the SBC deferred balance over-recovery be applied to the 2002 interim program USF balance, and that the permanent program be established pursuant to the Board's forthcoming Order in the USF matter.

RAIB at 36.

Board Staff concurs with the Ratepayer Advocate's recommendation to apply the over-recovery in the SBC deferral, including accrued interest, to the 2002 USF costs, thereby eliminating the need to establish a USF charge effective August 1, 2003. SIB at 45-46.

**C. New Jersey Clean Energy Program Funding**

The Company should comply with all provisions of the New Jersey Clean Energy Program (formerly "CRA") ordered by the Board. Currently the Company has projected a cumulative under-recovery deferral in this program in the sum of $1.386 million for the period from August 1999 through July 2003. RAIB at 37; Sched. HACR-14. As the Ratepayer Advocate recommended above and in its Initial Brief, this under-recovery should be included with the other SBC elements and the balance of the total over-recovery should be credited to ratepayers.

**D. Uncollectibles**

Atlantic has projected a deferred under-recovery of $7,798,000 in its Uncollectibles Account for the period from August 1999 through July 2003. PIB at 38; HACR-14. The Company states that this sum should be included in the total SBC. *Id.*

In its evaluation of the Company's Uncollectibles Account, the Board's Auditors found that the total in the account exceeded the required allowance of $9,906,357 by $1,417,412 based on the estimated low percentages of the month end aging accounts. SIB at 46-47. The Audit Report recommended that the deferred balance be reduced by $1,417,412, the amount determined to be excessive. SIB at 47. Both Staff and the Ratepayer Advocate recommend that the Auditors' adjustment be adopted and that the deferred balance be reduced by $1,417,412. SIB at 47; RAIB at

38.

### E. Consumer Education Costs

The Company argues that it should be permitted to recover CEP costs because the expenses were incurred pursuant to Board Order. PIB at 49. However, as the Ratepayer Advocate explained in its Initial Brief, the Company has failed to prove that its CEP expenditures were reasonable and prudent for Years 1, 2, and 3. RAIB at 40. Moreover, the Company has not attempted to provide support for its claim that the CEP costs are recoverable. In its Initial Brief the Company stated,"[t] he most important point to consider is that these were expenditures undertaken to provide consumer education as directed by the BPU." PIB at 49. Perhaps that is true, but, the Company must still meet the standards of reasonableness and prudence.

As part of the CEP program, Measures of Success were developed to determine the success of the statewide program. *Id.* However, the Measures of Success are only benchmarks for the success of that year's program, not a demonstration that the Company spent its CEP funds reasonably or prudently. Even if the Measures of Success were to be achieved, the Company must still demonstrate that the costs incurred were reasonable and prudent. *Id.*

In its June 25, 1999 CEP Order, the Board stated that it would look to "the extent these [expenditures] represent prudently incurred expenses." *I/M/O Consumer Education Program on Electric Rate Discounts and Energy Competition,* Docket No. EX99040242 (Order of Extension dated April 8, 2002) ("CEP Order") Reaching the Measure of Success for a particular year is not proof that the Company's expenditures that year were prudent. RAIB at 41. The Board further declared in the CEP Order that the "reasonableness and prudence of the cost levels incurred to achieve the Board approved measures of success will need to be assessed in reviewing the SBC filings." *Id.*

Staff's analysis of the Company's CEP costs is erroneous. Staff stated, without explanation, that it found the CEP costs "to be consistent with the intent of the Board's consumer education initiative and prudent". SIB at 49. However, it reserved its rights to modify its position after its review of the Auditors' Phase II Report which is to address CEP costs from August 12, 2002 through March 31,

2003. *Id.* The Ratepayer Advocate disagrees with Staff's conclusion. Atlantic did not provide sufficient documentation to prove prudence.

Atlantic has failed to prove reasonableness and prudence in its CEP expenses. Its CEP expenses should therefore be disallowed.

## V. METHOD OF COLLECTION OF DEFERRED COSTS

### SBC Credit

In its Initial Brief, the Company has expressed its desire to retain its SBC over-recovery rather than return it to ratepayers as the Ratepayer Advocate has recommended. The Company argues that because the Board is expanding some SBC programs, this will necessarily increase customers' rates. Atlantic further expresses concern that ratepayers will see a reduction in rates from the SBC credit and a subsequent increase resulting from expansion of SBC programs. There is no way to know what the Board will require of the utilities, so an SBC rate increase is purely speculative. More importantly, ratepayers will see an increase in rates on August 1, 2003; application of the SBC overrecovery to SBC rates will mitigate this imminent increase.

## VI. THE COMPANY HAS NOT PRESENTED ANY ARGUMENT WHICH SERIOUSLY REFUTES THE RATEPAYER ADVOCATE'S INTEREST AND TIMEFRAME RECOMMENDATIONS FOR DEFERRED BALANCE RECOVERY AND, THEREFORE, THE RECOMMENDATIONS SHOULD BE ADOPTED.

As set forth in the testimony of its witness, Mr. James Rothschild, and in its Initial Brief, the Ratepayer Advocate recommended a ten-year amortization period for the Company's deferred balance, with interest fixed at the seven-year treasury rate.[3] *RA-18*; RAIB, pp. 50-54. In its Initial Brief, the Company did not present any convincing argument to undermine the Ratepayer Advocate's recommendation, as demonstrated below.

At its agenda meeting on March 20, 2003, the Board recalled several issues related to the securitization and amortization of deferred balances. The Board's action was memorialized in a letter dated March 25, 2003 from Board Secretary Kristi Izzo ("Secretary's Letter"). The letter recalled "the issue of how much of the prudently incurred deferred balances should be securitized and how much should be amortized, what is the appropriate length of the amortization and the interest rate." Secretary's Letter, p. 1. The Secretary's Letter also recalled the issue of "whether all or part of the prudently incurred deferred balances are legally eligible for securitization under EDECA." *Id*. However, the Secretary's Letter also provided that "[t]o the extent that the parties have offered opinions on the setting of transitional amortization and interest rates in their cases, those portions of their briefs will be reserved to the Board and decided by the Board as part of their final rate Order." *Id*., p. 2. The Ratepayer Advocate, the Company, and intervenor NJLEUC addressed the amortization and interest issues in their Initial Briefs. *See* RAIB, pp. 50-54; PIB, pp. 50-54; and LEIB, pp. 39-44. So as not to prejudice its position, the Ratepayer Advocate will address the Initial Briefs filed by the other parties on these issues. The Ratepayer Advocate also wishes to reserve its right to augment and supplement its briefs in any future proceedings on these issues before the Board. Atlantic and the NJLEUC briefly addressed in their Initial Briefs the issue of whether prudently incurred deferred

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[3] Seven-year treasury rate shown in the Federal Reserve Statistical Release on or closest to August 1, plus 60 basis points.

balances are eligible for securitization, the Ratepayer Advocate reserves it right to address this issue in submissions to the Board when this issue is considered, pursuant to the Secretary's Letter.

### A. Amortization Period

In contrast to the Ratepayer Advocate's ten-year amortization recommendation, the Company argues for the use of a four-year amortization period. RAIB,pp. 50-52; PIB, pp. 50-51. While the Company acknowledged the impact of a shorter amortization period on its customers, the Company cites the "financial risks" borne by the Company as one of the balancing factors weighing against using a ten-year amortization period. PIB, p. 50. However, the Company failed to quantify its claimed financial risks. In contrast, the rate increase mitigation benefits of a ten-year amortization period are measurable and provide concrete benefits to ratepayers.

As noted by Ratepayer Advocate witness Mr. James Rothschild at an evidentiary hearing, the Company did not provide balance sheets, cash flow statements, and coverage ratio information in support of its contention that an extended recovery period would impact its borrowing capacity. T839:L2-11. Moreover, the Company's financial hardship claims fail to consider the change from negative cash flow when the deferred balances grew during the Transition Period, to positive cash flow when the deferred balances are recovered in the post Transition Period. T838:L17-23.

In contrast to the Company's vague claims about financial hardships, the use of a ten-year amortization period will bring concrete rate relief to its ratepayers. Mr. Rothschild demonstrated that extending the amortization period from four-years to 10-years produced a steep drop in rates. *R-18*, Table 2, pp. 12-13. Mr. Rothschild found that using a 10-year amortization period instead of a four-year period would significantly lower the annual charge to recover the deferred balance, from 0.5770 cents per kWh to 0.2603 cents per kWh, using the Company's filed deferred balance estimate of $176,777,198 for purposes of illustration. *Id.*, p. 9. The 10-year amortization period recommended by Mr. Rothschild results in significant savings for Atlantic's ratepayers.

The Ratepayer Advocate's recommended ten-year amortization period was supported by the

NJLEUC. LEIB, pp. 39-41. The NJLEUC's witness, Mr. Gorman, cited the impact of lower charges for Atlantic's business and residential customers, especially in the current economic downturn. LEIB, p. 40 citing *NJLEUC-1*, p. 7.

One of the objections raised by the Company to the ten-year amortization proposal was the need for nine future true-up proceedings, instead of three. PIB, pp. 50-51. The Ratepayer Advocate submits that even if one were to consider the administrative burden of such proceedings, in light of the size of the Company's claimed deferred balance and its impact on ratepayers, the Company's concern about nine true-up proceedings is without merit. Furthermore, the Company's concerns about rate "see sawing"should be dismissed. PIB, p. 51. Assuming a*rguend*o that the Company's concerns materialize, the Board certainly has the power to address them in subsequent true-up proceedings.

Finally, as Mr. Rothschild testified, amortization of the deferred balance over ten-years is a less costly alternative than securitization over fifteen years. RA-18, p. 6. Mr. Rothschild calculated that securitization over fifteen years would cost ratepayers $6.95 million more than amortization over a ten-year period, using Mr. Rothschild's parameters. *Id*., p. 14.

**B. Interest Rate**

The Ratepayer Advocate recommends the use of a fixed interest rate for the post Transition Period. RAIB, pp. 52-53. The Company's arguments for resetting the interest rate applied to the deferred balance are unconvincing. PIB, pp. 52-53.

The Company claims that there is nothing in the record to support the claim that the deferred balance will be financed at the beginning of the recovery period using any particular financing vehicle. PIB, p. 52. However, while the deferred balance might not be financed using any single financial vehicle, it is incredulous to suggest that the balance will not be financed somehow at the beginning of the recovery period. The Company's concerns about rates changing every year whether or not a fixed interest is used and the merits of whether a fixed or variable rate better facilitates a comparison with securitization, do not address the underlying rationale for using a fixed interest rate. PIB, p. 51,53. The use of a fixed interest rate is very sound and reasonable, as set forth herein and in the Ratepayer Advocate's Initial Brief and its witness' testimony. RAIB, pp. 52-53; RA-18.

As Mr. Rothschild testified, the outstanding deferred balance will gradually decline over the ten years, accompanied by a cash flow from ratepayers to pay both interest and principal on debt. *RA-18*, p. 9; T838:L17-23. Once the recovery procedure is decided by the Board, before the start of the recovery period, the Company will be able to achieve permanent financing to match its cash flow, at a fixed interest rate.

### C. Tax Considerations

As set forth in its Initial Brief and the testimony of its witness, the Ratepayer Advocate recommends that the Company's deferred balance be adjusted to reflect tax benefits. RAIB, pp. 53-54; *RA-18*, p. 15-16. Additionally, the interest expense recovery revenue should not be grossed-up for income taxes. RAIB, p. 54; RA-18, p.16.

As demonstrated above, the Company has not provided any convincing argument which refutes the reasonableness of the Ratepayer Advocate's amortization proposal. For the reasons set forth above and in its Initial Brief and witness' testimony, the Ratepayer Advocate recommends that the ten-year amortization proposal set forth by Mr. Rothschild, and the resulting rates, should be adopted by the Board as the proper going-forward ratemaking treatment of the Company's deferred balance.

## VII. YOUR HONOR AND THE BOARD SHOULD REJECT ANY PROPOSAL TO MODIFY MTC AND NNC CHARGES IN THIS PROCEEDING AND INSTEAD SHOULD ADOPT THE COMPANY'S FILED POSITION ON AN INTERIM BASIS UNTIL THE ISSUE CAN BE FULLY VETTED IN THE COMPANY'S PENDING RATE CASE.

In its initial filing, the Company proposed that MTC recovery be allocated based on uniform energy rates. The Company provided schedules supporting this testimony including the calculation of the deferred recovery rate based on annual sales ($/kWh) and the MTC rate design schedule. *P-14*, JFJ-1, JFJ-3. The Ratepayer Advocate recommended that this proposal be adopted provisionally and that the methodology of the MTC be addressed in the Company's pending base rate case.

Then, in its Initial Brief, the Company changed its position and announced that it "does not object to the NJLEUC proposal as set forth by Mr. Gorman that the Company's MTC and NNC rates be adjusted to reflect differing loss factors for customers served at transmission and primary voltage levels." PIB 56-57. Thus, the Company accepts without comment the testimony of a witness it characterized two paragraphs earlier as demonstrating "a lack of knowledge about the customers on whose behalf he testified," "uncertain" about traditional recovery mechanisms, and mistaken about relevant portions of EDECA. *Id*.

Similarly, Board Staff accepted Mr. Gorman's position that "line losses should be reflected in the MTC and NNC charges." SIB at 52. However, Board Staff conditions this position with the **assumption** that "the Company's allocators and rates have not already been adjusted for such line losses." *Id.*

The Ratepayer Advocate recommends that the Company's rate design not be determined by acquiescence and assumption. The Company's as-filed uniform methodology should be adopted provisionally and the methodology of the MTC be addressed in the rate design portion of the Company's pending base rate case. Rate design cannot be done in a vacuum. Atlantic's customers pay one bill. The various components that make up a customer bill must be designed

as a balanced whole, not as a series of unrelated charges.

The Company's current MTC rates were developed during the restructuring process. There was no attempt made at that time to assign costs on a casual basis. Rather, the MTC rate was established on a residual basis to preserve revenue neutrality and to provide equal reductions by customer class. To change this balance without consideration of the other changes that shaped this residual rate and without consideration of class impacts would upset the careful balance of the transition period rates. That we consider these changes within the context of the class impacts is especially important as we move into a more competitive market.

Accordingly, the Ratepayer Advocate respectfully requests that Your Honor and the Board adopt on an interim basis the Company's as filed MTC recovery mechanism and allow this issue to be finally decided in the context of the Company's pending rate case where it can be fully explored by all interested parties. Such a decision can only result in a carefully considered, carefully crafted overall rate design that fairly allocates the Company's revenue requirement among all rate classes.

## VIII. CONCLUSION

For the reasons set forth in the Ratepayer Advocate's Initial Brief, this Reply Brief, and the testimony of Ratepayer Advocate witnesses Andrea Crane and James Rothschild, the Ratepayer Advocate respectfully submits that Your Honor and the Board should adopt the following recommendations:

(1) Atlantic's claimed BGS deferral should be reduced from $72,512,000 to $31,989,000.

(2) Atlantic's claimed NUG deferred over-collection should be increased from $6,365,000 to $9,301,000.

(3) Atlantic's claimed MTC deferred balance should be reduced from $124,682,000 to $70,344,000.

(4) Atlantic's claimed SBC over-collection should be increased from $20,083,000 to $21,5000,000.

(5) The deferred balance recovery period should be extended to ten years.

(6) The interest rate for the term of the recovery period should be set at the beginning of the recovery period.

(7) The amount upon which the interest accrual is based should be reduced to reflect the tax benefit associated with the underlying expenses.

(8) The interest recovery revenue should not be grossed-up for taxes.

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