December 15, 2000

<u>Via Hand Delivery</u>
Honorable Frances L. Smith
Secretary
New Jersey Board of Public Utilities
Two Gateway Center
Newark, NJ 07101

RE: **Gas Utilities' Provisional Rate and Flexible Pricing Mechanisms**

PSE&G- LGAC	**BPU Dkt. No. GR00070491**
NUI/Elizabethtown Gas Co.- LGAC	**BPU Dkt. No. GR00070470**
NJNG-LGAC	**BPU Dkt. No. GR99100778**
SJG-LGAC	**BPU Dkt. No. GR00050293**

Dear Secretary Smith:

Enclosed please find an original and eleven copies of the Direct Testimony of Richard W. LeLash filed on behalf New Jersey Division of the Ratepayer Advocate in the above captioned matter.

Copies are being served via hand delivery or UPS Overnight Mail. In addition, copies are being provided by e-mail to parties who have supplied e-mail addresses.

We are enclosing one additional copy of the materials transmitted with a stamped self-addressed envelope. <u>Please stamp and date the copy, as filed, and return in the enclosed envelope.</u> Thank you for your consideration and assistance.

Very truly yours,

BLOSSOM A. PERETZ, ESQ.
RATEPAYER ADVOCATE

By:______________________________
Sarah H. Steindel, Esq.
Deputy Ratepayer Advocate

SHS:lg
Enclosures
c: President Herbert H. Tate
Commissioner Carmen J. Armenti
Commissioner Frederick Butler
John Valeri, Chief of Staff
Frances I. Smith, BPU Secretary
Service List

BEFORE THE STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

GAS UTILITIES' PROVISIONAL RATES AND FLEXIBLE PRICING MECHANISMS	)))	
I/ M/O PUBLIC SERVICE ELECTRIC & GAS COMPANY LGAC FILING	)))	**BPU DOCKET NO. GR00070491**
I/M/O NUI/ELIZABETHTOWN GAS COMPANY GR00070470 LGAC FILING	)))	**BPU DOCKET NO.**
I/M/O NEW JERSEY NATURAL GAS COMPANY LGAC FILING	)))	**BPU DOCKET NO. GR99100778**
I/M/O SOUTH JERSEY GAS COMPANY LGAC FILING	))	**BPU DOCKET NO. GR00050293**

DIRECT TESTIMONY OF RICHARD W. LELASH
ON BEHALF OF THE
NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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1 I. STATEMENT OF QUALIFICATIONS

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.

3 A. My name is Richard W. LeLash and my business address is 18 Seventy Acre Road, Redding,

4 Connecticut.

5 Q. WHAT IS YOUR CURRENT BUSINESS AFFILIATION?

6 A. I am an independent financial and regulatory consultant working on behalf of several state

7 public utility commissions, attorneys general, and consumer advocates.

8 Q. PRIOR TO YOUR WORK AS AN INDEPENDENT CONSULTANT, WHAT WAS YOUR

9 BUSINESS AFFILIATION, AND WHAT WAS YOUR REGULATORY EXPERIENCE?

10 A. I was a principal with the Georgetown Consulting Group for twenty years. During my

11 affiliation with Georgetown, and continuing to date, I have testified on cost of service, rate

12 of return, and regulatory policy issues in about 230 regulatory proceedings. These

13 testimonies were presented before the Philadelphia Gas Commission, the Federal Energy

14 Regulatory Commission and in the following jurisdictions: Alabama, Arizona, Colorado,

15 Delaware, District of Columbia, Georgia, Illinois, Kansas, Maine, Maryland, Minnesota,

16 Missouri, New Jersey, New Mexico, New York, Ohio, Oklahoma, Pennsylvania, Rhode

17 Island, U.S. Virgin Islands, and Vermont.

1 Q. MR. LELASH, WHAT IS YOUR EDUCATIONAL BACKGROUND?

2 A. I graduated in 1967 from the Wharton School with a BS in Economics and in 1969 from the
3 Wharton Graduate School with an MBA.

4 Q. DURING THE COURSE OF YOUR REGULATORY WORK, WHAT HAS BEEN YOUR
5 EXPERIENCE WITH GAS POLICY AND PROCUREMENT?

6 A. Since 1980, I have worked extensively on gas policy and procurement issues. In Appendix
7 A there is a listing of the recent cases in which I have sponsored testimony. In addition to
8 these cases, I have reviewed and analyzed many other gas policy filings which were resolved
9 through stipulation. Among other issues, my testimonies have involved gas service
10 unbundling, physical and economic bypass, gas supply incentives, gas plant remediation costs,
11 gas price hedging, demand and capacity planning, gas storage options, gas price forecasting,
12 and least cost gas standards. In addressing these issues, I have analyzed gas regulatory filings
13 involving about 30 different local distribution companies. During the past few years, I have
14 worked on restructuring and unbundling matters for regulatory commissions or their staffs
15 in Georgia, Delaware, and Rhode Island and for consumer advocates in New Jersey and
16 Pennsylvania.

1 II. SCOPE AND PURPOSE OF TESTIMONY

2 Q. WOULD YOU PLEASE STATE THE SCOPE AND PURPOSE OF YOUR TESTIMONY
3 IN THIS PROCEEDING?
4 A. I was engaged by the New Jersey Division of the Ratepayer Advocate ("Ratepayer
5 Advocate") to review the Levelized Gas Adjustment Clause ("LGAC") filings made by Public
6 Service Electric and Gas Company ("Public Service"), New Jersey Natural Gas Company
7 ("New Jersey Natural") and South Jersey Gas Company ("South Jersey"). My review and
8 analysis evaluated these companies' LGAC and gas procurement practices against established
9 regulatory standards. As part of these engagements, I was also asked to review the December
10 1, 2000 filings submitted by these companies in response to the Board's November, 2000
11 Orders Authorizing Provisional Rates ("Provisional Rate Orders") and provide my
12 recommendations with regard to the issues raised. In addition, I was requested to review the
13 Elizabethtown Gas Company ("Elizabethtown") LGAC and December 1, 2000 filings, as they
14 relate to the issues raised in the Provisional Rate Orders.
15 This testimony presents my findings and recommendations to the New Jersey Board
16 of Public Utilities ("Board") concerning the gas pricing mechanisms that should be in effect
17 for the remainder of this winter and spring and the prudency of the companies' gas
18 procurement activities, including the adequacy of their efforts to hedge their gas supplies for
19 this winter.

1 Q. IN PERFORMING YOUR REVIEW AND ANALYSIS, WHAT DATA SOURCES DID
2 YOU UTILIZE?
3 A. My review and analysis encompassed the companies' December 1 filings, responses to
4 discovery requests, and information provided during discovery meetings. I also utilized
5 information provided in previous proceedings before the Board and general data concerning
6 gas prices and procurement and related gas cost recovery issues.

7 Q. ARE THERE ANY OTHER MATTERS WHICH HAD A BEARING ON THE SCOPE OF
8 YOUR TESTIMONY?
9 A. Yes. In the case of South Jersey Gas, the Board, in its Provisional Rate Order for this
10 company, directed that any issues related to its proposed Levelized Gas Adjustment Clause
11 Recovery Clause ("LGACRC") which South Jersey wished to pursue should be addressed as
12 part of its December 1 filing. However, in its filing, Mr. Kindlick, its witness, stated on pages
13 11 and 12 of his testimony that the Company believes that a "simpler proposal" which was
14 presented makes more sense at this time. Accordingly, the South Jersey LGACRC has not
15 been addressed in this testimony.

16 Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR DIRECT
17 SUPERVISION AND CONTROL?
18 A. Yes, it was.

1 III. SUMMARY OF FINDINGS AND RECOMMENDATIONS

2 Q. BASED ON YOUR INVESTIGATION, WHAT ARE YOUR FINDINGS AND
3 RECOMMENDATIONS?

4 A. As a result of my review and analysis, I make the following findings and recommendations:

5 1. In order to avoid large deferred fuel balances and to have the gas distribution
6 companies' ("GDCs") rates more accurately reflect current market prices, the Board's
7 current Flexible Pricing Mechanism ("FPM") should be continued with two
8 modifications. First, the monthly adjustments should be extended through April 2001,
9 and then, upon an appropriate showing, they could be extended further through July
10 2001. Second, beginning in the fall of 2001, the Board should adopt a revised
11 version of the FPM which would allow no more than two adjustments during the peak
12 winter season only. Such a revised recovery method, with appropriate gas price
13 hedging by the GDCs, can eliminate large deferred fuel balances and adequately track
14 the market cost of gas.

15 2. Beginning with the 2001-2002 period, the GDCs should be required to make annual
16 filings, on or before August 1 of each year, which would include reconciliations,
17 review of gas procurement and related policy issues concerning gas supply matters.
18 These filings would document the basis for a gas cost recovery rate effective on
19 October 1. The GDCs would then be permitted to make no more than two

1 adjustment filings to become effective after appropriate notice and review during the
2 November through February period if they can demonstrate that they will have a
3 deferred balance which will be larger than 2% of their forecasted gas costs for the
4 prospective 12 month period.

5 3. To the extent the Board defers recovery of some gas costs during the 2000-2001
6 LGAC period, the GDCs should not be allowed to accrue interest on associated under
7 recovered balances. The Board has appropriately maintained its LGAC precedent
8 concerning one-way interest accruals and there is no compelling reason to alter that
9 principle at this time. To a large degree, the GDCs' lack of adequate gas price
10 hedging and their delay in seeking LGAC adjustments contributed to the unaffordable
11 gas prices which are potentially to be charged to ratepayers. Additionally, with the
12 advent of a competitive marketplace for gas supply, it would be counter productive
13 to require ratepayers to compensate the GDCs for their inability to effectively mitigate
14 gas price increases. Certainly, third party suppliers do not have the luxury of interest
15 accruals on under recoveries, nor do they have the benefit of an LGAC pass-through
16 recovery mechanism when they make supply offers to potential customers.
17 Accordingly, the GDCs' request for interest accruals on under recoveries should be
18 denied.

19 4. As a general matter, the GDCs did not adequately mitigate their gas price exposure
20 for the 2000/2001 LGAC period. Only one GDC, New Jersey Natural, undertook

1 any significant hedging activities on a timely basis. In its December 1 filing, New
2 Jersey Natural projected about $41 million in hedging savings for the 2000/01 heating
3 season. While the other GDCs did obtain limited fixed price supply contracts, their
4 price protection as a percentage of total purchases, particularly for the peak winter
5 season, was too little and/or established too late. It also must be noted that the
6 inherent price hedge associated with traditional storage injections and withdrawals
7 does not in and of itself provide adequate hedging. With the lessening of the
8 historical winter/summer price differentials, it is apparent that storage injections, in
9 addition to flowing gas requirements, must be price hedged in order to truly reduce
10 a portfolio's vulnerability to price movements.

11 5. The Board should make gas cost disallowances for Public Service, South Jersey and
12 Elizabethtown based upon their failure to take reasonable hedging positions for the
13 2000/2001 winter. While these GDCs concentrated on capacity transactions which
14 benefitted their stockholders handsomely, they failed to meaningfully limit the impact
15 of gas price increases for their firm residential customers. While far larger
16 disallowances could reasonably be assessed, these companies should, at a minimum,
17 be charged with a gas cost disallowance equal to their portion of capacity margin
18 sharing.
19
20 6. With reference to Public Service specifically, the company failed to follow its stated
21 price hedging objectives to which it had committed in the past. Based apparently on

its own corporate objectives, it ceased hedging early in 2000 based on the availability of residential unbundling and its desire to adopt monthly pricing for basic gas supply service ("BGSS"). Given the fact that only 4,398 residential customers out of a total of about 1.6 million (less than 1%) had migrated to transportation by November of this year, residential unbundling is not yet a procurement consideration. To fail to continue price hedging for more than 99% of its customers based on potential migration is clearly unreasonable. As for its goal of adopting monthly pricing for residential customers, Public Service cannot unilaterally redefine the nature of its BGSS, but rather, it must obtain Board approval before adopting monthly pricing and changing its procurement procedures.

In its testimony, Public Service claims that it has locked in the price of over 30 Bcf of supply which represents 40% of residential winter gas use. What it does not highlight is the fact that its hedging activities were done principally in October, well after gas prices had risen to historically high levels. Indeed, its estimated hedging savings, based on current market pricing, is evidence alone that it did too little, too late.

7. For Elizabethtown and South Jersey the recommended disallowance of gas costs is based on their failure to pursue meaningful non-storage related price risk management measures. New Jersey Natural and Public Service had initiated gas price hedging positions as early as 1995. These initial hedging pilot programs were expanded in 1997, at which time the Board authorized them to price up to 50% of their gas

1 purchases for residential customers through either physical or financial hedging
2 transactions. Elizabethtown's and South Jersey's failure to emulate these established
3 programs, or to even address the possible parameters of a price hedging strategy,
4 warrant the recommended gas cost disallowance.

5 8. Each of the GDCs should be required to mitigate future gas price fluctuations using
6 appropriate hedging techniques. The price hedging should be applicable to all annual
7 gas purchases and the companies should hedge at least 50% of such purchases in any
8 twelve month period. Unless specifically authorized by the Board, the hedging should
9 be accomplished with financial hedges comprising no more than 50% of the overall
10 hedging positions. Failure of the GDCs to adhere to such a hedging guideline should
11 expressly subject the GDCs to gas cost disallowances in subsequent annual
12 reconciliations.

13 9. In order to implement adequate gas price hedging programs, the Board should require
14 each GDC to prepare and submit an evaluation of its prospective hedging strategies
15 and future programs. Once the submission is made, the Ratepayer Advocate and
16 other parties should be provided the opportunity to have input into the prospective
17 programs. Finally, the programs should be submitted to the Board for hearings and
18 subsequent approval or modification. Concurrently with the submissions on future
19 hedging programs, the Board should require the GDCs to address the future options
20 concerning the continuation of the LGAC mechanism and the prospective nature of

1 BGSS. With the advent of competition, it is increasingly important for there to be a
2 reassessment of how gas costs should be collected in addition to how they should be
3 controlled.

4 10. It would also be appropriate for the Board to require the GDCs to explore other
5 possible mitigation initiatives which could help to lower gas costs for residential
6 customers. For example, the GDCs could be trying to obtain additional underground
7 storage capacity which, if economical, would provide greater price stability for their
8 overall gas portfolios. The GDCs could likewise seek to increase operational
9 flexibility in their underground storage contracts through negotiations prior to the
10 contract termination dates for their existing storage capacity. The GDCs also could
11 be reassessing their interruption practices to ensure that firm ratepayers are not being
12 adversely affected by interruption limitations. Subject to public policy constraints, in
13 times of very high natural gas prices, economic curtailments may well be able to
14 mitigate firm ratepayers' gas costs. As a corollary, the GDCs should also ensure that
15 all rate classes are not being provided with gas supplies which, because of low ceiling
16 rates, might be priced below market levels and not subject to reconciliation.

17 11. Based on a review of the GDCs' December 1, 2000 filings, it is evident that the
18 submissions did not properly address many of the education and mitigation issues
19 required by the Provisional Rate Orders. All of the filings were incomplete and the
20 GDCs uniformly failed to provide key information that the Board needs to determine

1 whether or not the GDCs have complied with the Provisional Rate Orders.
2 Accordingly, the Board should require the GDCs, prior to the start of the evidentiary
3 hearings in this matter, to submit supplemental testimony addressing in detail the
4 various omissions and deficiencies within their filings, such as their failures to conduct
5 an assessment of the impact of higher rates on low-income customers, and their
6 incomplete descriptions of their efforts to educate consumers through individual
7 efforts and through state-wide media initiatives.

1 IV. GAS PRICES AND PROCUREMENT

2 Q. DURING THE PAST SIX MONTHS GAS PRICES HAVE ESCALATED TO
3 HISTORICALLY HIGH LEVELS. WHAT EFFECT HAS SUCH ESCALATION HAD ON
4 THE LGAC RATES OF THE GDCs?

5 A. Based on the Henry Hub benchmark prices, there has been a 155% increase in prices from
6 January to December of this year. As of December 11, the NYMEX futures had an average
7 price of $8.90 per Dth for the first quarter of 2001. This price escalation has substantially
8 affected the GDCs' gas costs.

9 To supply their firm customers, New Jersey GDCs rely on a combination of flowing
10 and stored gas supplies. The gas price movement, in addition to escalating the cost of flowing
11 gas requirements, has also affected the availability of lower cost gas supplies for summer
12 injections into storage. While historically storage gas supplies provided a hedge against high
13 winter prices, the narrowing, or elimination, of the peak vs. non-peak price differentials may
14 reflect a major shift in the pricing structure of natural gas. In 2000, the Henry Hub average
15 monthly price for the first quarter was $2.53 per Dth, while for the June to July storage
16 injection period the average monthly gas price was $4.19 per Dth. This trend appears to be
17 continuing at least to some degree.

1 Q. WHAT ARE THE GAS SUPPLY FACTORS WHICH APPEAR TO BE CAUSING THE
2 CURRENT INCREASE IN PRICING FOR NATURAL GAS?
3 A. The principal factor appears to be a lower than normal level of gas storage levels in both the
4 market and the production areas. The low levels of gas storage were first evident during the
5 spring of this year, when, despite milder than normal winter temperatures, storage levels were
6 below normal. In addition, non-heating gas use, stimulated by the economy and gas-fired
7 electric generation demand during the summer, hindered GDCs' ability to inject low cost gas
8 into storage. This, in turn, increased concerns about the gas market's ability to meet current
9 demand requirements.
10 However, whatever the cause, gas prices have trended up and price volatility has
11 increased greatly. As a result, GDCs which have not incorporated sufficient gas price hedging
12 into their procurement strategies are forecasting higher prices than necessary, thereby
13 requiring consumers to pay unreasonable rates for the foreseeable future.
14 Unfortunately, the unprecedented increase in natural gas prices has focused attention,
15 to a large extent, on GDC gas cost recovery, while equal attention should be paid to its
16 associated impact on ratepayers. When the GDCs filed their Emergent Motions in early
17 October, it was emphasized that material LGAC under recoveries would accumulate if the
18 GDCs' gas rates were not increased. Little, if any, consideration was given in the motions
19 to the ratepayers' ability to pay or the economic hardship which was to be imposed upon
20 them.
21 By the time the Board delivered its oral rulings on the utilities' motions on October
22 10, 2000, natural gas costs for the January through March 2001 period were averaging $5.00

1 per Dth. With gas prices at that level, the Board, in addition to authorizing provisional
2 increases, specifically adopted the recommendations of the Ratepayer Advocate and directed
3 the GDCs to mitigate the impact on customers through extended payments plans, various
4 energy assistance and conservation programs and educational initiatives to inform customers
5 of the gas cost increases and the availability of relevant programs.
6 Now, in proceedings to evaluate the implementation of additional LGAC increases,
7 the parties and the Board face even more dire circumstances. The average January through
8 March natural gas price has increased from $5.00 per Dth to $8.90 per Dth, a 78% increase
9 from levels which in October were seen to be almost unmanageable. The current critical
10 situation presents real problems for the GDCs' recovery mechanisms but, far more
11 importantly, the requested increases would make gas service all but unaffordable for a very
12 large segment of natural gas consumers in New Jersey.

13 Q. IN LIGHT OF THIS CRITICAL SITUATION, WHAT CONSIDERATIONS MUST BE
14 TAKEN INTO ACCOUNT WHEN DETERMINING THE PROSPECTIVE RATE
15 LEVELS FOR THE COMING MONTHS?
16 A. Given the attendant financial hardships which will be imposed on gas consumers, the Board
17 should depart from its established LGAC recovery practices. It does not appear possible for
18 the LGAC rates to be increased to levels which will prevent significant under recoveries
19 during this winter peak season. Accordingly, the Board should reaffirm limited monthly
20 increases during the period from now to April 1 and then provide for rate revisions which
21 would address under recovered gas costs over the following eighteen month period.

1 At the same time, the Board should evaluate whether or not the GDCs took all
2 reasonable actions to mitigate their gas costs, and if it is determined that they did not, then
3 a portion of the GDC's proposed gas cost recoveries should be disallowed. In much the same
4 way that the GDCs are rewarded for good performance under their capacity margin sharing
5 mechanisms, they must be accountable for their inaction when they fail to provide service at
6 just and reasonable rates. Additionally, the Board should reaffirm its directives concerning
7 energy assistance initiatives, conservation options, and consumer education.
8 The Board also needs to address the prospective procurement strategies and
9 objectives of each GDC to ensure that all reasonable mitigation options are utilized by the
10 GDCs in order to eliminate the reoccurrence of recent events. Ratepayers need sufficient
11 protections to ensure that high gas costs and price volatility can be avoided for an essential
12 service which must be priced at affordable rates.
13 To this end, the Board should require the GDCs to identify additional mitigation
14 initiatives which could help lower and stabilize gas costs for firm ratepayers. For example,
15 if the GDCs required additional capacity, they could seek additional underground storage
16 capacity as an alternative to pipeline transportation, thus providing greater price stability for
17 their gas portfolios. There has been increasing recognition of the importance of storage as
18 a tool to meet increased demand for natural gas at reasonable rates. "Power Demand to
19 Place New Strains on Gas," The Energy Report (Sept. 11, 2000); "Storage Crucial to
20 Changing LDC Industry's Future, Study Says," Gas Storage Report (June 1, 1998) (see
21 Appendix B). Many new underground storage projects are under development nationwide,
22 including at least four high-deliverability storage projects in Pennsylvania to serve the

1 Northeast market. "Northeast Storage Promises High-Deliverability", Transportation and
2 Storage Week (May 4, 2000); CNG Project Might Set Stage for Pa. Contest," Transportation
3 and Storage Week (Feb. 10, 2000) (see Appendix B). While present storage capacity is
4 limited, the GDCs should identify any available economic storage capacity from either existing
5 sources, the projects currently under development, or any other feasible storage sites. The
6 GDCs could also seek to increase the operating flexibility of their existing underground
7 storage through contract negotiations prior to the termination dates for their present storage
8 capacity. Another source of storage is above-ground liquefied natural gas ("LNG") facilities.
9 The utilities should re-examine the economics of expanding their LNG facilities in light of the
10 substantial changes in the natural gas market that have occurred over the past several months.
11 And finally, the Board should require the GDCs to reassess their interruption practices
12 to ensure that firm ratepayers are not being adversely affected by limitations placed on
13 economic interruption. Subject to public policy constraints, such as those required in
14 February of this year due to fuel oil supply and demand factors (see Appendix C), economic
15 curtailments may well be able to help mitigate ratepayers' gas costs. As a corollary, the
16 GDCs should also be required to ensure that all current rate classes are not receiving gas
17 supplies at less than market rates. This might be occurring because of the presence of ceiling
18 rates or pricing methodologies which either do not or are slow to reflect the market costs of
19 gas to the utility and which are not subject to reconciliation and true-up.

1 V. FLEXIBLE PRICING MECHANISM ("FPM")

2 - Generic FPM Issues

3 Q. WHAT IS THE NATURE OF THE REGULATORY ISSUES WHICH ARE TO BE
4 ADDRESSED IN THIS PROCEEDING?

5 A. In response to the Board's Provisional Rate Orders, the companies have made their requisite
6 filings concerning gas procurement and a prospective Flexible Pricing Mechanism. (It should
7 be noted that in the Board's Provisional Rate Orders both a Monthly Pricing Mechanism
8 ("MPM") for Public Service and Flexible Pricing Mechanisms ("FPMs") for the other GDCs
9 were approved. In this testimony both will be referred to as "FPMs.") In the GDCs' filings,
10 there is ample evidence that natural gas prices have risen to historically high levels and that
11 the associated price volatility has become a relevant procurement concern.

12 From a regulatory perspective, the current natural gas market conditions have brought
13 two issues into focus. First, how should two conflicting policies - avoiding large deferred fuel
14 balances and moderating rate shock for consumers - be balanced? Second, is it desirable to
15 maintain the established levelized annual fuel recovery mechanism or, alternatively, should
16 GDC gas prices more closely follow market rates under either a monthly or quarterly
17 adjustment procedure? Both of these issues have a significant bearing on the nature of BGSS
18 and the transition to a competitive "choice" gas supply market. If the levelized concept is
19 abandoned, then customer choice may be enhanced, but BGSS customers will no longer have

1 the stable and predictable gas prices which they have had in the past. This is true because the
2 gas cost recovery mechanism which is utilized effectively defines the nature of BGSS.

3 Q. HOW HAVE THE GDCs PROPOSED TO ACHIEVE THEIR GAS COST RECOVERY
4 OBJECTIVES?

5 A. For the most part, the companies are proposing to adopt an on-going FPM which will serve,
6 over time, to reduce or eliminate large deferred fuel (over or under recovery) balances. The
7 FPMs which are proposed would incorporate the five monthly adjustments envisioned in the
8 Board's Provisional Rate Orders, with two modifications. First, the utilities are proposing
9 that 2% monthly adjustments would continue beyond April for three additional months until
10 July. And second, the utilities are asking that these monthly adjustments be resumed in the
11 winter of 2001/2002 and continue thereafter until, presumably, they are modified or
12 terminated by the Board. From the GDCs' filings, it is unclear how reconciliations and
13 general procurement reviews would be structured, nor is it clear what methodology would
14 be utilized to determine whether or not an adjustment is warranted in any given month.

15 There is also an interesting dichotomy within the GDCs' filed testimonies concerning
16 the FPM. At the same time as they are asking for an open-ended FPM, they are committing
17 to active gas price mitigation through hedging activities. Any on-going need for FPMs should
18 be dramatically lessened if the companies can successfully hedge their gas portfolios. Indeed,
19 had they followed reasonable hedging objectives through 2000 there would be far less need
20 for the continuing LGAC increases which are currently being requested.

1 Q. WHAT ARE YOUR RECOMMENDATIONS CONCERNING PRICE INCREASES
2 DURING THE 2000/2001 LGAC PERIOD?
3 A. Given the current cost of natural gas supplies, the previously-approved FPM appears
4 reasonable. However, any proposed extension for the months of May, June, and July should
5 depend upon a showing of need by the GDCs. The Ratepayer Advocate objects to any
6 automatic monthly adjustment either in the summer or winter of 2001/2002 without filings
7 and evidentiary hearings. The companies should substantiate the need for additional
8 adjustments in order to prevent large deferred fuel balances as of the fall of 2002. This would
9 be very similar to the data presented in the December 1 filing concerning expected recovery
10 positions for the fall of 2001. The filings should also include detailed descriptions of the
11 companies' efforts to assure reasonable and stable prices for the upcoming winter season.
12 The adoption of continuing FPM adjustments of 2% should only be used as an interim
13 mechanism in order to address what is expected to be an extraordinary and atypical market
14 price transition. Such 2% changes adhere to rate "gradualism" whereby customers' charges
15 are increased over time in order to make the transition to a higher level. By using the 2%
16 adjustments, the gas cost increase will be spread over about a 9 month period. However, this
17 procedure could be replaced by an adjustment mechanism which recognizes the fact that most
18 volumes and cost recoveries occur during the winter months. As addressed below, this
19 mechanism should evolve with the development of a competitive natural gas marketplace.

20 Q. WOULD YOU PLEASE EXPLAIN WHY VOLUME IS A CRITERION FOR THE
21 DESIGN OF A FLEXIBLE PRICING MECHANISM AT THIS TIME?

1 A. Perhaps the best way to illustrate the impact of volume on recoveries is to look at the
2 proposed 2% FPM adjustments. On page 1 of my Schedule 1, the LGAC rates and deferred
3 fuel balances are shown for the GDCs. The data at the top of the schedule shows the impact
4 with two monthly (December and January) adjustments. The data in the middle of the
5 schedule includes three additional adjustments (February, March, and April), while the data
6 at the bottom assumes monthly adjustments through July. As the deferred fuel balances
7 indicate, monthly adjustments during the May, June and July period do not significantly lower
8 the under recoveries for the fall of 2001. This is true because the volumes to which the 2%
9 adjustments are applied are very low. Page 2 of Schedule 1 shows the volume distribution
10 for the GDCs. As shown, the volumes during the five months November through March
11 equals about 70% of the annual level. By comparison, the three month volume for December,
12 January, and February is about five times the level of the May, June and July volumes.
13 Accordingly, the majority of any over or under recoveries are accumulated during the peak
14 winter season, and only increases which are in place for a major portion of the winter will
15 have a significant impact on eliminating them.
16
17 Q. DO YOU HAVE AN ALTERNATIVE PROPOSAL WHICH COULD BE ADOPTED BY
18 THE BOARD IN ORDER TO ADDRESS THE NEED FOR LGAC RATE
19 ADJUSTMENTS?
20 A. Yes, there is an adjustment framework which is, to a large degree, compatible with the
21 mechanism adopted in the Provisional Rate Orders. The major difference is that, rather than
22 utilizing monthly adjustments, the framework envisions one or two adjustments during the

1 winter season, which would be tailored to the actual level of projected gas costs and
2 recoveries existing at the time.

3 As shown by the various filings for provisional rates, even during a period of
4 extraordinary price escalation, one or two adjustments can be tailored to eliminate large over
5 or under recoveries. Such limitation of the adjustments is also preferable for ratepayers, who
6 are accustomed to the existing annual LGAC mechanism, and who may find it difficult to
7 budget for frequent adjustments in rates. Likewise, one or two adjustments can provide
8 sufficient regulatory review, particularly if adjustment filings are standardized, and, as has
9 been shown by the recent motions for provisional rates, they need not entail any extensive
10 administrative burden on the GDCs or the parties.

11 I recommend that the companies be permitted to file for no more than two rate
12 increases which would become effective during the November to February time period.
13 Increases could be requested only if the recovery variation were estimated to exceed 2% of
14 gas costs for the next 12 month period. Thus, the trigger point would be satisfied if the prior
15 net recovery balance plus the estimated recovery over the next 12 months indicated a 2% or
16 greater under recovery. An adjustment filing, subject to notice and hearings, would be made
17 at least six weeks prior to the proposed implementation date, and the Board would evaluate
18 the need for the adjustment in light of the GDCs' price mitigation efforts and the desirability
19 of implementing the adjustment in one or two phases.

20 Such a recovery framework would link rate adjustments to any associated price
21 movements immediately before or during the peak winter period and it would ensure that
22 ratepayers would "pay as they go" rather than face rate adjustments well after the underlying

1 price movement was over or even potentially when market prices are moving in the opposite
2 direction. Two adjustments during the November to February period would be sufficient to
3 avoid any on-going accumulation of a material over or under recovery and the adjustment
4 framework is compatible with how gas utilities have historically instituted LGAC charges.
5 Finally, if an initial rate were to be filed for implementation in October of each year, then
6 conceptually rates could be adjusted three times during the October through February peak
7 period.

8 It is also appropriate to note, in discussing the mechanism for 2% monthly
9 adjustments, that it must be made clear that GDCs are required to make rate reductions when
10 indicated. Such reductions are not to be subject to the 2% or any other limitations. This is
11 a monitoring and implementation obligation which the Board should specifically impose on
12 the GDCs as part of any FPM.

13 Q. IN MAKING YOUR RECOMMENDATION FOR A FLEXIBLE PRICING MECHANISM,
14 HAVE YOU CONSIDERED THE ALTERNATIVE OF ALLOWING QUARTERLY
15 ADJUSTMENTS?

16 A. Yes, I have. However, any flexible pricing framework is pragmatically limited by throughput
17 considerations. For example, a quarterly framework, assuming that the initial rate is set in
18 October, really only provides for an adjustment in January. By April, usage has fallen to such
19 a degree that it is difficult to correct for any significant over or under recovery. Likewise,
20 under current FPM frameworks there are five potential adjustments between December and

1 April. Under my proposal, the two contemplated potential adjustments can just as effectively
2 eliminate recovery variation with fewer changes, all of which would be made during the high
3 usage period.

4 Based on all of the above considerations, I recommend that the Board adopt such a
5 flexible pricing mechanism for implementation by the New Jersey GDCs during 2001 after the
6 expiration of the current provisional rate adjustments and subject to additional policy issues
7 related to the pricing and structure of BGSS which will be discussed later in the testimony.

8 - <u>Company Specific FPM Issues</u>

9 Q. IN PUBLIC SERVICE'S INITIAL LGAC FILING THERE WAS A PROPOSAL TO
10 CHANGE THE COMPANY'S FPM. WHAT WERE THE BASIC PROVISIONS OF THE
11 CHANGE?

12 A. In its initial filing, Public Service sought to modify its existing FPM which allowed $0.07 per
13 Dth monthly adjustments during the period November through April subject to a total annual
14 adjustment limit of $0.35 per Dth. The proposed change would implement adjustments of up
15 to $0.35 per Dth in any month which would thus allow an annual change of up to $4.20 per
16 Dth. In addition, like the existing program, the new modifications were to be implemented
17 based on compliance filings, which would mean that they would not be subject to review
18 other than during an annual reconciliation. In effect, the new proposal would expand the
19 potential frequency of the monthly adjustments from the winter period to the entire year and

1 would increase the magnitude of the monthly adjustments five fold from $0.07 to $0.35 per
2 Dth.

3 Q. GIVEN THE LARGE INCREASES IN THE COST OF GAS AND THE GREATER GAS
4 PRICE VOLATILITY, ISN'T THERE SIGNIFICANT JUSTIFICATION FOR SUCH FPM
5 MODIFICATIONS?

6 A. While the recent experience in the gas market does warrant some greater flexibility, Public
7 Service's proposal goes much further than is required. Indeed, its proposal would allow it
8 to essentially obviate its need for future Board review of its gas procurement activities. The
9 continued need for annual regulatory oversight is apparent since each automatic adjustment
10 is potentially a rate increase for customers which, therefore, requires review. While Public
11 Service contends that annual filings are not mandated, annual reviews are contemplated in the
12 tariffs approved by the Board for the company's BGSS service in the recent natural gas
13 unbundling proceedings. For example, Public Service's Rate Schedule CS-RSG provides that
14 "[t]he estimated cost of gas will be established on a level annualized basis immediately prior
15 to October of each year for the succeeding twelve-month period." Public Service's failure
16 to make a full filing in either 1999 or this year shows the adverse oversight implications of
17 allowing it discretion as to when, or indeed whether, it will make a filing which will permit
18 review of its gas costs and procurement activities. The lack of such a filing in the fall of 1999,
19 for example, prevented the parties from addressing on-going procurement issues including
20 Public Service's plans concerning its gas price hedging program.

1 There is also little if any need to extend the FPM adjustments into the May through
2 September period. The Board has consistently utilized a twelve month levelized concept for
3 the LGAC recovery mechanism. Therefore, if the levelized concept is to be adhered to, the
4 fewer adjustments the better. Beyond the considerations of past practice, there are also
5 practical reasons for limiting the number of rate adjustments for residential customers. As
6 discussed above, rate changes during the May through October period have limited impact
7 because of the far lower throughput volumes. In order to eliminate any material recovery
8 variance in the summer, excessive adjustments, which tend to greatly distort rates, are
9 required.
10 Finally, there is an issue concerning the magnitude of any monthly adjustment. An
11 annual effective limit of $4.20 per Dth is excessive even given the current gas price volatility.
12 While all parties seem to agree that it is desirable to avoid large gas cost recovery variances,
13 it is not necessary to give the company unlimited adjustment authority to eliminate them.
14 Likewise, arbitrary monthly adjustment limits are not as effective as adjustments which are
15 determined based on the magnitude of the projected recovery variations and taking into
16 consideration the GDCs' efforts to mitigate them. For these reasons, the company's
17 proposed FPM should not be approved.

18 Q. WOULD YOU PLEASE DESCRIBE THE FPM MECHANISM WHICH NEW JERSEY
19 NATURAL PROPOSED?
20 A. In its Amendment to the Initial Petition which was filed on July 17, 2000, New Jersey Natural
21 proposed a modification to its established FPM. Citing the "unprecedented and unavoidable

1 increase in the commodity cost of gas" (Amendment to the Initial Petition, page 1), the
2 company requested monthly adjustments within the November to April time frame. Its
3 proposed monthly adjustments were to be capped at $0.14 per Dth and were to be subject to
4 an annual limitation of no more than $0.70 per Dth in total increases with a review by the
5 parties once increases of $0.35 per Dth were reached.

6 To a large degree, this proposal by New Jersey Natural closely matches the Board
7 approved provisional rate framework which is currently in place. The Board envisioned
8 monthly increases between December and April, only omitting the company's proposed
9 November adjustment. However, in lieu of a November adjustment, the framework provides
10 a larger incremental increase ($0.192 per Dth vs. the company's requested $0.14 per Dth
11 limit). Thus, the Board granted five $0.192 increases (a total increase of $0.96 per Dth)
12 rather than the company's requested six $0.140 increases (a total possible increase of $0.84
13 per Dth subject to the $0.70 per Dth limit).

14 With the continued gas cost escalation, the company's amended FPM effectively
15 became obsolete before it was fully investigated. As a result, in its December 1 filing the
16 company currently proposes 2% increases through July with additional monthly adjustments
17 resuming in December 2001 if required. Through July 2001 the company's latest proposal
18 would increase its LGAC by $1.536 per Dth vs. its July proposal for a total adjustment of
19 $0.70 per Dth.

1 Q. DO YOU HAVE ANY COMMENTS CONCERNING EITHER NEW JERSEY
2 NATURAL'S AMENDED FPM PROPOSAL OR ITS CURRENT REQUEST
3 CONCERNING THE FPM?

4 A. Yes, two observations are warranted. First, the monthly 2% increases through July may be
5 warranted given the current pricing in the gas supply market. Second, however, I take
6 exception to the Company's characterization, in its July 2000 amended filing, that the size of
7 the gas cost increases were unavoidable. While it is agreed that the gas price increases in the
8 market were beyond the company's control, it had, and continues to have, the ability and
9 indeed the obligation to avoid commodity cost increases as a result of the price escalation.
10 New Jersey Natural, with its existing gas price hedging program, should know this better than
11 most gas utilities.

12 As for the company's FPM framework after the July adjustment, it is my
13 recommendation that all New Jersey GDCs utilize the on-going adjustment framework
14 discussed previously.

15 Q. WOULD YOU NOW DISCUSS SOUTH JERSEY'S POSITION CONCERNING ITS FPM
16 FILING?

17 A. South Jersey has joined the other New Jersey GDCs in seeking to extend the Board's FPM
18 through July 2001. It also proposes that the FPM be approved for the period December 2001
19 through July 2002. South Jersey initially had also, in its Second Amended LGAC Petition,
20 sought to implement a quarterly LGAC adjustment mechanism pursuant to its Unbundling
21 Stipulation. This mechanism was to allow quarterly LGAC adjustments subject to an annual

1 cap limitation of $1.25 per Dth for any given LGAC period. Again, as is the case for other
2 FPM proposals, events have outpaced the originally filed LGAC methodologies. The Board's
3 FPM, if carried through July with 2% increases, would result in a total increase for South
4 Jersey of $1.632 per Dth, which is 30% higher than the company's proposed annual LGAC
5 adjustment limit.

6 Q. WHAT IS ELIZABETHTOWN'S PROPOSAL AS CONTAINED WITHIN ITS
7 DECEMBER 1 FILING?
8 A. It too is seeking to extend its Board authorized FPM through the month of July 2001, and
9 then be able to reinstitute it beginning December 2001. At this time, the extension to July 1
10 may be warranted based on the continuing escalation in gas prices. However, there is no
11 justification for converting such a one time FPM into an ongoing mechanism which is
12 implemented under compliance type filings.

1 VI. INTEREST ACCRUALS ON LGAC BALANCES

2 Q. THE GDCs HAVE STATED THAT THEY SHOULD BE ALLOWED TO ACCRUE
3 INTEREST ON ANY NET UNDER RECOVERED BALANCES. WHAT IS YOUR
4 POSITION ON THEIR PROPOSAL?

5 A. In their December 1 filings the GDCs contend that there should be interest on net under
6 recoveries because the traditional LGAC mechanism has been modified. While the established
7 precedent in New Jersey is to only accrue interest on over recoveries, they argue that such
8 a provision is associated with the practice of setting LGAC rates which are designed to
9 eliminate any deferred fuel balances by the end of the LGAC period. To the degree such a
10 practice is not followed, they argue that they are entitled to interest on any under recoveries.
11 In support of this position, at least one GDC cites Section 10(u) of the Electric Discount and
12 Energy Competition Act ("Act") which is alleged to require the Board to permit recovery of
13 all reasonable and prudently incurred costs of providing BGSS on a full and timely basis.

14 The GDCs are apparently relying on the "full and timely" language without paying
15 sufficient attention to the limitation of "reasonable and prudently incurred." A strong case
16 can be made that some of the GDCs, in failing to adequately hedge their gas supply portfolios,
17 have not met the criteria for full and timely recovery. Had the GDCs better mitigated price
18 fluctuations, there may not have been a need to defer LGAC increases over time. In addition,
19 in certain cases, GDCs could have sought adjustments sooner in order to bring their LGACs
20 more into line with market pricing.

1 Q. SHOULD THE BOARD AUTHORIZE ACCRUED INTEREST ON UNDER
2 RECOVERED BALANCES IN THE DEFERRED FUEL ACCOUNT?
3 A. No, it should not. New Jersey has had a long established precedent of not allowing accrued
4 interest on under recovered LGAC costs. At this time, there is no compelling reason why that
5 precedent should be altered. With the advent of competition in the gas supply market, it is
6 particularly inappropriate to compensate the GDCs if under recoveries are accumulated over
7 time. The GDCs have relatively automatic pass throughs of their gas costs and this fact alone
8 gives them a material advantage over competing third party suppliers. To add accrued
9 interest on under recoveries to the LGAC's full cost recovery mechanism would only
10 increase the GDCs' embedded competitive advantage over alternative suppliers.
11 In addition, all of the New Jersey GDCs, to varying degrees, are themselves
12 responsible for a significant portion of the forecasted under recoveries. Had Public Service
13 and New Jersey Natural more aggressively pursued their hedging programs, there would be
14 far lower levels of under recoveries for both utilities. The two other GDCs have failed to
15 even develop meaningful hedging programs, and as such, they have subjected their ratepayers
16 to unnecessary price volatility and increases.
17 Gas utilities frequently complain that regulators seek to micro-manage their
18 operations. And yet, in the case of price hedging, the New Jersey GDCs, without minimum
19 hedging requirements, have failed to effectively address gas price variability. In such
20 circumstances, it is inappropriate to compensate the GDCs for a result which they,
21 themselves, to a large degree, created. The GDCs' arguments that a lack of accrued interest
22 on their under recoveries is economically unfair trivializes the plight of their ratepayers. If

1 one is evaluating relative economic harm due to the experienced gas price increases, it is the
2 ratepayers, and not the shareholders, of the GDCs that should warrant economic relief from
3 the Board. Accordingly, the Board should not authorize accrued interest on any net LGAC
4 under recoveries.

1 VII. PROCUREMENT AND PRICE HEDGING

2 - Generic Procurement Issues

3 Q. WHAT HAVE BEEN THE REGULATORY STANDARDS THAT ARE USED TO
4 EVALUATE THE GAS PROCUREMENT PRACTICES OF A UTILITY?

5 A. As a general standard, regulation has always required that utility service should be "just and
6 reasonable" in terms of reliability and cost. Since gas utilities provide an essential service, the
7 reliability issue, encompassing safety and service availability, has always been subject to on-
8 going evaluation and sanctions for inadequacy. However, especially in the early years of
9 LGAC mechanisms, the cost issue was raised infrequently.

10 To a large degree, the historical structure of the gas supply market accounted for the
11 absence of cost evaluation. Gas utilities purchased supplies from the interstate pipelines under
12 long-term contracts for the gas commodity and for both transportation and storage capacity.
13 In addition, the prices for such supplies were set by federal regulators and, as such, were not
14 subject to state regulatory review. In essence, the interstate pipelines performed the gas
15 supply procurement function for gas utilities subject to federal oversight. With the passage
16 of the FERC's Order 636 in 1992, this gas supply structure was fundamentally changed. Gas
17 supply and transportation capacity were unbundled and, most importantly, commodity gas
18 became available under separate contracts with gas suppliers under varying terms and
19 conditions. Thus, for the first time, gas utilities became responsible for their own gas

1 procurement, and market conditions began to have an impact on the gas supply's cost to the
2 consumer.
3 In this environment the gas utilities began the practice of buying some of their supply
4 in the "spot market" and price volatility became a consideration to regulators. This, in turn,
5 emphasized the value of gas storage activities and ultimately the need for gas price hedging
6 for price stability. Like many other commodity users, the gas utilities began to recognize that
7 the reasonableness of procurement might be evaluated on the overall cost of the gas supply.

8 Q. WITHIN THE ELECTRIC DISCOUNT AND ENERGY COMPETITION ACT, IS THERE
9 A STANDARD TO BE APPLIED TO GAS PROCUREMENT EVALUATIONS?
10 A. The Act states that charges for BGSS shall be based on the cost to the utility of providing
11 such service, including the cost of gas commodity and capacity purchased at prices consistent
12 with market conditions ...." In a broad sense, this could be interpreted to be a procurement
13 standard, but several additional considerations are warranted. Given that gas supply is now
14 available on a competitive basis, all gas procurement, with the exception of affiliate
15 transactions, is by definition consistent with market conditions. Also, since the majority of
16 entities that purchase commodities, including third party suppliers in New Jersey offering
17 alternative gas supply service, utilize gas price hedging as a standard practice, it would appear
18 that a narrow interpretation of "consistent with market conditions" does not define the just
19 and reasonable cost standard for gas procurement.
20 Rather, it appears that the Act does not remove the Board's historical obligation to
21 determine the reasonableness of gas costs. This would of necessity mean that the appropriate

1 standard would incorporate the Board's evaluation of issues such as the duration of capacity
2 and supply contracts, timing of purchases, use of storage transactions, and the ability of the
3 utility to achieve price stability and insulate its purchases from the adverse effects of short
4 term price volatility.

5 Q. IN LIGHT OF THESE CONSIDERATIONS, WHAT STANDARD SHOULD THE
6 BOARD UTILIZE IN EVALUATING THE REASONABLENESS OF A GAS UTILITY'S
7 PROCUREMENT?

8 A. Even with the advent of retail competition in New Jersey's gas supply market, the provision
9 of gas supply remains an essential service whose cost is a material component of the typical
10 consumer's total budget. It is therefore recommended that the Board place a priority on
11 having gas utilities utilize all reasonably available options to ensure affordable and relatively
12 stable gas prices. As directed in the Board's recent Provisional Rate Orders, "Petitioner shall
13 address its gas purchasing strategy, including its use of fixed gas price contracts (both short-
14 term and long-term), storage inventories, financial instruments, and spot market purchases."
15 (see, for example, Public Service Provisional Rate Order at 8). From this language, at a
16 minimum, it can be inferred that gas utilities are expected to use all available options to
17 address the gas market's high price volatility.

18 Further, in my opinion, the recent gas price increases and volatility have provided
19 ample evidence that gas utilities should be required to utilize at least some threshold level of
20 price hedging in order to limit the impact of gas price fluctuations and sharp price escalations.
21 Of all the industries involved in commodity trading, only the utilities, with their fuel clause

1 recovery mechanisms, have substantially refrained from utilizing price hedging techniques.
2 If non-regulated entities have determined that price hedging can benefit their operations, then
3 gas utilities, in the competitive environment, should be expected to do the same.
4 During my prior work in consulting and for PepsiCo, I received first hand knowledge
5 of how large commodity users had to use price hedging positions in order to ensure that their
6 products could be sold in the marketplace. For example, Pepsi-Cola faced record high sugar
7 prices during the early 1970's, and based on that experience, extensive hedging was used to
8 ensure stable and predictable raw material costs. Indeed, even homeowners recognize the
9 economic value of hedging when they lock in their costs of home heating oil prior to the start
10 of the heating season.

11 Q. HAVE NEW JERSEY GDCs' GAS PROCUREMENT PROGRAMS UTILIZED PRICE
12 HEDGING TO LESSEN THE IMPACT OF SUCH GAS PRICE INCREASES?
13 A. The GDCs have locked in prices for some gas, principally through their normal injections for
14 storage inventory. Unfortunately, with current gas price levels, the GDCs' storage activities
15 will not sufficiently serve to ameliorate their gas cost increases. They must also use other
16 readily available hedging tools such as fixed-price contracts of varying durations and financial
17 instruments such as calls and collars.
18 On my Schedule 2, the gas cost impacts of storage transactions are shown for each
19 of the New Jersey GDCs. As indicated, while all of the companies were able to achieve gas
20 cost savings through their storage injections, all but New Jersey Natural failed to materially
21 achieve price protection through non-storage related hedging.

1 Page 1 of the schedule shows the GDC mitigation actions based on the NYMEX strip
2 prices as of November 27, 2000. As the data shows, the GDCs mitigated prices by 15% to
3 27% depending upon their use of price hedging. New Jersey Natural, with hedge savings of
4 about 10% of total LGAC costs, achieved the highest relative level of price stabilization. The
5 second page of this schedule provides the same data based on the NYMEX strip as of
6 December 8, 2000. As would be expected, as the market prices increase, the relative cost
7 savings from the mitigation actions increase to an even greater extent.

8 - Company Specific Procurement Issues

9 Q. IN THE SPECIFIC CASE OF PUBLIC SERVICE, HASN'T THE COMPANY
10 DEVELOPED A RATHER COMPREHENSIVE HEDGING PROGRAM OVER THE
11 PAST SEVERAL YEARS?
12 A. Yes, it has. In Public Service's last LGAC proceeding in Docket No. GR98070445, it stated
13 that it would "continue to acquire future supplies of gas up to the allowed limits in order to
14 stabilize the cost of the residential customers' gas portfolio" (Scarlata testimony, page 10).
15 Public Service also stated that it had taken "the approach of locking in prices on winter
16 supplies on a consistent basis by attempting to acquire a certain number of contracts ratably"
17 (Scarlata testimony, page 10). In the Board's Order of July 30, 1997 Public Service was
18 authorized "to lock-in the price of 50% of its residential supply utilizing gas futures prices"
19 (Scarlata Testimony, page 9). Unfortunately, this hedging program, which had been
20 developed in a collaborative effort with the Board Staff and the Ratepayer Advocate, was

1 unilaterally terminated by Public Service without any notification or consultation with the
2 other parties.

3 Q. WHAT REASONS WERE GIVEN BY THE COMPANY FOR THE TERMINATION OF
4 ITS GAS PRICE HEDGING ACTIVITIES?

5 A. In a discovery response in the current LGAC proceeding, Docket No. GR00070491, the
6 company, for the first time, disclosed that "due to the availability of residential unbundling and
7 its request for monthly pricing for residentials, the company made a decision not to hedge
8 volumes for the 2000-2001 winter season" (Response RAR-PS-3). In my opinion, neither
9 residential unbundling nor the pending monthly pricing proposal are valid reasons for
10 unilaterally terminating the hedging program. As for the unbundling, at the start of the
11 2000-2001 winter season, 4,398 residential customers out of a total of about 1.6 million
12 customers (or less than 1%) had migrated to transportation service (Responses RAR-PS-7
13 and RAR-PS-10). Thus, it does not appear reasonable to modify the established procurement
14 policy for 1.6 million customers based on the prospect that there may be some incremental
15 migration. The company's major service obligation remains with those customers who
16 continue to utilize BGSS.

17 Public Service also stated, in response to Staff Request S-PLGAC-8, that "If a
18 customer has the right to choose his supplier with no obligation to the utility, there cannot be
19 a situation where the price of gas to the customer is different from the price in the market."
20 This statement is questionable in two respects. First, is the market defined by a benchmark
21 price of gas or by the price to compare as offered by third party suppliers who themselves

1 routinely utilize hedging positions? Second, it is unclear what price variation is of concern
2 to the company. If its price is lower than any applicable market standard, BGSS ratepayers
3 will benefit. If the price is higher than market, migration to transportation will increase, but
4 with hedged gas supply at only a 50% target, it is very unlikely that the company would face
5 any take-or-pay liability. As for its transportation capacity, it is probable that the same third
6 party suppliers, which are to serve the migrating customers, would take at least some capacity
7 assignment, and the company can still obtain some capacity release revenues on the
8 remainder. Additionally, to the degree there is any capacity which creates costs in excess of
9 revenue, under my proposed flexible pricing mechanism it is the BGSS ratepayers, and not
10 Public Service, that will bear the cost.

11 Q. BASED ON THE COMPANY'S FAILURE TO PURSUE ITS OWN GAS PRICE
12 HEDGING OBJECTIVES, DO YOU HAVE ANY RECOMMENDATION FOR THE
13 BOARD?
14 A. Based on the circumstances and the nature of Public Service's inaction, I recommend that the
15 Board disallow $9.7 million of the company's gas costs which would otherwise be
16 recoverable through the LGAC. This disallowance amount is equal to the amount paid to the
17 company's shareholders for incremental performance in capacity transactions. While the
18 recommended disallowance is less than could be justified, it is important to establish the
19 principle that gas costs will be disallowed if the company has taken insufficient steps to
20 stabilize costs and reduce exposures to rapidly escalating gas prices.

1 In support of this recommendation, it is submitted that the company failed to follow
2 its own established hedging objectives, and in failing to do so it caused ratepayers to be
3 subject to higher gas costs. It is also apparent that Public Service's termination of its hedging
4 activities was, at least in part, motivated by its desire to seek a monthly price mechanism
5 which is associated with its proposal to transfer its gas supply portfolio to an unregulated
6 affiliate. However, the termination of its hedging activity is instructive because it was done
7 several months before the company reactivated its portfolio transfer request in August 2000,
8 and well before any party or the Board had a chance to evaluate either the transfer or the
9 cessation of price hedging.
10 In short, the company's ratepayers lost an important cost mitigation initiative solely
11 based on a Public Service specified agenda. Such an action by the company, without any
12 consultation with the parties to the previous LGAC Stipulation, effectively violated the
13 provisions of that Stipulation for all practical purposes. Therefore, the Board should order
14 a $9.7 million disallowance and make it very clear that the failure to pursue all available
15 options to mitigate BGSS gas costs will subject the company to cost disallowances and that
16 such disallowances in the future will be commensurate with the level of cost mitigation which
17 is foregone.

1 Q. WOULD YOU PLEASE EXPLAIN THE BASIS FOR THE AMOUNT OF THE COST
2 DISALLOWANCE WHICH YOU RECOMMEND?
3 A. During 2000, New Jersey Natural, a far smaller GDC, was able to take hedge positions which
4 reduced its cost of gas for the 2000/2001 LGAC period by about $41 million. Were Public
5 Service to have taken comparable hedging actions, the cost savings to its customers would
6 have been far greater. Thus, New Jersey Natural's hedging savings are an appropriate
7 benchmark when assessing the negative impact of Public Service's failure to mitigate price
8 exposure for its gas supply portfolio.
9 During the last 12 months, Public Service's stockholders have earned $9,731,000
10 through capacity related incentives. These incentives, which flowed to stockholders, are
11 shown on Schedule 3. Adding the $4.1 million from conveyances, the $4.8 million from
12 capacity reductions and the $0.8 million from portfolio enhancements produces the
13 recommended $9.7 million cost disallowance.
14 In effect, while the company concentrated on capacity transactions which benefitted
15 its stockholders handsomely, it failed to meaningfully limit the impact of gas price increases
16 for its 1.6 million residential customers. Far larger disallowances could reasonably be
17 justified, and therefore a gas cost amount equal to the company's capacity margin sharing is
18 a minimum disallowance when compared to the excess gas costs that customers will be forced
19 to pay.

1 Q. WITH RESPECT TO THE OTHER NEW JERSEY GDCs, WERE THEY ABLE TO
2 ADEQUATELY MITIGATE THE EFFECTS OF THE HIGHER GAS COSTS?
3 A. In order to evaluate all of the GDCs' mitigation efforts, the comparison on page 2 of
4 Schedule 2 is useful. This schedule shows the GDCs' prospective LGAC costs both with and
5 without mitigation actions. Thus, for New Jersey Natural, its LGAC costs would have been
6 $467.0 million were it not for various actions taken by the company. In total, New Jersey
7 Natural was able to reduce its LGAC costs by 29.6%. Thus, its actions saved ratepayers
8 almost $140 million in overall gas costs. Of note for New Jersey Natural is the significant
9 portion of the savings which arose from its gas price hedging activities. To a large degree,
10 this portion of its mitigation actions is the most important in terms of impact on ratepayers.

11 Q. WOULD YOU PLEASE DESCRIBE WHY GAS HEDGING IS MORE IMPORTANT
12 THAN, FOR EXAMPLE, THE GDCs' SAVINGS FROM STORAGE?
13 A. To a large degree, the mitigation due to storage transactions results from what is an automatic
14 hedge. This is not meant to imply that the storage related locked in prices are not valuable.
15 Rather, the level of storage is the result of procurement decisions which often were made
16 many years ago. In addition, because of the injection limits which are often imposed, the rate
17 of injection and its timing are generally circumscribed by the storage operator. Thus, while
18 a valuable hedging tool, storage is not really a discretionary action which requires a significant
19 degree of judgment, nor does it subject the GDC to any regulatory recovery risk.

1 Q. IN YOUR OPINION, DID ELIZABETHTOWN AND SOUTH JERSEY TAKE
2 SUFFICIENT ACTIONS TO MITIGATE THEIR GAS SUPPLY COSTS?
3 A. No, I believe that they did not. For apparently a variety of reasons, both of these GDCs have
4 failed to develop hedging programs to better mitigate their procurement programs. While
5 both New Jersey Natural and Public Service developed hedging pilot initiatives which later
6 were expanded to on-going risk management programs, Elizabethtown and South Jersey
7 continued to utilize only limited fixed price contracts to extend their price stabilization beyond
8 that associated with storage activities. For this reason, these GDCs were unable to effectively
9 mitigate the gas price increases, and the Board should therefore impose disallowances similar
10 to those recommended for Public Service. The relevant issue is whether the failure to pursue
11 price hedging is comparable to Public Service's failure to utilize its existing hedging program
12 to fulfill commitments which were made as part of its procurement objectives. Based on my
13 understanding of the facts and circumstances, I believe that Elizabethtown's and South
14 Jersey's inaction warrant the disallowance of gas costs equal to their off-system and capacity
15 credits for the 1999/2000 LGAC period.
16 The relevant comparison with respect to hedging is shown on Schedule 4. The
17 calculations, which are based on both late November and early December NYMEX prices,
18 shows a significant difference in the hedging activities for the four GDCs. Had all of the gas
19 utilities matched New Jersey Natural's percentage of hedging savings, ratepayers would have
20 been facing far lower costs. For Elizabethtown and South Jersey, the additional hedging
21 savings would have been in excess of $20 million, while for Public Service the added savings
22 would have exceeded $80 million.

1 In this context, the disallowance of gas costs equal to the GDCs' capacity and off-
2 system sharing is a reasonable amount, which, while not replacing the hedging saving, at least
3 moderates the gas costs to be paid by ratepayers. While the disallowance for Public Service
4 should be $9.7 million, the comparable amount for Elizabethtown is $412,000 and for South
5 Jersey $1,259,000.

6 Q. IF NEW JERSEY NATURAL IS YOUR BENCHMARK FOR THE HEDGING
7 PERFORMANCE OF THE OTHER GDCs, WHY ARE YOU RECOMMENDING
8 DENYING IT INTEREST ON ITS UNDER RECOVERY BALANCES?
9 A. There are two basic reasons. The first, as I have stated previously, involves the established
10 precedent concerning accrued interest within the LGAC framework. The second reflects the
11 fact that, even with its hedging activity, more could have been done to hedge gas costs. New
12 Jersey Natural is one of the gas utilities which initiated hedging at an early date. However,
13 it must be remembered that its total hedging activities still only are projected to lower its
14 LGAC costs by 9% to 10%. New Jersey Natural has been authorized to use financial hedging
15 subject to specified dollar limits. As of July and August of this year, the company had
16 committed only between 25% and 50% of these dollar limits. Likewise, the company's
17 forecasts for calendar year 2000 projected hedged prices on only 28% of the company's total
18 firm sales, compared to my recommended minimum of around 50%. Thus, while its hedging
19 performance was good compared to the other New Jersey GDCs, it should not be considered
20 to be totally satisfactory. For this reason, no disallowance is being recommended for the

1 company, and the denial of interest on its under recovered gas costs is consistent with its
2 performance.

3 - Prospective Procurement Hedging

4 Q. GIVEN CURRENT NATURAL GAS PRICING, ARE THERE ANY INDICATIONS
5 THAT THE GDCs NEED TO REASSESS THEIR GAS PROCUREMENT STRATEGIES?
6 A. Yes. At this point in time we have not as yet seen detailed procurement plans from the GDCs
7 despite the fact that they were directed by the Board to develop them. When these plans are
8 developed and presented, it would appear that the New Jersey GDCs are going to have to
9 rethink how they manage their price risk relative to gas supply procurement. This is not an
10 isolated situation, since most of the gas utilities that I am familiar with are also involved in
11 reassessing their gas hedging strategies because of the recent gas price increases. Many of
12 the utilities' hedging models were based on historical gas price trading ranges and were
13 therefore ineffective in maintaining appropriate price protection for firm sales customers when
14 the market departed from prior levels.

15 Q. IN EVALUATING THEIR GAS PRICE RISK MANAGEMENT PROGRAMS, WHAT
16 PARAMETERS SHOULD BE CONSIDERED BY THE GDCs?
17 A. It should first be recognized that many gas utilities are utilizing more extensive hedging
18 programs than those being utilized by some of the New Jersey GDCs. It is not uncommon
19 for gas utilities to lock in prices for between 30% and 60% of annual gas purchases.

1 Accordingly, the New Jersey GDCs should first evaluate the scope of their hedging with the
2 potential of expanding price protection to closer to 50% of their requirements. This is
3 particularly warranted since the hedging value of their storage transactions has been
4 diminished given the current peak and non-peak price relationships.
5 The GDCs should also seek to establish the regulatory treatment for costs associated
6 with expanded price hedging. Gas utilities, generally, have been reluctant to implement a
7 comprehensive hedging strategy without obtaining regulatory approval to have hedging
8 related costs recoverable through their applicable gas cost mechanism. It is also highly
9 desirable to establish the regulatory review framework for hedging activities, particularly if
10 financial, in addition to physical, contracts are used for a significant portion of the hedging
11 positions. Gas utilities frequently, as part of their programs, seek to establish evaluation
12 criteria to prevent after-the-fact or "hindsight" judgments concerning gas price hedging
13 activities.

14 Q. HOW WOULD YOU PROPOSE THAT THE GDCs PURSUE THEIR HEDGING
15 EVALUATION AND THE FUTURE ADOPTION OF ANY SPECIFIC PROGRAM?
16 A. It should be recognized that the underlying objective is to have the GDCs and the Board
17 recognize the greater need for hedging given the recent price levels and extreme volatility
18 associated with natural gas prices. Based on this recognition, I recommend that the Board
19 require that each GDC:

1 1. Prepare and submit an evaluation of a prospective hedging strategy and program
2 within a specified period of time;

3 2. Once the submission is received, provide an opportunity for the Ratepayer Advocate
4 and other parties to analyze and have input into any prospective program; and

5 3. Formally submit any program to the Board for approval subject to hearings which
6 may be required concerning its proposal's adoption.

7 In addition, it is recommended that the Board make a finding that, for all of the GDCs'
8 gas procurement after a specified date, actual incurred gas costs will be subject to review as
9 to whether or not adequate steps were taken to protect ratepayers from unreasonable gas
10 prices and price volatility. Such a finding by the Board should explicitly recognize that the
11 purchase of gas supplies at spot or "market" prices should not be presumed to be reasonable
12 and prudent.

13 Q. WHY IS IT APPROPRIATE THAT THE BOARD RECOGNIZE THAT SPOT OR
14 MARKET PRICES ARE NOT NECESSARILY APPROPRIATE?
15 A. With the advent of universal open access in New Jersey, it is necessary that the sales
16 customers of the GDCs be able to benefit from, rather than be penalized by, the existence of
17 prevailing market forces. Under competition, non-regulated firms routinely utilize hedging
18 programs if their businesses rely on the purchase of commodities. While utilities have not

1 historically done the same, the competitive natural gas market requires that they do so now.
2 Additionally, the GDCs cannot realistically be expected to obtain the "lowest" price in the
3 market, rather they should be held to a standard which requires a "reasonable" price. While
4 gas prices are set at the market rate, the timing of the purchases is critical to the
5 reasonableness of the procurement transactions. Prospectively, GDCs should not be able to
6 pay spot or indexed rates for gas and presume that such purchases are prudent.
7 The current gas market pricing should be seen as a lesson in how spot or indexed
8 prices can be excessive given that there were ample price risk management techniques
9 available which could have lessened the price impact. Effectively, GDCs should be required
10 to reduce the risk of sharp price run-ups which frequently occur during winter periods when
11 customer usage is at its highest level. Therefore, hedging should be required for LDCs in
12 order to appropriately limit their exposure to price volatility.

13 Q. DO YOU HAVE ANY GENERAL RECOMMENDATIONS AS TO HOW THE GDCs'
14 PRICE HEDGING PROGRAM SHOULD BE STRUCTURED?
15 A. In my opinion, it is best to let each GDC tailor its own program and objectives subject to
16 certain general requirements. For example, this year certain GDCs were "hedging" but the
17 expectations as to the percentage of gas purchases which were price protected were vastly
18 different among the various parties. If any lesson is to be learned from the past nine months,
19 it is that GDCs should incorporate some specified minimum percentage of annual gas
20 purchases which must be price protected. From a practical perspective, the minimum
21 requirement should be between 30% and 50%. In addition, there should be a "discretionary"

1 component to the hedging which would be responsive to where gas prices are relative to some
2 agreed upon benchmark.
3 A second general requirement involves the mix between physical and financial hedges.
4 The GDC should specify what percentage of total hedge positions will be fixed using financial
5 hedges or derivatives. In my opinion, the risk factors are essentially the same for both
6 financial and physical positions, but it is understandable that some limits may be desirable
7 within the GDCs' regulatory framework. However, in setting any specified mix requirement,
8 it should be recognized that financial positions offer far greater flexibility to the GDC. They
9 are not encumbered by physical gas requirements, there is a wide diversity of available
10 instruments and strategies, the underlying markets are competitive, and the hedged positions
11 provide considerable trading flexibility. Based on the characteristics of the current gas
12 market, it is therefore suggested that at least 50% of hedged positions be authorized through
13 financial transactions.

14 Q. BASED ON YOUR EXPERIENCE, IS THERE ANY EXAMPLE OF A HEDGING
15 STRATEGY WHICH REFLECTS CONSIDERATION OF THE NEW MARKET
16 ENVIRONMENT?
17 A. Yes, I am currently working on several gas hedging programs which are being restructured.
18 By far the simplest involves a dollar cost averaging concept. In this program the utility would
19 fix the price on 40% of its purchase requirements based on pro rated purchases over 18
20 months. The associated positions for the 40% would be taken irrespective of prevailing prices
21 or forecasted trends. A second facet of the program involves discretionary hedging which

1 would be triggered based on market price relationships to the utility's filed gas cost rate.
2 Thus, if prices were within $1.00 of the GCR, an additional 20% of purchases would be
3 hedged. If the market rates were more than $1.00 above, only 10% additional would be
4 taken, while 30% would be taken if market prices would be more than $1.00 below the GCR.
5 Under such a framework, the utility would be forced to hedge 50% of its gas
6 purchases (including storage injections) over an 18 month time horizon. Conceptually, with
7 such a strategy, at least 50% of the gas utilized in any month would reflect that month's
8 average price of the prior 18 months. Had such a strategy been in place this year, its use
9 would have materially lessened a utility's exposure to the current gas prices. This framework
10 also allows the utility and the Board considerable latitude in setting the hedging percentages
11 as well as the benchmark trigger price. As a general matter, the more sophisticated the utility
12 in hedging matters, the higher would be the discretionary portion of the program. Thus, a gas
13 utility with extensive hedging expertise might only have a 20% dollar cost average component
14 with discretionary percentages of 30%, 40%, and 50%, depending on the market price to
15 benchmark relationship.

16 Q. ARE THERE ANY OTHER PROCUREMENT OR GAS COST RECOVERY ISSUES
17 WHICH YOU WISH TO DISCUSS?
18 A. Yes, as part of the GDCs' contemplated filings concerning future hedging strategies, it would
19 be appropriate for the Board to have the basic issue of the LGAC's role also addressed. The
20 LGAC developed within the historical regulatory framework, and with the advent of
21 competitive market forces, it is appropriate that it be reassessed. Gas procurement, like other

1 aspects of utility operations, is now ripe for some performance-based incentives. Likewise,
2 the nature of the GDCs' BGSS is under evaluation and may very well be subject to change
3 in the near future. In this environment, it is quite possible that the traditional LGAC recovery
4 framework will become an impediment to the implementation of change. Accordingly, the
5 Board should require that the GDCs evaluate and offer alternatives to the LGAC mechanism
6 at the time they make their contemplated hedging filings. These issues, hedging and the
7 LGAC mechanism, are interrelated and it is time that New Jersey regulation subjects them to
8 review and analysis.

1 VIII. EDUCATION AND MITIGATION MEASURES

2 Q. PLEASE COMMENT ON THE GDCs' COMPLIANCE WITH THE EDUCATION AND
3 MITIGATION REQUIREMENTS AS SET FORTH IN THE BOARD'S PROVISIONAL
4 RATE ORDERS.

5 A. Based upon my review of the GDCs' December 1, 2000 filings made pursuant to the
6 Provisional Rate Orders, I believe that all the filings were incomplete or vague with respect
7 to many education and mitigation issues. The GDCs uniformly failed to provide key
8 information that the Board would need to determine whether they fully complied with the
9 Provisional Rate Orders. I recommend that the Board take action immediately to insure that
10 the GDCs are in full compliance.

11 Q. CAN YOU PLEASE ELABORATE?

12 A. Yes, pursuant to the Board's Provisional Rate Orders, each of the four GDCs were required
13 to do the following:

14 C Submit on December 1, 2000 an assessment of how the rate increases have impacted
15 its low-income customers and how programs, such as budget billing and extended
16 payments, have mitigated the impact of the increases on these customers.

17 C Implement extended payment plans "above and beyond" what is already offered
18 including interest free plans which spread payment over six months.

1 C With respect to NJ SHARES:

2 a. Increase the number of community action program ("CAP") and other social
3 service agencies for intake within the utility's service area;

4 b. Make the company call centers able to direct customers to the intake centers
5 closest to the customer and give information about NJ SHARES and its
6 eligibility requirements;

7 c. Expand the number of eligible participants;

8 d. Include bill inserts or other means to encourage donations by customers.

9 C Make sure budget payments are accurately set for budget billing plan customers and
10 that they are based upon actual meter readings (the company must exercise best
11 efforts to have accurate readings).

12 C Prepare and distribute two bill inserts, with advance copies to Staff by November,
13 2000, providing:

14 a. Information about gas cost increases, including typical monthly bill impacts
15 for residential heating and non-heating customers with various usages;

16 b. Information about budget billing and extended payment programs; and

17 c. Detailed information about all available government and utility energy
18 assistance and energy efficiency programs such as eligibility information for
19 each program including samples of income levels needed to qualify and a toll-

1 free phone number for the utility for information on assistance with utility
2 bills, energy efficiency and related programs. The information should also
3 advise customers where to apply for State and federal assistance, including the
4 toll-free phone number for LIHEAP.

5 C Establish and maintain its current tariffs on its web site to assist customers in adjusting
6 their usage.

7 C Provide additional education through other media, to be funded through the existing
8 consumer choice education program to advise customers of the availability of the
9 various assistance programs for help.

10 C Require its customer service and collections personnel to advise all customers with
11 payment problems about available assistance programs and their toll-free phone
12 numbers.

13 In addition, two company specific requirements were set forth in the Orders:

14 C Public Service was required to investigate the feasibility of expanding the use of the
15 Chronicles software and related hardware to additional agencies and unmanned
16 kiosks; and

1 C New Jersey Natural was to explore possibility of joining NJ SHARES.

2 Q. DID THE GDCs COMPLY WITH THE REQUIREMENTS AS LISTED ABOVE?

3 A. With respect to some of the Board requirements, it is clear that the GDCs did not comply
4 with the Provisional Rate Orders. For example, the Provisional Rate Orders clearly required
5 the GDCs to submit by December 1, 2000 an assessment on how the impact on rates will
6 affect low income customers and how programs such as budget billing and extended payments
7 have mitigated the impact of the increases. Not one GDC complied, or was even willing to
8 state when it would be able to comply with the Board Order. Elizabethtown and South Jersey
9 claimed that there was not enough time to make such an analysis while Public Service did not
10 bother to address the issue at all.

11 The dramatic increases in natural gas rates will burden all ratepayers but especially the
12 low income consumer that can least afford such increases. It is of the utmost importance to
13 assure that the rate increases being requested by the GDCs are adequately off-set by
14 mitigation measures.

15 Q. WHAT ARE THE OTHER DEFICIENCIES IN THE GDCs' FILINGS?

16 A. As mentioned earlier, the filings were vague or lacking in detail, making it difficult or
17 impossible for the Board to determine whether the GDCs complied with the required
18 education and mitigation measures.

19 Q. WHAT ARE SOME EXAMPLES?

1 A. For example, the GDCs were required to offer extended payment plans to their customers,
2 above and beyond what they may be currently offering. One of the plans offered must be a
3 payment plan that spreads the payments over a period of at least six months without interest.
4 The GDCs' descriptions of their extended payment plans did not specify which plans were
5 already in existence prior to the Provisional Rate Orders and which plans were modified or
6 extended in compliance with the Board's Orders. The Board specifically required that the
7 GDCs provide additional programs "above and beyond" those already existing. From the
8 submissions made December 1, 2000, it is impossible to know whether such new programs
9 have been established by the GDCs. In addition, the GDCs failed to state whether they
10 offered or plan to offer a payment plan that spreads the payments over six months without the
11 customer incurring interest.

12 Q. DID THE GDCs FULLY COMPLY WITH THE PROVISIONAL RATE ORDERS'
13 MANDATES WITH RESPECT TO MODIFYING NJ SHARES?
14 A. Based on the testimonies submitted by the GDCs, very limited effort has been made.
15 Elizabethtown was the only company to file testimony about its efforts to increase the number
16 of CAP agencies for intake, and it also discussed expanding eligibility criteria and directed
17 customers service representatives to refer payment troubled customers to NJ SHARES as
18 required by the Provisional Rate Orders. No GDC stated it encouraged donations to NJ
19 SHARES by its customers as required by the Board Orders. Funding is critical, if customer
20 service representatives are referring payment troubled customers to NJ SHARES. The Board

1 should require the GDCs to have concrete plans to solicit customer donations and to expand
2 NJ SHARES.
3 Further, two GDCs, New Jersey Natural and Public Service, were required to fulfill
4 additional requirements pursuant to the Provisional Rate Orders. New Jersey Natural was
5 required to explore the possibility of joining NJ SHARES and Public Service was to
6 investigate the feasibility of expanding the Chronicles software and related hardware for use
7 by additional agencies and unmanned kiosks. New Jersey Natural did not include testimony
8 regarding efforts being made by the company to join NJ SHARES. The company should be
9 required to submit testimony in this proceeding regarding the efforts being made. Public
10 Service was specifically directed to investigate expanding the use of the Chronicles system
11 for both additional CAP agencies and free standing kiosks. However, the company states
12 that it is limiting its investigation to the use of kiosks in some customer service centers.
13 Public Service should be directed to complete a full study including the feasibility of installing
14 Chronicles systems in other agencies before the start of the evidentiary hearing is this matter.

15 Q. DID THE GDCs FULLY COMPLY WITH THE PROVISIONAL RATE ORDERS WITH
16 RESPECT TO ACCURATE METER READING AND BILLING?
17 A. Only Elizabethtown provided testimony regarding its efforts to read meters for up to date,
18 accurate billing. None of the other GDCs testified as to their efforts to read meters in order
19 to bill accurately. Public Service, South Jersey and New Jersey Natural should submit
20 testimony in this proceeding regarding the steps taken to comply with the Provisional Rate
21 Orders.

1 Q. PURSUANT TO THE PROVISIONAL RATE ORDERS, THE GDCs WERE TO
2 PREPARE BILL INSERTS PROVIDING INFORMATION ABOUT: 1) GAS COST
3 INCREASES; 2) BUDGET BILLING AND EXTENDED PAYMENT PROGRAMS; AND
4 3) ALL AVAILABLE GOVERNMENT AND UTILITY ENERGY ASSISTANCE AND
5 ENERGY EFFICIENCY PROGRAMS. DO YOU HAVE ANY COMMENTS
6 REGARDING THESE REQUIREMENTS?
7 A. Yes, I believe that the information contained in the GDCs' bill inserts should be substantially
8 similar for all four GDCs. One model bill insert should be created to insure all relevant
9 information is provided by all the GDCs in an easy to understand format. Therefore, the
10 GDCs should be required to submit to all the parties in this proceeding the bill inserts they
11 intend to distribute so that a generic format can be established. At this time we do not have
12 enough information to know the type of bill inserts being sent to customers or whether all
13 relevant information that the GDCs are required to provide customers appear on the inserts.
14 This can be remedied by requiring a model bill insert format.

15 Q. HAVE ALL THE GDCs COMPLIED WITH THE REQUIREMENT THAT UTILITY
16 TARIFFS BE ACCESSIBLE THROUGH THE INTERNET?
17 A. No, South Jersey does not have a current tariff on its website to date. The other three GDCs
18 have had their tariffs posted on the Internet for a considerable period. The Board should not
19 allow South Jersey to lag behind. South Jersey should be required to state when its customers
20 can reasonably expect compliance with the Board Order.

1 Q. DO YOU HAVE ANY COMMENTS REGARDING THE REQUIREMENT THAT THE
2 GDCs PROVIDE ADDITIONAL EDUCATION ON THE AVAILABILITY OF
3 ASSISTANCE PROGRAMS BE DISSEMINATED THROUGH VARIOUS MEDIA
4 WITH FUNDS FROM EXISTING CONSUMER CHOICE EDUCATION PROGRAM?
5 A. Yes, the GDCs failed to submit any information regarding their activities to fulfill this
6 requirement. We are well into the winter heating season, a period of time when information
7 regarding assistance programs is most needed. Information like this must be distributed
8 widely through television, radio, newspaper and other forms of mass media in a timely manner
9 (*i.e*., when the customers are most likely to encounter a crisis situation). It is clear that more
10 specific direction is required from the Board to assure that an appropriate mass media
11 campaign is implemented. The Board should direct the Utility Education Committee and the
12 natural gas utilities to immediately begin developing material to be disseminated no later than
13 January 2001. In addition, the Board should order its Staff to implement a statewide
14 consumer education program this winter as has the New York Public Service Commission,
15 to educate consumers about the increases forecasted in natural gas prices and to inform
16 consumers of steps they can take to mitigate the costs (see Appendix D).

17 Q. DO YOU HAVE ANY COMMENTS REGARDING THE REQUIREMENT THAT THE
18 GDCs' CUSTOMER SERVICE AND COLLECTIONS PERSONNEL ADVISE ALL
19 CUSTOMERS WITH PAYMENT PROBLEMS ABOUT AVAILABLE ASSISTANCE
20 PROGRAMS AND TO PROVIDE THE GDCs' TOLL-FREE PHONE NUMBER?

1 A. New Jersey Natural and South Jersey did not specifically state that they are instructing their
2 customer service and collection personnel to advise customers about available assistance. In
3 addition, none of the GDCs indicated that their personnel are required to provide the
4 company's toll free number for further assistance. Whether the GDCs instruct their personnel
5 about LIHEAP, Lifeline, winter termination and other programs can mean the difference
6 between a payment troubled customer being shut-off or not. Getting all the relevant
7 information to customers in a timely manner is critical, especially this winter.

8 Q. IN CONCLUSION, DO YOU HAVE ANY OVERALL RECOMMENDATION
9 CONCERNING CUSTOMER EDUCATION AND MITIGATION MEASURES?
10 A. Yes, the Board should require the GDCs, prior to the start of the evidentiary hearings in this
11 matter, to submit supplemental testimony addressing in detail the various omissions and
12 deficiencies which have been identified here, and should also direct the Utility Education
13 Committee, the utilities, and its Staff to begin implement state-wide consumer education no
14 later than January.

15 Q. MR. LELASH, DOES THIS CONCLUDE YOUR DIRECT TESTIMONY IN THIS
16 MATTER?
17 A. Yes, it does.

IX. SUPPORTING SCHEDULES

LGAC Rates and Deferred Fuel Balances
Based on the Nov. 27 NYMEX Prices

	Elizabethtown	NJ Natural	Public Service	South Jersey
Jan. 1st LGAC Rate (per Dth)	$ 5.88	$ 2.57	$ 5.07	$ 3.17
Est. Fall 2001 Balance (000's)		$(42,000)		$(39,320)
April 1st LGAC Rate (per Dth)	$ 6.43	$ 3.12	$ 5.87	$ 3.78
Est. Fall 2001 Balance (000's)	$(20,000)	$(25,900)	$(98,600)	$(32,000)
July 1st LGAC Rate (per Dth)	$ 7.00	$ 3.66	$ 6.35	$ 4.39
Est. Fall 2001 Balance (000's)	$(18,300)	$(14,400)	$(88,000)	$(29,600)

NOTE: Negative amounts denote under recovered LGAC balances.

SOURCE: GDC Filings December 1, 2000.

LGAC Volumes By Month
Normalized Mdth Volumes

	Elizabethtown	NJ Natural	Public Service	South Jersey
November	2,355	4,599	14,207	2,050
December	4,084	7,174	24,373	3,390
January	6,008	9,033	28,083	4,928
February	5,682	7,504	24,468	4,923
March	5,203	6,125	19,809	3,941
April	3,371	3,559	11,831	2,864
May	2,028	1,800	5,333	1,481
June	964	1,090	3,537	1,004
July	782	1,009	2,204	786
August	737	1,012	2,338	636
September	797	1,241	2,988	608
October	1,159	2,574	9,044	1,011
Totals	33,170	46,720	148,215	27,622
November - March	70.3%	73.7%	74.8%	69.6%
December - February	47.6%	50.8%	51.9%	47.9%
May - July	11.4%	8.3%	7.5%	11.8%

Public Service Electric & Gas Company
Market Transaction Margin Sharing
($000's)

	Conveyances		Capacity Reductions		Enhancements	
Month	Company	Ratepayers	Company	Ratepayers	Company	Ratepayers
January 1999	$ 413	$ 2,341	$ 493	$ 740	$ 707	$1,296
February	322	1,823	486	729	119	422
March	405	2,293	486	729	119	413
April	396	2,246	512	769	33	38
May	121	687	512	769	33	34
June	132	749	512	769	35	62
July	200	1,134	512	769	33	59
August	179	1,020	513	769	35	62
September	125	709	513	769	35	62
October	142	803	513	769	35	62
November	423	2,394	400	1,315	59	196
December	579	3,282	400	1,329	73	271
Total 1999	$3,437	$19,481	$5,852	$10,225	$1,316	$2,977
January 2000	$ 662	$ 3,749	$ 387	$ 1,309	$ 125	$ 524
February	670	3,795	380	1,293	124	524
March	440	2,494	380	1,293	124	518
April	145	819	390	1,348	43	110
May	153	869	390	1,348	46	112
June	197	1,115	390	1,348	47	132
July	307	1,738	390	1,348	50	133
August	251	1,421	390	1,352	51	137
September	138	782	390	1,352	47	131
YTD 2000	$2,963	$16,782	$3,487	$11,991	$ 657	$2,321
Last 12 months	$4,107	$23,261	$4,800	$15,404	$ 824	$2,850

SOURCE: Company’s Monthly Reports on Conveyance, Capacity Reduction and Enhancement Margins.

LGAC Cost Mitigation
Incremental Hedging Savings
($ millions)

	Elizabethtown	NJ Natural	Public Service	South Jersey
Based on 11/27/00 NYMEX Strip				
Annual LGAC Costs	$271.4	$429.0	$1,202.0	$246.4
Assumed Hedging Percentage	9.53%	9.53%	9.53%	9.53%
Assumed Hedging Savings	$ 25.9	$ 40.9	$ 114.6	$ 23.5
Actual Hedging Savings	6.8	40.9	39.0	7.8
Indicated Incremental Savings	$ 19.1	$ -0-	$ 75.6	$ 15.7
Based on 12/08/00 NYMEX Strip				
Annual LGAC Costs	$312.6	$467.0	$1,374.0	$278.1
Assumed Hedging Percentage	10.69%	10.69%	10.69%	10.69%
Assumed Hedging Savings	$ 33.4	$ 49.9	$ 146.9	$ 29.7
Actual Hedging Savings	9.5	49.9	66.0	13.5
Indicated Incremental Savings	$ 23.9	$ -0-	$ 80.9	$ 16.2

SOURCES: Schedule 2, pages 1 and 2.

LGAC Cost Mitigation
Based on 11/27/00 NYMEX Strip
($ millions)

	Elizabethtown	NJ Natural	Public Service	South Jersey
Estimated Annual LGAC Costs	$229.9	$314.9	$ 981.0	$195.4
Total LGAC Costs Without Mitigation	271.4	429.0	1,220.0	246.4
Cost Mitigation Actions:				
Storage - Marked to Market	$ 23.6	$ 44.4	$ 124.0	$ 30.4
Gas Price Hedging	6.8	40.9	39.0	7.8
Off System and Capacity Credits	2.1	22.4	36.0	11.5
Interruptible and Other Credits	9.0	6.4	42.0	1.3
Total Mitigation Savings	$ 41.5	$114.1	$ 241.0	$ 51.0
% Reduction in LGAC Costs	15.3%	26.6%	19.8%	20.7%
Hedging as a % of LGAC Costs	2.51%	9.53%	3.20%	3.17%

SOURCES: Informal Discovery Responses from Companies, December 11, 2000.

LGAC Cost Mitigation
Based on 12/08/00 NYMEX Strip
($ millions)

	Elizabethtown	NJ Natural	Public Service	South Jersey
Estimated Annual LGAC Costs	$256.2	$328.6	$1,047.0	$208.9
Total LGAC Costs Without Mitigation	312.6	467.0	1,394.0	278.1
Cost Mitigation Actions:				
Storage - Marked to Market	$ 35.8	$ 59.7	$ 203.0	$ 42.9
Gas Price Hedging	9.5	49.9	66.0	13.5
Off System and Capacity Credits	2.1	22.4	36.0	11.5
Interruptible and Other Credits	9.0	6.4	42.0	1.3
Total Mitigation Savings	$ 56.4	$138.4	$ 347.0	$ 69.2
% Reduction in LGAC Costs	18.0%	29.6%	24.9%	24.9%
Hedging as a % of LGAC Costs	3.04%	10.69%	4.73%	4.85%

SOURCES: Informal Discovery Responses from Companies, December 11, 2000.

X. APPENDIX A: PRIOR R.W. LELASH TESTIMONIES

R. W. LELASH'S REGULATORY TESTIMONIES
(1995 to Present)

188. Vermont, Green Mountain Power Company (Docket No. 5780) Gas Plant Remediation Testimony for the Vermont Department of Public Service (January, 1995).

189. New Mexico, U S West Communications, Inc. (Docket No. 94-323-TC) Sales of Local Exchanges Testimony for the New Mexico Attorney General (May, 1995)

190. Delaware, Chesapeake Utilities Corporation (Docket No. 95-73) Rate of Return and Gas Remediation Cost Recovery Testimony for the Delaware Public Service Commission (July 1995).

191. Delaware, Delmarva Power & Light Company (Docket No. 95-44) Testimony in Support of Gas Tariff Restructuring for the Delaware Public Service Commission (August, 1995).

192. Philadelphia Gas Commission, Philadelphia Gas Works (1996 Gas Cost Rate Filing) Gas Procurement and Policy Testimony for the Public Advocate (September, 1995).

193. New Jersey, United Water New Jersey (Docket No. WR950780303) Rate of Return Testimony for the New Jersey Division of the Ratepayer Advocate (December, 1995).

194. Vermont, Green Mountain Power Corporation (Docket No. 5857) Rate of Return and Gas Remediation Recovery Testimony for the Vermont Department of Public Services (January, 1996).

195. Rhode Island, Providence Gas Company, (Docket No. 2374) Gas Tariff Restructuring Testimony for the Rhode Island Division of Public Utilities (February, 1996).

196. Rhode Island, Providence Gas Company (Docket No. 1673) Gas Price Hedging Testimony for the Rhode Island Division of Public Utilities (August, 1996).

197. Philadelphia Gas Commission, Philadelphia Gas Works (1997 Gas Cost Rate Filing) Gas Procurement and Policy Testimony for the Public Advocate (September, 1996).

198. Georgia, Atlanta Gas Light (Docket No. 6717-U) Gas Service Unbundling Testimony for the Georgia Public Service Commission (January, 1997).

199. FERC, Cleveland Electric and Toledo Edison (Docket No. ER97-529-000, Consolidated) Rate of Return Rebuttal Testimony for Centerior Energy (April, 1997).

200. Rhode Island, Providence Gas Company (Docket No. 2581) Price Stabilization Plan Testimony for the Rhode Island Division of Public Utilities (August, 1997).

201. New Jersey, New Jersey Natural Gas Company (Docket No. GT96070524) Gas Policy Testimony for the New Jersey Division of the Ratepayer Advocate (August, 1997).

202. Vermont, Green Mountain Power Corporation (Docket No. 5983) Gas Remediation Recovery Testimony for the Vermont Department of Public Service (October, 1997).

203. Philadelphia Gas Commission, Philadelphia Gas Works (1998 GCR Proceeding) Gas Procurement and Policy Testimony for the Public Advocate (December, 1997).

204. Vermont, Green Mountain Power Corporation (Docket No. 5983) Gas Remediation Surrebuttal Testimony for the Vermont Department of Public Service (December, 1997).

205. Delaware, Delmarva Power & Light Company (Docket No. 97-293F) Gas Price Hedging Testimony for the Delaware Public Service Commission (January, 1998).

206. Delaware, Artesian Water Company (Docket No. 97-340) Rate of Return Testimony for the Delaware Public Service Commission (February, 1998).

207. Georgia, Atlanta Gas Light Company (Docket No. 8390-U) Regulatory Policy Testimony for the Energy Service Providers Association (March, 1998).

208. New Jersey, Public Service Electric & Gas Company (Docket No. GR97110839) Gas Procurement and Policy Direct Testimony for the New Jersey Division of the Ratepayer Advocate (April, 1998).

209. New Jersey, Public Service Electric & Gas Company (Docket No. GR97110839) Gas Procurement and Policy Surrebuttal Testimony for the New Jersey Division of the Ratepayer Advocate (April, 1998).

210. Philadelphia Gas Commission, Philadelphia Gas Works (1998 GCR Proceeding) Gas Price Hedging Position Statement for the Public Advocate (May, 1998).

211. Philadelphia Gas Commission, Philadelphia Gas Works (1999 GCR Proceeding) Gas Procurement and Policy Testimony for the Public Advocate (October, 1998).

212. Georgia, Cumberland Pipeline Investigation (Docket No. 10064-U) Regulatory Policy Testimony for East Tennessee Natural Gas Company (March, 1999).

213. New Jersey, Generic Unbundling Proceeding (Docket No. GX99030121) Gas Policy Testimony for the New Jersey Division of the Ratepayer Advocate (July, 1999).

214. New Jersey, Public Service Electric & Gas Company (Docket No. GO99030124) Gas Unbundling Testimony for the New Jersey Division of the Ratepayer Advocate (July, 1999).

215. Philadelphia Gas Commission, Philadelphia Gas Works (2000 GCR Proceeding) Gas Procurement and Policy Testimony for the Public Advocate (September, 1999).

216. New Jersey, Generic Unbundling Proceeding (Docket No. GX99030121) Gas Policy Surrebuttal Testimony for the New Jersey Division of the Ratepayer Advocate (September, 1999).

217. New Jersey, Public Service Electric & Gas Company (Docket No. GO99030124) Gas Unbundling Surrebuttal Testimony for the New Jersey Division of the Ratepayer Advocate (September, 1999).

218. Pennsylvania, Columbia Gas of Pennsylvania, Inc. (Docket No. R-00994781) Restructuring Testimony for the Pennsylvania Office of Consumer Advocate (October, 1999).

219. Pennsylvania, Columbia Gas of Pennsylvania, Inc. (Docket No. R-00994781) Restructuring Surrebuttal Testimony for the Pennsylvania Office of Consumer Advocate (October, 1999).

220. Rhode Island, Narragansett Electric Company et al. (Docket No. 2930) Merger Policy Testimony for the Rhode Island Department of Attorney General (November, 1999).

221. Delaware, Delmarva Power & Light Company (Docket No. 99-425F) Evaluation of Price Hedging Testimony for the Delaware Public Service Commission (December, 1999).

222. Rhode Island, Narragansett Electric Company et al. (Docket No. D-99-12) Merger Policy Testimony for the Rhode Island Department of Attorney General (December, 1999).

223. Pennsylvania, PECO Energy Company (Docket No. R-00994787) Restructuring Testimony for the Pennsylvania Office of Consumer Advocate (January, 2000).

224. Pennsylvania, PECO Energy Company (Docket No. R-00994787) Restructuring Surrebuttal Testimony for the Pennsylvania Office of Consumer Advocate (February, 2000).

225. Rhode Island, Providence Gas Company and Southern Union (Docket No. D-00-3) Merger Policy Testimony for the Rhode Island Division of Public Utilities and Department of Attorney General (May, 2000).

226. Philadelphia Gas Commission, Philadelphia Gas Works (2001 GCR Proceeding) Gas Procurement and Policy Testimony for the Public Advocate (August, 2000).

227. Rhode Island, Providence Gas Company (Docket No. 1673) Price Stability Plan Testimony for the Rhode Island Division of Public Utilities (September, 2000).

228. Pennsylvania, Philadelphia Gas Works (Docket No. R-00005654) Interim Base Rate Testimony for the Pennsylvania Office of Consumer Advocate (September, 2000).

229. Pennsylvania, Philadelphia Gas Works (Docket No. R-00005619) Gas Procurement and Policy Testimony for the Pennsylvania Office of Consumer Advocate (September, 2000).

230. New Jersey, Public Service Electric & Gas Company (Docket No. GR00070491) Levelized Gas Adjustment Clause Testimony for the New Jersey Division of the Ratepayer Advocate (November, 2000).

XI. APPENDIX B: ARTICLES ON NATURAL GAS STORAGE PROJECTS

XII. APPENDIX C: FEBRUARY 2000 PRESS RELEASES ON FUEL OIL PRICES

XIII. APPENDIX D: NEW YORK PSC PRESS RELEASE