STATE OF NEW JERSEY
OFFICE OF ADMINISTRATIVE LAW
BEFORE HONORABLE RICHARD MCGILL, ALJ

I/M/O the Verified Petition of JCP&L for Review and Approval of Increases in and Other Adjustments to its Rates and Charges for Electric Service, and For Approval of Other Proposed Tariff Revisions in Connection Therewith; and for Approval of an Accelerated Reliability Enhancement Program ("2012 Base Rate Filing")	)	**OAL Docket No. PUC 16310-12N** **BPU Docket No. ER12111052**

INITIAL BRIEF ON BEHALF OF THE DIVISION OF RATE COUNSEL

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PUBLIC VERSION

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PRELIMINARY STATEMENT

This matter began when Rate Counsel filed a Motion in September, 2011 alleging that Jersey Central Power &Light ("JCP&L" or "the Company") was over-earning and asking the Board of Public Utilities ("Board" or "BPU") to require the Company to file a base rate case to protect ratepayers from continued excessive rates. The record that has been developed since then shows clearly that Rate Counsel's concerns were well-founded. While the Company has sought an increase in rates, the record demonstrates that the Company has been over-earning and that ratepayers are entitled to a rate *reduction* of over $200 million. The record also supports a reduction in the Company's overall rate of return.

Rate Counsel recognizes that a rate reduction of this magnitude is extraordinary. Yet the evidence is clear and Your Honor and the Board must fulfill the statutory obligation to establish rates that are just and reasonable based on the evidence in the record. Unfortunately for JCP&L's ratepayers, however, the story does not end there. While this matter was pending, the State suffered several severe storms that led to extensive and long outages throughout New Jersey. JCP&L's territory was hit particularly hard and customers suffered through outages of extraordinary scope and duration. In many ways, the pendency of the rate case was fortuitous, as it led to an opportunity to examine the Company's reliability spending and practices as well as its earnings.

What that examination has shown is of great concern. While JCP&L was granted additional funds in the second phase of its last base rate case in 2005 to address ongoing reliability concerns, it substantially decreased spending on reliability once the initial work

mandated by the BPU was completed. Between 2008-2010 the Company's reliability spending was reduced and its tree-trimming budget was cut back significantly. During this same period, JCP&L was sending a whopping 170% of its earnings to its sole shareholder and parent corporation, FirstEnergy.

While the money paid by New Jersey's ratepayers was being sent off to Ohio, insufficient funds were being invested in JCP&L's infrastructure in New Jersey. While some of that spending has now been increased as a result of the storms, ratepayers need the protection of their regulators to ensure not only that the Company's rates are just and reasonable, but that ratepayers' investment in this Company is spent for their benefit. Ratepayers are entitled to better reliability and for this reason Rate Counsel seeks relief in this case that would require more rigorous reliability reporting and standards as well as consequences if the Company fails to provide that reporting or meet those standards.

The record also demonstrates that while JCP&L steered its extensive earnings to its parent, the credit rating of FirstEnergy has negatively impacted the credit worthiness of JCP&L. It is fundamentally unfair for the ratepayers to pay more than enough to maintain the stability of the utility and then potentially pay more because of the negative impact of JCP&L's parent on the utility's cost to borrow money. For this reason Rate Counsel is also asking the Board to order the Company to conduct a study to determine ring-fencing measures to protect JCP&L's credit worthiness and thus protect New Jersey ratepayers.

As is evident by the way it started, this is not a standard rate case. It is an opportunity for the Board to reinforce its mandate to ensure safe, adequate and proper service for New Jersey's ratepayers at just and reasonable rates. It is an opportunity to

rein in JCP&L's persistent reliability problems, to ensure appropriate and continued investment in New Jersey's infrastructure, and the financial health of a local utility. Rate Counsel is confident that the record in this case supports the relief sought by Rate Counsel and we respectfully request that Your Honor and the Board grant that relief.

PROCEDURAL HISTORY

By Order dated July 31, 2011, pursuant to a petition filed by the Division of Rate Counsel (:Rate Counsel") the New Jersey Board of Public Utilities ("BPU" or the "Board") directed Jersey Central Power and Light Company ("JCP&L") to file a base rate case on or before November 1, 2012 using an historical 2011 test year.[1] In so ordering, the Board noted that JCP&L had not filed a base rate case since its last rate Order dated May 2005. Id. at 11. The Board further considered the various service related issues arising out of the 2011 major storms and the "recent reliability and service quality concerns" that "necessitated . . . a special investigation into JCP&L's underground electric system." Id. at 12. The Board therefore found:

> that a base rate proceeding with appropriate data including an examination of rate base, expenses, operations and rate of return as required by N.J.S.A. 48:2-21 will assure the provision of safe, adequate and proper utility service to its customers as required by N.J.S.A. 48:2-23. The rate case will include a review of financial integrity and adequacy of capital expenditures, and provide valuable insight as to the company's operational efficiency and organizational effectiveness.

JCP&L Base Rate Case

On November 30, 2012[2], Jersey Central Power and Light Company filed a petition with supporting testimony with the Board of Public Utilities requesting an increase of $31.7 million in their electric base rates. In addition to the $31.7 million rate

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[1] I/M/O The Petition of Rate Counsel Requesting a Board Order Directing Jersey Central Power And Light Company To File a Base Rate Case Petition and Establishing a Test Year Of 2010**,** BPU Dkt. No. EO11090528, Order, (7/31/12).

[2] By letter dated October 31, 2012, JCP&L requested an extension of the filing date so that the Company could address the aftermath of Hurricane Sandy. By Order dated November 11, 2012, the Company was granted the filing extension until December 3, 2012.

increase, JCP&L requested BPU approval for its implementation of an accelerated reliability enhancement program ("AREP") and the associated cost recovery mechanism.

The matter was transmitted to the Office of Administrative Law ("OAL") on December 10, 2012 for evidentiary hearings and was assigned to the Honorable Richard McGill, Administrative Law Judge ("ALJ").

The following parties filed motions for intervention and ALJ McGill granted their requests: Gerdau Ameristeel Sayreville Inc. ("Gerdau"). New Jersey Large Energy Users Coalition ("NJLEUC"), Wal-Mart Stores East, L.P. and Sam's East, Inc. (collectively "Walmart"), AARP, Tewksbury Township ("Tewksbury"), Township of Robbinsville ("Robbinsville"), Township of West Milford ("West Milford"), Township of Wayne ("Wayne"), County of Morris ("Morris") and Consolidated Edison Development, Inc. ("Consolidated Edison").

In addition, Public Service Electric and Gas ("PSE&G") and New Jersey Natural Gas Company ("NJNG") filed for and were granted participant status from ALJ McGill.

On February 8, 2013, a prehearing conference was held before ALJ McGill and a Prehearing Order was issued on March 7, 2013. In accordance with the schedule set forth in the Prehearing Order, discovery was propounded. Public hearings were held on April, 8, 2013 (Toms River), April 16, 2013 (Morristown) and April 24, 2013 (Freehold).

On February 22, 2013, the Company updated its filing to include costs associated with Hurricane Sandy and the November 2012 Nor'easter.

On May 31, 2013, JCP&L filed the supplemental direct testimony of Jeffrey L. Adams (JC-12 Supplemental).

On June 14, 2013, Rate Counsel filed direct testimonies of six witnesses. On that same day, Consolidated Edison filed the testimony of Stephen B. Wemple (CED-6), Gerdau filed the testimonies of Jeffry Pollock (Gerdau-4), Mark Quiring (Gerdau-6), and Kevin O'Donnell (Gerdau-1), and Walmart filed the direct testimony of Steve Chriss (WM-1).

In addition on that same day, JCP&L filed the deprecation study and supporting testimony and an updated version of Appendix G.

On July 3, 2013 Rate Counsel filed the direct testimonies of Michael Majoros (RC-166) and David Peterson (RC-152).

On August 7, 2013, Rate Counsel filed the rebuttal testimony of David Peterson (RC-153) that addressed rate design issues raised by the intervenors. On that same day, JCP&L filed the rebuttal testimonies and exhibits.

On August 30, 2013, Rate Counsel filed the supplemental testimony of Robert Henkes (RC-146) to reflect the Company's updates and revised schedules.

Evidentiary hearings, which included oral surrebuttal testimony on behalf of Rate Counsel, were held at the OAL on September 12, 16, 23 and October 1, 2, 4, 7, 9, 10, 16 and 19, 2013

According to the schedule set at the last evidentiary hearing, initial brief were due on January 17, 2014 and reply briefs on February 14, 2014. The schedule was subsequently modified, initial briefs are now due on January 27, 2014 and reply briefs are due on February 24, 2014.

Motions

Depreciation Study

On January 10, 2013, Rate Counsel submitted a Notice of Motion to Compel a New Depreciation Study as JCP& refused to prepare and file a new deprecation study. On January 22, 2013, JCP&L filed a reply letter brief in opposition to the request. On January 25, 2013, Rate Counsel filed a response letter reiterating its initial position. On February 1, 2013, ALJ McGill denied Rate Counsel's motion to compel.

On February 7, 2013, Rate Counsel filed with a Request for Interlocutory Review of ALJ McGill's February 1, 2013 Order with the BPU. On February 13, 2013, JCP&L filed a response. At the February 20, 2013 Board Agenda meeting, the Board granted Rate Counsel's Request for an Interlocutory Review. On March 20, 2013 the BPU issued on Order compelling JCP&L to file a new depreciation study as part of its pending rate case on or before June 14, 2013.

2011 and 2012 Storm Damage Prudency Review

On March 20, 2013, the BPU issued an Order[3] initiating a generic proceeding to investigate the prudency of costs incurred by all New Jersey utilities for utility service restoration efforts associated with Major Storm Events in 2011 and 2012.

On April 4, 2013, JCP&L filed Motion for Reconsideration and/or Clarification of the Board's March 20, 2013 Order. The following day, JCP&L filed a letter motion with ALJ McGill requesting that the: (1) defer action on BPU's request to turn over a portion of the case to the agency until the Board acted on JCP&L's Motion for Reconsideration and/or Clarification, and (2) suspend the procedural schedule in the base rate case pending Board action on JCP&L's motion. On April 15, 2013, Rate Counsel filed a response motion opposing JCP&L's request for a suspension of the procedural schedule.

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[3] I/M/O the Board's Establishment of a Generic Proceeding to Review the Prudency of Costs Incurred by New Jersey Utility Companies in Response to Major Storm Events in 2011 and 2012 ("2011 and 2012 Major Storm Events Order"), BPU Dkt. No. EX13030196, (3/20/13)

On April 15, 2013, ALJ McGill found that the Company's entire supplemental filing should be returned to the Board and denied JCP&L's request to suspend the procedural schedule with the exception of any procedures concerning expenditures related to major storm events.

On May 31, 2013, the BPU issued an Order[4] that affirmed the 2011 and 2012 Major Storm Events Order and clarified a portion of the Order that pertained to the Major Storm Event costs that were being reviewed.

Township of Marlboro Motion

On April 17, 2013, Township of Marlboro filed a letter motion requesting that ALJ McGill establish an escrow account to fund experts and professional fees that Marlboro will have to expend to participate in JCP&L's 2012 Base Rate Case. On April 25, 2013, Rate Counsel filed a letter response that urged ALJ McGill to deny Marlboro's request. On April 26, 2013, JCP&L filed a letter in support of Rate Counsel's postion. On May 14, 2013, Marlboro filed a Request for Oral Argument. JCP&L filed a letter in opposition to Marlboro's request. On May 22, 2013, ALJ McGill issued an Order that denied Marlboro's request for oral argument and their motion.

On June 3, 2013, the Township of Marlboro filed a Request for Interlocutory Review of ALJ McGill's May 22, 2013 Order. On June 6, 2013, Rate Counsel and JCP&L filed motions in response, opposing Marlboro's request. On June 21, 2013, the BPU issued on Order affirming the decision issued by ALJ McGill.

Motion to Compel Documents

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[4] I/M/O the Board's Establishment of a Generic Proceeding to Review the Prudency of Costs Incurred by New Jersey Utility Companies in Response to Major Storm Events in 2011 and 2012, BPU Dkt. No. EX13030196 and I/M/O the Board's Review the Prudency of the Costs Incurred by Jersey Central Power and Light Company in Response to Major Storm Events in 2011 and 2012, BPU Dkt. No. EO13050391, (5/31/13).

On May 30, 2013 Rate Counsel filed a motion to compel requesting that JCP&L comply with the Agreement of Non-Disclosure of Information Claimed to Be Confidential ("Agreement") and be required to provide public, redacted copies of documents claimed to be confidential. On June 7, 2013, JCP&L filed a response opposing Rate Counsel's motion. On June 14, 2013, Rate Counsel filed a response to JCP&L's opposition reiterating the need for redacted versions of documents labeled as "Confidential". On July 10, 2013, ALJ McGill issued an Order that required Rate Counsel to provide a list of the documents claimed to be confidential that Rate Counsel intended to challenge.

Rate Counsel filed on letter on July 22, 2013 that challenged 39 discovery responses that were designated as confidential. On August 1, 2013, JCP&L filed a motion for a Protective Order for 21 of the 39 responses and argued that they should remain confidential. Rate Counsel responded in a letter on August 12, 2013 opposing JCP&L's motion and challenged 13 of the 21 discovery responses. On August 19, 2013, JCP&L filed a reply. On September 4, 2013, ALJ McGill issued an Order granting JCP&L's request that 12 responses be designated as confidential but denied their request for one response.

STATEMENT OF FACTS

JCP&L is a public utility corporation of the State of New Jersey and is subject to the jurisdiction of the Board. JCP&L maintains a regional office at 300 Madison Avenue, Morristown, New Jersey. The Company is a direct, wholly owned subsidiary of FirstEnergy, Corporation, which is a corporate holding company that owns several other major electric utility operating companies in Pennsylvania, Ohio, West Virginia and Maryland. In addition, FirstEnergy has extensive non-regulated operations. FirstEnergy acquired through mergers and acquisitions the utilities and other assets of the former GPU (which previously owned JCP&L) and Allegheny Energy. *RC-111*.

JCP&L is engaged in the retail distribution and sale of electric energy for residential, commercial and industrial purposes to more that 1,000,000 customers located within 13 counties and 236 municipalities in New Jersey. The Company is subject to the jurisdiction of the Board pursuant to N.J.S.A. 48:2-21 et seq.

JCP&L's previous base rate case was filed on August 1, 2002. The 2002 Petition was filed in response to the Board's directive in the Final Restructuring Order.[5] In that 2002 base rate proceeding, the Board found that the Company's "*pro forma* operating income at present rates to be $300,436,000 or $131,470,000 more than its operating income requirement."[6] The Company was directed to "reduce its base rates by $222.7 million. In addition, the Board ordered a Phase II proceeding "to review whether the Company is in compliance with current service reliability and quality standards" . . . "and

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[5] I/M/O JCP&L d/b/a GPU Energy – Rate Unbundling, Stranded Cost and Restructuring Filings, BPU Dkt. Nos. EO97070458, EO97070459, and EO97070460, Final Decision and Order, p. 91,36 (March 7, 2001).

[6] I/M/O the Verified Petition of JCP&L for Review and Approval of an Increase in and Adjustments to Its Unbundled Rates and Charges for Electric Service, and for Approval of Other Proposed Tariff Revisions in Connection Therewith, et. al., BPU Docket No. ER02080506 et. al., Final Order, p. 78, (May 17, 2004)("2004 Final Order").

to address whether additional performance standards are required for JCP&L." Id. p. 69.

In addition, the Board Order ruled:

> The Board will use the allowed return on equity as the most direct and powerful signal that they can send to the company to improve their system reliability and do it as soon as practicable. The Board ORDERS that the Company's return on equity be reduced from the 9.75% allowed to 9.5%, a reduction in 25 basis points until such time as the Company provides sufficient evidence to the Board that they have made the necessary improvements required to maintain system reliability.

Id. at 39.

In accordance with the Board's Final Order, on July 16, 2004, JCP&L filed its Phase II Petition seeking a total of $55 million.[7] The 2005 Order adopted two stipulations of settlement and resolved the Phase II proceeding.

Stipulation I resolved issues related to pending motions for reconsideration of the Final Order. Stipulation I, which was executed by JCP&L and Board Staff, increased distribution revenues by $23.0 million a year which included a two year amortization of $42.7 million in costs to achieve merger savings and an extension of the three year amortization of unamortized storm costs for an additional eight years with no change in recovery level.

Stipulation II, executed by JCP&L, Board Staff and Rate Counsel resolved the Phase II proceeding. Stipulation II increased distribution revenues by $36.1 million. This increase reflected a three-year amortization of one-time operation and maintenance costs incurred in 2003-2005 relating to Reliability Programs other than accelerated tree trimming costs and a three year amortization of accelerated tree trimming costs incurred

[7] I/M/O the Verified Petition of JCP&L for Review and Approval of an Increase in and Adjustments to Its Unbundled Rates and Charges for Electric Service, and for Approval of Other Proposed Tariff Revisions in Connection Therewith, et. al., BPU Docket No. ER02080506 et. al., Decision and Order Adopting Stipulations of Settlements Approving Phase II Rate Increase and Resolving Motion and Cross Motion for Reconsideration, (May 31, 2005) ("2005 Order") .

in 2003-2005. Id. at 10. Stipulation II also provided for continued monitoring of JCP&L reliability metrics with potential penalties for not meeting established standards. Id. at 11

In this base rate case, JCP&L's Petition was again filed in response to a Board Order.[8] On November 30, 2012, JCP&L filed a Petition seeking an increase of revenues of $31.47 million annually and seeking Board authority to implement an Accelerated Reliability Enhancement Program ("AREP") under which the Company would accelerate capital investment "for the purpose of enhancing the Company's reliability." Petition, p.7. The Company's case is based on a fully historic 2011 test year.

Company witnesses:

> Mr. Mark A. Mader, Director, Rates and Regulatory Affairs for New Jersey, served as a policy witness for JCP&L. *JC-2* Mr. Mader focused on the Company's need for rate relief. He also testified regarding the revenue normalization adjustments and the costs to achieve merger savings. Mr. Mader was also the Company witness in support of the proposed AREP. On February 22, 2012, Mr. Mader filed Supplemental testimony to include costs in this base rate case associated with the 2012 major storms. Mr. Mader testified that including these costs in this case would increase the Company requested increase to $112,324,536 annually. *JC-2 Supplemental.* Mr. Mader subsequently updated his testimony to include the results of the Board ordered depreciation study. This second update excluded 2012 major storm costs pursuant to the Board's directive in the generic storm cost proceeding. Based on this update, the Company proposed an increase of $20.624 million. *JC-2 Supplemental 2*. Mr. Mader also filed rebuttal testimony addressing issues raised by Rate Counsel witnesses Robert Henkes and Andrea Crane and Gerdau witness Jeffry Pollock.
>
> Susan D. Marano, Staff Business Analyst for JCP&L, presented the revenue requirement for JCP&L, including distribution rate base and operating income and expenses for the 2011 test year. *JC-3* Ms. Marano filed supplemental testimony to reflect the 2012 storm costs in her revenue requirement schedules. *JC-3 Supplemental*. Ms. Marano also filed supplemental testimony to incorporate into her revenue requirement calculation the effects of the revised depreciation expense resulting from the Board ordered depreciation study, the revised cash working capital allowance as corrected by Mr. Adams to exclude transmission expenses and to incorporate other corrections and revisions revealed

[8] I/M/O The Petition of Rate Counsel Requesting a Board Order Directing Jersey Central Power And Light Company To File a Base Rate Case Petition and Establishing a Test Year Of 2010, BPU Dkt. No. EO11090528, Order, (7/31/12).

during the discovery process. *JC-3 supplemental 2*. Ms. Marano also filed rebuttal testimony responding to issues raised by Rate Counsel witness Henkes. At the evidentiary hearing before Judge McGill, Richard D'Angelo, Manager of Regulatory Affairs, Pennsylvania, adopted Ms. Marano's testimony due to Ms. Marano's retirement shortly after the final piece of rebuttal testimony was filed. *T13:L18-25 (Oct. 7, 2013.)*

Carol Pittavino, Staff Business Analysis, testified to the normalization / annualization operations and maintenance expense adjustments to the test year. *JC-4* Ms. Pittavino filed supplemental testimony to include annualized depreciation expense related to the 2012 major storm capital additions. *JC-4 Supplemental*. Ms Pittavino filed additional supplemental testimony to reflect depreciation expense updates and to "reflect corrections discovered during the course of discovery." *JC-4, Supplemental 2*.

Steven R. Staub, Executive Director and Assistant Treasure, FirstEnergy Service Company, testified regarding the Company's proposed capital structure and cost of capital. *JC-5* Mr. Staub's rebuttal testimony addressed the testimony of Rate Counsel witness Matthew I. Kahal and Gerdau witness Kevin W. O' Donnell. *JC-5 Rebuttal.*

Pauline M. Ahern recommended a cost of equity for JCP&L in the range of 11.45 to 11.60%. *JC-6* In her rebuttal testimony, Ms. Ahern revised her cost of equity recommendation downward to a range of 10.8% to 11.0%. *JC-6 Rebuttal*.

Meghan C. Moreland sponsored JCP&L's cost of service study. *JC-7* Ms. Moreland subsequently revised her cost of service study to reflect the 2012 major storm costs. *JC-7 Supplemental*. Ms. Moreland filed additional supplemental testimony on June 14, 2013 (*JC-7 Supplemental 2*) and rebuttal testimony on August 7, 2013 *JC-7 Rebuttal*.

Sally J. Cheong provided testimony regarding JCP&L's proposed tariff revisions and testified regarding the proposed rate design and customer impacts. *JC-8* Ms. Cheong updated her rate design testimony to include the effects of the 2012 major storm costs. *JC-8 Supplemental*. Ms. Cheong filed additional supplemental testimony on June 14, 2013 addressing "various revisions to rate base and expenses" (*JC-8 Supplemental 2*) and rebuttal testimony on August 7, 2013 responding to Gerdauy witness Pollack regarding the rate design of the Company's proposed AREP and to Consolidated Edison witness Wemple regarding a billing issue for solar projects. *JC-8 Rebuttal*.

Kevin F. Connelly testified regarding proposed tariff modifications and proposed fee changes. *JC-9* Mr. Connelly filed rebuttal testimony to Rate Counsel witness David Peterson's recommended revisions to proposed tariff changes.

Marlene A. Barwood testified regarding FirstEnergy Service Company services and charges. *JC-10*

James I. Warren, a tax attorney with the Washington D.C. firm Miller & Chevalier Chartered, testified in support of JCP&L's position that reflecting a consolidated income tax adjustment would be inappropriate. *JC-11* Mr. Warren filed rebuttal testimony reiterating his position that the Board should not impose a consolidated tax adjustment in this proceeding. *JC-11 Rebuttal*.

Jeffrey L. Adams testified in support of the Company's cash working capital rate base adjustment. *JC-12* Mr. Adams subsequently updated his direct testimony to remove from his lead/lag study transmission revenues and expenses. *JC-12 Supplemental*. Mr. Adams filed rebuttal testimony setting out his disagreement with Rate Counsel witness Peterson's recommended adjustments to JCP&L's proposed lead/lag study. *JC-12 Rebuttal*.

Donald M. Lynch, President, JCP&L, addressed the Company electric distribution operations, capital investments and O&M expenses. *JC-13*. Mr. Lynch filed supplemental direct testimony regarding the 2012 major storm restoration effort and costs. *JC-13, Supplemental*. Mr. Lynch retired and his testimony was adopted at the hearing by Company witness Strah. *T49:L16-23*. (Oct. 1, 2013).

Steven E. Strah, FirstEnergy Services Corp, Vice President, Distribution support, testified regarding allocations and the budget process for FirstEnergy system utilities. *JC-14* Mr. Strah in his rebuttal testimony addressed Rate Counsel witness Peter Lanzalotta's testimony regarding the Company's reliability performance and Rate Counsel witness Colton's testimony about JCP&L's communications. *JC-14 Rebuttal.*

Jeffrey W. Cummings, Vice President, UMS Group, testified regarding JCP&L's reliability and investment spending levels. *JC-15*. Mr. Cummings in his rebuttal testimony addressed Rate Counsel witness Lanzalotta's testimony regarding JCP&L reliability performance. *JC-15 Rebuttal.*

Ralph C. Hillmer provided testimony regarding the Company's vegetation management practices. *JC-16* Mr. Hillmer in his rebuttal testimony addressed Rate Counsel witness Lanzalotta's testimony regarding JCP&L vegetation management practices and Rate Counsel witness Henkes' proposed adjustment to the Company tree trimming expense amount. *JC-16 Rebuttal*

Dennis Pavagahdi filed testimony regarding changes to Appendix A of the tariff – costs of underground construction. *JC-17*

John J. Spanos is the Company's depreciation witness and sponsor of the depreciation study filed in June 2013. *JC-18.* Mr. Spanos filed rebuttal testimony

responding to the direct testimony of Rate Counsel witness Majoros. *JC-18 Rebuttal*

Harvey Wagner filed Rebuttal Testimony responding to the testimony of Rate Counsel witness Mitchell Serota with respect to Rate Counsel's proposed adjustments to pension and OPEB expenses. *JC-19 Rebuttal*

Gary W. Grant, Jr. filed Rebuttal Testimony with respect to the Company's billing and collection practices. *JC-20 Rebuttal*

Mark A. Jones filed Rebuttal Testimony with respect to the Company's communications issues discussed in the direct testimony of Rate Counsel witness Colton. *JC-21 Rebuttal*

Christine L. Walker filed Rebuttal Testimony with respect to the FirstEnergy's Incentive Compensation and Supplemental Employee Retirement Plan. *JC-22 Rebuttal*

James F. Pearson filed Rebuttal Testimony with respect to the financial impact of Rate Counsel's proposed rate reduction. *JC-23 Rebuttal*

Rate Counsel witnesses:

Robert Henkes filed testimony on the appropriate rate base, pro forma operating income, and overall revenue requirement for JCP&L. Mr. Henkes in his initial filing recommended a $202,759.000 rate decrease. *RC-145*, On August 30, 2013, Rate Counsel filed the supplemental testimony of Robert Henkes to reflect the Company's updates and revised schedules. This update demonstrated that a $214,868,000 rate decrease was appropriate. *RC-146*

At the hearing on October 7, 2013, in oral surrebuttal, Mr. Henkes responded to the rebuttal testimony of the Company's witnesses. *T56:L1-T74:L22* (Oct. 7, 2013). In his surrebuttal, Mr. Henkes recommended that the 2011 storm costs determined by the Board to be reasonable and prudent and incorporated into this base rate proceeding should be amortized over a six year period rather than the 3 year period proposed by the Company. T57:L73:16 – T74:22.

Matthew I. Kahal filed testimony on behalf of Rate Counsel on the fair rate of return on JCP&L's jurisdictional electric distribution rate base. Mr. Kahal recommended an overall cost of capital of 7.76 percent reflecting a 9.25 percent return on equity and a hypothetical 50/50 capital structure. Mr Kahal recommended the use of a hypothetical capital structure due to the $1.8 billion of goodwill embedded in the Company's capital structure. Mr. Kahal further recommended that JCP&L should be directed to undertake additional ring fencing measures to protect the Company's credit rating. *RC-111*.

Andrea C. Crane filed testimony on the behalf of Rate Counsel on two issues, the Company's proposed AREP and the proper calculation of the consolidated tax benefit adjustment. Ms. Crane calculated a $511.66 million rate base deduction using the Board approved CTA Methodology. In addition, Ms. Crane recommended that the Board reject the Company proposed AREP as the Company has not shown that the AREP would benefit customers but would reduce shareholder risk, transfer risk from shareholders to ratepayers, and increase shareholder's actual return on equity. *RC-13*

Mitchell Serota testified regarding the Company's proposed pension expense adjustment. Mr. Serota found that the Company's proposed pension expense of $40.4 million was driven by FirstEnergy's decision to change accounting methods and to incorporate in the pension expense for ratemaking purposed the large actuarial loss in the test year. Mr. Serota recommended that the proper pension expense for the test year is $2,738,000, arguing that this amount is designed to strip out all actuarial gains and losses leaving the pension expense with the true on-going cost of the pension plan. *RC-158*,

Peter Lanzalotta testified regarding the Company's performance, as measured by current BPU reliability standards, and addressed the issue of possible modifications to those standards. *RC-87*

Roger Colton filed testimony on behalf of Rate Counsel to assess the Company's performance during storm events and to evaluate the Company's performance on certain customer credit and collection service issue. *RC-72*.

Michael J. Majoros reviewed the accuracy and reasonableness of the Company's depreciation study. *RC-166*. Mr. Majoros proposed a $1.6 million decrease in the Company's depreciation rates. Mr. Majoros also proposed the amortization of the Company depreciation reserve excess.

David Peterson filed testimony on behalf of Rate Counsel regarding the Company's cash working capital lead/lag study and JCP&L's embedded class cost of service study. Mr. Peterson's made a $69.8 million adjustment to the Company's proposed cash working capital allowance based on modifications to the Company's lead/lag study. Mr. Peterson also addressed proposed changes to the Company's service charges and proposed an allocation of Rate Counsel's recommended revenue decrease among the various rate classes which reflected basically the same cost of service and rate design principles set out in the testimony of JCP&L's witnesses Cheong and Moreland. *RC-152*. On August 7, 2013, Rate Counsel filed the rebuttal testimony of David Peterson that addressed rate design issues raised by the intervenors. *RC-153*.

<u>Intervenor Testimony</u>

Stephen B. Wemple filed testimony in this proceeding on behalf of Consolidated Edison proposing changes to JCP&L's tariff to accormodate lare solar electricity producing customers. *CED-6.*

Jeffry Pollock filed testimony on behalf of Gerdau addressing JCP&L's cost of service study. *Gerdau-4.*

Mark Quiring filed testimony on behalf of intervenor Gerdau (*Gerdau-6)* regarding the impact of the JCP&L's rates and proposed AREP on industrial customers. Gerdau also filed the testimony of Kevin O'Donnell. *Gerdau-1.*

Steve Chriss filed direct testimony on behalf of Walmart. *WM-1.*

As set forth more fully in the sections which follow, and in the testimony of Rate Counsel's witnesses, the Company's request is excessive and should be rejected. Rate Counsel asserts that in accordance with the analyses and recommendations set forth in the testimony of Rate Counsel's witnesses, a rate decrease of approximately $214 million is an appropriate increase in base rates. *RC-146, RJH-.* In sum, as set forth in the sections which follow, Rate Counsel respectfully submits that Rate Counsel's recommended adjustments and modifications to the Company's request be adopted by Your Honor and the Board.

ARGUMENT

POINT I

THE CYCLE OF JCP&L'S POOR PERFORMANCE SHOULD BE STOPPED AND THE COMPNAY SHOULD BE REQUIRED TO IMPROVE ITS RELIABILITY PERFORMANCE OR FACES SPECIFIC FINANCIAL CONSEQUENCES.

A. INTRODUCTION

New Jersey Statutes expressly require JCP&L to provide safe adequate and proper service at just and reasonable rates. N.J.S.A. 48:2-21 and N.J.S.A. 48:2-23. Reliability is a cornerstone of safe, adequate and proper service. To measure an electric company's reliability performance the Board looks at **SAIFI** (System Average Interruption Frequency Index) which measures the average frequency of sustained interruptions per customer during the reporting period and **CAIDI** (Customer Average Interruption Duration Index) which measures the average time in minutes required to restore service to those customers that experienced sustained interruptions during the reporting period. See, N.J.A.C. 14:5-1.2 and N.J.A.C. 14:5-8.7. The Board sets a minimum reliability level which each electric public utility must meet by using each company's 5 year SAIFI and CAIDI average (without major events) between the years 2002 to 2006 with 1.5 standard deviation. N.J.A.C. 14:5-8.9.

As will be discussed herein, the Board's existing reliability standards for JCP&L are set too low. JCP&L's performance between 2002-2006 was sub-standard. By measuring JCP&L's current performance based on its performance during that period the Company is being permitted to continue its sub-standard reliability performance. Furthermore, the Company uses the term "major event" too liberally, which allows it to

remove too many outages from its data and causes the SAIFI and CAIDI numbers reported to the Board in its Annual System Performance Report to appear better than what is experienced by JCP&L's customers. Instead of solely relying on the minimum reliability levels currently set for JCP&L, the Board should consider modifying the minimum reliability benchmark by using more recent, SAIFI and CAIDI data, and setting a different benchmark utilizing other measures such as CEMI[9] to address pockets of poorly performing areas that may be too small to be captured by SAIFI and CAIDI. Even if the Board does not alter its standards, it must acknowledge JCP&L's poor performance and specifically order the Company to establish an improvement plan with specific deadlines and consequences, such as a reduction of its Return or Equity, if reliability does not improve.

B. JCP&L MINIMUM RELIABILITY LEVEL IS SET USING THE COMPANY'S WORST PERFORMING YEARS

In order to put JCP&L's current reliability performance in context and to understand the reliability concerns expressed by its customers, it is important to look at the Company's past performance. This is especially critical because the Board's own reliability requirements are heavily focused on past performance as a measure of current conditions. Although JCP&L claims that its current reliability is more than adequate and meets the reliability standards set by the Board, the Board's benchmarks are based on JCP&L's performance from 2002- 2006,[10] a period of time when JCP&L was providing extremely poor service. As acknowledged by Company witness Mr. Strah during cross examination, 4 out of the 5 data points used to set the CAIDI and SAIFI minimum

[9] Customers experiencing multiple interruptions ("CEMI").

[10] The current benchmark is set at 5 year average between the years 2002 to 2006 with 1.5 standard deviation. N.J.A.C. 14:5-8.9.

reliability levels for JCP&L represent the Company's worst performance in the last 10 years. *RC-79* and *T:71L21-T73L2* (October 2, 2013).

The Board in its Order approving JCP&L's last base rate case in 2003 noted that reliability problems in JCP&L were, even at that time, old news: "[t]he board has long had a concern with reliability in JCP&L's service territory." I/M/O The Verified Petition of Jersey Central Power & Light Company for Review and Approval of an Increase in and Adjustment to its Unbundled Rates and Charges for Electric Service and For Approval of Other Proposed Tariff Revisions In Connection Therewith. Docket No. ER02080506 –Final Order (May 17, 2004) at p. 68.

The Board also noted JCP&L's failure to maintain its system:

> During the course of litigating and deliberating on this case, the Board was compelled to deal with a number of operating problems directly attributable to JCP&L's failure to appropriately maintain system reliability. These recurring problems brought into sharp focus the potentially serious long-term negative impacts on their customers, the economy of their service territory and on the confidence of ratepayers in the Boards ability to effectively regulate JCP&L. The Board cannot ignore these recurring reliability problems and determined to take immediate action to construct an interim remedial regulatory incentive mechanism. *Id*. p. 39.

To address these concerns, the Board adopted the analysis and resulting recommendations of Staff, finding that JCP&L's return on equity should be lowered by 25 basis points due to the Company's poor reliability performance:

> The Board will use the allowed return on equity as the most direct and powerful signal that they can send to the company to improve their system reliability and do it as soon as practicable. The Board **ORDERS** that the Company's return on equity be reduced from the 9.75% allowed above to 9.50%, a reduction of 25 basis points, until such time as the Company provides sufficient evidence to the Board that they have made the necessary improvements required to maintain system reliability. *Id*.

The Board also initiated two separate reliability audits to investigate the Company's maintenance practices and to ensure that JCP&L was providing safe, adequate and proper service to its customers. The first audit was initiated on August 2, 2002 when a severe thunderstorm resulted in approximately 180,000 JCP&L customers losing service and "approximately 40,000 customers were without electricity for over three days, and the total restoration was not completed until five days after the storm." *RC-75,* p 1. The Board retained the services of Booth and Associates to complete a Focused Audit of the Planning, Operations and Maintenance Practices, Policies and Procedures of JCP&L. *Id*. Subsequently, during the pendency of the 2003 base rate case, JCP&L had a major outage on July 5, 2003 due to a sub-transmission failure causing prolonged outages in six shore towns during peak tourist season. At the behest of then Governor James E. McGreevey, the Board issued an Order Directing the Implementation of Corrective Measures and Investigation in a separate BPU docket[11]. As part of the investigation in the July 5th outage, the Board retained the services of Downes and Associates as a Special Reliability Master to, among other things, oversee JCP&L's maintenance and performance standards and to make recommendations to the Board. *Id*. p. 2. Both Booth and Associates and Downes and Associates submitted reports and thereafter by Order dated July 23, 2004, the Board accepted chapters 1 and 12 of the Booth Report and Downes Report in its entirety and adopted a stipulation between BPU Staff and the Company based recommendations made in the two reports to improve JCP&L's system. *Id*. pp. 4-5.

The recommendations of the Booth and Downes Reports, makes clear that JCP&L allowed its system to deteriorate over many years. The very first finding of the Booth

[11] . Docket No. EX03070503

Audit was that JCP&L's problems and deficiencies "are predominantly in the areas which have developed over a course of ten to twenty years." *RC-74*, pp. 1-5. The Booth Audit's negative observations included, among other things:

4. For the substation inspected, direct lightning strike shielding was non-existent for the most part. Only three (3) of the 24 substations inspected had any kind of lightning protection. JCP&L has acknowledged that such protection was not standard JCP&L practice in the past, but states that it is part of current construction standards for new installations;

   (a) JCP&L uses an approach towards repair and maintenance of distribution poles which is often temporary in scope rather than completing a permanent repair upon identification of a repair or maintenance need. Rotten poles are either patched instead of replaced or simply left in place with no action. Damaged poles are splinted as a means of lowering maintenance cost. Only double red-tagged poles are replaced. Double red tag poles mean that they cannot be climbed. This means the pole inspector may have called for this pole to be replaced not once but twice or the inspector has determined that the pole is unsafe to climb. To further exacerbate the distribution pole maintenance deficiency, JCP&L has eliminated the cyclic pole inspection program. Therefore, by default, JCP&L has gone to a program of replacement upon failure for low growth areas of its system.

7. JCP&L's capital expenditures for the last five years have averaged $160 million. The 2003 Budget is $102 million and $120 million for the years 2004-2007. Operating and maintenance expenditures have averaged $117 million for the last five years. The 2003 Budgeted T&D O&M is $161 million, including an incremental $21 million for the Company's voluntary Accelerated Reliability Improvement Program. These levels of spending have not been sufficient to prevent the deterioration of the electric infrastructure.

12. JCP&L's combined Northern and Central CAIDI for the year 2002 was the second highest level (2.53 hours) [12] in the last ten years. JCP&L's combined Northern and Central Areas SAIFI for the year 2002 was also the second highest level (1.18) in the last ten years. In the Northern Region the highest cause of interruptions and customer minutes for 2002 was tree related outages. In the Central Region the highest cause of interruptions and customer minutes for 2002 was equipment failure.

    RC-74, pp. 1-6 to 1-8.

[12] 2.53 hours of CAIDI equals 156 minutes CAIDI.

The Booth Audit makes clear that JCP&L has a long history of poor reliability performance. In response to the audits, the Board awarded additional funds to JCP&L in the Phase II of the Company's last base rate case in 2005 to allow it to improve its reliability. I/M/O the Verified Petition of Jersey Central Power and Light Company For Review and Approval of An Increase In and Adjustments To Its Unbundled Rates and Charges for Electric Service, and for approval of Other Proposed Tariff Revisions In Connection Therewith, BPU Docket No. ER02080506 (May 31, 2005). But as discussed below, after making initial repairs, it is unclear whether the Company continued to use all the funds collected for continued reliability investment. Instead, it appears that excess funds went to shareholder dividends.

JCP&L's poor performance continues to this day. For example JCP&L experienced a series of reliability incidents in its Morristown Underground Distribution System that spurred the Board to appoint yet another Special Reliability Master. In the Order that directed JCP&L to hire the Special Reliability Master, the Board noted:

> A series of reliability-related events or "incidents" have occurred over the past several years on the Morristown under ground electric system. The number of incidents and the severity of some of the incidents, lead the Board to conclude that there needs to be an investigation to determine if the incidents reflect systemic problems in the system, and if so, what measures, if any should be taken by the Company to rectify the situation.
>
> The latest incident, on August 31, 2011, resulted in personal injuries when heat discharged from a manhole injured a motorist waiting at a traffic light in Morristown, New Jersey. Before that, the Morristown community experienced a series of explosions that caused serious damage to the Morristown and Morris Township Library in May of 2010. There have also been a number of other incidents where equipment malfunctions have caused power interruptions. Since 2005, there has been at least four other

> incidents where power was lost, evacuations were required or explosions that could have endangered lives have occurred.
>
> I/M/O the Board's Investigation into Reliability Issues Related to Jersey Central Power & Light Company's Morristown Underground System, Reliability & Security and Energy, BPU Docket EO11090526 (Sept. 22, 2011) p. 2.

The conclusion of the Special Reliability Master after his audit was nothing short of damning of JCP&L's poor maintenance practices.

> The [Special Reliability Master's] report was critical of JCP&L's performance with respect to preventive and corrective maintenance procedures on its underground network system …
>
> The report found that, while the plan, design and construction of the Network are sound, JCP&L had not followed its own procedures for undertaking preventive maintenance; that JCP&L failed to appropriately prioritize corrective maintenance measures; and that the Company was deficient with respect record keeping regarding corrective maintenance issues. The report also indicated that the Company needed to improve communications with local officials. I/M/O the Petition of Rate Counsel Requesting a Board Order Directing Jersey Central Power & Light Company to File a Base Rate Case Petition and Establishing a Test Year of 2010, Order BPU Docket No. EO11090528 (July 31, 2012) p. 12.

Another example of JCP&L's poor maintenance practices negatively impacting its customers was during the aftermath of Hurricane Irene. Upon reviewing all four of New Jersey's electric utilities, the Board was most critical of JCP&L:

> While Staff's Hurricane Irene Report found that certain practices of all the electric utilities need to be reexamined, it specified that JCP&L was deficient in its storm restoration process, and that the Company's planning and preparation in the areas of communications, estimating outage restoration, supplemental crew mobilization and mitigation of tree related damages particularly required review. *Id*.

When the Company was ordered to file the present base rate case, the Board cited to the Morristown Underground Fire and the Company's response to Hurricane Irene as an example of reliability problems that troubled the Board stating that whether the

Company has maintained a sufficient level of investment in infrastructure to be able to provide safe adequate and proper service is an issue to be addressed in the base rate case. Id.

Relying solely on JCP&L's reliability performances during 2002 through 2006 as a measure of current reliability performance is no longer sufficient. At this juncture it is imperative that the Board end this cycle and require the Company to invest in its system. The Board should take additional measures to require JCP&L to provide safe, adequate and proper service and reject the Company's attempt to use the extremely lenient minimum reliability standard applicable to JCP&L to excuse its poor performance.

As Rate Counsel witness Mr. Lanzalotta recommended:

> … the benchmark standards and minimum reliability levels for JCP&L, which exclude major event performance, have increasingly become a non-issue in part because they are so far out of touch with the Company's actual performance. Reliability benchmark standards should reflect either more recent historical performance, at a minimum, or they should reflect a reliability target sought after by the Board, rather than just a level of historical performance. *RC-87*, p. 24.

In addition, to address the pockets of poor reliability that JCP&L's customers face Mr. Lanzolatta recommended that JCP&L be required to report the customers experiencing multiple interruptions ("CEMI"). This will permit examination of problems that may be too localized for the Annual System Reliability Report to capture. As Mr. Lanzalotta testified:

> I am aware of the Board's recent initiative addressing poorest performing feeders. The approach of identifying poorest performing feeders, however, does not necessarily address smaller pockets of poor reliability performance on the system. I feel there's a need for the metric such as CEMI, C-E-M-I, refers to customers experiencing multiple interruptions, which provides information about the existence of pockets of customers

smaller than entire distribution feeders that have been experiencing poor performance. *T22:L19 to T23:L4* (October 2, 2013)

In order to address the concerns of JCP&L's residential and business customers, Rate Counsel respectfully requests that the Board set JCP&L's minimum reliability level using more recent CAIDIs and SAIFIs or, in the alternative, develop a benchmark that the Board believes that JCP&L should meet that is more rigorous than the current reliability level. In addition, to address small pockets of the service territory that are riddled with poor performance, the Company should measure and report CEMI to better understand the areas most in need of maintenance and investments. Rate Counsel respectfully requests that the Company be ordered to use this data to develop an improvement plan that includes specific measures and deadlines and that the Board establish consequences for failure to achieve the stated goals.

C. JCP&L HAS PROGRESSIVELY INCREASED THE NUMBER OF MAJOR EVENT DAYS WHICH ARE NOT COUNTED TOWARDS SETTING THE COMPANY'S MINIMUM RELIABILITY LEVELS

As discussed earlier, the Board sets a minimum reliability level for each electric company using the company's 5 year SAIFI and CAIDI average between 2002-2006 **without major storms** and 1.5 standard deviation.[13] N.J.A.C. 14:5-8.9. Due to the increase in the number of major event days, the CAIDI and SAIFI numbers reported by the utility to the Board are becoming less reflective of the customer experience.

In his direct testimony, Mr. Lanzalotta included a table that shows the increase in the number of days each year on which JCP&L experienced a major event. Data from those days were excluded from their reported SAIFI and CAIDI:

Number of Major Events Days by Year

[13] In an normal distributed "bell-shaped" curve 87% of all outcomes are within 1.5 standard deviation from the mean.

Table 1[14]

Year	MEDs[15]
2004	4
2005	9
2006	13
2007	10
2008	40
2009	22
2010	56
2011	*62*

RC-87, p.8.

In 2011 for example, more than one day in six was a major event day. It may have made sense in the past to exclude major event days from the CAIDI and SAIFI reporting requirement when only a handful of days out of the year represented major event days. However with such an exponential increase in major event days in recent years, inclusion of major event days in the Annually System Performance Report becomes critical for the Board to obtain a clear understanding of how the utility is performing in all types of conditions. Therefore, the Board should require JCP&L to report CAIDI and SAIFI with and without major events.

Otherwise, the Board's current regulations may have the effect of encouraging the Company to define more and more bad performance days as "major storms" so that blue sky CAIDIs and SAIFIs appear to be improving. As Mr. Lanzolatta explains:

> As can be seen from my testimony above, the minimum reliability levels provided for SAIFI and CAIDI (without major events) are increasingly marginalized because JCP&L's performance in these metrics is achieved, in part, by declaring an increasing number of days each year as major events. *RC-87*, pp. 23-24

[14] Data taken from Figure III.3 from Cummings Direct Testimony, page 22.
[15] "MED" means major event days.

As Mr. Lanzalotta testified, the Company can manipulate the categorization of "major events." It can declare a major event in both of its service areas when there is a major event in one of them. Also, it can declare major event when providing mutual assistance to other utilities. *Id*.

The report prepared by Booth and Associates noticed similar shifting of outages days in to the major event category, artificially improving the reported blue sky reliability performance. The report stated: "… it is critical to redefine "major events" since the JCP&L definition is too liberal and does not appropriately reflect the magnitude of reliability deficiency" *RC-74,* pp 8-16. Mr. Lanzolatta noted that the current regulations for "reliability performance for periods outside major storms are outdated and so flexible that JCP&L could have a significant decline in its reliability performance, excluding major storm events, and still meet the statutory minimum performance levels." He suggested that the definition of a major event be "tightened up" by setting the benchmark and minimum reliability levels based on a target level set by the Board, rather than by an EDC's past performance. *RC-87*, p. 22.

Therefore, to arrive at a more accurate picture of JCP&L's overall reliability performance, the Board should order JCP&L to include in its annual system report the Company's CAIDI and SAIFI both including and excluding major events. In addition, the Board should better define "major events" so that the definition cannot be modified to skew the Company's performance results. Rate Counsel submits that these measures will ensure that JCP&L's reporting appropriately reflects the true state of the Company's reliability.

D. JCP&L'S DECREASED SPENDING ON VEGETATION MANAGEMENT NEGATIVELY IMPACTED STORM DAMAGE AND RESTORATION.

Vegetation Management is one of the most important measures that an electric utility can take to keep its distribution system resilient, especially during major storms. During Hurricane Irene and the October 2011 Snowstorm, tree related faults were the largest outage cause category and second largest during Hurricane Sandy. *RC 87*, pp 28-29. The Board's regulations specifically require that all electric public utilities operating in the State follow the Board's vegetation management regulations "in order to ensure public safety and the efficient and reliable supply of electric power." N.J.A.C. 14:5-9.1. To this end, the Board requires that an electric utility perform annual visual inspections and perform vegetation management on vegetation that is close enough to pose a threat to its energized conductors at least once every four years. N.J.A.C.14:5-9.4. The evidence in the record shows that despite this regulatory mandate, JCP&L deferred needed vegetation management and reallocated revenues to other projects. Table 7 of Mr. Lanzalotta's direct testimony shows that in 2008-2011, critical periods prior to Hurricane Irene, and Hurricane Sandy, the Company deferred tree trimming. The quality of the trimming is also in question because between 2007-2010 the per mile trimming costs was in the range of $3,773 to $4,641 in contrast to an eight year average of $5,469 per mile spent by the Company. As Mr. Lanzalotta's testimony demonstrates, the low cost per mile may be an indication that fewer tree limbs were pruned or priority trees removed during these years. *RC-87,* p. 31.

Table 7

	JCP&L Distribution				
Year	Miles Trim	Cost ($)	Cost/Mile ($)	SAIDI	Miles
				(with ME)	Deferred
2005	3,073	21,438,756	6,976	137	
2006	1,784	10,201,663	5,718	167	
2007	2,842	12,503,253	4,399	132	
2008	3,923	15,232,972	3,883	164	1,152
2009	3,382	12,761,529	3,773	122	1,135
2010	2,945	13,668,141	4,641	231	902
2011	2,925	23,462,674	8,021	1,298	416
2012	4,001	26,760,999	6,689	3,248	
Ave.	3,109	17,003,748	5,469		

As Mr. Lanzalotta testified, four years of low cost tree trimmed per mile along with miles of vegetation management deferred, had a dramatic negative impact on JCP&L's SAIDI (System Average Interruption Duration Index) that includes major event. Id. pp. 31-32 .

JCP&L's reduction in right of way vegetation management and the low cost per mile is especially egregious in light of the Phase II Board Order in the Company's last base rate case in which JCP&L was granted over $41 million in O&M expenses amortized over 3 years and over $4 million in capital expenses for vegetation management above and beyond the base line level of vegetation management costs already recovered by the Company in the first phase of the base rate case.[16] In that Order JCP&L was given a total annual revenue increase of $36.1 million to pay for incremental reliability related projects. The $36.1 million additional revenue did not stop after the

[16] I/M/O the Verified Petition of JCP&L for Review and Approval of an Increase In And Adjustments to its Unbundled Rates and Charges for Electric Service, and for Approval of Other Proposed Tariff Revisions In Connection Therewith Decision and Order Adopting Stipulations of Settlements Approving Phase II Rate Increase and Resolving Motion and Cross Motion for Reconsideration BPU Docket Nos. ER02080506, ER02080507, ER02070417 Stipulation of Settlement, Attachment I page 2 of 3.

three year amortization period but continued to this day. It is inexplicable, then to see vegetation management expenditures going down since 2006, as Table 7 clearly shows. As Mr. Lanzalotta expressed during his live surrebuttal:

> When trimming of trees are limited or when such trimming is deferred or when old existing equipment is not replaced, there are savings to the utility. And those are savings they realize immediately upon those deferrals. Service interruptions resulting from such deferred maintenance don't happen right away. They may not happen at all depending on whether or not you have major storms or you don't have any really strong major storms. So there's -- there's a quid pro quo on both sides of that statement.

While JCP&L enjoys cost savings by deferring projects, a substantial amount of revenue are being collected from ratepayers that has not been invested in JCP&L's infrastructure. At that same time JCP&L was giving its parent FirstEnergy a generous dividend. *JC-6*, Sched. PMA-3; T12:17 Over 70 percent of JCP&L's profits during 2009 to 2011 were paid out in dividends to its parent FirstEnergy instead of reinvesting its profits in its New Jersey electric distribution utility. The Company claims that "necessary" right of way vegetation management was deferred due to an off right of way vegetation management program called the Corridor Widening Initiative. *JC-16,* p. 11. However, in light of the millions of dollars sent to Ohio in dividends, it appears that the Company collected sufficient ratepayer funds to maintain its vegetation management spending and still complete the Corridor Widening Initiative. Rate Counsel requests that Your Honor and the Board Order JCP&L to maintain an increased level of vegetation management spending and require reporting and sanctions if its vegetation management practices and spending are not maintained at a sufficient level.

In conclusion, Rate Counsel recommends that JCP&L should be required to meet a modified minimum reliability benchmark by using more recent, SAIFI and CAIDI data, and additional benchmarks utilizing other measures such as CEMI[17] to address pockets of poorly performing areas that may be too small to be captured by SAIFI and CAIDI. Rate Counsel respectfully request that Your Honor and the Board acknowledge JCP&L's poor performance and specifically order the Company to establish an improvement plan with specific deadlines and consequences, such as a reduction of its Return or Equity, if reliability does not improve.

JCP&L should be required to include in its annual system reliability report the Company's CAIDI and SAIFI both including and excluding major events. In addition, the Board should better define "major events" so that the definition cannot be modified to skew the Company's performance results.

JCP&L should be ordered to maintain an increased level of vegetation management spending and require reporting and sanctions if its vegetation management practices and spending are not maintained at a sufficient level.

[17] Customers experiencing multiple interruptions ("CEMI").

POINT II

JCP&L SHOULD BE REQUIRED TO CONDUCT A RING-FENCING STUDY TO PROTECT ITS FINANCIAL PROFILE AND ITS RATEPAYERS

Rate Counsel witness Mr. Kahal found that JCP&L's position as a subsidiary of FirstEnergy adversely affects its financial profile. *RC-111*, pp. 21-28. To protect ratepayers, Rate Counsel respectfully requests that the Your Honor and the Board accept Mr. Kahal's recommendation and order JCP&L to conduct a "ring fencing" study - within 90 days of the Board Order resolving the instant case - to evaluate the Company's financial status as an affiliate of FirstEnergy and identify mechanisms to insulate JCP&L from the business and financial risks of its corporate parent and affiliates.[18]

Specifically, Mr. Kahal concluded that "the credit rating agencies concur in their review that JCP&L has a very favorable business profile based on its status as a monopoly utility, the absence of generation assets and operations, supportive New Jersey regulation, a favorable and diverse service territory, and strong and stable cash flows." *RC-111*, p. 27, *RC-93, RC-104*. However, Mr. Kahal also testified that "at least in the case of S&P and Fitch Ratings (Moody's is less clear on this issue), JCP&L's credit rating is impaired and weakened by its affiliation with FirstEnergy's non-utility operations." Id. This manifests itself in JCP&L's lower credit rating, relative to its utility peers.T97:L9-T99:L20 (October 4, 2013).

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[18] Mr. Kahal describes "ring fencing" and its benefits as follows:

> "Ring fencing" refers to corporate structural protections and business practices that can help separate the utility subsidiary from its riskier parent and corporate affiliates. These measures, if properly designed, could help the utility avoid becoming involved in a bankruptcy in the event of a parent (or affiliate) bankruptcy and/or reduce the likelihood that the utility subsidiary would be downgraded by credit rating agencies due to the parent being downgraded. Properly designed ring fencing measures can help to protect the financial health of the utility, avoid unwarranted credit downgradings, and provide reassurance to utility bond investors. [*RC-111*, p. 9.]

Aside from the less tangible adverse effects related to its lower debt rating, FirstEnergy over time drained cash from JCP&L. The record shows that JCP&L has paid much of its earnings over recent years to its parent FirstEnergy in the form of dividends and a $500 million "return of capital." *RC-111*, p. 8; *T50:L6-T51:L13, T74:L7-12*. (October 4, 2013). JCP&L witness Ms. Ahearn testified that the five-year average, from 2007 to 2011, of JCP&L's dividend payout ratio was 70.84 percent. *JC-6*, Sched. PMA-3; *T12:17-T13:L21*. (October 4, 2013). FirstEnergy owns 100 percent of JCP&L's outstanding stock. This means that over 70 percent of JCP&L's profits during this period were paid out in dividends to parent FirstEnergy instead of reinvesting its profits in its New Jersey electric distribution utility operations. However, as explained below, even the 70 percent is misleadingly low. JCP&L witness Mr. Staub confirmed that JCP&L's dividend payout ratio from 2009-2011, as computed by Moody's, was 170 percent. *RC-11*, p. 8; *T74:l7-12*. (October 4, 2013).

JCP&L's contribution to its parent was not limited to regular cash dividends. In addition to regular cash dividends, JCP&L also made a payment of $500 million to its parent in 2011, which it characterized as a "return of capital." *T49:L13-23.* (October 4, 2013). Meanwhile, in 2013 JCP&L issued $500 million of new long-term debt. *JC-5A, RC-105*.

Ring fencing can help separate the finances of a subsidiary, such as JCP&L, from the financial health of its parent and corporate affiliates. *RC-111*, p. 9. In fact, a ring-fencing study was recommended in a management audit of the Company performed for the Board, which the Company did not contest at that time. *T71:L24-T72:L20*. (October 4, 2013); *RC-65A*, *RC-106*. The Board recently acknowledged the potential benefit of

ring fencing for JCP&L's customers, issuing an Order which provided *inter alia* that the issue of ring fencing "would be best pursued in the context of the Company's pending base rates case or other relevant proceeding."[19] Rate Counsel submits that this is appropriate in this case. Rate Counsel, therefore, respectfully requests that JCP&L be ordered to conduct a "ring fencing" study to enhance the financial status of JCP&L within 90 days of the Board Order resolving the instant case. *RC-111*, p. 27.

[19] I/M/O JCP&L, BPU Dkt. No. EO1308072, Order, (September 19, 2013), p. 6.

POINT III

RATE COUNSEL'S PROPOSED RETURN ON EQUITY OF 9.25% AND PROPOSED CAPITAL STRUCTURE OF 50% COMMON EQUITY SHOULD BE ADOPTED, RESULTING IN AN OVERALL RATE OF RETURN OF 7.76%

JCP&L's proposed return on equity ("ROE") of 11.0 percent is based on the implausible notions that capital costs have increased since JCP&L's last base rate case in 2005 and that the Company's business and financial risks warrant such a high ROE. In testimony, Mr. Kahal methodically refutes the arguments and analyses proffered by the Company in support of its unreasonably high ROE. First, Mr. Kahal definitively shows that capital costs have decreased since JCP&L's last base rate case. *RC-111*, pp. 10-14; *RC-113*; and *RC-115*. Then, Mr. Kahal conducts a conventional Discounted Cash Flow ('DCF") analysis using an appropriate proxy group, reviews JCP&L's witnesses' analyses, and concludes that an ROE of 9.25 percent is appropriate, in contrast to JCP&L's current authorized ROE of 9.75 and its proposed ROE of 11.0 percent. *RC-111*, pp. 29-56. JCP&L's ROE witness, on the other hand, Ms. Pauline M. Ahern, conducted DCF and Capital Asset Pricing Model ("CAPM") analyses using a dissimilar proxy group of companies, as well as a number of novel ROE methodologies. *JC-6*; *JC-6R*.

Furthermore, as set forth below and in Mr. Kahal's testimony, JCP&L's proposed capital structure of 53.8 percent common equity and 46.2 percent long-term debt is based on the Company's actual capital structure at June 30, 2012, adjusted for 2013 debt issuances, which improperly includes $1.8 billion of goodwill as common equity, in clear

violation of the terms of the Board's FirstEnergy-GPU Merger Order.[20] *JC-SR-1*. However, Mr. Kahal found that if goodwill were to be excluded, JCP&L would be faced with an unreasonable highly-leveraged capital structure. *RC-111*, pp. 19-20. Therefore, he recommended a hypothetical capital structure of 50 percent debt and 50 percent equity, which comports with that of other New Jersey electric utilities and falls at the midpoint of the Company's own target capital structure range. Id. at p. 20.

In sum, as summarized on Schedule MIK-1, page 1 of 1, Mr. Kahal recommends an overall weighted average cost of capital for JCP&L's jurisdictional electric distribution rate base of 7.76 percent, based on an ROE of 9.25 percent, a 6.26 percent cost of debt, and a hypothetical capital structure of 50 percent long-term debt and 50 percent common equity. *RC-111*, p. 5. In contrast, JCP&L proposes overall weighted cost of capital of 8.66 percent, based on an ROE of 11.0 percent, a debt cost of 5.93 percent, and a capital structure of 53.8 percent equity and 46.2 percent debt. *JC-SR-1*.

A. Return on Equity.

JCP&L's currently authorized ROE is 9.75 percent, which was set in 2005 as part of a Phase Two proceeding in its last base rate case.[21] Since that time, the financial environment has changed dramatically. In 2008, world financial markets tumbled, triggering both dramatic monetary and fiscal responses by governments around the world. The net result of both very weak economic conditions and the Federal Reserve's monetary accommodation was a lowering of capital costs to historic lows, as explained by Mr. Kahal in his testimony. *RC-111*, pp. 10-14. Consistent with an environment of

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[20] I/M/O JCP&L, BPU Docket No. EM00080608, Order of Approval, (October 9, 2001)("FirstEnergy-GPU Merger Order"), pp 22-23, *RC-92*.

[21] *See* I/M/O JCP&L, BPU Dkt. No. ER02080506 et al, Final Order, (May 31, 2005) ("2005 JCP&L Base Rate Case Order").

lower capital costs, Mr. Kahal recommended an ROE of 9.25 percent based on his cost of capital analyses. *RC-111*, p. 57. On its face, JCP&L's proposed ROE of 11.0 percent is demonstrably unreasonable and unfair to customers in an environment of historically low equity cost rates. Mr. Kahal's ROE analysis bears this out.

Mr. Kahal examined capital cost trends since 2002, through calendar year 2012, as well as monthly data from January through April 2013.[22] The data show what Mr. Kahal described as a "general declining trend in capital costs." *RC-111*, p. 10. For example, in the very early part of this 10-year period, Mr. Kahal found that utility bond yields averaged about 7 to 8 percent, with 10-year Treasury yields of 4 to 5 percent. *Id*. By 2011, Mr. Kahal found that single A utility bond yields had fallen to an average of 5.1 percent, with 10-year Treasury yields declining to an average of 2.8 percent. *Id*. In the recent past (i.e., calendar 2012 into early 2013), Mr. Kahal found that Treasury and utility long-term bond rates have declined even further "to near or below the lowest levels in many decades." *Id*.

Furthermore, Mr. Kahal found that for the past three years, short-term Treasury rates have been close to zero, with three-month Treasury bills averaging about 0.1 percent. *Id*. Mr. Kahal attributes this to a deliberate Federal Reserve policy to promote economic activity. *Id*. Mr. Kahal concluded "both the near- and long-term economic outlooks are for sluggish economic growth and low inflation, implying low market capital costs." *Id.* at p.13. In short, the present environment of historically low capital costs supports a lower cost of capital for JCP&L than that awarded in 2005.

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[22] *See* *RC-111*, Schedule MIK-1. The indicators examined by Mr. Kahal include the annualized inflation rate (as measured by the Consumer Price Index), 10-year Treasury yields, 3-month Treasury bill yields and Moody's single A and triple B yields on long-term utility bonds.

Based on his cost of equity analysis, Mr. Kahal recommended an ROE of 9.25 percent for JCP&L. _Id_. at p. 5. Mr. Kahal utilized the Discounted Cash Flow ("DCF") method to develop his ROE recommendation, which he validated through the Capital Asset Pricing Model ("CAPM") method as a check. _Id_. at p. 7. Notably, Ms. Ahern's application of the DCF method in her rebuttal testimony, using different data inputs, produced results which support Mr. Kahal's conclusion. Mr. Kahal found that Ms. Ahern's updated DCF analysis presented in her rebuttal testimony, using her proxy companies and with certain data input adjustments by Mr. Kahal, resulted in an ROE figure of "around 9 percent." *T129:L13-14* (October 4, 2013). This comports with Mr. Kahal's DCF results, where he computed a range of 8.4 to 9.5 percent for JCP&L's ROE. *RC-111*, p. 7. Gerdau witness Kevin W. O'Donnell's ROE study results and recommendation are also fully consistent with Mr. Kahal's ROE recommendation. Mr. O'Donnell's ROE analyses yielded a range of 8.1 to 9.0 percent, and he ultimately recommended an ROE of 8.9 percent for JCP&L. *Gerdau-1*, p.18.

As set forth below and in the testimony of Mr. Kahal, the DCF method yields the most reliable measure of the cost of equity and therefore a reasonable ROE for a low-risk regulated utility. _See_ *RC-111*, pp. 11-12. In contrast, Mr. Kahal found the various other methodologies utilized by Ms. Ahern are "poorly explained, unconventional cost of equity methods." _Id_., p. 57. In fact, one method used by Ms. Ahern, the Predictive Risk Premium Model ("PRPM") is so novel that it is only used by Ms. Ahern's consulting firm and has yet to be adopted or endorsed by any utility regulatory agency. T24*:L17-T25:L.* (October 4, 2013).

Mr. Kahal recommends an ROE for the Company of 9.25 percent. Mr. Kahal's expert opinion is based upon his straight-forward application of the widely accepted Discounted Cash Flow "DCF" model applied to a selected proxy group of utility companies with risk attributes similar to JCP&L. Mr. Kahal chose for his proxy group companies that closely reflect the Company's electric utility distribution service business model. He supported his findings with a Capital Asset Pricing Model "CAPM" analysis. Mr. Kahal testified to his selection of his proxy group, the necessary assumptions he made, and why some companies were inappropriate for use in his proxy group. *RC-111*, p.31-39. Mr. Kahal further testified that he preferred the DCF model and used it as a basis for his ROE recommendation, believing it to be more reasonable than the somewhat lower result he obtained using the CAPM method. *Id*. at p. 31. Mr. Kahal's 9.25 percent recommendation results in an ROE that is reasonable, fully reflects capital market requirements and risk, and will fairly compensate JCP&L's shareholders.

In contrast, JCP&L's Mr. Pearson recommends an ROE of 11.0 percent, based on Ms. Ahern's analyses. *JC-23R*, p. 10. Although this is a slight reduction from JCP&L's original ROE recommendation of 11.53 percent, it still is much higher than the overwhelming evidence supports in this case. Incredibly, Mr. Pearson recommends an unreasonably high ROE that is 125 basis points higher than JCP&L's currently authorized ROE that was established in the Company's 2005 base rate case, and 175 basis points above Mr. Kahal's recommendation, despite compelling evidence that the cost of capital has declined materially since the Company's previous base rate case in 2005. *RC-111*, pp. 10-14; *RC-112* and *RC-115*. Mr. Pearson claims that an ROE of 11.0 percent is needed to instill investor confidence. *JC-23*, p. 10. However, the fact that

JCP&L did not initiate any action to increase its authorized 9.75 percent ROE belies his claim. Apparently, JCP&L was satisfied with a 9.75 percent ROE, since the Company opposed efforts to compel it to file the instant base rate case.[23] Furthermore, Mr. Kahal found no evidence that credit rating agencies have any concerns with JCP&L's current authorized ROE of 9.75 percent. *T96:L22-T97:L1*. (October 4, 2013).

As shown below and in Mr. Kahal's testimony, Ms. Ahern's conclusions on ROE, upon which Mr. Pearson relied for his recommendation, are based on flawed analyses. For the reasons set forth below and in Mr. Kahal's testimony, Rate Counsel respectfully submits that the Company's proposed ROE is overstated and should be rejected in favor of Mr. Kahal's well-supported 9.25 percent ROE.

1. Mr. Kahal's Application of the Discounted Cash Flow and Capital Asset Pricing Methods

The DCF method is based upon the principle that the price of a stock will reflect the discounted stream of cash flows expected by investors. *RC-111*, p. 31. Mr. Kahal used the standard constant growth DCF model to determine his recommendation of the fair return on equity for JCP&L. *Id*. at p. 31. This model is widely accepted and has consistently been used in setting equity rates in New Jersey. The constant growth DCF model assumes, for mathematical simplicity, that an investor's required ROE is equal to the dividend yield plus the expected dividend or earnings rate of growth, and assumes further that the growth rate is constant for an indefinitely long period. Mr. Kahal testified that this model is particularly applicable to regulated public utilities, which are more stable than unregulated companies. *Id*.

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[23] I/M/O JCP&L, BPU Dkt. No. EO11090528, Order, (July 31, 2012).

To apply the model, Mr. Kahal selected a proxy group of utilities with attributes and a business risk profile similar to JCP&L. He chose his proxy group from companies that "are mostly or entirely electric (and in some cases combination electric/gas) distribution and transmission ("T&D") utilities," and therefore reasonably comparable to JCP&L. *Id*. at p. 33. For his proxy group, Mr. Kahal initially selected five T&D utilities that are located in the mid-Atlantic or northeast (with one exception), operate in Regional Transmission Organizations ("RTOs") and provide for retail access, but are not considered "vertically integrated" nor do they have substantial unregulated generation. *Id*. Mr. Kahal then adjusted his initial proxy group to reflect recent mergers, and added another company with a similar profile, Centerpoint Energy, to yield a proxy group of five T&D utilities. *Id*. at 34.

Mr. Kahal used his proxy group to measure the dividend yield component of the DCF formula over the six month period from November 2012 through April 2013. *Id*. at p. 37. The proxy group average yield for this period was 4.24 percent, with a range over this six month period of 3.88 to 4.44 percent. *Id*. at 35. In order to properly incorporate the dividend the investor would receive over the first year after purchase of the stock, Mr. Kahal then applied the standard "half year" growth adjustment technique to calculate an average adjusted dividend yield of 4.3 precent. *Id*. at 36

Mr. Kahal's next step in applying the DCF method was to estimate the growth rate. Mr. Kahal used five separate sources for projected earnings growth rates published by securities analysts. *Id*. at. 37. In Schedule MIK-4 attached to his Direct Testimony, Mr. Kahal showed his calculations, which resulted in an average growth rate of 5.2 percent, with a range of 4.8 percent to 5.8 percent. He used these sources "along with

other evidence" to obtain a "reasonable" growth range for the proxy group of 4.0 to 5.2 percent. *Id*. at 37. In addition, Mr. Kahal considered the internal and external "sustainable growth" rate, which he calculated to be 3.8 percent. *Id*. at. 38. When combined with the adjusted dividend yield of 4.3 percent, this produced an ROE range of about 8.3 to 9.5 percent, with a midpoint of 8.9 percent. *Id*. at. 39.

As a secondary DCF analysis, Mr. Kahal applied the DCF model to Ms. Ahern's two proxy groups of vertically-integrated electric and combination electric/gas utility companies (except for two companies one of which Ms. Ahern herself eventually dropped). This proxy group study, derived from Ms. Ahern's two proxy groups, resulted in a DCF return range estimate of 8.4 to 8.9 percent, with an 8.7 percent midpoint. *Id*. at p. 42.

Mr. Kahal also conducted cost of equity studies using the CAPM method. *See RC-111*, pp. 47. However, Mr. Kahal placed little weight on CAPM analyses, limiting his CAPM analysis to only serve as a "check" on his DCF results. *Id*. at p. 31. The CAPM is a "risk premium" approach, where the cost of equity is equal to the yield on a risk-free asset, plus a stock market risk premium multiplied by the company's "Beta," a measure of the firm's risk relative to the overall market. *Id*. at pp. 43-44. The risk premium is the amount by which the expected return on the overall stock market exceeds the yield on a risk-free asset.

As presented in his direct testimony, Mr. Kahal's analysis using the CAPM resulted in a cost of equity range of about 6.6 to 8.7 percent, which was even lower than his results of his DCF analyses. *Id*. at p. 45. Mr. Kahal later updated his CAPM analysis with more recent data, as presented in his live surrebuttal testimony at hearing. *See*

T93:L23-T95:L14 (October 4, 2013); *RC-112* through *RC-115*. His updated CAPM analysis resulted in a range 7.3 to 9.4 percent. T:95:L1-14 (October 4, 2013); *RC-112*. Thus, Mr. Kahal's analyses using the CAPM resulted in cost of equity ranges which were similar to or somewhat lower than the results of his DCF analyses. Mr. Kahal's CAPM analyses confirm that his DCF estimate and ultimate ROE recommendation are conservatively high. *RC-111*, p.40.

Mr. Kahal's analyses, taken in conjunction with recent conditions in financial markets, support the reasonableness of his 9.25 percent return on equity recommendation for JCP&L at this time, a reduction of 0.5 percent from JCP&L's last rate case. In fact, Mr. Kahal testified that "the 9.25 percent is a conservative recommendation given current market conditions and my cost of equity evidence." *Id*. at p. 7. Notably, Gerdau witness Kevin W. O'Donnell recommended a lower ROE for JCP&L, 8.9 percent. *Gerdau-1*, p.18. In sum, Mr. Kahal's use of both the DCF and the CAPM methods confirms that his recommended ROE of 9.25 percent will provide JCP&L with sufficient opportunity to earn the necessary overall return to attract equity capital and is fair to both investors and ratepayers.

2. Critique of Ms. Ahern's ROE Study

In her direct testimony filed in 2012, Ms. Ahern recommended an ROE range for JCP&L of 11.45 to 11.60 percent. *JC-6*, p. 2. JCP&L then proposed an ROE of 11.53 percent, based on Ms. Ahern's conclusions at that time. *JC-5*, pp. 6-7, Sched SRS-4. In her rebuttal testimony Ms. Ahern updated her analyses, resulting in an ROE range of 10.80 to 11.00 percent. *JC-6R*, p. 43. In turn, JCP&L's Mr. Pearson proposed an ROE of 11.00 percent. *JC-23*, p. 10.

Ms. Ahern utilized three basic cost of equity methods: (1) the DCF; (2) the CAPM; and (3) the Risk Premium method. *See* *JC-6*, *JC-6R*. These three methods were applied to three proxy groups of companies: a group of nine vertically-integrated electric companies, a group of six combination electric/gas utility companies, and a group of non-regulated, non-utility companies that operate in various unregulated industries. *Id*.

In her direct testimony, Ms. Ahern reported cost of equity estimates of 8.9 to 10.4 percent using the DCF model, 11.1 to 11.8 percent using the Risk Premium Method and 11.3 percent using the CAPM. *JC-6*, Sched. PMA-1. Her cost of equity results for the non-utility companies are summarized as being 10.6 to 11.1 percent. *Id.* Ms. Ahern averages together these results, obtaining a range of 10.7 to 11.15 percent. *Id.* Finally, she includes two JCP&L-specific "adders" (flotation expense and credit risk) to obtain the final range for JCP&L of 11.45 to 11.60 percent, with 11.53 percent being the midpoint. *Id*.

In her rebuttal testimony, Ms. Ahern reported updated cost of equity estimates of 8.84 to 9.01 percent using the DCF model, 11.22 to 11.72 percent using the Risk Premium Method and 10.53 percent using the CAPM. *JC-6R*, Sched. PMA-10R, p. 1. Her cost of equity range for the non-utility companies is 10.25 to 10.6 percent. Id. Ms. Ahern averages together these results, obtaining a range of 10.40 to 10.55 percent. Finally, she includes two JCP&L-specific "adders" (flotation expense and credit risk) to obtain her updated recommended final range for JCP&L of 10.80 to 11.00 percent. JC-6R, p. 43

In addition, she assembled two groups of unregulated non-utility companies and applied her DCF, Risk Premium, and CAPM models to these proxy groups. *JC-6*, pp. 36-39. It is particularly inappropriate to use the return requirements for non-regulated companies as the basis for setting the fair return for JCP&L since their business models

and risk profiles of these companies inevitably are quite different from that of a low-risk delivery service utility.

In testimony, Mr. Kahal demonstrated that Ms. Ahern's studies (and adders), other than her electric utility DCF studies, greatly overstate JCP&L's cost of equity. See *RC-111*, p.8.

a. Ms. Ahern's DCF Studies

Mr. Kahal's DCF study and Ms. Ahern's updated electric utility DCF study do not differ significantly, with both witnesses' studies supporting a cost of equity estimate of about 9 percent or possibly slightly higher. *T103:L7-20, T128:l21-T129:L17.* (October 4, 2013). As Mr. Kahal testified, the utility DCF studies are the only credible and reliable cost of equity evidence in this case and, in contrast to other arcane methods, are "transparent", "generally understandable", and "widely relied upon by the regulatory community." *RC-111*, pp. 8 and 31-32; *T104:L3-22*. (October 4, 2013). However, Ms. Ahern inappropriately applies a flotation cost adder and a credit risk adder which inflate the results of her proxy group DCF analyses. *RC-111*, pp. 55-56.

In his direct testimony, Mr. Kahal summarized the three main differences between his DCF study and Ms. Ahern's initial DCF study:

> (1) Ms. Ahern emphasizes vertically-integrated electric utilities rather than delivery service electrics.
>
> (2) Her studies are based on market and other published data as of September 2012, whereas my study reflects more current data and the improvements in equity markets in recent months.
>
> (3) Ms. Ahern's study employs only one measure of expected long-term growth, i.e. security analyst growth rate estimates, whereas my study also uses a second measure, the "sustainable" growth method, to develop a range. It should be noted that Ms. Ahern and I use very similar sources of security analyst growth rates. *RC-111*, p. 49.

Mr. Kahal found that Ms. Ahern's electric utility proxy group, which includes a number of vertically integrated utilities with generation assets, "is less appropriate in this case because it measures (to some degree) the risks associated with generation assets and supply, whereas this case sets rates for JCP&L's distribution service." *RC-111*, pp. 33-34. JCP&L ratepayers already pay for the risks associated with generation supply in Basic Generation Service ("BGS") charges or in competitive service energy rates. *RC-111*, p. 7. Moreover, Mr. Kahal found that Ms. Aherns' credit risk and flotation cost adders improperly inflate her DCF ROE results. *RC-111*, p. 8. For these reasons, Ms. Ahern's DCF analyses and adders should be rejected as the basis for any JCP&L ROE determination.

b. Ms. Ahern's Risk Premium and CAPM Analyses.

The theory underlying the Risk Premium method is that the cost of common equity (i.e., ROE) equals the cost rate for long-term debt capital plus a risk premium to compensate equity investors for their added risk. See *JC-6*, p. 23. Risk Premium and CAPM studies are quite similar in that both require estimates of the market equity premium. *RC-111*, p. 48. Therefore, two of Ms. Ahern's three utility-based ROE analyses (Risk Premium and CAPM) rely on the risk premium methodology and assumptions, in contrast to the DCF method. One critically important measure for these methods is the equity risk premium. Mr. Kahal classified Ms. Ahern's three measures of the equity risk premium as follows: (1) the Predictive Risk Premium Model ("PRPM"); (2) a Value Line projection method; and (3) a conventional historic returns-derived risk premium. Id. at p. 50. Ms. Ahern updated her rate of return ranges using the Risk Premium and CAPM methods in her rebuttal testimony. *JC-6R*, Sched. PMA-10R. The

flaws identified by Mr. Kahal in Ms. Ahern's derivation and application of the Risk premium and CAPM models demonstrate that her studies cannot be relied upon as the basis for an ROE determination in this case.

i. Ms. Ahern's Equity Risk Premium Measures.

a. Predictive Risk Premium Model ("PRPM").

Mr. Kahal examined Ms. Ahern's PRPM methodology and concluded that it "appears to be based in some fashion on historic market returns data, incorporating volatility over time" *RC-111*, p. 50. Ms. Ahern describes this method of applying market return data as "Generalized Autoregressive Conditional Heteroskedasticity", also referred to as "GARCH." *JC-6*, p. 24.

Using PRPM, in her direct testimony Ms, Ahern obtains average cost of equity estimates of 12.81 and 13.13 percent for her proxy groups.[24] *JC-6*, p. 24. Mr. Kahal found that these results were "astonishingly high estimates, particularly compared to her far more moderate and conventional DCF estimates that are nearly 400 basis points lower." *RC-111*, p. 51.

Moreover, Mr. Kahal could not determine how these values or estimates were calculated, either from Ms. Ahern's testimony description or her schedules, and concluded that it appears to be a "black box" method. *Id.* In addition, Mr. Kahal found that Ms. Ahern's PRPM results "make little sense," noting the PRPM method estimates Southern Company's cost of equity at 21.35 percent and Portland General Electric's at 6.48 percent. *Id*.

[24] Mr. Ahens updated PRPM averages were 13.3 percent and 13.41 percent. JC-6R, Sched. PMA-10R, p. 18-19.

Given the flaws identified by Mr. Kahal, it is not surprising that the PRPM method is only used by Ms. Ahern's consulting firm and has yet to be adopted or endorsed by any other rate of return analysts or utility regulatory agency. *T24:L17-T25:L7* (October 4, 2013). For these reasons, the outlandishly high and inexplicable PRPM estimates should not be given any consideration in determining a fair return for JCP&L in this case.

b. Value Line Projection Method.

Ms. Ahern also uses a method based on Value Line projection of stock market returns to compute the equity risk premium. However, as Mr. Kahal testified, her calculation is not a Value Line projection but, rather, her calculation of the expected rate of return for the stock market. *RC-111*, p. 52. Value Line does not publish a projection of the overall expected rate of return on the stock market. *Id*. Specifically, Mr. Kahal summarized Ms. Ahern's calculation as follows:

> The core of her calculation is the potential for share increase for the median stock in Value Line's data base over the next several years. The Value Line median stock and the overall stock market are very different measures. [*RC-111*, p. 52.]

Mr. Kahal found that Ms. Ahern's calculation in her direct testimony yielded an "absurdly high" overall stock market return of 16.55 percent. *RC-111*, p. 53. Mr. Kahal found that Ms. Ahern's 16.55 percent rate of return estimate is based on Value Line's share price "Appreciation Potential" of 70 percent over the next three to five years for the median stock plus a median dividend yield of 2.36 percent. *Id*. This contrasts to plausible range for the equity risk premium of 5 to 8 percent, per Mr. Kahal's interpretation of the Brealey et. al. textbook. *RC-111*, p. 53.

c. Historic Returns Method.

Ms. Ahern's third method for estimating the equity risk premium is based on the conventional historic returns-derived risk premium for the stock market obtained from a standard source, i.e., Ibbotson/Morningstar. Using the Ibbotson/Morningstar historical data series (1926-2011), in her direct testimony she identifies a historical average stock market risk premium of 6.45 percent. *JC-6*, Sched. PMA-9, p. 2. Unlike Ms. Aherns other estimates for the equity risk premium, the 6.45 percent Morningstar-derived estimate is within the plausible 5 to 8 percent range of an equity risk premium noted by Mr. Kahal. *RC-111*, p. 53. However, this is just one of the three measures used by Ms. Ahern to estimate equity risk premium. Her other equity risk premium methodologies are both flawed and yield unreasonable results.

ii. Ms. Ahern's CAPM Analyses.

Ms. Ahern utilizes two CAPM methods in her ROE analysis, which she describes as a "traditional" CAPM analysis and an "Empirical Version of the CAPM" {"ECAPM"). *JC-6*, pp. 30-31. However, as set forth below and in the record, Ms. Ahern's application of the traditional CAPM suffers from inappropriate inputs, and her ECAPM suffers from a flawed application of the model. For the CAPM analyses presented in her direct testimony, Ms. Ahern used three risk premium estimates, i.e., Value Line-derived, PRPM and Ibbotson/Morningstar. *RC-111*, p. 50.

a. Ms. Ahern's "Traditional" CAPM Analysis.

According to the CAPM model, the cost of equity is equal to the yield on a risk-free asset plus an equity risk premium multiplied by a firm's "beta" statistic. *RC-111*, p. 44. The equity risk premium is defined as the expected return on the overall stock market

minus the yield or return on a risk-free asset. Id. Here, Ms. Ahern's inflated risk-free rate distorts her CAPM results, yielding an unreasonably high ROE estimate.

In her rebuttal testimony, Ms. Ahern uses a market risk premium for her CAPM analysis of 8.15 percent. *JC-6R*, Sched. PMA-10R, p. 27. Mr. Kahal found her 8.15 percent figure is near the upper bound of his range (5 to 8 percent) and concluded, "it's pretty close to being acceptable." *RC-111*, p. 46; T105:L5-8 (October 4, 2013).

The CAPM also requires an estimate of the "risk free" interest rate. Here, Ms. Ahern inflates the risk-free rate, which distorts the results of her CAPM analysis. Mr. Kahal used the recent 3.0 percent actual yield on a long-term Treasury bond for his CAPM analysis, which he described was the typical figure used by analysts. *RC-111*, p. 45 and 51. In contrast, Ms. Ahern employs a "risk-free rate" of 4.5 percent as the representation of the 30-year Treasury bond yield. *JC-6R*, Sched. PMA-10R, p. 27; T105:L10-12 (October 4, 2013). This contrasts with a more contemporary treasury rate of around 3.7 percent. T36:L18-23 and T105:L14-17 (October 4, 2013). Mr. Kahal observed that Ms. Ahern derived her risk-fee rate by using an "80-year average going back to the 1920s on treasury income returns." T105:L19-23 (October 4, 2013).

In testimony, Mr. Kahal explained why the use of a historic risk-free rate is improper for the CAPM analysis:

> Using a historic average risk-free cost rate in place of today's (or at least a relatively current) cost rate means that she is not measuring JCP&L's cost of equity as of the time of this rate case. The cost of equity is a current and prospective concept. It makes no more sense to employ the historic risk-free rate than it would to use historic average long-term stock prices in the DCF study. [*RC-111*, p. 51]

For these reasons, Ms. Ahern's CAPM analysis should be given no weight in determining the appropriate ROE for JCP&L.

b. Ms. Ahern's ECAPM Analysis.

As Mr. Kahal testified, Ms. Ahern' application of the ECAPM model improperly increases the utility cost of equity estimate and should be disregarded. *RC-111*, p. 54. The crux of the problem is the ECAPM models use of a weighted average of the Value Line published betas for her proxy companies (which average about 0.7) and a much higher beta of 1.0. *Id*. Mr. Kahal further explains the problem as follows:

> This is mathematically equivalent to simply taking the utility betas that Value Line reports and adjusting then upwards part of the way toward 1.0. Since utility betas are nearly always less than 1.0 (due to the inherently low risk of utilities), the ECAPM serves as a mechanism for increasing the utility cost of equity estimate. [*Id.*]

Therefore, Mr. Kahal concluded that "the ECAPM method is improper when used with Value Line betas." *Id*.

c. Ms. Ahern's Non-Utility Estimates.

Mr. Kahal examined Ms. Ahern's analyses of unregulated companies and found that they provide "no useful guidance to the Board in determining JCP&L's cost of equity and fair return." *RC-111*, p. 55. Ms. Ahern assembled two groups of unregulated non-utility companies and applied her DCF, Risk Premium, and CAPM models, and reported ROE estimates of 10.6 to 11.1 percent, respectively, for the two groups. *JC-6*, pp. 36-39. Mr. Kahal found that the non-regulated companies in Ms. Ahern's non-utility group are "different in character and risk attributes from regulated, monopoly utilities." *RC-111*, p. 55. Furthermore, the record in this case provides no indication that either this Board or any other utility regulatory commission has relied upon studies using non-regulated companies as a basis for setting the fair return on equity for regulated utility companies.

For these reasons, Ms. Ahern's non-utility ROE estimates should be rejected as the basis for any JCP&L ROE determination.

d. Ms. Ahern's Flotation Adjustment.

Ms. Ahern's flotation cost adjustment should be rejected since there is no indication that a FirstEnergy stock issuance can be expected anytime in the near term. *RC-111*, p. 56. Furthermore, even if it were deemed proper to include a flotation expense adder, Ms. Ahern has greatly overstated the proposed adjustment. *Id.* Neither Mr. Kahal nor Gerdau witness Mr. O'Donnell included a flotation cost adjustment in their respective ROE recommendations.

Ms. Ahern proposes a flotation cost adjustment to recover the costs associated with new issuances of common stock, e.g. underwriting fees and out-of-pocket costs for printing, legal, registration, etc." *JC-6*, p. 40. Specifically, Ms. Ahern seeks an adjustment which reflects the costs of issuing equity incurred by FirstEnergy since 2003, which she claims would support an adjustment of 0.14 percent. *Id*. at p. 42, Sched. PMA-13, p. 1. T28:L16-19 (Oct. 4, 2013) However, as Mr. Kahal testified, the flotation cost data presented by Ms. Ahern dates from 2003, when FirstEnergy incurred $34.6 million in flotation costs. *RC-111*, p. 56. Mr. Kahal concluded that a "ten-year old expense is simply too far in the past for inclusion in the cost of service in this rate case." *Id*. Furthermore, Mr. Kahal recalculated the flotation cost adjustment using FirstEnergy's current equity balance. Mr. Kahal amortized FirstEnergy's claimed $34.6 million in flotation expense over ten years, then divided it by FirstEnergy's equity balance of $13.5 billion (as reported by Mr. Staub), and found that this would yield ($3.5 million/$13,512 million) a flotation adjustment of 0.03 percent (*i.e.*, three basis points). *Id*.

In sum, the premise for Ms. Ahern's flotation adjustment lacks factual support and the underlying cost data is simply too old to support an ROE adjustment.

Furthermore, even if a flotation adder is found to be reasonable, the appropriate adder should be no more than approximately three basis points.

e. Ms. Ahern's Credit Risk Adder.

Ms. Ahern's updated proposed credit risk adders for her ROE are contradicted by the record. In her rebuttal testimony, Ms. Ahern proposed ROE risk adders for her nine-company and five-company proxy groups of 0.33 percent and 0.25 percent, respectively. *JC-6R*, Sched. PMA-10R, p. 1. However, Ms. Ahern appears to concede in her testimony that on an overall basis, JCP&L has about the same business risk as her proxy group: "…[I]n my opinion, no business risk adjustment is warranted." *JC-6*, p. 6; *RC-111*, p. 55. This would support the conclusion that an ROE credit risk adder is improper. *RC-111*, pp. 21-25 and pp. 55-56. Nonetheless, she includes a "credit risk" adder because of JCP&L's asserted weaker than average credit rating compared to her barometer group of companies. *JC-6R*, p. 13.

Mr. Kahal testified that "the cost of equity is essentially a market price, and as such, it is ultimately determined by the forces of supply and demand operating in financial markets." *RC-111*, p. 30. In turn, two key determinants of market price are the fundamental conditions in capital markets (e.g., outlook for inflation, monetary policy, changes in investor behavior, investor asset preferences, the general business environment, etc.) and the business and financial risks of the company. *Id.*

Here, a regulated public utility monopoly such as JCP&L providing an essential electric distribution service typically would imply very low business risk and therefore a relatively low cost of equity. *Id.* Furthermore, JCP&L's financial strength and favorable business risk profile, as assessed by credit rating agencies (i.e., Moody's, FitchRatings and S&P), also contribute to its relatively low cost of equity. *Id.*

Like Ms. Ahern, Mr. Kahal concluded that JCP&L's business risk does not exceed the proxy group and both his and Mr. Staub's proposed capital structures are stronger than the proxy group company averages, so there is no need to consider a financial risk adder. *RC-111*, p. 55. Moreover, negative factors that contribute to JCP&L's somewhat weaker credit rating are attributable to the FirstEnergy's financial policies and unregulated operations. *Id*. at p. 56. Therefore, as Mr. Kahal testified, there is no basis in the record to support an ROE credit adder as proposed by Ms. Ahern. *Id*. The inclusion if any such credit risk factor would effectively force JCP&L's ratepayers to pay a penalty associated with the risks associated with FirstEnergy's financial policies and unregulated operations, which is prohibited by the Board's FirstEnergy-GPU Merger Order.[25]

B. Cost of Long-Term Debt

In August 2013, the Company issued $500 million of 10-year debt at a cost rate of 4.91 percent, a higher cost rate than originally assumed by the Company. *T65:L21-T66:L15* (October 4, 2013). At hearing, JCP&L updated its recommended embedded cost of debt calculation to reflect the actual cost of this issuance, yielding an embedded cost of debt of 5.93 percent. T66:L12-17 (October 4, 2013); *JC-5A*. Since this issuance of debt had taken place in late 2013, it is too far beyond the end of the historic test year for inclusion in this case. Thus, Mr. Kahal adopted the actual June 30, 2012 embedded cost rate of 6.26 percent originally presented in Mr. Staub's direct testimony, which includes all long-term debt-related expenses. *RC-111*, p. 21. The 6.26 percent rate for the embedded cost of long-term debt does not reflect the inclusion of the $500 million debt issuance in August 2013. *JC-5*, Sched. SRS-3; *JC-5A*.

[25] FirstEnergy-GPU Merger Order, pp. 22-23.

C. Capital Structure

Mr. Kahal recommended a capital structure of 50 percent equity and 50 percent debt.[26] *RC-111*, p. 5. In contrast, JCP&L proposes the use of a capital structure comprised of 53.8 percent common equity and 46.2 percent debt. *JC-5*, p. 4, Sched. SRS-2; *JC-5R*, p. 2. JCP&L's proposed capital structure represents a significant increase in the equity component set in its most recent base rate case, which was 46 percent.[27] Moreover, JCP&L's proposed capital structure is fundamentally flawed since it is based on the improper inclusion of approximately $1.8 billion of goodwill in its capital structure. As Mr. Kahal testified, removal of goodwill from JCP&L's capital structure would result in an "imprudent and overleveraged capital structure with too little common equity." *RC-111*, p. 19. Therefore, in accordance with industry norms and JCP&L's own stated target capital structure range, Mr. Kahal recommended a 50/50 capital structure. *RC-111*, p. 20. As set forth below and in his testimony, Mr. Kahal based his capital structure recommendation on numerous factors.

1. Goodwill Should Not be Included in the Capital Structure.

JCP&L's proposed capital structure is fundamentally skewed by the improper inclusion of goodwill in its proposed capital structure. JCP&L's proposed capital structure was derived from the Company's calculation of its actual capital structure, which includes goodwill amounting to approximately $1.8 billion out of a total common equity balance of about $2.3 million. *T73:L11-16* (October 4, 2013). Including goodwill and excluding short-term debt and securitized debt, JCP&L's calculated unadjusted

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[26] Mr. Kahal accepted JCP&L's exclusion of short-term debt from its capital structure and its exclusion of securitized debt. *RC-111*, p. 16. Mr. Kahal also conditioned his recommended 50/50 capital structure on the continuation of JCP&L's current practice to directly assign short-term debt to CWIP for AFUDC rate calculation and accrual purposes. *RC-111*, p. 21; *RC-92*; and *RC-94*.

[27] 2005 JCP&L Base Rate Case Order, pp. 38-39.

actual capital structure was 60.8 percent common equity and 39.2 percent long-term debt. *JC-5*, p. 3, Sched. SRS-1. JCP&L then adjusted its calculated actual capital structure to reflect its issuance of $500 million of new long-term debt to derive its proposed capital structure of 53.8 percent common equity and 46.2 percent long-term debt. *JC-5*, p. 4, Sched. SRS-2. However, as Mr. Kahal testified, goodwill should not be included in JCP&L's capital structure for several reasons. See *RC-111*, pp. 18-20.

First, a merger acquisition premium should not be considered to be part of the cost of providing utility delivery service, since this is a cost that shareholders should be required to bear. The Company did not cite a single instance of another utility commission or electric utility rate case where inclusion of goodwill in capital structure was sanctioned. Goodwill does not represent actual utility assets or investor-supplied funds, which Mr. Kahal found adversely affects the quality of JCP&L's balance sheet and the Company's credit agency ratings. *T98:L19-T99:L20* (October 4, 2013). Mr. Kahal concluded that this goodwill is "an accounting adjustment to the Company's balance sheet that occurred in conjunction with the GPU/FirstEnergy merger approximately a decade ago." *RC-111*, p. 17. In response to a discovery request, JCP&L's witness stated that "the $1.8 billion of goodwill on its [JCP&L's] books represents a premium over book value that FirstEnergy paid for GPU." *RC-97*.

Second, the Board's Order approving FirstEnergy's acquisition of JCP&L specifically disallowed cost recovery of transactions costs and, in particular, goodwill:

> 13. In connection with the 2002 base rate case and in all subsequent rate cases, appropriate pro forma adjustments to the test year shall be made by JCP&L, as necessary, to ensure that any costs related to *goodwill*, merger transaction costs (i.e., investment banker and attorneys fees associated with the merger agreement), the acquisition premium and executive separation costs (i.e.,

> “golden parachutes” listed on pages 62-63 of the Proxy) which costs are listed in full on Exhibit 1 to Attachment A of the Stipulation shall not be used to reduce merger savings and shall not be included in JCP&L’s test-year cost of service or otherwise charged to JCP&L’s customers for ratemaking purposes.[28]

Mr. Kahal testified that the Company’s capital structure proposal is part of its “ratemaking cost of service and asserted revenue deficiency in this case.” *RC-111*, p. 18. Mr. Kahal characterized JCP&L’s treatment as improper, “by including goodwill in the ratemaking capital structure, FirstEnergy is seeking cost recovery (i.e., a higher rate of return on rate base) of its merger acquisition premium.” *RC-111*, p. 17. If Mr. Staub’s proposed capital structure which includes goodwill were adopted, ratepayers would be charged for goodwill and the FirstEnergy acquisition premium. Mr. Kahal concluded that recognition of goodwill produces “the very high … capital structure, which unquestionably increases customer rates.” *RC-111*, p. 19. This is impermissible under the terms of the Board’s FirstEnergy-GPU Merger Order.

For all these reasons, an adjustment to remove goodwill from capital structure would be appropriate. However, Mr. Kahal found that in this case, goodwill is so large relative to JCP&L’s equity balance (i.e., $1.8 million out of a total $2.3 billion), that removing goodwill from JCP&L’s capital structure would “produce an imprudent and overleveraged capital structure with too little common equity.” *RC-111*, p. 19. Therefore, Mr. Kahal recommended a reasonable 50/50 capital structure, which corresponds to the midpoint of JCP&L’s own target capital structure range.

2. First Energy’ Capital Structure Should Not Be Adopted as JCP&L’s Capital Structure

[28] FirstEnergy-GPU Merger Order, p. 22. (*Emphasis added.*)

In accordance with the Board's FirstEnergy-GPU Merger Order, JCP&L presented parent FirstEnergy's capital structure as part of its initial filing in the instant case. *JC-5*, pp.2-3, SRS-1. The Company concedes that FirstEnergy's capital structure should not be used as the basis for JCP&L's capital structure. *JC-5*, p. 3. Company witness Mr. Staub cites FirstEnergy's unique risk profile and the fact that it is a non-regulated entity. Id. Mr. Kahal also noted the distinct financial structure of FirstEnergy, compared to JCP&L. Mr. Kahal found First Energy's capital structure to be "quite different from that of JCP&L." *RC-111*, p. 16.

As of June 30, 2012, FirstEnergy's capital structure was presented as 45.8 percent common equity and 54.2 percent long-term debt, which reflects the removal of securitized debt and does not include any of the JCP&L planned new debt. *JC-5*, pp.2-3, SRS-1. While Mr. Kahal testified that FirstEnergy's capital structure would be "far more reasonable" than the Company's actual 61 percent equity ratio (unadjusted for the new debt issuance), he also testified that it would be necessary to remove goodwill from FirstEnergy's actual capital structure for ratemaking purposes, in conformance with the Board's FirstEnergy-GPU Merger Order. *RC-111*, pp. 19-20. However, Mr. Kahal testified that removal of goodwill from FirstEnergy's capital structure might result in "an overly leveraged capital structure." *RC-111*, p. 20. For the reasons set forth above, FirstEnergy's capital structure should be rejected for use as the basis for JCP&L's capital structure.

3. Mr. Kahal's 50/50 Capital Structure Recommendation is Reasonable and Should be Adopted.

Notably, Mr. Kahal's 50/50 capital structure recommendation was equal to the midpoint of what one JCP&L witness called "the traditional 45%-55% common equity

range typically sanctioned by the Board." *JC-5R*, p. 6; *RC-97*. In fact, JCP&L itself has identified a target capital structure range of about 45 to 55 percent common equity. *RC-98*. Furthermore, a 50/50 capital structure favorably compares with the capital structures found in both Mr. Kahal's proxy group and Ms. Ahern's two proxy groups of companies. *See RC-111*, p. 17, MIK-3; *JC-6*, PMA-4, p. 1, and PMA-5, p. 1. Mr. Kahal found that the 50/50 structure is "approximately consistent" with the approved ratemaking capital structures of Atlantic City Electric ("ACE") and Public Service Electric and Gas Company ("PSE&G"). *RC-111*, p. 17.

Furthermore, a 50/50 capital structure fully supports the argument that the ROE risk adjustment proposed by Ms. Ahern is not needed. Ms. Ahern included an upward "credit risk" adjustment or "adder" in her recommended ROE for JCP&L. *JC-6*, p. 4; *JC-6R*, p. 32. As Mr. Kahal testified, there is no basis for such an adjustment given JCP&L's very favorable business risk profile. *RC-111*, p. 20. Yet, he also testified that "if a very unusual capital structure were to be used for ratemaking, it could be argued that a risk adjustment (related to financial leverage) is needed." *Id.* Mr. Kahal concluded: "employing a relatively standard 50/50 capital structure - consistent with the various electric utility proxy groups and New Jersey practice - removes any rationale for including Ms. Ahern's upward adjustment to the cost of equity." *RC-111*, p. 20. In sum, Mr. Kahal's recommended 50/50 capital structure is eminently reasonable and, by mitigating the effect of leverage risk, enhances JCP&L's risk profile.

In contrast, the Company proposed a capital structure of 54 percent equity and 46 percent debt, derived from its (adjusted) actual capital structure which improperly includes $1.8 billion of goodwill attributable to FirstEnergy's purchase of GPU, JCP&L's

then parent company. *RC-97.* Inclusion of goodwill increases the Company's overall cost of capital, resulting in higher rates for its customers.

As set forth above and in his testimony, Mr. Kahal's recommended 50/50 capital structure is reasonable, falling at the precise midpoint of the Company's own capital structure target equity range of 45 to 55 percent. Thus, Rate Counsel respectfully submits that Your Honor and the Board adopt the 50/50 capital structure recommended by Rate Counsel's witness.

D. Conclusion

In sum, Rate Counsel respectfully submits that Your Honor and the Board make the following findings:

1. The appropriate capital structure is 50 long term debt and a 50 percent common equity, as recommended by Mr. Kahal, and JCP&L's proposed capital structure of Mr. Staub which inappropriately includes goodwill should be rejected;

2. That Mr. Kahal's ROE of 9.25 percent was developed using an appropriate proxy group and DCF analysis, was supported by Mr. Kahal's CAPM analysis and should be adopted;

3. Ms. Ahern's updated DCF evidence and Mr. O'Donnell's testimony support Mr. Kahal's recommendation and Ms. Ahern's other methodologies, adders, and calculations are improper, non-standard and fail to support an ROE recommendation above 9.25 percent; and

4. JCP&L's overall weighted average cost of capital is 7.76 percent, based on a 9.25 percent ROE, a 6.26 percent cost of debt, and a 50/50 capital structure.

POINT IV

RATE COUNSEL'S RECOMMENDED RATE BASE OF $1,247,783,394 SHOULD BE ADOPTED

By Order dated July 31, 2012, the BPU directed JCP&L to file a base rate case on or before November 1, 2012.[29] As ordered by the BPU, JCP&L used the twelve month period ending on December 31, 2011 as the test year. *JC-2,* p.2. The Company's initial filing reflected a test year end rate base of $2,076,589,171 adjusted to include actual plant additions through June 30, 2012 fo a total as-filed rate base of $2,040,326,088. *JC-3*, SDM-5. In second supplemental testimony, the Company updated its June 30, 2012 Distribution Rate Base to $2,024,166,188 to reflect "corrections or revisions" identified in discovery and to remove costs related to the 2012 major storms. *JC-3-S2*, SDM-5 Supplemental No. 2.

Rate Counsel witness Robert J. Henkes, in his Direct Testimony filed on June 14, 2013 (*RC 145*) and in his Supplemental Direct filed on August 30, 2013 (*RC 146*) accepted the Company proposed Utility Plant in Service balance at June 30, 2012 of $3,948,975,061. *RC-146,* RJH-3R. Mr. Henkes adjusted that Plant in Service amount to remove the 2011 major storm costs of $77,120,550 included in the Company's filing. Mr. Henkes then recommended additional rate base adjustments to the Company's updated and revised *pro forma* rate base of $2,024,166,188. *JC-3S2,* Sch. SDM-5. In this brief, Rate Counsel is recommending a total electric rate base adjustment of $776,382,794 resulting in a rate base for the Company's electric operations of $1,247,783,394. *RC-146,* Sch. RJH-3R. Each of Mr. Henkes' recommended adjustments is discussed below.

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[29] I/M/O the Petiton of Rate Counsel Requesting a Board Order Directing JCP&L to File a Base Rate Case Petition and Establishing a Test Year of 2010, BPU Dkt. No. EO11090528, 7/31/12.

A. Unamortized Net Losses on Reacquired Debt (Net of Tax)

The net loss (or gain) on reacquired debt is the difference between the amount paid upon reacquisition and the net book value of the debt. The net loss (or gain) is amortized over the remaining term of the debt. JCP&L proposes to include as an addition to rate base $17,920,314 of unamortized losses on reacquired debt. *JC-3, SDM-5*. Mr. Henkes made two adjustments to this proposal. First, Mr. Henkes recognized that the amount proposed by the Company as an addition to rate base incorrectly included the Company's total electric balance, not just the distribution-related portion. The Company quantified the distribution-related portion of the total electric balance for the net loss on reacquired debt as 78.78%. *RC-133*. The application of this allocator results in a recommended distribution-related balance of $14,117,623. *RC-145, Sch. RJH-4*.

Mr. Henkes also made an adjustment to recognize the deferred income tax balance related to the net loss on reacquired debt. Mr. Henkes calculated the offsetting tax benefit of $5,767,049 by applying the composite income tax rate of 40.85% to the distribution-related net loss on reacquired debt balance. The resultant recommended net-of-tax loss on reacquired debt balance is $8,350,574 which is $9,569,740 lower than JCP&L's proposed balance of $17,920,314. *RC-145, Sch. RJH-4*.

B. Unamortized Storm Damage Cost (Net of Tax)

JCP&L included as an addition to rate base $26,470,956 in unamortized storm damage costs associated with the 2011 major storms to provide investors a return on "substantial expenditures" incurred by the Company for which JCP&L is proposing recovery over a period of time. *JC-3,* p.5. The prudency of these costs and the

appropriate recovery mechanism is yet to be determined.[30] Accordingly, Rate Counsel has deducted from rate base the net of tax unamortized 2011 major storm costs. *RC-145, Sch. RJH-3*.

C. Excess Cost of Removal Reserve

In the Company's prior base rate case, Rate Counsel witness Michael Majoros demonstrated that the Company had incorporated $43.1 million in annual net negative salvage (cost of removal) in its depreciations rates but over the previous five years had only experienced $3.9 million in negative net salvage. Based on this, Rate Counsel proposed, and the Board agreed, that the cost to remove an asset at its retirement should be removed from the depreciation rate calculations and replaced with a separate calculation of five-year average net negative salvage which is then added to the annual depreciation expense and included in the reserve.[31] In that Order, the Board did not address the issue of the excess depreciation reserve balance related to the past over-recovery of cost of removal in depreciation rates.

In this proceeding, the Company has included as a rate base deduction the actual distribution-related depreciation reserve balance as of June 30, 2012, $1,502,324,772. This balance includes a balance of $107,158,582 for excess cost of removal reserve. The Company proposes to remove this $107.2 million excess cost of removal reserve from the depreciation reserve, thereby increasing rate base by this amount. *RC-145,* Sch. RJH-3. The Company claims that this treatment is appropriate as the cost of removal expense is

[30] I/M/O the Board's Review of the Prudency of the Costs Incurred by JCP & L in Response to Major Storm Events in 2011 and 2012, BPU Docket Nos. AX13030196 and EO13050391 (Storm Prudency Proceeding). Rate Counsel will not object to incorporating into rate base in this base rate proceeding 2011 major storm costs found by the Board to be reasonable and prudent in the Storm Prudency proceeding.

[31] I/M/O the Verified Petition of Jersey Central Power and Light Company, BPU Docket No. ER02080506, Final Order, May 17, 2004, p.54

no longer included in depreciation rates but is being collected from ratepayers through a separate charge.

As noted by Rate Counsel witness Henkes, "[t]his justification makes no sense whatsoever." *RC-145,* p.17. Mr. Henkes notes that this excess cost of removal reserve balance was funded by ratepayers in the past and is being returned to ratepayers over an amortization period of 28.5 years. Thus, during the time that this fund is being returned to ratepayers, the unamortized balance, which has been funded by and not yet returned to ratepayers, must remain as a rate base deduction to provide ratepayers with an appropriate return on their investment.

Mr. Henkes' recommendation to treat this balance as a rate base deduction is wholly consistent with Board policy. In a PSE&G proceeding, the Board set a five year amortization period for the Cost of Removal reserve and directed that "[a]ll amounts associated with Cost of Removal which remain in the depreciation reserve will continue to be an offset to the Company's rate base."[32]

If the cost of removal reserve balance is not deducted from rate base, JCP&L's shareholders will earn on this balance. Yet, the cost of removal reserve was funded by ratepayers, not by JCP&L shareholders. Accordingly, it is inequitable and contrary to Board policy to force ratepayers to pay JCP&L its overall rate of return on that part of rate base funded by ratepayers.

D. Materials and Supplies ("M&S")

The Company included in rate base $20,461,958 representing the actual M&S inventory balance as of June 30, 2012. Rate Counsel witness Henkes made two

[32] I/M/O the Petition of Public Service Electric & Gas Company for Approval of an Increase in Gas Rates, Depreciation Rates for Gas Property and for Changes in the Tariff for Gas Service, BPU Docket No. GR05100845, Decision and Order Adopting Initial Decision, (Jan. 09, 2006).

adjustments to this proposed rate base addition. First, Mr. Henkes identified an error in the Company's M&S calculation. The corrected M&S balance was $16,699,010. This correction was adopted by the Company in rebuttal testimony. *JC-3R,* p. 6.

Secondly, Mr. Henkes recommended that a more appropriate M&S balance would be calculated using a 13-month average rather than selecting a single point over the course of a year. Mr. Henkes noted that, as can seen from JCP&L's monthly M&S inventory balances provided in response to discovery, the Company's M&S balance varied significantly over a twelve month period. *RC-145,* p. 19. Utilizing a 13-month average, Mr. Henkes calculated an M&S balance of $14,821,243, which results in a rate base deduction of $1,877,767. *RC-146,* Sch. RJH-3R.

E. Cash Working Capital ("CWC").

Cash working capital is an element of rate base and can be defined as monies advanced by either investors or ratepayers to cover expenses associated with the provision of service to the public during the period of time between the payment of those expenses and the Company's collection of revenues from customers. In this proceeding, the Company's CWC was calculated based upon the results of a lead/lag study. A lead/lag study measures the difference between when the Company receives revenue for the provision of service and when the Company pays for the costs of providing service.

Company witness Jeffrey L. Adams initially proposed a CWC rate base addition of $146,298,532. This request was based on a Company-performed lead/lag study using JCP&L's 2011 revenues and expenses, as reported in JCP&L's FERC Form 1. *JC-12,* p.3. Mr. Adams subsequently corrected his CWC calculation to remove transmission-

related revenues and expenses. The Company's corrected cash working capital request was a $138,138,683 addition to rate base. *JC-12 Supplemental, p.3.*

Rate Counsel witness David E. Peterson recommended a CWC allowance of approximately $76,484,029. Mr. Peterson opined that this amount is reasonable when appropriate adjustments are made to the Company's lead/lag study. *RC-152,* p. 8. In calculating the Company's CWC requirement, Mr. Peterson adjusted three lead/lag components included in the Company's study, namely: (1) the payment lead days that Mr. Adams assigned to JCP&L's federal income tax payment, which was significantly understated in Mr. Adams' study, (2) the inclusion of non-cash expenses and (3) the incorrect expense lead days that Mr. Adams assigned to the debt and equity components of JCP&L revenue requirement. *RC-152,* p.10.

1. Expense Lead Days Associated with the Payment of Federal Income Taxes

To calculate the expense lead[33] days associated with the payment of federal income taxes, Mr. Adams reviewed the quarterly payments made by JCP&L to First Energy in 2011. Mr. Adams weighted the lead days by the amount of each tax payment. As shown in the chart below, this resulted in a weighted average expense lead days of (50.24) days. Negative expense days implies that on average, income taxes are prepaid by JCP&L, that is, the tax payment was made before JCP&L received revenues from customers, thereby creating a cash working capital requirement.

	Payment	**Lead (days)**
April 15, 2011	$ 24,271,000	(78.00)
June 15, 2011	$ 9,908,000	(17.00)

[33] The Company is obligated to make quarterly estimated tax payments. The expense lead days for Federal Income Taxes is the number of days from the estimated payment date (April 15, 2011, June 15, 2011, September 15, 2011 and January 15, 2012) until the mid-point of the tax year (July 1, 2011).

September 15, 2011	$ 31,613,000	75.00
December 15, 2011	$(16,690,000)	166.00
Total	$ 49,302,000	(50.24)

However, as noted by Mr. Peterson in his direct testimony, the uneven amount of JCP&L's 2011 quarterly tax payments, distorted the expense lead day calculation to make it appear that there was an obligation to prepay taxes. *RC152,* p. 11. This distortion occurred in part because JCP&L overpaid estimated taxes to FirstEnergy in the first three quarters of 2011 and then received a significant refund from FirstEnergy in December, 2011. *Id.*

Mr. Peterson testified that an assumption of uniform quarterly income tax installments is a more reasonable position to take when measuring the cash working capital requirement associated with federal income tax payments. As acknowledged by Company witness Adams, the Internal Revenue Service allows taxpayers to utilize a number of different methods to estimate quarterly tax payments. *T122:L2-18.* (October 10, 2013). JCP&L and FirstEnergy have the option to choose the method that is the most advantageous to themselves. Had JCP&L not made significant overpayments to FirstEnergy early in the year but instead had, more reasonably, made equal quarterly tax payments to FirstEnergy, the expense lead days would have been 36.50 days rather than the (50.24) days calculated by Company witness Adams. *RC-152,* p.11.

Moreover, Mr. Adams testified that the unequal quarterly tax payments made during 2011 were unusual in that they were primarily the result of two unusual events (an early October snowstorm and Hurricane Irene) that occurred during the last quarter of 2011. *JC-1,* Rebuttal, p. 3. The obvious implication of Mr. Adams' testimony in this regard is that had the two unusual events not occurred, JCP&L's quarterly tax payments

would have been more uniform. It is axiomatic in ratemaking that unusual and nonrecurring events occurring during a test year should be eliminated or normalized in the rate setting process. Mr. Peterson's proposed adjustment to the expense lead days associated with federal income tax payments does just that.

The Company's manipulation of its cash working capital requirement for federal income taxes is especially bothersome when one considers the fact that JCP&L is a member of the FirstEnergy consolidated tax group and, therefore, is making these quarterly tax payments, not to the IRS, but to its parent corporation, FirstEnergy. And, in fact, in 2011, parent corporation FirstEnergy paid no income taxes to the IRS. *RC-3.*

JCP&L is therefore not only charging ratepayers for income taxes that were never paid to the IRS, it also seeks to charge ratepayers for a phantom cash working capital requirement on those phantom taxes. This is unfair and should not be allowed. Properly measuring the expense lead days associated with the payment of federal income taxes reduces JCP&L's claimed CWC requirement by approximately $10.5 million.

2. Non-Cash Depreciation and Amortization Expenses

A rate base allowance for cash working capital is intended to compensate investors for investor-supplied funds, if any, used to finance the day to day operating needs of the utility. *RC152,* p.14. As explained by JCP&L witness Adams, a properly conducted lead/lag study should exclude non-cash expenses, because, by definition, non-cash expenses do not create a day to day operating cash requirement for JCP&L. *JC-12,* p.7. Accordingly, the Company excluded "accounting items which are non-cash in nature," "amortizations" "and non-cash transactions." *JC-12,* p.7. Having made these specific exclusions from his lead-lag analysis, Mr. Adams inexplicably went on to

include over $276 million of non-cash depreciation and amortization expenses in his CWC analysis.

Rate Counsel recognizes that Rate Counsel's recommended treatment for depreciation and amortization expenses differs from current Board policy.[34] However, Rate Counsel suggests that this policy should be re-visited at this time. As a non-cash expense, depreciation does not create a need for cash to be supplied by investors (or by ratepayers) during the lead/lag study period. *RC-152,* p.14. Indeed, as recognized by Company witness Adams at the evidentiary hearing, for financial reporting purposes, depreciation expense is recorded as a cash inflow, or a source of cash to the Company; not a cash outflow or requirement for cash. *T129:L2-3.* The cash transaction associated with a plant asset occurred when the asset was first acquired. No additional investor-supplied funds are required following the initial investment. Moreover, no cash flows out of the utility for depreciation expense. Depreciation is included as an expense in the income statement and in the cost of service, even though no cash account is reduced on the balance sheet. Rather, the Company records the consequences of depreciation expense on the balance sheet in the accumulated reserve for depreciation account, which it reports as an offset to plant in service. Since there is no cash involved in the depreciation transaction, no CWC allowance is necessary for the depreciation expense. The exclusion of depreciation expense from JCP&L's claimed CWC requirement has an impact of approximately $14.3 million.

Mr. Adams' lead/lag analysis also improperly included regulatory debits and credits and deferred income taxes. JCP&L's regulatory debits include various

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[34] See, e.g., I/M/O Middlesex Water Company, BPU Docket No. WR00060362, Order, (June 6, 2001), p. 16.

amortizations of costs incurred prior to the 2011 test year. As with depreciation expense, the cash transactions associated with these amortizations took place in years prior to the 2011 study period. Thus, as with depreciation, there is no continuing need for investor-supplied capital to wind down the remaining accounting write-off of costs incurred in prior years.

Similarly, with deferred taxes, there is no continuing cash payment required from the Company or from investors for deferred taxes. Therefore no investment in working capital is required. The inclusion of deferred taxes is especially egregious as investor supplied capital was never involved in the Company's deferred tax balance. Deferred taxes have been collected from ratepayers with no tax payment made to the U.S. Treasury by the utility.

Rate Counsel's reasoning on the exclusion of non-cash expenses in a lead/lag analysis is supported by the NARUC Staff Subcommittee on Accounting and Finance.[35] In its 2003 Rate Case and Audit Manual, the NARUC Staff Subcommittee noted that under the lead-lag methodology, "one is attempting to measure the actual time between a utility's out-of-pocket payment of expense to provide service and the collection of revenues for service." The committee goes on to say that any debate as to which expenses should be included in a cash working capital should be answered "by looking at the theory of what is attempting to be measured (e.g., the measurement of *paid* expenses may argue against the inclusion of depreciation) and what treatment these items have been given in previous cases." *Id*. Thus, as the purpose of the lead/lag study is to measure paid expenses, non-cash items which do not require an outlay of cash do not

[35] Rate Case and Audit Manual, NARUC Staff Subcommittee on Accounting and Finance, Summer 2003, www.naruc.org/publications/ratecase_manual.pdf. Rate Counsel asks Your Honor and the Board pursuant to NJAC 1:1-15.2 to take judicial notice of this NARUC treatise.

belong in a lead/lag study. Rate Counsel recommends that the Board's current policy with respect to depreciation expense vis-à-vis a lead-lag analysis be reconsidered and that depreciation and amortization expenses be excluded from the lead/lag study for purposes of determining the Company's appropriate cash working capital in this case.

Rate Counsel believes that its recommended position is correct and urges its adoption by Your Honor and the Board. Cash working capital reflects the need for investor-supplied funds to meet the day to day expenses of operations that arise from the timing differences between when JCP&L must expend money to pay the expenses of operation and when revenues for utility service are received by the utility. *RC-4,* p.15. Only those items for which actual out-of-pocket cash expenditures are made should be included in the Company's CWC lead-lag calculation. Rate Counsel therefore recommends that the Board reconsider its current policy on this matter and exclude depreciation and amortization expenses from the lead/lag study for purposes of determining the Company's appropriate cash working capital in this case. *RC-4, Sch. ACC-7*. As the expenses that relate to depreciation and amortization simply do not represent or require cash outlays by JCP&L investors, a properly conducted lead/lag study should exclude these non-cash expenses. *RC-152,* p.15.

Rate Counsel urges the Board to continue its past policy of excluding deferred income taxes from lead-lag analyses. Like depreciation, deferred taxes are also non-cash expenses to the utility. However, including deferred taxes in the lead-lag analysis as JCP&L proposes is even more egregious than including depreciation expense in that no investor-supplied funds were ever used or required for deferred taxes.

3. The Return on Investment Capital

Mr. Adams' lead/lag analyses assigns incorrect expense lead days to the debt and equity return components of JCP&L's revenue requirement. By assigning JCP&L's debt and equity returns a zero-day expense lead, it is as if stockholders and debt-holders are being compensated on a daily basis. Mr. Adams justifies this treatment by arguing that "all of the payments for these items come from operating income, which is the property of the investor once service is provided." *JC-12.* p.8. While Mr. Adams may be correct in this statement, as noted by Mr. Peterson in his direct testimony, ownership of operating income is not the issue. Indeed, all revenues become property of the investor once service is provided. But this ownership entitlement does not mean that JCP&L does not have to meet payment requirements to employees, vendors, and investors. Rather than ownership of the funds, the real issue in determining a CWC allowance is how much investor-supplied capital (or how much ratepayer capital) is required to meet the utility's day-to-day operating expenses.

Thus, it is incorrect to include any recognition of a fictional CWC requirement associated with a return on common equity on a daily basis. If one were to examine the actual cash transaction associated with common equity, one would look to FirstEnergy's quarterly dividend payments, rather than fictional daily payments. But, JCP&L is under no contractual obligation to make dividend payments to shareholders before collecting the corresponding revenue. *RC-152,* p.16.

Moreover, the Company's fundamental assumption that the common shareholder is entitled to the return on his/her equity investment at the exact instant that service is rendered is incorrect. The fact is that the shareholder receives his/her return through the quarterly payments of dividends and any gain in the Company's stock price once the

stock is sold. This is the mechanism by which the common shareholder is compensated in the real world. Furthermore, there is no guarantee of any such return. The Company is under no contractual obligation to provide dividends; nor is there any guarantee that the Company's stock price will increase. Shareholders have no contractual right to receive either dividends or growth in share price. Shareholders assumed the risk when they purchased common stock. In addition, companies generally retain a portion of their earnings rather than paying out all earnings as dividends. Therefore, it is inappropriate to reflect a zero lag and to correspondingly increase the Company's CWC for the return on equity to account for a fictional zero-day expense lead. Rate Counsel recommends that the return on equity component be excluded from the lead/lag analysis.

Similarly, because JCP&L has included long term debt in its lead/lag analysis using a zero day expense lead, JCP&L is acting as if debt-holders are being compensated on a daily basis. This is incorrect. There are contractual requirements associated with long-term debt interest payments that obligate JCP&L to make specified payments on certain dates (i.e., semi-annually).

In its CWC calculation, the Company failed to properly reflect the fact that the revenue requirement includes a component for interest expense. The rates paid by the Company's customers are set to produce, in addition to other amounts, the sums necessary for the Company to pay interest to bondholders. Since the Company pays its bondholders twice a year but collects revenues for such bondholder payments much sooner, the Company has the use of funds provided by ratepayers for interest expense as working capital during the interim period between interest payments. The Company's ratepayers provide these funds continuously, in a steady stream, and not in a pattern that

matches or coincides with the Company's liability for the expense. Ratepayers, not the Company, are correctly entitled to the benefit of funds collected from them earlier than the Company's obligation to pay interest expense. Ratepayers clearly should not be required to pay a return to shareholders on capital which ratepayers themselves provided. It is settled regulatory policy that shareholders are not entitled to a return on capital which the shareholders have not provided. Federal Power Commission v. Hope Natural Gas, 320 U.S. 591 (1944), Bluefield WaterWorks v. Public Service, 262 U.S. 679 (1923). Accordingly, the actual long-term debt interest payment lag should be reflected in the calculation of cash working capital.

The Board has decided that long-term debt interest should be included in a lead/lag study by assigning a zero (0) day lag to long-term debt payments. In the Atlantic Order, the Board opined that the return on investment is the property of investors when service is provided. Atlantic City Electric Company, BPU Docket No. 8310-883, Decision and Order, (August 17, 1984). Earlier in Rate Counsel's Brief we addressed the ownership issue finding that it is irrelevant to the CWC discussion. Moreover, the Board's present position is inconsistent with the manner in which other cash flow items are handled in a lead/lag study. The lead/lag study examines the actual cash flows, not the accounting for an expense or liability, in determining the Company's CWC requirement. Long term debt interest expense should be treated in a similar manner. Interest payments are not due to bondholders until the payment dates specified in the bond indenture documents. Bondholders are not entitled to receive daily interest payments or a return on interest payments since daily payments are not specified in the bond indentures.

In addition, bondholders considered the periodic nature of interest payments when they determined the interest rate that they would require to purchase the bonds. That rate is embedded in the Company's cost of capital. It is unreasonable to ask ratepayers to pay this actual interest rate, which reflects a premium required due to the payment lag, and then require ratepayers to also pay a cash working capital requirement based on the assumption that interest payments are made daily.

Rate Counsel submits that its position on long-term debt interest is consistent with the Company's treatment of other revenues and expenses. The Company does not use zero lag days for revenues, even though the Company "earns" its revenues on the day that service is provided and is required to account for revenues on that basis. Similarly, the Company does not use zero lag days for payroll expense, even though employees earn their salaries each day that they work. Instead, revenue and payroll (and other cash expenses) are reflected in the lead/lag study based on when cash is actually received or paid. Thus, the lead/lag study examines specific, actual cash flows, not the accounting accrual for revenue or expenses, in determining the Company's CWC requirement. Interest expense should be treated in a similar manner. Therefore, the average payment lead for long-term debt should be separately recognized in the lead/lag calculation. Long-term debt is paid semi-annually, creating a 91.25 day expense lead. *RC-152,* p. 17. Rate Counsel's recommended adjustment for equity returns and long-term debt expense reduces JCP&L's CWC requirement by approximately $26.5 million.

4. CWC Conclusion

In summary, based on the above described approach and based upon the cash operating expenses and taxes recommended by Rate Counsel in this case, Your Honor

and the Board should adopt a positive lead/lag study cash working capital requirement of approximately $76,484,029. *RC-152,* Sch. DEP-2. This is approximately $69,814,503 less than the cash working capital requirement of approximately $138,138,683 claimed by the Company.

F. Consolidated Income Tax Benefit

JCP&L computed its pro forma income tax expense on a "stand alone" basis. By establishing a revenue requirement based solely on a stand-alone federal income tax methodology the Company has overstated its expense, resulting in a windfall to shareholders and higher rates for New Jersey ratepayers. The Company's tax calculation ignores the fact that JCP&L does not file its federal taxes on a stand-alone basis, but rather files as part of a consolidated income tax group with FirstEnergy. By filing as part of a consolidated return, FirstEnergy can take advantage of tax losses experienced by other member companies. The tax loss benefits generated by one group member can be shared by other consolidated group members, resulting in a reduction in the overall effective federal income tax rate.

It has long been the law in New Jersey that ratepayers are entitled to a sharing of these tax benefits. The New Jersey Supreme Court long age decided:

> [T]he Utility is allowed a deduction from gross income for actual operating expenses only (or actual normalized operating expenses) and not for hypothetical expenses which did not and foreseeably will not occur. Thus it is entitled to an allowance for actual taxes and not for higher taxes that it would pay if it filed on a different basis. This results in a conclusion that the respondent's allowance to the Utility of even 50 per cent of the difference between actual and hypothetical taxes was in error.

I/M/O the Revision in Rates Filed by New Jersey Power & Light Company, Increasing its Rates for Electric Service, 9 N.J. 498, 528 (1952) (Internal citations omitted).

When Lambertville Water Company appealed a decision by the BPU that disallowed a portion of the water utility's claimed federal income tax expense, the Appellate Division said:

> If Lambertville is part of a conglomerate of regulated and unregulated companies which profits by consequential tax benefits from Lambertville's contributions, the utility consumers are entitled to have the computation of those benefits reflected in their utility rates.
>
> It is only the real tax figure which should control rather than that which is purely hypothetical. And, the P.U.C. Commissioners therefore have the power and function to take into consideration the tax savings flowing from the filing of the consolidated return and determining what proportion of the consolidate tax is reasonably attributable to Lambertville.

I/M/O the Revision of Rates Filed by Lambertville Water Company Increasing the Rates for Water Service, 153 N.J. Super 25, 28 (App. Div. 1977) (internal citations omitted).

More recently, by Order dated July 31, 1991, the Board directed that a Phase II of the Atlantic City Electric Company base rate case be initiated to address the issue of the "flow through of consolidated tax savings." I/M/O The Petition of Atlantic City Electric Company for Approval of Amendments to Its Tariff to Provide for an Increase in Rates And Charges for Electric Service Phase II, BPU Docket No. ER90091090J, Order Adopting in Part and Modifying in Part the Initial Decision (Oct. 20, 1992). In that Phase II proceeding initiated to determine the proper consolidated tax adjustment, the Board adopted the "rate base" method, endorsed by Staff and Rate Counsel, which "essentially treats the tax benefits derived by the holding company as cost free capital contributed by ratepayers." *Id* at 6. The Board characterized this method as a "sharing approach, since only the carrying costs are credited to ratepayers." *Id*. The Board also noted that we "reaffirm and emphasize that the Board's policy is to reflect an equitable and appropriate sharing of consolidated tax benefits for ratepayers in future rate proceedings." *Id*. at 8.

In 1993 the issue of a consolidated tax savings adjustment was again addressed by the Board. I/M/O the Petition of Jersey Central Power and Light Company for Approval of Increased Base Tariff Rates and Charges for Electric Service and Other Tariff Revisions, BPU Docket No. ER91121820J, Order, (June 15, 1993). In that proceeding, JCP&L voluntarily included in its federal income tax calculation the tax savings resulting from its parent company and affiliate tax losses in its unadjusted test year operating income. The Board rejected the income statement adjustment proposed by JCP&L and adopted the rate base adjustment proposed by Staff as "a more appropriate methodology for the reflection of consolidated tax savings." *Id.* at 8.

More recently, in 2004, the rate base methodology was again endorsed by the Board with the direction that "future consolidated tax adjustments are to be made utilizing the methodology that Staff utilized to calculate its $1.329 million adjustment as shown on Exhibit 4 of this order." I/M/O the Verified Petition of Rockland Electric Company for Approval of Changes in Electric Rates, Its Tariff for Electric Service, Its Depreciation Rates, and for Other Relief, BPU Docket No. ER02100724, Final Decision and Order, April 20, 2004.

Earlier this year, the Board established a generic proceeding to review this policy. I/M/O the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment, BPU Docket No. EO12121072, Order Opening a Generic Proceeding, Jan. 23, 2013. The generic proceeding is currently on-going. In that Order the Board directed that "until such time as the Board makes a final determination on the consolidated tax adjustment issues, the current consolidated tax savings policy shall apply". *Id.* at 2.

The "current consolidated tax savings policy" is the policy established by the Board in the 2004 Rockland base rate case discussed above. Rate Counsel witness Andrea Crane used this methodology as set out in the Staff exhibit in the RECO case to calculate her recommended CTA in this proceeding. *RC-13,* p. 10. Based on this methodology, Mr. Crane recommended a rate base reduction of $511.66 million. *RC-13,* Sch. ACC-1. Company witness Warren conceded that Ms. Crane's calculation was consistent with the RECO methodology, and, despite finding "fundamental flaws" in the RECO methodology, JCP&L did not quantify the impact these "fundamental flaws" would have on Rate Counsel's recommended CTA. *RC-13,* RCR-CIT-58. Nor did the Company propose any alternative calculation of a CTA. Rather, in defiance of New Jersey law and Board policy, the Company "contends that there should be no CTA and, for that reason, has not included one in its filing." *JC-11,* p. 7. Thus, the only evidence in this proceeding that comports with current BPU consolidated tax policy is Rate Counsel's recommended rate base adjustment of $511.66 million.

Rate Counsel's proposed CTA fully conforms with New Jersey law and Board precedent and provides a benefit to ratepayers in exchange for FirstEnergy's use of ratepayer funds to subsidize unregulated and unprofitable affiliates.

Accordingly, Your Honor and the Board should adopt Rate Counsel's recommended CTA and reduce JCP&L's rate base by $511.66 million.

G. Customer Refunds

The Company carries on its books a certain level of customer refunds. Mr. Henkes recommended that the 2011 test year average customer refund balance of $1,163,573 be deducted from rate base. *RC-145,* Sch. RJH-3. This reflects Rate

Counsel's position that FirstEnergy investors should not be allowed to earn a return on funds supplied by ratepayers. Federal Power Commission v. Hope Natural Gas, 320 U.S. 591 (1944), Bluefield WaterWorks v. Public Service, 262 U.S. 679 (1923). Rate Counsel's adjustment should be adopted.

H. Operating Reserves (Net of Tax)

In JCP&L's 2002 base rate case, the Company proposed and the Board adopted a distribution related rate base deduction for certain operating reserves (net of offsetting deferred income taxes). As operating reserves consist of accumulated funds that have been supplied by ratepayers, FirstEnergy investors should not be earning a return on funds supplied by ratepayers. The Company has agreed that operating reserves (net of deferred tax) should be deducted from rate base. *JC3-S2,* p.4, Sch. SDM-5 Supplemental No.2. Accordingly, the Company's operating reserve (net of tax) balance of $4,237,102 should be deducted from rate base in this proceeding. *RC-146,* RJH-3R.

I. Three Mile Island – Unit 2 ("TMI-2") Non-Qualified Decommissioning Trust Fund Deferred Tax

The Company proposed not to include in its rate base $19.8 million associated with prepaid deferred taxes related to the TMI-2 Non-Qualified Decommissioning Trust Fund because this asset will be eliminated in 2013. Rate Counsel witness Henkes rejected this proposal as the balance in this account will not be eliminated until the end of 2013, well beyond the 2011 test year. Mr. Henkes therefore has treated the $19.8 million prepaid deferred tax balance as a rate base addition. This adjustment is appropriate and should be adopted.

J. Summary of Rate Base Adjustments

(1) Rate Counsel’s recommended rate base of $1,247,783,394 should be adopted. *RC-146,* Sch. RJH-1R.

(2) Your Honor and the Board should adopt Rate Counsel’s $9,569,740 adjustment to JCP&L’s unamortized net losses on reacquired debt balance. The appropriate net-of-tax distribution net loss on reacquired debt is $8,350,574. *RC-145,* Sch.RJH-4.

(3) Your Honor and the Board should reject the Company’s removal from rate base of the excess cost of removal reserve balance of $107.2 million. It is inequitable and contrary to Board policy to force ratepayers to pay JCP&L its overall rate of return on that part of rate base funded by ratepayers. *RC-145,* Sch.RJH-3.

(4) Your Honor and the Board should adopt Mr. Henkes recommended 13-month average M&S balance of $14,821,243. *RC-145,* Sch. RJH-6.

(6) Your Honor and the Board should adopt a positive lead/lag study cash working capital requirement of approximately $76,484,029. *RC-152,* Sch. DEP-2. This is approximately $61,654,653 less than the cash working capital requirement of approximately $138,138,683 claimed by the Company. *RC-146,* Sch. RJH-3R.

(5) Your Honor and the Board should adopt Rate Counsel’s recommendation that the 2011 test year average customer refund balance of $1,163,573 be deducted from rate base. *RC-145,* Sch. RJH-3.

(6) To properly share with ratepayers the benefits of the tax sharing agreement between FirstEnergy and JCP&L, Your Honor and the Board should adopt Rate Counsel’s recommended Consolidated Tax Adjustment, a deduction from rate base of $511,030,428. *RC-145,* Sch.RJH-3*; RC-13,* Sch.ACC-1.

(7) Your Honor and the Board should treat the Company’s operating reserve (net of tax) balance of $4,237,102 as a rate base deduction. *RC-146,* RJH-3R.

(8) The Company’s prepaid deferred tax balance related to the TMI-2 Non-Qualified Decommissioning Trust Fund will not be eliminated until 2013. Accordingly, Your Honor and the Board should treat the $19.8 million prepaid deferred tax balance as a rate base addition.

POINT V

THE APPROPRIATE PRO FORMA OPERATING INCOME AMOUNTS TO $223,860,850 WHICH IS $56,125,932 MORE THAN JCP&L'S' PROPOSED UPDATED AND REVISED PRO FORMA OPERATING INCOME OF $167,734,919

On November 28, 2012, JCP&L filed a Petition with the Board seeking a base rate increase of $31,471 million, including sales and use tax. JCP&L subsequently updated its filing to reflect the results of the depreciation study ordered by the Board and again to remove all 2012 storm damage costs from the filing. JCP&L ultimately requested a revenue requirement increase of $10,958,240. Rate Counsel is recommending a rate decrease of $214,868,497. Following are Rate Counsel's proposed Revenue and Expense adjustments in support of our recommended rate decrease.

A. Major Storm Costs

Rate Counsel's recommendations in this brief do not include costs associated with the Company's claimed 2011 storm damage costs associated with Hurricane Irene, the October 2011 Snowstorm and the July 2011 heat wave. These costs will be reviewed for prudency in the Board's Storm Costs prudency review proceeding.[36] 2011 Major Storm Costs deemed in that proceeding to be reasonable and prudent will then be incorporated into this base rate proceeding for base rate recovery. Also, excluded from Rate Counsel's recommended rate base are costs associated with 2012 major storms, Hurricane Sandy and the November 2012 Nor'easter.

The Company has argued that 2012 storm damage costs should also be rolled into this base rate case. Including these costs in this base rate case is inappropriate in light of

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[36] I/M/O the Board's Review of the Prudency of the Costs Incurred by Jersey Central Power & Light Company in Response to Major Storm Events in 2011 and 2012, BPU Docket Nos. AX13030196 and EO13050391

the Board's post-test year ratemaking policy.[37] Both the October 2012 Sandy super storm and the November 2012 Nor'easter and the costs incurred in response to these events are too far beyond the end of the 2011 test year to be given rate recognition in this case.

Moreover, to give rate recognition only to costs associated with these two isolated events violates the Board's long standing single issue rate making policy.[38] Super Storm Sandy and the November 2012 storm were not the only factors affecting the Company's rates since the close of the test year. As we know, amortizations have expired and financing costs have gone down. Certainly many other changes have also occurred. Accordingly, it is Rate Counsel's position that all costs associated with the major storms in 2012 should be deferred for recovery in a future base rate case.

B. Pro Forma Revenue Adjustments

In calculating its *pro forma* revenues, the Company began with 2011 test year unadjusted distribution revenues of $620,180,353. *JC-3,* SDM-1. The Company used the average number of customers in the 2011 test year to establish the *pro forma* test year sales level. The Company then proposed a $27,520,031 weather normalization adjustment using a 20-year period to determine normal weather.

While Rate Counsel witness Robert Henkes did not object to the Company's weather normalization adjustment, Mr. Henkes did reject the Company's proposal to use the average number of customers in the 2011 test year to establish the *pro forma* test year sales level. *RC-145,* p.24. As noted by Mr. Henkes, the Company in this proceeding has proposed to re-state its rate base based on actual balances as of June 30,2012 and has

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[37] In re Elizabethtown Water Company, BPU Docket No. WR8504330, Decision on Motion for Determination of Test Year and Appropriate Time Period for Adjustments, (May 23, 1985.)

[38] I/M/O the Petition of Atlantic City Electric, BPU Docket No. ER97020105, Order Accepting Initial Decision with Modification, (6/4/98) at p.8

proposed to annualize depreciation expenses based on plant in service balances as of June 30, 2012. Mr. Henkes concluded that in order to provide for a proper matching between the Company's proposed rate base and depreciation expense on the one hand and the Company's revenues on the other hand, it is appropriate to re-state *pro forma* test year sales levels based on the number of customers as of June 30, 2012, thereby giving proper recognition to any customer growth from the mid-point of the 2011 test year to June 30, 2012.

Rate Counsel's position is consistent with long standing Board policy to recognize customer growth when establishing rate case revenues. As noted by the Board in JCP&L's prior base rate case "The Board **HEREBY FINDS** the inclusion of revenues related to such growth is appropriate when matching revenues with the use of test-year end rate base and annualized depreciation expense based on year end plant. *JCP&L 2004 Final Order*, p.48. In accordance with that finding, Rate Counsel in this proceeding recommends that Your Honor and the Board use the number of customers as of the date of the Company's June 30, 2012 rate base. This adjustment increases JCP&L's proposed test year sales revenues by $823,138 for total test year sales revenues of $577,627,291.

C. Expense Adjustments

1. Deferred Amortization Expense

The 2011 test year includes $562,500 in amortization expenses related to the Werner CT plant. The amortization of this asset expired in April 2013 when the regulatory asset was fully amortized. Rate Counsel has not removed this expired amortization expense from the test year for ratemaking purposes as the amortization

expiration date is too far removed from the end of the 2011 test year to be given rate recognition in this proceeding.[39]

The 2011 test year also includes $3,320,472 in amortization expenses related to certain deferred OPEB costs. The amortization of this asset expired on December 31, 2012 when the asset was fully amortized. Rate Counsel has not removed this expired amortization expense from the test year for ratemaking purposes as the amortization expiration date is too far removed from the end of the 2011 test year to be given rate recognition in this proceeding.[40]

2. Amortization of Net Loss on Reacquired Debt

JCP&L included in its filing an amortization expense amount of $1,772,706 for net loss on reacquired debt. *JC-3, SDM-2,* p. 6 of 24. This test year amortization expense amount represents the Company's total electric amortization expense rather than just the distribution related amortization expense. The Company quantified the distribution portion of its total electric amortization expense for the net loss on reacquired debt as 78.78%. The application of this distribution allocator to the total electric amortization expense results in a recommended distribution-related amortization expense of $1,396,538. This expense amount is $376,168 lower than the Company's proposed amortization expense amount of $1,772,706. *RC-145,* RJH-4, lines 6-8.

3. Rate Case Expenses

[39] In re Elizabethtown Water Company, BPU Docket No. WR8504330, Decision on Motion for Determination of Test Year and Appropriate Time Period for Adjustments, (May 23, 1985.)

[40] Id. However, it is Rate Counsel's position that if Your Honor and the Board should allow rate recognition for amounts incurred beyond the Elizabethtown Water time frame, then the $562,500 Werner CT and the $3,320,472 OPEB amortization expenses should be removed from the test year as well.

The Company proposed to recover its rate case expenses of approximately $2,348,000 amortized over a four year period. *JC-,* p.4. The Company subsequently updated its rate case expense estimate to $3,208,101. *RC-146,* Sch. RJH-9R. Rate Counsel witness Henkes recommended two adjustments to the Company's proposal.

First, consistent with long standing Board policy, Mr. Henkes removed 50% of the total amount requested. The Board has ruled in numerous rate cases that it is appropriate to have shareholders and ratepayers share the responsibility of rate case expenses. See, e.g., I/M/O Pinelands Water Company and Pinelands Wastewater Company, BPU Docket No. WR00070454 and WR00070455, Order, (8/1/01); I/M/O the Petition of Pennsgrove Water Company, BPU Docket No. WR98030147, Order, (6/24/99). I/M/O Hackensack Water Company, BPU Docket No. 815-447, Final Decision and Order, (January 12, 1983).

The Company argues that because JCP&L was ordered by the BPU to file this base rate case, "[s]haring of rate case expense is not appropriate." *JC-4 Rebuttal,* p.3. The sharing of rate case expense in this situation may not be appropriate, but that is because of unfairness to ratepayers, not shareholders. In JCP&L's last base rate case, by Order dated August 1, 2003, the Board allowed recovery 50% of the Company's claimed rate case expense of $2.4 million over four years - for an annual rate case expense allowance of $294,000.[41] The Company has been recovering this amount since 2003, well beyond the four year amortization authorized by the Board. To date, the Company has recovered more than 100% of the rate case expenses claimed in that last base rate

[41] I/M/O the Petition of JCP&L for Review and Approval of an Increase in and Adjustments to Its Unbundled Rates and Charges for Electric Service, BPU Docket No. ER02080506, Summary Order, (August 1, 2003), p. 7.

proceeding. Thus, Rate Counsel submits that the Company has already fully recovered claimed expenses for this proceeding and rate case expense should be set to zero.

The fact that the Company had to be directed to come in for a base rate case further supports zero rate case expense recovery. Rate Counsel's motion was based on an allegation that the Company has been significantly over-earning for the past several years. The BPU granted that motion and directed the Company to file a base rate case so the Board could "investigate" concerns that the Company was over-earning.[42] The record in this case shows that those concerns were justified. As noted by Rate Counsel witness Kahal, during 2009-2011, JCP&L paid out 170 percent of its earnings as dividends to its parent FirstEnergy. *RC-111,* p.25. To charge customers full rate case expenses because the Company was over-earning and therefore declined to file a rate case voluntarily would defy logic.

In sum, despite the fact that zero recovery for rate case expense is appropriate here, Rate Counsel acknowledges that 50/50 sharing of rate case expenses is long standing Board policy and Mr. Henkes' adjustment to rate case expenses reflects that policy. However, Rate Counsel submits that if the Board is inclined to reconsider this policy as proposed by JCP&L, then the Board should find that equity demands that as JCP&L's shareholders have benefited from the Company's reluctance to come in for a base rate case, JCP&L's shareholders should pay for all of the rate case expenses. Indeed, it is Rate Counsel's position that when the Board finds it necessary to order a company to make a base rate case filing because "a rate case review is a reasonable course of action

[42] I/M/O the Petition of Rate Counsel Requesting a Board Order Directing Jersey Central Power and Light Company to File a Base Rate Case Petition and Establishing a Test Year of 2010, Order, July 31, 2012, p.13.

to allow a full investigation of the issues that have been raised" then all rate case expenses should be borne by the Company.[43]

The second rate case expense adjustment made by Mr. Henkes concerns the amortization period. JCP&L has proposed an amortization period of four years. However, as discussed above, rates authorized in JCP&L's last base rate became effective August 1, 2003, more than ten years ago. To more closely align the amortization period with the time between rate cases, Rate Counsel witness Henkes recommended that rate case expenses should be amortized over a six year period.

Rate Counsel's recommended adjustments, that is, 50/50 sharing of rate case expenses amortized over a six year period reduces the Company's annual rate case expense amount of $802,025 by $534,684 for a total recommended annual rate case expense amount of $267,342. *RC-146,* RJH-9R. It should be noted that this recommended amount is based on the Company's projected rate case expense. This amount should be adjusted at the conclusion of this case to reflect actual rate case expense incurred through the completion of this case.

4. Cost to Achieve Merger Savings

The Company is seeking to recover from New Jersey ratepayers $14,466,766 in costs to achieve merger savings associated with FirstEnergy's 2010 acquisition of Allegheny Energy, Inc. *JC-2,* p. 16. The Company claims that in 2011 JCP&L customers received $19.5 million in benefits from the merger, including a $13.1 million NGC credit. *JC-2,* p. 17. Rate Counsel recommends that the Board reject the Company's request to recover $14,466,766 in cost to achieve from New Jersey ratepayers.

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[43] *Id.*

Initially, it should be noted that there is nothing in the record in this proceeding detailing exactly what costs are included in this catch-all amount, when these costs were incurred, and by whom. The Company has failed to introduce into this proceeding any specific information regarding these costs, merely stating that the costs to achieve "related to materials, outside services and employee separation necessary to produce the synergy savings." *JC-2,* p. 13.

It is Rate Counsel's position that this vague reference to the specific expenses for which the Company seeks recovery does not support recovery of these expenses. Certainly, any costs associated with "employee separation" should not be recovered from New Jersey ratepayers. The merger stipulation specifically provides:

> Pursuant to the Stipulation, there will be no change in staffing levels or in collective bargaining agreements. The Company agreed there will be no net reduction due to involuntary attrition as a result of the Transaction integration process in the JCP&L utility and FirstEnergy Service Company employment levels for a period of two years after the consummation of the transaction. [44]

Furthermore, the Company agreed that no costs associated with the merger Transaction would be passed onto ratepayers. [45] Arguably, any Board of Director Costs, Financing Fees, Advertising costs and/or Audit fees included in the claimed "costs to achieve" would qualify as Transaction Costs rather than "costs to achieve" and should therefore be disallowed. Similarly, any executive bonuses included in the cumulative costs to achieve should also be disallowed. Because the Company has failed to introduce into the record in this proceeding any evidence showing exactly what costs the Company

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[44] I/M/O the Business Combination of FirstEnergy Corp. Parent Company of Jersey Central Power and Light Company and Allegheny Energy, Inc., BPU Docket No. EM11010012, Decision and Order, Feb. 10, 2011.

[45] *Id*. p.4.

has included in the claimed $14,466,766 "costs to achieve," the entire amount claimed by the Company should be disallowed.

JCP&L has also failed to demonstrate that ratepayers have received any benefit from the merger. The merger transaction was consummated on February 25, 2011. JCP&L would have us believe that in the ten months since the merger closing, the Company has achieved significant merger savings that are reflected in the 2011 test year. Rate Counsel submits that after a merger a certain amount of "ramping up" is required before actual merger savings are realized.

The Company claims that merger benefits can directly be seen from the reduction in the indirect corporate cost allocation to JCP&L. *JC-2,* p. 14. The Company compares the 2009 17.62% allocation and the 2010 16.40% cost allocation with the 14.83% corporate cost allocation in 2011. JCP&L calculates that based on total test year indirect corporate costs of $409,054,835, the savings in allocated costs to JCP&L in the test year is $6,422,161. *Id.*

As noted by Rate Counsel witness Henkes, there are numerous other factors that could have caused this reduction in the indirect corporate cost allocation. JCP&L agrees, acknowledging that the variance in indirect corporate cost allocation captures "initiatives not related to merger activities." *JC-2,* p.15.

In response to a discovery request, the Company provided the actual JCP&L Indirect Cost Allocation percentages from 2005 through 2011.

2005	20.15%
2006	18.13%
2007	18.32%
2008	16.88%
2009	17.62%
2010	16.40%

2011 14.83%

As noted by Mr. Henkes, this chart shows that JCP&L has in the past experienced similar reductions in its Indirect Cost Allocation. For example, as can be seen from the above chart, there was a reduction of 2.02% between 2005 and 2006; 1.44% from 2007 to 2008 and 1.22% from 2009 to 2010. Since no mergers occurred during those years, it is clear that non-merger factors can significantly influence the Company's Indirect Cost Allocator. The assumption that JCP&L has made, that the 1.57% reduction in Indirect Cost Allocation is directly related to the merger, is unsupported and unreliable.

Accordingly, Rate Counsel recommends that Your Honor and the Board reject the Company's proposal to include in base rates $14,466,766 in cost to achieve merger savings. The Company has failed to demonstrate that the costs included in this cumulative account are properly recoverable from New Jersey ratepayers. Furthermore, the Company has failed to demonstrate that there are any merger-attributable Indirect Cost Allocation savings incorporated in the 2011 test year. Most importantly, JCP&L ignores the fact that, as recognized by the Board in the merger Order, the merger resulted in a detriment to New Jersey ratepayers.

> Shortly after the announcement of the Agreement, on February 17, 2010, JCP&L notified the Board that on February 11, 2010, Standard & Poors ("S&P") lowered its corporate credit rating of JCP&L's parent holding company FirstEnergy from BBB to BBB- and its senior unsecured credit rating of FirstEnergy from BBB- to BB+. In addition, S&P lowered JCP&L's corporate credit rating and senior unsecured debt from BBB to BBB-.
>
> While the Board determined it did not have to take additional measures with regard to impacts to BGS, the credit downgrade occurred as a direct result of the announcement of the Agreement

> and demonstrated that the Transaction had an effect on the underlying financial integrity of JCP&L.[46]

As a result of the merger, JCP&L's credit rating is lower than it should be. *RC-111,* p.9. Thus, any benefits from the merger may be wholly or partially offset by the future increased capital costs of JCP&L as a result of the merger - attributable credit downgrade. Accordingly, Your Honor and the Board should disallow the entire $14,466,766 of JCP&L's claimed costs to achieve.

As a final comment, if Your Honor and the Board should determine that it is appropriate to grant the cumulative costs to achieve claimed by the Company, Rate Counsel submits that a six year amortization period is more appropriate than the three year period suggested by the Company because if the Company's rates stay in effect for more than 3 years, as was the case in the Company's prior base rate proceeding, JCP&L would inappropriately over-collect its proposed annual amortization expense of $4.8 million after the 3rd rate effective year. However, it bears repeating that there is insufficient evidence in the record in this proceeding to support the full recovery of these claimed costs.

5. Normalize Forestry Maintenance Expenses

The Company has strayed from the 2011 test year and, rather than use the 2011 actual tree trimming expense amount of $9.3 million, has propose to set tree trimming expense based on the projected tree trimming expense level from the Company's 2013 Operating Budget, $14.4 million. Your Honor and the Board should reject this increase of $5.1 million in tree trimming expense proposed by the Company.

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[46] *Id*. pp 2-3.

First, this proposal should be rejected because it is based on a 2013 expense level which represents a time period falling two years beyond the end of the test year and therefore violates the Board's post test year ratemaking policy allowing adjustments to expenses based on changes occurring within nine months after the end of the test year.[47] Second, the $14.4 million request is based on fully projected financial numbers from the Company's 2013 Operating Budget. This amount does not qualify as a 'known and measurable" change to the test year expense "carefully quantified through proofs which manifest convincingly reliable data." *Id.* Tree trimming expenses vary significantly from year to year and are strongly influenced by factors such as the weather and the financial condition of the Company. The Company's 2013 Budget is not an adequate basis for inclusion in this base rate case with a Board mandated 2011 test year.

Accordingly, Rate Counsel recommends that Your Honor and the Board reject the Company's proposal to significantly increase the amount of tree trimming expense collected from ratepayers. Rate Counsel recommends that the actual 2011 test year expense level is the appropriate amount.[48] As detailed in Mr. Henkes' testimony, the 2011 actual tree trimming amount of $9.3 million is very much in line with the 5-year average (2007-2011) expense level of $8.7 million and the 6-year average (2007–2012) of $9.1 million. *RC-145,* p. 36.

6. Account 935 – Maintenance of General Plant Expense Normalization

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[47] In re Elizabethtown Water Company, BPU Docket No. WR8504330, Decision on Motion for Determination of Test Year and Appropriate Time Period for Adjustments, (May 23, 1985.)

[48] If, as recommended by Rate Counsel, JCP&L should engage in a more aggressive tree trimming program, JCP&L could then seek recovery for their actual test year tree trimming expense in a future base rate proceeding.

The Company's account 935 – Maintenance of General Plant expense, for the 2011 test year totals $2.74 million. This amount is significantly higher than amounts posted to this account in 2007 ($1.55 million), 2008 ($1.50 million), 2009 ($1.56 million), and 2010 ($1.27 million). *RC-141*. Because the test year level of $2.74 million appears to be abnormally high, Rate Counsel recommends that Your Honor and the Board use a 5-year historic average expense level of $1.72 million.

7. Incentive Compensation

JCP&L seeks to recover in base rates incentive compensation expenses amounting to $8,418,907, consisting of $6,657,938 for the Short Term Incentive Plan ("STIP") and $1,760,969 for the Long Term Incentive Plan ("LTIP"). *RC-145,* p. 37. These numbers represent incentive compensation expenses included in the test year distribution O&M expenses for both the JCP&L Direct charges and the incentive compensation charges allocated to JCP&L from the Service Company. JCP&L is proposing to recover 100% of these incentive compensation expenses from ratepayers. Because these incentive programs are tied to enhancing the financial performance of the Company, Rate Counsel maintains that shareholders, not ratepayers, should bear these costs. Rate Counsel therefore recommends that JCP&L's incentive compensation expenses be disallowed.

The FirstEnergy STIP provides annual cash incentive awards to employees whose contributions support the successful achievement of FirstEnergy's financial and operational Key Performance Indicators ("KPIs"). *RC-116,* Attachment 1, p. 1. According to the Company, the program supports FirstEnergy's compensation philosophy by linking awards directly to annual performance results in relation to company and business unit objectives key to FirstEnergy's success. Forty percent (40%)

of the incentive awards paid out under the STIP are tied to the achievement of certain FirstEnergy corporate financial criteria (Earnings Per Share ("EPS") and Debt-to-Capitalization ratio), while sixty percent (60%) of the awards paid out are dependent on the achievement of certain FirstEnergy operational goals. It is important to note, however, that the STIP also has the following overriding provision: "Payment of any short-term incentive [STIP] award is contingent upon the Company [FirstEnergy] achieving the Earnings Per Share threshold level, after accounting for the cost of the payout." *Id.* p. 2. Thus, if the minimum FirstEnergy EPS threshold is not reached or exceeded in the award year, no STIP incentive compensation will be paid out, whether based on corporate financial or operational performance criteria. This overriding provision makes 100% of the STIP incentive compensation tied to and dependent upon FirstEnergy's corporate financial performance during the award year.

The FirstEnergy LTIP is an equity-based program designed to reward executives for achievement of FirstEnergy goals that are intended to increase shareholder value. *RC-116,* Attachment 2, p. 6. The LTIP consists of two components: 1) the Performance Share Program, and 2) the Performance-Adjusted Restricted Stock Unit (RSU) Program.

The Performance Share Program is 100% tied to the achievement of FirstEnergy's Total Shareholder Return (TSR). The incentive compensation paid out under the RSU Program is dependent upon the achievement of three performance criteria: 1) Earnings Per Share; 2) Safety; and 3) Operational Performance. Thus, the RSU Program is tied partially to corporate financial performance measures and partially to operational performance measures. The LTIP award program is for executives only.

Rate Counsel recommends that, consistent with long standing Board policy, 100% of JCP&L's claimed incentive compensation expenses should be disallowed for ratemaking purposes. While in JCP&L's most recent 2002 base rate case, the Board allowed a portion of JCP&L's incentive compensation expenses, that portion allowed in rates was tied to an incentive compensation plan available to a wider array of employees, including union members, with specific operational measures that have been specifically negotiated between the union and management. In an earlier review of JCP&L incentive programs, the Board found:

> We are persuaded by the arguments of Staff and Rate Counsel that, at this time, the incentive compensation or bonus expenses should not be recovered from ratepayers. The current economic condition has impacted ratepayers' financial situation in numerous ways, and it is evident that many ratepayers, homeowners and businesses alike are having difficulty paying their utility bills or otherwise remaining profitable. These circumstances as well as the fact that the bonuses are significantly impacted by the Company achieving financial performance goals, render it inappropriate for the Company to request recovery of such bonuses in rates at this time. Especially in the current economic climate, ratepayers should not be paying additional costs to reward a select group of Company employees for performing the job they were arguably hired to perform in the first place.

I/M/O of the Petition of Jersey Central Power & Light, BPU Docket No.ER91121820J, Decision and Order, p.4. (June 15, 1993).

The Board also denied a utility's request to include incentive compensation costs in rates in the 2001 Middlesex Water Company base rate case. In rejecting the ALJ's recommendation to share incentive compensation costs 50%-50% between ratepayers and shareholders, the Board reiterated the policy set forth in the JCP&L decision by stating: "The language in the Board's JCPL 1993 Order is especially appropriate today when consumers are still faced with increasing energy costs, as well as other increased costs." I/M/O the Petition of Middlesex Water Company for Approval of an Increase in its Rates

for Water Service and Other Tariff Changes, BPU Docket No. WR00060362, Order Adopting in Part/Modifying in Part/ Rejecting in Part Initial Decision, (June 6, 2001). And again, in 2003, the Board denied Rockland Electric Company's request for recovery of incentive compensation from New Jersey ratepayers, stating:

> The Board continues to believe that incentive or "bonus" compensation should not be paid for by New Jersey ratepayers. New Jersey ratepayers are entitled to safe, adequate and proper utility service at just and reasonable rates, and should not, in our view, be required to pay incentives or bonuses for the utility to provide such service. Some New Jersey ratepayers continue to face many of the same economic difficulties which existed at the time the Board formulated the above policy, and which, in the Board's view, justify its continuance. Accordingly, the Board HEREBY ORDERS that all of RECO's proposed incentive compensation should be disallowed from rates.[49]

As correctly observed by the Board in the Middlesex case, denial of JCP&L's incentive compensation recovery request is especially appropriate today when the state is still faced with record unemployment levels and stagnant or decreasing wage levels. Given rising energy costs and current economic conditions ratepayers should not have to shoulder the additional burden of over $8 million in bonuses included in rates.

As noted by Rate Counsel witness Henkes there are many reasons why this Board policy should be imposed in this proceeding. First, the incentive compensation expenses recommended to be removed from this case are either wholly or significantly dependent upon the achievement of FirstEnergy's improvements in EPS and TSR. FirstEnergy's shareholders are the primary beneficiaries of such corporate financial performance improvements by virtue of the resulting increases in their stock value or dividend receipts.

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[49] I/M/O the Verified Petition of Rockland Electric Company for Approval of Changes in Electric Rates, BPU Docket No. ER02100724, Final Decision and Order, (April 20, 2004), p. 71.

For that reason, JCP&L's stockholders should be made responsible for these discretionary costs.

Second, the Company's proposed incentive compensation expenses are not known and certain. They are dependent on FirstEnergy's achievement of certain pre-determined financial thresholds. In determining its proposed *pro forma* incentive compensation awards, the Company has assumed that these financial thresholds will be achieved. However, if these financial thresholds are not reached, the incentive compensation could be substantially different from what the Company has assumed in this case.

Moreover, LTIP payments can range from 0% to 200% based upon the TSR ranking of Company common stock. *RC-116,* Attachment 2, p. 7. The STIP provides that the plan "may be amended or terminated at any time by the Company during any plan year." *RC-116,* Attachment 1, p. 1. Thus, whether or not awards will be made in the future and, if made, the total amount that will be awarded is unknown and entirely within management's discretion.

Third, during a time that employees in other industries, including many in New Jersey's state and local government, have not had wage/salary increases as a result of the Great Recession and the associated budget crises, JCP&L's employees that are eligible for incentive compensation have continued to receive base salary increases and will continue to receive annual salary increases of at least 3% as reflected on an annualized basis for 2012 on a *pro forma* basis in this case. Given these facts, it is not reasonable nor appropriate to saddle the ratepayers with an additional amount in excess of $8.4 million for bonus awards to be paid out under the Company's incentive compensation programs.

Fourth, the Company has not presented any evidence in this case showing the specific benefits that are accruing to the ratepayers as opposed to JCP&L's shareholders as a result of the incentive compensation plans for which these same ratepayers are asked to pay 100% of the costs. Neither has JCP&L presented any evidence in this case showing that there is any appreciable difference in the productivity level of JCP&L and JCP&L's employees or that the ratepayers are receiving more efficient service at reduced overall costs as a direct result of the Company's incentive compensation programs.

Fifth, there is no incentive for management to control the level of the incentive compensation costs if 100% of these costs can be flowed through to the captive ratepayers. This would be particularly true given that the Company's management is the primary beneficiary of these incentive compensation plans.

Finally, Rate Counsel submits that the Company's request for rate recovery of approximately $8.4 million in bonus compensation on top of regular compensation particularly objectionable because this proposal is being made during a time when the effects of the Great Recession are still lingering, and where ratepayers are faced with job losses and reduced home values. It is especially during these difficult economic conditions that ratepayers need relief from these discretionary costs.

In sum, FirstEnergy's incentive compensation programs are heavily weighted toward the achievement of certain financial objectives, with no payout being made unless certain financial goals are met. Incentive plans that are based largely on earnings criteria are not sufficiently related to the provision safe and reliable utility service to justify passing this cost onto ratepayers. If incentive compensation programs are tied to increased corporate and shareholder earnings, then the corporate shareholders, not

ratepayers, should pay for them. To do otherwise violates all sense of fairness to the ratepayers of the regulated entity. Accordingly, Rate Counsel recommends that JCP&L's proposed incentive compensation expenses of $8.4 million be disallowed for rate making purposes in this case.

8. Supplemental Executive Retirement Program (SERP) Expense

In this proceeding, the Company is seeking recovery for $408,576 in expenses associated with the FirstEnergy Supplemental Executive Retirement Program. These costs relate to supplemental retirement benefits for key executives that are over and above the normal retirement programs provided by FirstEnergy for its employees. These programs generally exceed various limits imposed on retirement programs by the IRS and therefore are considered "non-qualified" plans. In the 2011 test year, only nine active employees were eligible for a SERP benefit upon retirement. *RC-117*. The Company claims that "participation in the SERP has been provided to certain key executives as part of the integrated compensation program intended to attract, motivate, and retain top executives who are in a position to make significant contributions to our operations and profitability for the benefit of our customers and shareholders." *RC-117*.

Rate Counsel urges the Board to reject the Company's proposal that SERP expenses be recovered from ratepayers. JCP&L ratepayers are already paying for the regular retirement benefits of these top executives and should not be forced to also fund these SERP perks. If the Company wants to provide additional retirement benefits to these key employees, then shareholders rather than ratepayers should be picking up the tab for that.

Rate Counsel does not object to the Company offering SERP benefits to these nine top executive officers whose retirement benefits are "limited" by the IRS. Rate Counsel does object, however, to including these extra benefits in rates. Accordingly, Rate Counsel recommends that the Board exclude the SERP benefit from JCP&L's distribution rates, thereby reducing the Company's operating expense by $408,576. *RC-145,* Schedule RJH-12.

9. Pension Expense

Based on the testimony of Rate Counsel witness Mitchell Serota, (see Point VI) Rate Counsel recommends a reduction in pension expense of $37,664,418. *RC-145,* RJH-8.

10. OPEB Expenses

Based on the testimony of Rate Counsel witness Mitchell Serota, (see Point VI) Rate Counsel recommends a reduction in OPEB expense of $814,905. *RC-145,* RJH-8.

11. Miscellaneous O&M Expense Adjustments.

The Company has included in the test year several miscellaneous expense items that should be removed for ratemaking purposes.

- The Company has included $1,387 in matching contributions for employees who are in employee retirement clubs. "The objectives of such clubs are to promote, develop and carry out a variety of social, recreational, and educational activities that appeal to the diverse interests of its members." *RC-156.*

- The Company has also included "Celebrate Success" expenses of $5,707 and service award expenses of $37,875. These expenses were incurred for "employee awards, parties, outings and gifts." *RC-145,* p. 46.

- The Company has included institutional and goodwill advertising expenses of $8,140.

- The Company has included civic membership expenses of $25,295 to a number of civic organizations such as chambers of commerce, mayor associations, area associations, Jersey Shore partnership association and economic development associations.
- The Company has included $854 in expenses related to private club membership.

As these miscellaneous expenses are not related to the provision of safe, adequate and reliable service, they are not appropriate for inclusion in rates set for utility service. Certainly the Company has not demonstrated how funding of retiree clubs and parties will have a positive impact on the provision of electric service. Moreover, it is long standing Board policy in this state that institution and goodwill advertising shall be paid by shareholders, not ratepayers.

> We believe we have exercised reasonable discretion herein by presumptively attributing institutional, promotional and political advertising to the corporate utility rather than the ratepayer. At a time when significant rate increases often become inevitable, sound business judgment dictates that advertising not of direct customer benefit should not be charged to the ratepayer, a practice which often exacerbates customer resentment.[50]

The Company has failed to demonstrate that these various expenses provide any "measurable benefit to its ratepayers" and therefore "the mandate of Title 48 for just and reasonable rates precludes the captive ratepayer from subsidizing those costs."[51] Accordingly, Your Honor and the Board should reject the Company's proposal to include the above listed $79,258 in miscellaneous expenses in claimed operating expenses.

12. Depreciation Expense

[50] I/M/O the Board's Investigation of Advertising Practices of the Telephone, Electric and Distribution Gas Companies of New Jersey, BPU Docket No. 7512-1254, Decision and Order, (May 31, 1977),pp.18-19.
[51] I/M/O the Petition of New Jersey American Water Co, 169 N.J. 181, 196-97, (2001)(holding that a utilities charitable contributions are not a proper charge to operating expense.)

Rate Counsel's recommended *pro forma* annualized depreciation expenses for JCP&L in this case is based on the depreciation rates recommended by Rate Counsel witness Michael Majoros. *RC-166*. Mr. Majoros' recommended depreciation expense is detailed in Point VII.

In addition to the adjustment to depreciation expense recommended by Mr. Majoros, Mr. Henkes made two other depreciation adjustments. First, Mr. Henkes removed $1,673,516 from the Company's proposed depreciation expenses associated with the December 31, 2011 plant in service balances associated with the 2011 major storms. *RC-146,* Sch. RJH-14R. Depreciation expense will be updated when the Board determines the appropriate 2011 storm damage plant in service balance that will be reflected in the base rates set by this proceeding.

The second adjustment made by Mr. Henkes was a correction to the Company's proposed distribution-allocated Intangible Plant depreciation expense amount. The Company subsequently agreed with Mr. Henkes and included this correction in its updated Supplemental Filing.

Rate Counsel recommends that Your Honor and the Board reduce the Company's claimed depreciation expense of $83,826,938 by $11,143,224 for a total depreciation expense of $72,683,714. *RC-146,* Sch. 14R.

13. Amortization Expenses – Summary

The Company's per books test year distribution-related amortization expenses amount to $3,912,364. This balance consists of the deferred OPEB amortization and Werner CT amortization which were discussed above. In addition, Rate Counsel

recommends that Your Honor and the Board adopt the following three recommended adjustments to the Company's proposed amortization expense.

Storm Damage Cost Amortization

Rate Counsel recommends that the Company's proposed three year amortization of deferred costs associated with the 2011 major storms be removed from this base rate case until the prudence of these deferred costs has been established in JCP&L's Generic Storm Damage Cost proceeding. As discussed in Mr. Henkes' surrebuttal a six year amortization is more appropriate. *T73L:24-T74L:18* (Oct. 7, 2013).

Net Salvage and Cost of Removal

In the Company's previous base rate case, the Board adopted a recommendation to exclude estimated net salvage and cost of removal costs from JCP&L's depreciation rates and instead allow a separate recovery of these costs based on a five year historical average of actual net salvage and removal costs. *RC-126,* p. 54.

JCP&L's five year historical average of actual net salvage and removal costs for the most recent period 2007 – 2011 is approximately $2.4 million. *RC-145,* p. 49. However, JCP& has rejected the use of the traditional five-year historical average and has used a two-year historical average (2012-2011) in its place. The two-year historical average proposed by the Company produces an average net salvage and removal cost of approximately $4.8 million, twice the annual cost based on the traditional five-year historical average.

Rate Counsel urges Your Honor and the Board to continue using a five-year historical average for the determination of net salvage and removal cost recovery. The Company has provided no instance of another New Jersey utility using a two-year

average for the net salvage determination, rather than the five-year average traditionally used by the Board. In directing JCP&L to use the five-year average, the Board noted, "a five year average of actual salvage expense in depreciation expense is reasonable as it more closely aligns the amount recovered in base rates with the historical level of expenses incurred." *RC-126,* p. 54. The Company has provided no compelling reason to stray from the use of a five-year average.

Production Related Regulatory Asset Amortization

The test year includes $109,008 in amortization expenses for two regulatory assets involving Oyster Creek and TMI-1 design basis documentation studies. *JC-3, Sch. SDM-2, p. 22*. The amortization periods underlying this test year amortization expense is equal to the operating license lives of these two facilities. JCP&L argues that as the Company no longer owns these facilities the amortization period should be accelerated to three years. This results in a *pro forma* annual expense amortization of $1,629,650, which is $1,520,642 higher than the per books test year amortization expense of $109,008. *Id*.

JCP&L initially sought recovery for the cost associated with the Design Basis documentation for Oyster Creek and for TMI-1 nuclear plants in the Company's 1989 base rate case. In that proceeding the Board allowed recovery of the Design Basis documentation, amortized over the respective lives of the plants.[52] Specifically, the Board found:

> The Company has incurred $892,100 of costs ($213,713 for TMI and $678,387 for Oyster Creek) related to a project for the development of documentation for the current configuration of

[52] I/M/O the Application of Jersey Central Power & Light Company for Approval of an Amendment of its Tariff to Provide for an Increase in Rates and Charges for Electric Service, BPU Docket No. ER89110912J, Final Order Adopting Partial Initial Decision Settlement, (Jan.7, 1991).

> Oyster Creek and TMI-1 nuclear plants. This amount and the additional costs anticipated to complete such project shall be deferred and recovered without a return on the unamortized balance, over the respective lives of Oyster Creek (approximately 19.5 years) and TMI (approximately 24.5 years).[53]

Subsequently, in the Restructuring proceeding, the Board determined that "[r]ecovery of all regulatory assets previously recognized in rates, as set forth in Appendix D to the Stipulation is recognized as being included in the unbundled distribution rates approved in this Order.[54] Appendix D attached to the Stipulation specified the expense included in rates and the final year of Amortization: for Oyster Creek, $83,000 to be recovery through 2009 and for TMI, $26,000 to be recovered through 2014.[55]

In the Company's prior base rate case, the Company's proposal to adjust the amortization of these assets was rejected by the Board. "The Board HEREBY FINDS consistent with the positions of Staff and the RPA, an alteration of the amortization of these assets as proposed by the Company is inappropriate."[56]

The Summary Order allowing the recovery of $213,713 for TMI and $678,387 for Oyster Creek was dated November 21, 1990. After more that 20 years, the Company claims that the balance remaining for recovery for TMI is $1,481,760 and the balance remaining for Oyster Creek is $3,407,191. The Company seeks to recover these balances over three years. *JC-3,* Sch. SDM-2, p. 22. Rate Counsel objects.

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[53] Id at 4.

[54] I/M/O Jersey Central Power and Light Company, d/b/a GPU Energy – Rate Unbundling, Stranded Cost and Restructuring Filings, BPU Docket Nos. EO97070458, EO97070459 and EO97070460, Final Decision and Order, (March 7, 2001).

[55] Id. appendix D. (A complete copy of the Restructuring Board Order will be provided for your Honor under a separate cover.

[56] I/M/O the Verified Petition of Jersey Central Power & Light Company for Review and Approval of an Increase in and Adjustments to Its Unbundled Rates and Charges for Electric Service, and for Approval of Other Proposed Tariff Revisions in Connection Therewith, BPU Docket No. ER02080506, Final Order, May 17, 2004 p.61.

The Restructuring Order clearly provides that the amortization of Oyster Creek Design Basis documentation costs expires in 2009. Accordingly, the amortization expense associated with Oyster Creek should be excluded from rates in this proceeding. If the Company incurred additional expenses related to this asset, JCP&L should have come to the Board with the appropriate documentation and sought an increase in the annual amortization expense level. There is no evidence in the record to support continued amortization of this asset.

The annual amortization of $26,000 in TMI related costs is scheduled to expire in 2014. Thus no adjustment should be made to that amortization level. The Board established an amount to be recovered over a specific period of time. Again, if the Company incurred addition costs associated with the TMI Design Basis documentation, JCP&L should have applied to the Board for an increase in the amortization expense level.

Accordingly, Rate Counsel recommends that the Oyster Creek amortization expense amount of $83,000 be excluded from rates in this proceeding and the amortization of the TMI Design Basis documentation continue at its current level of $26,000 a year.

Operating Income Conclusion

(1) Rate Counsel recommends that the Your Honor and the Board adjust the sales projections of Petitioner's *pro forma* revenue claim to reflect customer growth to June 30, 2012. Rate Counsel's recommendation will increase the Company's *pro forma* revenues by $823,138.

(2) Your Honor and the Board should reduce JCP&L's claimed Total Electric New Loss on Reacquired Debt Amortization by $375,168 to reflect only that portion properly allocated to distribution-related amortization expense.

(3) Your Honor and the Board should adopt Rate Counsel's recommended adjustments, that is, 50/50 sharing of rate case expenses amortized over a six year period for a total annual rate case expense amount of $267,342. *RC-146,* RJH-9R.

(4) Your Honor and the Board should reject the Company's proposal to include in base rates $14,466,766 in cost to achieve merger savings.

(5) Your Honor and the Board should reject the increase of $5.1 million in tree trimming expense proposed by the Company. Rate Counsel recommends that the actual 2011 test year expense amount of $9.3 million is the appropriate amount. *RC-145,* p. 36.

(6) Because the test year level of $2.74 million in account 935-Maintenance of General Plant appears to be abnormally high, Rate Counsel recommends that Your Honor and the Board use a 5-year historic average expense level of $1.72 million.

(7) Rate Counsel recommends that the Company's proposed incentive compensation expenses of $8.419 million be disallowed for rate making purposes in this case.

(8) Rate Counsel recommends that Your Honor and the Board exclude the SERP benefit from JCP&L's distribution rates, thereby reducing the Company's operating expense by $408,576. *RC-145,* Schedule RJH-12.

(9) Based on the testimony of Rate Counsel witness Mitchell Serota, Rate Counsel recommends a reduction in pension expense of $37,664,418. *RC-145,* RJH-8.

(10) Based on the testimony of Rate Counsel witness Mitchell Serota, Rate Counsel recommends a reduction in OPEB expense of $814,905. *RC-145,* RJH-8.

(11) Your Honor and the Board should reject the Company's proposal to include $79,258 miscellaneous expenses such as club memberships and institutional and goodwill advertising in claimed operating expenses.

(12) Rate Counsel recommends that Your Honor and the Board reduce the Company's claimed depreciation expense of $83,826,938 by $11,143,224 for a total depreciation expense of $72,683,714. *RC-146,* Sch. RJH-14R.

(13) Rate Counsel recommends that Your Honor and the Board adopt Rate Counsel's three recommended adjustments to the Company's proposed amortization expense: (1) the storm cost amortization expenses should be reduced by $29,834,833 to remove costs associated with 2011 major storms; (2) the net cost of removal amortization should be reduced by $2,346,633 to reflect Rate Counsel's recommended 5 year average expense level and (3) the production related regulatory asset amortization test year expense level should be reduced by $83,000 to reflect the expiration of the amortization of TMI Design Basis document study costs.