

**STATE OF NEW JERSEY
NEW JERSEY DIVISION OF THE RATE COUNSEL**

IN RE PETITION OF FISHERMEN'S
ATLANTIC CITY WINDFARM, LLC
FOR THE APPROVAL OF THE STATE
WATERS WIND PROJECT AND
AUTHORIZING OFFSHORE WIND
RENEWABLE ENERGY CERTIFICATES

BPU DOCKET NO.: EO11050314V

REPLY BRIEF BY THE NEW JERSEY DIVISION OF RATE COUNSEL TO THE POSITION
PAPER OF THE STAFF OF THE NEW JERSEY BOARD OF PUBLIC UTILITIES
REGARDING THE STIPULATION EXECUTED BY THE NEW JERSEY DIVISION OF
RATE COUNSEL AND FISHERMEN'S ATLANTIC CITY WINDFARM, LLC

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PRELIMINARY STATEMENT

In the 2011 Energy Master Plan (“EMP”), the State expressed its support for offshore wind, citing the fact that it “has no carbon output, and has the potential to develop a manufacturing and support industry within the State, thereby creating direct, indirect, and induced economic benefits for many years to come.” (2011 EMP, p. 101). Through the EMP and the Offshore Wind Economic Development Act, (“OWEDA”) N.J.S.A. 48:3-87.1, et seq., the State sought to incentivize offshore wind but ensure that it was developed with appropriate consideration of the impact on ratepayers and the need to attract investment. Accordingly, OWEDA required not only consistency with the EMP, but also demonstration of financial integrity and “net benefits” to ratepayers.

This application by Fisherman’s Energy (“FACW”) represents the New Jersey Board of Public Utilities’ (“Board”) first opportunity to review an offshore wind project off New Jersey’s coast pursuant to the provisions of OWEDA. Before the Board is a Stipulation that contains a proposed agreement governing the Offshore Wind Renewable Energy Certificate (“OREC”) price, and various assurances that the applicant agreed to that ensure that ratepayers are protected. The OREC price is at the low end of other offshore wind proposals and is substantially lower than the price originally proposed by the applicant. The additional assurances protect ratepayers from exposure for construction costs or decommissioning and ensure that they are not responsible for any non-performance by the applicant. As acknowledged by the experts retained by both the New Jersey Division of Rate Counsel (“Rate Counsel”) and Board Staff (“Staff”), the company’s current proposal as modified in the Stipulation, does satisfy the statute’s “net benefits” test.

The Stipulation also contains provisions designed to maximize the use of federal incentives. FACW is competing for grants from the United States Department of Energy (“DOE”) and is seeking to comply with the requirements to become eligible for Federal Investment Tax Credits. This federal money allows for the low OREC price that is included in the Stipulation. Under the federal programs, however, FACW must spend money to qualify. Even if the company fully complies with its obligations, there is a risk that the federal funds will not be awarded. The Stipulation thus provides a mechanism through which ratepayers accept a small, defined risk in the event the Federal money is not awarded, in exchange for the lower OREC price. In addition, because the BPU’s process to develop long-term OREC financing regulations is ongoing, but the work that needs to be done to qualify for federal money must be started soon, the Stipulation includes an OREC processing procedure that takes into account the discussions regarding the Board’s forthcoming regulations and will be replaced by the process ultimately adopted by BPU.

As set forth in this brief, Rate Counsel strongly disagrees with the assertions in Staff’s position paper that the Stipulation is inconsistent with OWEDA. To the contrary, the Stipulation provides even greater protections than required by the statute and presents terms as favorable to ratepayers as possible while still allowing the applicant to finance the project through private capital. The provisions of the Stipulation adhere to the statute’s language and intent, while taking into account the real-world requirements for building and financing offshore wind. In contrast, the requirements Staff advocates are not mandated by the statute, and would effectively preclude approval of any financeable project.

It is, of course, the prerogative of the Board to decide as a policy matter whether to approve an offshore wind project at all. Through this Stipulation, Rate Counsel and the company have negotiated a settlement that presents the best feasible terms for a viable project. Rate Counsel recognizes that this project will cost a substantial amount over time and that the Board is not required by the statute to approve any offshore wind project. However, if the Board is inclined to incentivize offshore wind as set forth in OWEDA and the EMP, this Stipulation sets forth a reasonable, practical and legal way to do so.

ARGUMENT

I. THE STIPULATION IS CONSISTENT WITH OWEDA

A. FACW IS STILL RESPONSIBLE FOR ITS OWN NON-PERFORMANCE

The stipulation does not violate OWEDA because the financing mechanism “fairly balances the risks and rewards of the project between ratepayers and shareholders” and ensure that any costs of non-performance, in either the construction or operational phase of the project, shall be borne by shareholders.... N.J.S.A. 48:3-87.1(b)(1)(c).

“Non-performance” is defined as:

Neglect, failure, or refusal to do or perform an act stipulated to be done. Failure to keep the terms of a contract or covenant, in respect to acts or doings agreed upon. The failure or neglect to render performance called for in a contract, rendering the non-performer liable in damages or subject to a decree or judgment of specific performance.

Black's Law Dictionary, 5th edition (1974). This definition refers to neglect or failure to perform an act or keep the terms of a contract. As applied to OWEDA, this neglect or failure must occur in the construction or operational phase of the project.

On December 12, 2012, the United States Department of Energy (“DOE”) announced that FACW, along with six other projects, were awarded an Advanced Technology Demonstration grant from the Division of Energy Efficiency & Renewable Energy (“EERE”). FACW will receive up to \$4 million to complete engineering, site evaluation, and other planning related tasks associated with its project. All seven OSW projects (including FACW) will also be eligible for an additional “Phase 2” grant covering design, fabrication, and deployment phases once Phase 1 of the program has been satisfactorily completed. However, only three OSW projects will be awarded an additional \$47 million each under Phase 2 of this program.

The contingency provision in the Stipulation was established as an innovative way to provide a “backstop” to the project developer. The developer was concerned about fronting \$19.2 million in engineering and planning costs, and then not receiving the DOE grant and the tax credits in a timely manner. The provision only involved the ability to recoup the “upfront” costs, if failure to receive the grant and tax incentives was not the fault of the Project developer. The contingency fund only addresses the pre-construction and pre-operational costs of the project, specifically those engineering and consulting costs described above. All costs of non-performance, in either the construction or operational phase of the project are still borne by the shareholders and not the ratepayers. See: Stipulation paragraph 5(c) at pp. 6-7; para. 6 at pp. 7-8; and para. 8 at pp. 8-9.

Rate Counsel disagrees with Staff's assertion that the Contingency Fund provision of the Settlement violates the OWEDA. The basis for Staff's objection rests upon its faulty characterization of the Settlement as allowing reimbursement to FACW for what it refers to as non-performance, something explicitly prohibited under OWEDA. The Staff goes further in noting that the Settlement allows FACW to "unilaterally discontinue" its project and "recover up to \$19.2 million from ratepayers." The Staff's conclusions on this matter should be rejected for a number of reasons.

First, Staff is incorrect in asserting that FACW can in anyway abandon its project in a "unilateral" fashion and receive over \$19 million in subsidies. That is simply an incorrect characterization of the agreement and the facts. There is only one condition under which FACW can collect the \$19 million in the Contingency Fund and that is if it's U.S. DOE Phase II grant is insufficient or rejected. The grant decision is made by DOE, not FACW, so there is no way FACW can make a "unilateral" decision about its eligibility to receive Contingency Funds.

Second, Staff is incorrect in claiming that the potential award of dollars to FACW from the Contingency Fund is not performance-based, and therefore, inconsistent with OWEDA. The Contingency Fund has very strong and clear performance standards. FACW must continue to compete for its Phase 2 DOE grants. It shall use "all commercially reasonable efforts to obtain the USDOE Grant Commitments and the ITC in the maximum amount available for the Project." See: Section 2 of Attachment B to the Stipulation, "Cost Verification and Disbursement Process". If FACW fails to continue to compete for these funds, or drops out of the DOE program, it will not be eligible for any cost recovery from the Contingency Fund. Equally important, if FACW fails to deliver

its Phase 1 deliverables to DOE in a timely fashion, thereby jeopardizing its potential Phase 2 funding, the project will also be ineligible for any cost recovery from the Contingency Fund. Further, if FACW fails to provide a satisfactory grant application, or is denied Phase 2 funding for any grant performance issue, it will not be eligible for cost recovery from the Contingency Fund. Lastly, FACW will only be reimbursed for the expenses and investments it has incurred up to \$19.2 million if its Phase 2 DOE funding request is rejected. The \$19.2 million is a “hard cap” that cannot be exceeded and FACW will be reimbursed for only the dollars that it can legitimately show were expended in project development, and no more.

The Contingency Fund provisions of the settlement were developed to facilitate FACW’s efforts in securing the Phase 2 DOE grant which, as Staff notes, is an important factor in lowering FACW project costs from their originally-anticipated level. FACW is currently in competition for this additional Phase 2 funding with six other OSW projects around the U.S. But, like any competition, market participants often have to “pay to play,” and FACW’s ability to secure this Phase 2 grant will be contingent on continued development success, as well as showing the DOE that its project has a high chance of successful completion and operation. Continued construction, as well as Board approval of a funding mechanism, will be very important and likely one of the crucial differentiating factors in the DOE’s determination in awarding the grants.

FACW has a reasonably good chance at receiving the DOE Phase 2 grant, and thus the risk of the contingency provision is low. There are six other OSW projects around the country that were awarded DOE Phase 1 grants and are, therefore, eligible for potential Phase 2 funding. Two of the projects (Baryonyx and Dominion) have no

announced commercial operation dates and are located in states (Texas, Virginia) with no legislatively created offshore wind financial structures in place. The Statoil project in Maine just announced last week that it was suspending its project due to regulatory uncertainty.¹ That leaves only three relatively bona fide projects under the Phase 1 program: FACW, Lake Erie, and Principle Power. Of those three, the Principle Power project has no announced commercial operation date and indicated earlier in the year that its scope of work was still undefined.

Therefore, the FACW project has a reasonably good chance of continued DOE funding through the Phase 2 program, if it continues to make development progress. However, its chances of gaining DOE Phase 2 funding diminish substantially if it does not make investments now. The Contingency Fund is therefore necessary to prevent FACW from transforming that risk to ratepayers through a higher OREC price. The Contingency Fund actually reduces ratepayer exposure as it limits it to \$19.2 million: an amount far less than ratepayers would pay if this risk was reflected in the OREC price proposed by FACW in its Rebuttal Testimony. In other words, ratepayers are agreeing to a low-probability maximum risk of \$19.2 million in exchange for a \$50 million OREC cost savings.

Staff states that OREC payments should be the only payment ratepayers make to FACW. *Staff Brief* at 8. However, there is no such limitation in OWEDA. The Administrative Code reference (N.J.A.C. 14:8-6.5(a)(12)(iv)) Staff cites to support their position is inapposite as it applies to the operational phase of the Project and as

¹ Statoil wind project on hold. Boothbay Register. July 5, 2013. Available at: <http://www.boothbayregister.com/article/statoil-wind-project-hold/17078>.

previously stated, the contingency fund only applies to the pre-construction phase of the Project.

In sum, Staff's position fails to appreciate one of the most important underlying benefits of the Proposed Settlement: if the Settlement is approved, New Jersey will be able to move forward with its energy policy goals of developing offshore wind at an OREC price that is affordable and significantly lower than what was originally proposed at the onset of this proceeding. FACW's Original Verified Application (May 19, 2011) proposed an OREC approximately 40 percent more than the amount in the stipulation. Overall, the Settlement offers ratepayers a \$136 million in savings relative to FACW's original proposal over the term of the agreement. The Stipulation is thus consistent with OWEDA's goal of protecting ratepayers while encouraging viable projects. Nothing in the contingency fund provisions runs afoul of any provision of OWEDA and Staff's objections should therefore be rejected.

B. THE ESCROW FUND FOR DEVELOPMENT AND CONSTRUCTION IS SUFFICIENT

OWEDA also requires that an applicant demonstrate sufficient financial integrity to allow for a reasonable expectation of project completion. N.J.S.A.48:3-87.1(b)(1)(d). To satisfy concerns raised regarding this provision, FACW has agreed in the Stipulation to provide security in the form of an escrow, letter of credit or other instrument sufficient to cover capital construction costs. Staff's consultant, Boston Pacific ("BP"), reached the conclusion and recommendation in its rebuttal testimony that FACW's proposed Escrow Fund would be sufficient in demonstrating financial integrity. Despite this, Staff argues that this security is insufficient to demonstrate compliance with the statute.

Staff argues that "BP's conclusion was based on the assumption that FACW would provide an amount sufficient to cover development and construction of the project." *Staff Brief* at 10, emphasis added. However, even if its consultants made that assumption, it would not have been consistent with the actual testimony provided by FACW. FACW clearly offered: "As a demonstration of Petitioner's commitment to address the concerns of Boston Pacific and Acadian (Rate Counsel's consultants), Petitioner will agree to security in the form of escrow, letter of credit, or other form to be agreed upon, for the balance of the **capital required** to complete the Project thirty (30) days prior to commencement of offshore construction, **net of costs already incurred as of that date.**" Wissemann, *Rebuttal Testimony*, p. B-5, 15-20. FACW did not agree to provide all project costs but only those associated with the "capital required" to complete the project. FACW's construction budget was also provided with Mr. Wissemann's

rebuttal testimony and it clearly identifies the capital related components as totaling approximately \$63 million.

Staff's argument seems to be that the only means of demonstrating financial integrity under the statute would be for an applicant to establish an escrow or other instrument totaling the entire project cost prior to the commencement of construction. This would render project financing virtually impossible for most applicants and is not mandated by the statutory language. It is a tortured reading of the statute that would effectively preclude the development of offshore wind.

C. THE DECOMMISSIONING FUND IS SUFFICIENT

Staff also raises questions about the appropriateness of the Proposed Settlement's Decommissioning Fund stating simply that the reduction relative to FACW's original proposal is "without explanation." *Staff Brief* at 12. Staff offers no evidence for why the proposed Decommissioning Fund is inappropriate nor has it provided any explanation regarding an alternative Decommissioning Fund amount. The Decommissioning Fund amount is sufficient to protect ratepayers.

The Board should consider a number of facts in reviewing the appropriateness of the \$4 million Decommission Fund amount included in the Proposed Settlement. First, while the Fund has been reduced by as much as 50 percent, the OREC price associated with FACW's Original Application has fallen by almost the same level (i.e., 40 percent). If the unit cost of developing the project (i.e., the OREC) has fallen by such a significant amount, it stands to reason that the overall cost of taking the project down should follow a comparable reduction.

Second, Staff fails to appreciate that “front-loading” a large Decommissioning Fund presumes an exceptionally high probability of project insolvency. In other words, Staff expects FACW to place the entire amount of its decommissioning costs (assuming that \$8 million is the most appropriate cost) into an up-front insurance fund in case it abandons its proposed OSW project. Rate Counsel believes this is unreasonable given the terms of this Proposed Settlement which creates a very stable and secure financial platform from which FACW should be able to develop its project. The reduction in insolvency risk created by this Settlement, should also be reflected, or considered, in determining the appropriate amount for the Decommissioning Fund.

Third, while FACW has “offered” to place an amount in escrow for decommissioning purposes, this cost is almost certainly reflected in the OREC price. The amount included in the Stipulation balances the anticipated need with the desire to avoid “over-collecting” for decommissioning expenses that may never be used. Consider that a decommissioning fund can be established in three different ways: (1) the fund can be “pre-paid” and allowed to grow over time with interest in an escrow account; (2) the fund can be “grown” over time through contributions on a “pay-as-you-go” basis; or (3) some combination of (1) and (2) can be utilized. The first option, which appears to be the one preferred by Staff, shifts risks to ratepayers since it requires them to completely fund the decommissioning activities for a unique, first-of-its-kind project. If the fund amount is set too high, ratepayers will have over-contributed to the cost of decommissioning, and in the process, will have sent poor signals to the developer to minimize the cost of its future decommissioning activities as well as prolonging the life of the asset or maximizing any

salvage or alternative asset use.² Setting a reasonable, yet conservative decommissioning amount, helps to balance the risk of future unknown decommissioning activities. The Settlement amount provides an appropriate balance between FACW and ratepayers: the \$4 million amount is large enough to be reasonable, but not so large as to create future decommissioning cost inefficiencies since any inefficiencies realized in future decommission costs will be borne by FACW.

II. THE STIPULATION SPECIFICALLY MEETS THE POSITIVE ECONOMIC AND ENVIRONMENTAL NET BENEFITS REQUIREMENT AND OTHER OWEDA REQUIREMENTS

A. OREC PRICE

Staff argues that the Stipulation fails to meet the statutory requirements in OWEDA to demonstrate “...positive economic and environmental net benefits to the State.” *Staff Brief* at 1. However, if the stipulation is approved, New Jersey will be able to move forward with its energy policy goals of developing offshore wind at an OREC price that is affordable and substantially lower than what was originally proposed by FACW. FACW’s original Verified Application dated May 19, 2011 proposed an OREC price that was approximately 40% more than the stipulated amount of \$187 per OREC. Given the projected output set forth in the record, the Stipulation therefore offers ratepayers \$136 million in savings relative to FACW’s original proposal over the term of the agreement. Because of this significant decrease in costs, the proposal set forth in the Stipulation satisfies the statutory requirement of providing net benefits to the state’s ratepayers. Staff’s own consultant acknowledged in their surrebuttal testimony submitted

² For instance, offshore oil and gas structures are commonly toppled in place and used as artificial reefs. This creates environmental benefits, and can substantially reduce platform removal costs.

on May 8, 2013 that the FACW application, as supplemented in its rebuttal testimony of March 25, 2013, met the standards in OWEDA for demonstrating positive net benefits. In their explanation of how FACW's rebuttal testimony concerning jobs and estimated benefits affected their opinion of the application, Boston Pacific/OutSmart testified:

FACW's guarantee of direct jobs and direct expenditures in New Jersey, and its substantiation with vendor quotes, provides documentation of economic benefits of \$156.5 million (net present value). With documented economic benefits and a lower OREC price, even if FACW's claimed benefits for tourism, environmental impacts, merit order effect, and lessons learned are excluded, the Project provides net benefits of \$33.4 million (net present value). The Project then meets the requirement to demonstrate net benefits to the State as required under the Act.

Staff's Surrebuttal, lines 4 -17 at 18.

In Footnote #3 of its Position Paper, Staff objects that Section 13 of the Stipulation does not contain guarantees regarding the specific amount of New Jersey jobs and expenditures. However, FACW does commit itself to incorporating a "provision in its contracts with third party contractors contractually committing its construction, operations and maintenance contractors to specified New Jersey spending levels." The Board has never previously sought guarantees or a precise number of New Jersey jobs and OWEDA does not require a "guarantee". Furthermore, mandating a specific amount of New Jersey expenditures may be violative of the Commerce Clause.

The Stipulation before the Board includes an OREC price that is even lower than the amount referred to in Boston Pacific/OutSmart's surrebuttal testimony. Thus, by Staff's own consultant's admission, the Stipulation complies with OWEDA's requirement of positive net benefits to ratepayers. Since the Stipulation incorporates a key element proposed by Boston Pacific/OutSmart (i.e., a lower OREC price) the record

does not support Staff's argument that the Stipulation does not meet the statutory requirement of demonstrating positive economic and environmental net benefits.

B. SELECTION OF FOUNDATION AND TURBINE REPLACEMENT

Staff alleges that the Stipulation further violates OWEDA by allowing substitution of the project foundation and turbine technology which has a potential to increase costs to ratepayers. *Staff Brief* at 16-19. The Stipulation does allow such substitution, but only to increase the chances of obtaining USDOE funding, and only if the selected foundation is certified by the American Bureau of Shipping (ABS). *Id.* It is Rate Counsel's contention that these provisions meet the requirements of OWEDA and in fact reflect recommendations proposed by Staff's consultants. Specifically, when explaining how FACW could mitigate the "pre-commercial stage" risks of using less-proven foundation and turbine technologies, Boston Pacific/OutSmart acknowledged: We believe the indicated design certification approach with ABS is acceptable for the foundation design as ABS is an authority in marine and offshore classification and certification. *Staff Surrebuttal*, lines 5-7 at 35.

Staff's concern regarding the additional potential costs to ratepayers for any substitution of technologies is also misplaced, as FACW has agreed to accept any additional costs if such substitution is necessary. FACW has also agreed to subject any change of turbine technology to Board review and approval, with reasonable notice. Thus, the Stipulation, in this regard, preserves the balance between protecting ratepayers from unexpected costs, and realistically encouraging an economically viable offshore wind project that accomplishes the stated goals of OWEDA and the EMP.

C. RETENTION OF THE INDEPENDENT ENGINEERING MONITOR

In further compliance with Boston Pacific/OutSmart's recommendations to reduce risks to ratepayers, FACW has agreed to fund an Independent Engineering Monitor ("IEM") to review the project certification process and report to the Board. *Staff Surrebuttal*, lines 11-14 at 35. Staff takes issue with the perceived scope of the IEM as summarized in the Stipulation. However, FACW's agreement to adopt the recommendation of an IEM chosen by the Board for project review and fund, up to a proposed cap of \$50,000.00, does not violate OWEDA or place ratepayers at risk. The Board has the authority pursuant to OWEDA to include in any order approving an offshore wind application that the applicant reimburses the Board and the State for costs related to regulatory review and possible monitoring of the project. N.J.S.A. 48:3-87.1(c) (4).

Staff's insistence that the Stipulation is rendered invalid because some of their consultants' recommendations regarding the IEM were not expressly adopted is misplaced. It is not unreasonable or inconsistent with the statute for FACW to place an estimate of costs for the IEM, subject to Board approval. Rate Counsel respectfully submits that the inclusion of the IEM and the cap is reasonable and satisfies OWEDA.

Further, Staff criticized the Stipulation provision regarding the approval of Type B certification of the turbines and timing for Board approval as not complying with the recommendation of Boston Pacific/OutSmart. *Staff Brief* at 21. However, if FACW were to implement Boston Pacific/OutSmart's recommendation to wait until receipt of the Type B certification, it would severely hamper the financing and completion of the project. In recognition of the difficulty of FACW to complete the construction on a

timely basis and comply with OWEDA, the Stipulation included the express provision that no ORECS would be issued until all certification were achieved. See: Stipulation, para. 15 at 13. Adoption of Staff's recommendation would effectively nullify the FACW project before it could begin. Such a requirement for Board approval should not be considered by the Board.

D. OTHER BENEFITS OF STIPULATION

Pursuant to OWEDA, the Board can consider "other elements" in its review of an offshore application. N.J.S.A. 48:3-87.1(b)(2)(b). The Stipulation proffered for review by Rate Counsel and FACW contains other benefits not explicitly mandated by OWEDA. For example, FACW agreed to place the turbine designs "...and any related information in escrow for the life of the Project to be accessed by FACW as needed." See: Stipulation, para. 16 at 13. This provision was incorporated in direct response to the recommendation by Boston Pacific/OutSmart suggested in their surrebuttal testimony. *Staff Surrebuttal*, lines 18-19, at 36. Given the 20-year term of the project, the Signatory Parties agreed that a secure method to protect the turbine designs could be useful in case of any future maintenance issues.

Another benefit secured in the Stipulation relates to FACW's financial partner, XEMC, being subject to the jurisdiction of both federal and NJ courts. See: Stipulation at para. 14 at p. 13. As explained in the revised application and organizational chart supplied in discovery, XEMC is a business entity owned by the Government of China. Both FACW and Rate Counsel agreed that providing the Board with some assurance that

XEMC would recognize and agree to be subject to the legal system in the US was important to demonstrating financial integrity and commitment to the project.

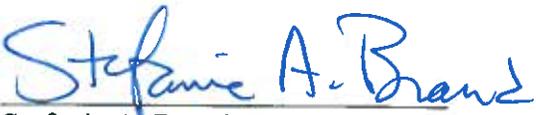
Lastly, the Stipulation incorporates an Interim OREC Pricing Plan to function in place of and until the Board adopts a Final OREC Pricing Plan. See: Stipulation, Attachment A. Pursuant to OWEDA, an application for an offshore wind project must include "... a proposed OREC pricing method and schedule for the board to consider." N.J.S.A. 48:3-87.1(a)(11). Presently, the Board is still in the process of developing a Final OREC Pricing mechanism through its rulemaking process. However, the Interim OREC Pricing Plan proposed in the Stipulation, if adopted, could serve as an opportunity for the Board to examine the practical application of such a financing mechanism beyond theory and provide valuable lessons.

CONCLUSION

For all the foregoing reasons, the New Jersey Division of Rate Counsel respectfully recommends that the Stipulation be accepted and approved by the Board.

Respectfully submitted,

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