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March 1, 2013

Via Electronic Mail and USPS Regular Mail
Hon. Gail M. Cookson, ALJ
Office of Administrative Law
33 Washington Street
Newark, New Jersey 07102

Re: In the Matter of the Petition of Public Service Electric and Gas Company For Approval to Offer New Appliance Service Products and/or Services In Accordance with N.J.A.C. 14:4-3.6(a) and (g)
BPU Dkt. No. GO12030188
OAL Dkt. No. PUC 08129-12

Dear Judge Cookson:

Kindly accept, in lieu of a more formal brief, this letter reply brief on behalf of the Division of Rate Counsel ("Rate Counsel") in the above captioned matter. In addition, an electronic copy of the reply brief is being sent to ila.dhabliwala@oal.state.nj.us. Copies of the reply brief are being provided to the parties on the attached service list by electronic mail and USPS Regular Mail.

We are enclosing one additional copy of the materials transmitted. Please stamp and date the copy as "filed" and return in the self-addressed stamped envelope. Thank you for your consideration and assistance.

PRELIMINARY STATEMENT

The parties to this matter, Public Service Electric & Gas Company ("PSE&G"), the Division of Rate Counsel ("Rate Counsel"), and the Staff of the Board of Public Utilities ("Board Staff"), filed Initial Briefs[1] on February 8, 2013. One fact stands out from the parties' Initial Briefs: Board Staff is almost uniformly in agreement with the positions advanced by Rate Counsel. Rate Counsel and Board Staff agree on the following issues:

- The net margins earned from new appliance services should be shared with ratepayers between rate cases. Concurring with Rate Counsel's recommendation, Staff believes that ratepayers should be "compensated for the embedded costs that are utilized by the competitive business side of PSE&G on a timelier basis." SIB at 27.
- PSE&G's proposals to offer Home Sewer Line Protection, Home Water Line Protection, Home Plumbing Systems Protection, and Home Electrical System Protection should be denied since they fail to satisfy the threshold legal requirement of N.J.S.A. 48:3-58(b). Indeed, Staff notes that these proposals are "not even remotely related, let alone substantially similar, to any product or service permitted under EDECA." SIB at 16.
- PSE&G's proposal to expand its WorryFree contracts to gas grills and pool heaters should be approved. SIB at 10. Since PSE&G offered repair of gas grills and pool heaters prior to the effective date of EDECA, this proposal satisfies the "substantially similar" requirement of N.J.S.A. 48:3-58(b)(4).

[1] PSE&G's initial brief will be referenced as PSIB, Rate Counsel's Initial Brief as RCIB, and Board Staff's Initial Brief as SIB.

- The Initial Decision should require PSE&G to monitor its fully allocated cost per hour on a more frequent basis (e.g. monthly or quarterly), as recommended in Overland Consulting's Audit Report in BPU Docket No. EA09040305. Board Staff "shares [Rate Counsel's] concern" that PSE&G may not be monitoring its fully allocated labor costs in a timely manner. SIB at 23.

In contrast to Board Staff and Rate Counsel, PSE&G stands alone in interpreting EDECA to give gas and electric utilities unlimited discretion to expand into new competitive services. As Rate Counsel argued in our initial brief, this position is unreasonable and violates numerous principles of statutory construction. RCIB at 12-14. Moreover, PSE&G's brief offers nothing new. The arguments advanced in PSE&G's brief have already been discredited by Rate Counsel's initial brief and the testimony of Rate Counsel witness David Peterson. Therefore, rather than restating our initial arguments, Rate Counsel offers the following limited response to PSE&G's brief.

I. Rate Counsel Properly Applied Current Law and Board Policy in Recommending that the Board Deny PSE&G's Proposals to Replace and Perform New Installations of Mini-splits and Heat Pumps, and to Offer WorryFree Contracts for Such Items.

Board Staff believes that PSE&G should be permitted to offer WorryFree contracts for mini-splits and heat humps, and to provide replacement and new installations of these two items. SIB at 12. Board Staff limited this recommendation to replacements and new installations for "existing customers" only. Id. In other words, PSE&G could not offer these services to new construction homes or new hi-rise buildings. Id. Rate Counsel agrees with Board Staff's recommendation to preclude new construction in the event that Your Honor allows PSE&G to offer these new services. But Rate Counsel disagrees with the analysis that would allow replacement and

installation of mini-splits and heat pumps, as it is inconsistent with relevant law and current Board policy.

The Electric Discount and Energy Competition Act ("EDECA"), N.J.S.A. 48:3-49 et. seq., requires any expansion of competitive offerings to be "substantially similar" to services that were offered by any gas or electric utility or approved by the Board prior to the effective date of EDECA, which was February 9, 1999. N.J.A.C. 14:4-3.6(b)(3). Board Staff argues that "repair and replacement of mini-splits and heat pumps is simply a natural progression of" PSE&G's Central Heater Replacement Program and Central Air Conditioning Replacement Program. SIB at 11-12. PSE&G makes a similar argument in its brief. PSIB at 46-47. Yet these two programs were not approved by the Board until March 22, 2002, several years after the effective date of EDECA. These programs fall outside of the scope of programs which are applicable to a "substantially similar" comparative analysis under EDECA. PSE&G and Board Staff inappropriately try to re-write EDECA to encompass any and all of PSE&G's current offerings, even those offerings that were approved post-EDECA. Even if the replacement and installation of mini-splits and heat pumps is a "natural progression" of an existing program, it is not permitted unless the program existed when EDECA went into effect.

Applying the actual language of the statute, PSE&G's Central Heater Replacement Program and Central Air Conditioning Replacement Program cannot satisfy the "substantially similar" standard because they were approved post-EDECA. Prior to the effective date of EDECA, PSE&G's (and other gas or electric utilities') appliance service business was limited to repair and parts replacement of household appliances. RCIB at 17-18. PSE&G also received approval to perform water heater replacements

during this time period. Id. at 18. Before EDECA, PSE&G was not in the business of doing HVAC replacements, much less new installations that add incremental revenues to PSE&G's bottom line.

Indeed, the Board has never sanctioned new installations of central air conditioners or heating units. RCIB at 21-22. Although PSE&G currently offers new installations of central air conditioners and heaters, PSE&G never petitioned the Board for approval of these services. Id. at 21. Not only should PSE&G's request to perform new installations of mini-splits and heat pumps be denied as failing to satisfy EDECA, but Your Honor should recommend that the Board determine whether PSE&G can continue performing new installations of central air conditioners and heaters since it is currently doing so without Board authority.

PSE&G receives incremental revenues from additional gas and/or electrical distribution sales when new air conditioners and new heating units are installed, in addition to the appliance service revenues received by performing the installation. The Board has never determined (1) whether PSE&G should even be in the business of performing new installations like a general HVAC contractor, and (2) if so, whether ratepayers should receive some sharing of this double benefit of additional revenues. It is Rate Counsel's position that Your Honor should recommend that the Board investigate these questions.

Rate Counsel also disagrees with Board Staff's position regarding PSE&G's proposals to offer WorryFree contracts for mini-splits and heat pumps. Before the passage of EDECA, PSE&G's appliance service business never involved any type of work on heat pumps and/or mini-splits. EDECA requires a new competitive service to be

"substantially similar" to a grandfathered service, not simply "similar." This strict requirement demonstrates the Legislature's intention to limit the ability of a regulated gas or electric utility to expand its competitive offerings. Rate Counsel believes the "substantially similar" language should be interpreted narrowly, consistent with the Legislature's intention. PSE&G should not be allowed to expand its offerings to new appliances, such as heat pumps and mini-splits, that were never part of PSE&G's appliance business prior to EDECA. If the Legislature had intended to give PSE&G broad discretion to expand its appliance service offerings, the Legislature would have chosen more permissive language. The Legislature chose not to do so, and its intent should be followed by denying PSE&G's proposals to offer WorryFree contracts for heat pumps and mini-splits.

Rate Counsel recommends that approval be limited to PSE&G's proposals to offer WorryFree contracts for gas grills and gas pool heaters. These proposals satisfy EDECA's threshold requirement since PSE&G already offered repair of these items prior to the effective date of EDECA.

II. PSE&G Asserts Numerous "Benefits" Stemming From its Appliance Service Business That Do Not Exist, And Simply Are Not Relevant.

PSE&G alleges several effects of the proposed offerings that will supposedly inure to the benefit of PSE&G's ratepayers and the State. PSE&G claims that its appliance services business aids "economic development in New Jersey" by employing outside plumbers and electricians; maintaining a large workforce to aid in storm restoration; and expanding customer access to services in urban and rural areas. PSIB at 2, 11, 36. First, the assertion that PSE&G's appliance service business increases

economic development in the State is simply not true. As Your Honor noted during the evidentiary hearing, there are only a finite number of appliance repairs needed in a given year. T78:L1(1/9/13). Any appliance service work captured by PSE&G is taken away from PSE&G's competitors. PSE&G's involvement in the appliance business does not increase the volume of work available. If anything, an expansion of PSE&G's competitive offerings may restrict "economic development." If PSE&G becomes more and more dominant in the appliance service business, this may discourage new, small competitors from entering the marketplace and attempting to compete with PSE&G.

While PSE&G attempts to make much of its appliance service personnel aiding in storm restoration, it ignores the fact that this benefit will not apply to the four proposed home protection plans that will be executed by outside contractors exclusively. PSE&G's brief also claims its involvement in the appliance service business will expand customer access to these services, "particularly in urban and rural areas of PSE&G's service territory where private appliance service contractors are less prevalent." PSIB at 2. Yet PSE&G never presented evidence of a lack of contractors, or that its competitors are engaging in discriminatory business practices, creating a need for access to these services. If no need exists, PSE&G's involvement in appliance services benefits no one. This purported benefit is wholly unsupported by the evidence.

Finally, these alleged benefits to ratepayers and the State are red herrings. They are not relevant to Your Honor's and the Board's evaluation of PSE&G's petition. Under EDECA, a gas public utility must first proffer that its proposed offerings fit within one or more of the five categories set forth in N.J.S.A. 48:3-58(b). If the utility satisfies this legal threshold, the Board may approve a new competitive service only if the utility

demonstrates: (1) the new service does not adversely impact the utility's ability to provide its non-competitive services in a safe, adequate and proper manner; (2) the price for the new service is not less than the fully allocated cost of providing the service; (3) regulated rates are not subsidizing competitive services; and (4) the new service is offered in a non-discriminatory manner. N.J.S.A. 48:3-58(d), (f), (j). While the Board clearly has broad discretion in evaluating PSE&G's petition, none of these alleged benefits are remotely related to the analysis set forth in EDECA. PSE&G may benefit the community by offering grocery delivery services, but that doesn't mean EDECA allows PSE&G to offer such services. Your Honor and the Board must evaluate the Petition based on the legal requirements, not on some subjective, unproven "community benefit" theory.

III. PSE&G Witness Jorge Cardenas, Whose Testimony Was A Net Opinion, Was Unqualified to Offer Policy Testimony Regarding PSE&G's Petition.

Rate Counsel feels compelled to point out the deficient qualifications of PSE&G witness Jorge Cardenas, particularly since PSE&G extensively attempted to attack Rate Counsel witness Peterson in its brief. Mr. Cardenas designed electrical systems for PSE&G for over seventeen years. T20:L19-22 (1/9/13). Mr. Cardenas does not have a background in public policy, has never worked for a utility regulatory agency, nor has he ever been employed by a water or sewer utility. T17:L21 – T18:L1 (1/9/13). Although PSE&G tries to portray this as an "operations" case, in fact the majority of this case involves policy and legal issues. Mr. Peterson is an expert in utility policy issues, having worked on competitive services issues for more than thirty years, first at the South Dakota Commission and then as a consulting expert witness. T173:L23 – T176:L8

(1/9/13). The same cannot be said of Mr. Cardenas, whose expertise is in the area of electrical systems design. Mr. Cardenas' testimony in this proceeding has little value beyond pure net opinion, and therefore should be given the weight such testimony deserves.

IV. Ignoring EDECA, PSE&G's Brief Utilizes a Stale Legal Standard.

Inexplicably, PSE&G's brief uses a stale, pre-EDECA legal standard in support of its position that its proposals are permitted by law. Citing a 1965 case, PSE&G argues that the Board does not have authority to consider the competitive effects of PSE&G's appliance services business on PSE&G's competitors. PSIB at 16-17. In doing so, PSE&G fails to acknowledge that EDECA was enacted in 1999. In fact, EDECA obligates the Board to consider the impact on PSE&G's non-utility competitors. N.J.S.A. 48:3-58(k) requires the Board to "adopt, by rule, regulation or order, such fair competition standards, affiliate relation standards, accounting standards, and reports as are necessary to ensure that gas public utilities…do not enjoy an unfair competitive advantage over other non-affiliated purveyors of competitive services…." The Legislature clearly was concerned about the ramifications of a utility monopoly's competitive services to non-utility purveyors. EDECA, which was intended to facilitate competition, explicitly gives the Board the authority to consider such ramifications, and to prevent any negative impact on these non-utility competitors.

Citing a 1967 case, PSE&G also claims that it may engage in "any reasonable legitimate business endeavors that are not directly or indirectly prohibited by law." PSIB at 14. Once again, PSE&G ignores EDECA's existence. Rate Counsel has demonstrated that most of PSE&G's proposals are in fact prohibited by EDECA. Board Staff's brief

accurately characterizes the unreasonableness of PSE&G's position. According to Board Staff, "the line of logic put forward by Mr. Cardenas, if permitted, can be extended to include, for example, personal computers, electric toys, toaster ovens, bathtubs, electric cars, and any household products that may spark the Company's fancy in the future." SIB at 17. Prior to EDECA, there were no statutes limiting the provision of competitive services by utilities. Concerned about the lack of statutory governance over such competitive services, the Legislature placed limitations on the expansion of competitive services in EDECA. Rate Counsel's and Board Staff's briefs follow the Legislature's intention by recommending that PSE&G's new competitive services be limited to WorryFree contracts for pool heaters and gas grills only.

V. PSE&G Has Not Presented Any Substantive Legal Basis for Opposing Rate Counsel's and Board Staff's Margin Revenue Recommendations.

For the reasons set forth in its initial brief and the testimony of its expert witness, Rate Counsel respectfully recommends that net margins from new service offerings initiated subsequent to PSE&G's last base rate case should be credited to ratepayers on a going forward basis through a mechanism. RCIB, pp. 28-33. Rate Counsel notes that Board Staff concurs that a mechanism should be established to share margin revenue with ratepayers between base rate cases. However, rather than sharing such margin revenue, as recommended by Board Staff, Rate Counsel submits that ratepayers should be credited on a going-forward basis with all margin revenues from new service offerings added since the Company's last base rate case. See SIB, pp. 24-28.

In its initial brief, Board Staff urged Your Honor to "recommend an appropriate means" to credit the margins to ratepayers in "a timely manner." SIB, p. 28. Board Staff

further noted that "sharing could be achieved through numerous mechanisms that should be further explored and left to the Board's discretion." SIB, p. 27. In addition, Board Staff presented four examples of ratemaking mechanisms to demonstrate how such shared revenues could be returned to ratepayers between base rate cases. SIB, pp. 27-28. Rate Counsel concurs with Board Staff's recommendation that a mechanism should be established to credit ratepayers with margin revenues between base rate cases and respectfully urges Your Honor to recommend a mechanism similar to the proposal by Rate Counsel, which was also listed as one of the alternative mechanisms by Board Staff. However, as noted above, rather than a sharing of the associated margins, Rate Counsel respectfully submits that all of the incremental net margins from new service offerings initiated subsequent to PSE&G's last base rate case should be credited to ratepayers on a going forward basis through a mechanism.

PSE&G's argument against the sharing of margin revenues between rate cases is rooted in the Board's historical treatment of such revenue, which dates to the pre-EDECA era. However, much has changed over the years and Rate Counsel submits that the historic treatment of these margin revenues should be revisited. There are a number of reasons for implementing a change at this point in time.

First, since PSE&G's last base rate case additional competitive service offerings were introduced, and the instant proceeding involves the proposed addition of even more new service offerings, promising additional margin revenue. PSE&G's appliance service business is not a static business with limited growth, but one which has grown in the number of service offerings since the Company's last base rate case. Between rate cases, under existing ratemaking treatment such additional margin revenues would accrue to the

benefit of the Company and its shareholders. In consideration of the growth in service offerings post-EDECA, Rate Counsel respectfully submits these additional margin revenues should be credited through a mechanism to ratepayers on a going-forward basis.

Second, EDECA addressed competitive services offered by gas public utilities. Notably, EDECA presents no statutory impediment to the sharing of margin revenues between rate cases, as set forth in Rate Counsel's initial brief. RCIB, pp. 28-33. Furthermore, as Board Staff noted, the Board may modify the present rate treatment of such revenues. SIB, pp. 27.

Finally, as Board Staff noted in its initial brief, Public Service is already required to "maintain separate detailed accounting for revenues and expenses" associated with its appliance service programs. SIB, pp. 26-27. Therefore, the accounting for margin revenues should not be problematic or an impediment to implementing a mechanism to return margins to ratepayers.

In sum, as set forth above and in Rate Counsel's initial brief, there are no practical or legal impediments to implementing a mechanism to credit ratepayers with margins between rate cases. PSE&G's ratepayers should be credited with these incremental margin revenues on a going-forward basis through a mechanism.

VI. PSE&G has Presented Nothing to Refute the Recommendation That the Company Monitor Its Hourly Charge Reports and Adjust its Hourly Rate if Needed.

Although PSE&G updates its hourly rate on a semi-annual basis, in the recent past its hourly labor rate increased by over 21 percent over a two year period.[2] See RCIB, pp. 33-35; RA-1, pp. 16-18. Therefore, Rate Counsel recommends that, in accordance with

[2] P-5, 6:23-7:3; See N.J.A.C. 14:4-3.6 (n), (o), and (p).

the affirmative duty imposed by N.J.A.C. 14:4-3.6(j), PSE&G should be required to file the necessary application for an hourly rate change if its monitoring shows an increase in the fully-allocated hourly rate. See RCIB, pp. 33-35. Board Staff supports more frequent monitoring by PSE&G of its fully-allocated hourly labor rate, as well as an evaluation of the floor prices for competitive services in the context of a base rate case. SIB, pp. 22-23. Rate Counsel supports Board Staff's recommendations with respect to these items. Furthermore, Rate Counsel respectfully submits that explicitly imposing an affirmative duty on PSE&G to more frequently monitor its fully allocated labor rate via an initial decision and/or Board Order would help ensure that ratepayers are not subsidizing the Company's Appliance Service Business.

CONCLUSION

For all of the reasons above and in Rate Counsel's Initial Brief, Rate Counsel respectfully submits that Your Honor find:

1. With the exception of WorryFree Contracts for gas grills and pool heaters, PSE&G's petition should be denied as a matter of law.
2. The Board should investigate whether or not PSE&G should be allowed to continue performing these new installations of central air conditioners and central heaters.
3. PSE&G should be explicitly directed to copy Rate Counsel on all future petitions and notices filed with the Board regarding any new appliance service offerings.
4. If PSE&G is permitted to expand its Appliance Service Business offerings, the incremental net margin revenues from new Appliance Service Business offerings

added since the Company's current base rates were established should be returned to ratepayers going forward on a concurrent basis through a mechanism.

5. An explicit affirmative duty should be placed on PSE&G to monitor its fully-allocated labor rate and to file the necessary application for an hourly rate change if its monitoring shows an increase in its fully-allocated hourly labor rate.

Respectfully submitted,

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By: *s/ Christine M. Juarez*
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C: Service List (Via Electronic Mail and USPS Regular Mail)

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BPU Docket No. GO12030188

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