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Irene Kim Asbury, Esquire
Secretary of the Board
Board of Public Utilities
44 South Clinton Avenue, 3rd Floor, Suite 314
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Trenton, New Jersey 08625-0350

AX17050469

RE: Comments of Atlantic City Electric Company Regarding the Stakeholder Process to Address the Implementation and Expansion of Infrastructure Programs

Dear Secretary Asbury:

The undersigned is Assistant General Counsel to Atlantic City Electric Company ("ACE"). Attached are eleven copies of ACE's Comments in connection with the Board of Public Utilities' pending Stakeholder Process regarding the implementation and expansion of infrastructure programs.[1] ACE appreciates the effort that has gone into the development of the Stakeholder Process, and the opportunity to provide its Comments. ACE looks forward to working with the Board of Public Utilities, its Staff and all interested parties on this important proposal.

Kindly accept this submission for filing and return one date-stamped and "filed" copy of this communication and its attachment in the pre-addressed, postage-prepaid envelope provided.

Case Mgmt
Legal (2)
A. Moreau
V. Beke
T. Walker

[1] Please note that ACE has separately filed Comments on the straw proposal concerning the implementation of provisional rates.

Thank you for your cooperation and courtesies. Feel free to contact me with any questions or if I can be of further assistance.

Respectfully submitted,

/jpr

Philip J. Passanante
An Attorney at Law of the
State of New Jersey

Enclosure

cc: Andrew J. McNally, Esquire, Chief Counsel (electronic mail and Federal Express)
Paul Flanagan, Esquire, Executive Director (electronic mail and Federal Express)

Comments of Atlantic City Electric Company
Regarding the Stakeholder Process to Address
The Implementation and Expansion of Infrastructure Programs

Overview

Atlantic City Electric Company ("ACE" or the "Company") is heartened that the Board of Public Utilities (the "Board") and its Staff have begun the task of considering more efficient regulatory mechanisms for recovering the costs of needed capital expenditures.[1] ACE appreciates and supports the Board's efforts, but also encourages the Board to use this proceeding to address capital expenditures in a comprehensive and innovative manner. As ACE explains below, this proceeding is an opportunity for the Board to go beyond codifying elements of previous infrastructure programs, and instead to implement more fundamental changes in the way capital expenditures are included in rates. Indeed, arguments that the Board should not deviate from its prior policies simply because those policies have been in place for extended periods are antithetical to innovation and efficiency, and ultimately work to undermine the Board's efforts to address the pressing infrastructure needs of New Jersey and its citizens. Eschewing new approaches simply because they are new is not a hallmark of this Board or the policies of this State.

ACE's view of the straw proposal proceeds from the perspective that regulatory mechanisms should be structured to ensure that needed capital expenditures are timely made, and investments are timely recovered. From ACE's perspective this is the essence of the regulatory compact: utilities invest in the facilities needed to provide service, and customers pay for the facilities used to provide service once the customers begin receiving the benefit of those investments. Linking the timing of cost recovery to the time when those assets are in service for the benefit of customers is vital to treating both utilities and their customers equitably. From ACE's perspective, this over-arching purpose should be reflected throughout the straw proposal and any related regulations.

ACE's view of the straw proposal is also informed by its experiences over the last several years regarding significant delays in the recovery of capital investment costs, and the impact of those delays on the Company's ability to earn its authorized rate of return. ACE continues to under-earn even with frequent base rate requests, and it is clear that current regulatory approaches, including infrastructure programs, are not sufficient to address fully the challenges ACE faces. Even with annual rate cases and the ability to settle rate cases in five to six months, it is important to note that the capital investments included in those rate cases may have already been in service two to eighteen months before recovery of those investments actually begins. In short, customers are receiving the benefits of ACE's capital investments but ACE's costs are not being fully or timely recovered. This is not a balanced approach to cost recovery or regulation, and should be addressed by the Board. Moreover, suggestions that the straw proposal lowers utility risk and so justifies a lower return on equity ("ROE") are inconsistent with the actual mechanics of the proposed tracker. The utility alone bears the burden of demonstrating that the

[1] Additionally, ACE supports and joins in the comments of the New Jersey Utilities Association, and submits these comments to provide additional input on the straw proposal.

capital projects are needed to serve customers, and that the costs of the projects are reasonable and prudent. As proposed, this showing would be made in a base rate proceeding--after the investments had been made. The utility is still fully at risk for the recovery of these costs and the inclusion of the investment in rate base: the tracker does not shift these burdens in any way. What the proposed tracker does do is more closely follow the matching principle in utility ratemaking because it more closely aligns rates and revenues with the related expenses and investments in the time period they occur. Adhering to the matching principle is an approach that fairly balances the interests of utilities and their customers, and should be a yardstick against which the tracker mechanism should be measured. Therefore, ACE has proposed changes to the straw proposal to increase its effectiveness and efficiency, and to facilitate timely cost recovery.

Specific Comments

Consistent with the general comments noted above, ACE offers the following specific suggestions and observations:

In paragraph one, the Infrastructure Program is slated to run for a period of five years or less. ACE believes that five years would be a reasonable minimum term. While some parties may argue that New Jersey case law, particularly *In re Intrastate Industrial Sand Rates*, 66 *N.J.* 8 (1974) ("*Industrial Sand*"), limits the term of this mechanism to three years, a reading of that decision and applicable case law contains no such express limitation. Rather, *Industrial Sand* and related cases stand for the proposition that temporary rates (such as trackers) are justified by the "legal umbilical cord" which ties them to the Board's "anticipated *eventual* determination" of rate base and fair rate of return in a future base rate proceeding. *Id.* at 25 (emphasis added). Indeed, New Jersey courts have not articulated a view as to the permissible period of time a clause may be in effect between base rate cases, preferring instead that the Board exercise its discretion and expertise in the rate setting process. Similarly, New Jersey courts have concluded that adjustment clauses and tracker mechanisms are permissible provided there is a legal nexus to a base rate case in which the justness and reasonableness of the rate will be determined. *Id.* at 26. Thus, well-settled New Jersey law is clearly at odds with unsupported blanket statements that tracker mechanisms are somehow inappropriate or improper. Tracker mechanisms are legally permissible, and five years is a reasonable period for the Infrastructure Program tracker to remain in effect.

In paragraph three, ACE believes the proposed spending threshold (which currently states that the spending must be incremental to the utility's average capital expenditures over the prior five years) is too limited, and undercuts the efficacy of the proposal. As noted above, ACE believes the public interest is best served by mechanisms that provide for timely investment coupled with timely cost recovery. By limiting the proposed mechanism to an arbitrary historical average, the straw proposal essentially codifies the fact that only some investments, if any, will be timely recovered, while others will be delayed until the conclusion of a base rate case. This approach is not equitable to utilities or their shareholders.

The eligibility limitation would also penalize companies, like ACE, that have made significant reliability and resiliency investments over the past several years to address issues important to the State, the Board and our customers, which have increased the five-year average capital spending threshold. Conversely, utilities with lagging capital investments that result in a lower five year average would be rewarded. This result cannot have been the Board's intention. Additionally, the proposal does not indicate how programs such as Energy Strong or PowerAhead will be treated for the purpose of calculating historic capital expenditure levels and whether those capital intensive programs are to be included or excluded in the calculation of the five year average. ACE is firmly of the view that existing infrastructure programs, such as Energy Strong and PowerAhead, should be excluded from any base spending calculation. As noted above, inclusion of such existing efforts in base spending effectively penalizes any utility that has already heeded the Board's call to enhance reliability and resiliency. Existing infrastructure programs were intended to be in addition to a utility's base spending and not a "new normal" base spending level, and should not be used now to limit future program eligibility levels. Indeed, the straw proposal fails to articulate any sound public policy reason for limiting program eligibility. In short, restricting program eligibility to incremental spending will not facilitate replacement and repair of aging utility infrastructure, and should be reconsidered.

The following chart summarizes the level of capital investments that ACE will be able to recover from the Infrastructure Program tracker mechanism, as currently proposed. As the chart shows, approximately $14 million of reliability spend would be eligible for timely recovery. Over the 4 years shown in the table, ACE is forecasted to spend approximately $535 million, and therefore the Infrastructure Investment tracker will only allow timely recovery of approximately 2.6% of ACE's total capital spend.

($millions)	**2018**	**2019**	**2020**	**2021**
Total Forecasted Construction Spend	$146	$133	$132	$124
Prior 5 Year Average Construction Spend	$134	$130	$136	$141
Maximum Construction Spend Recoverable Through Tracker	$12	$2	$0.0	$0.0

Ironically, under the current straw proposal, the only way that ACE can increase the amount of capital qualified to be recovered through the Infrastructure Investment tracker is to <u>lower</u> its overall capital spending over the next several years. As a result, a threshold requirement based on a 5-year average capital spend creates a disincentive for capital spending which runs counter to the objectives of the State of New Jersey and the Board, and the desire of our customers for increased capital spending for reliability and resiliency. Continued investment in ACE's service territory was a significant concern during the Exelon/PHI merger approval. The parties were concerned that ACE would not continue to invest at its previous levels and therefore the parties agreed to a merger commitment that established a minimum level of capital spending over the next several years. The Infrastructure Program tracker, as currently proposed, does not support or promote the intent of the parties for further, sustained investment in the region.

Given these concerns, ACE recommends that the eligibility limitation be removed. To the extent the Board is concerned that too many investments would be eligible to flow through the infrastructure program, ACE would point to two other provisions of the proposal that already address that concern making the eligibility limitation unnecessary. First, each program is subject to specific review and approval by the Board. This proposal does not create a blanket approval for any program, but instead provides the framework for continued regulatory oversight through which the Board can exercise its authority to limit the size and magnitude of any of these programs through the individualized and fact specific analysis that will result from the applications filed by each company wishing to implement a tracker. Second, the proposal includes a limitation on the customer impact of each proposal to no more than 2% of the customer bill.[2] That too, will limit the size of these programs in a way that is focused on the customer impact.

In the alternative, ACE has two, alternative approaches to propose as the appropriate benchmark. The first approach would set the base spending level at the utility's depreciation expense:

> *Any Infrastructure Program must be incremental to the Utility's average depreciation expense over the prior five years.*

Alternatively, to the extent the Board is concerned that too many investments would be eligible to flow through the infrastructure program, ACE would propose the following modification to the current straw proposal. This proposal strikes a balance between a calculation that is based on the CapEx over the prior five years and a calculation based on depreciation expense, and removes the disincentive for a Utility to spend less capital to lower its 5 year average:

> *A Utility may include both CapEx that is incremental to the Utility's average CapEx over the prior five years, and non-incremental CapEx in its Infrastructure Program. The annual increase in rates attributable to an Infrastructure Program will be no more than two percent of the total customer bill; and of this two percent limit, no more than a one percent increase of the total customer bill may be attributable to non-incremental CapEx (CapEx that is equal to or less than the Utility's average CapEx over the prior five years). The dollars used to calculate "average CapEx over the prior five years" shall not include any dollars associated with infrastructure tracker programs, whether those dollars are to be recovered on an accelerated basis or on a non-accelerated basis (e.g., "stipulated base").*[3]

ACE believes either of these approaches would be preferable to the straw proposal's current language.

[2] As discussed below, ACE also suggests that the Board clarify that the 2% cap is calculated based on the total bill.

[3] If the Board changes the 2% cap as proposed by the New Jersey Utilities Association, then that revised language should be reflected throughout the straw proposal, and any related regulations should be adjusted accordingly

With respect to the filing requirements set out in paragraph four, while ACE supports the directive to make a comprehensive filing, the regulations should not be drafted to require an automatic refiling of a utility's entire request if some element of the filing is deemed to be insufficient. This approach is inefficient and wasteful of limited administrative resources if a simple correction can be made, and it creates opportunities for extended delays and arbitrary enforcement. Moreover, the Board has typically employed a pragmatic approach to filings: petitioners are generally permitted to supplement and amend their filings as needed in the interest of administrative efficiency. Suggestions that the Board should abandon that practice in favor of a less efficient approach are inconsistent with the overall goal of the straw proposal.

With respect to paragraph four (d), the straw proposal is unclear as to what is contemplated by the requirement that the CapEx budget include ten percent of "similar projects" included in the Infrastructure Program filing. ACE finds this language confusing and unnecessary, and would eliminate this provision all together as advocated by the New Jersey Utilities Association. In the alternative, this provision must be clarified to indicate that these are not additional, incremental projects over and above the base spending amounts and the Infrastructure Program. ACE would propose the following clarifying language:

> *d. demonstrate that the utility's CapEx budget includes projects similar in nature and purpose to those included in the Infrastructure Program and in an amount equal to at least ten percent of the total amount of the Infrastructure Program. For the avoidance of confusion, the purpose of this provision is to ensure that resiliency and reliability investments are being made as part of the utility's routine capital budget and not solely through the Infrastructure Program. This provision is not intended to impose an incremental spending requirement on the utility in excess of its CapEx budget or the Infrastructure Program, and shall be demonstrated with semi-annual status reports for project management oversight purposes.*

With respect to paragraph six, ACE believes that the language making "blanket infrastructure programs" ineligible is not clear as to the nature of the projects deemed to be ineligible—particularly since this paragraph also requires that projects be non-revenue producing. Moreover, ACE does not see a principled distinction between "blanket" type programs and other capital investments. It is important to note that the concept of "blanket" type programs is generally used to assist in budgeting and planning. Since the Infrastructure Investment tracker is designed to recover costs only after the investments are in service and providing benefits to customers, all investments recovered under the Infrastructure Investment tracker will be known and measurable and specifically identifiable once the recovery of these investments begin. If the actual capital expenditure meets the definition of the categories and type of spend defined in the straw proposal, the Company should be allowed to include the cost in the Infrastructure Investment tracker, regardless of how the amount was originally described or budgeted. Both types of investments are needed and provide service to customers: those should be the criteria for inclusion. Therefore, ACE would recommend that the second sentence of paragraph six be eliminated.

In paragraph eight, a "cost benefit analysis" is required, but the straw proposal is unclear as to what specific information is required and when that analysis is to be provided. While information describing how investments will benefit customers is appropriate, performing a formal cost benefit study at the outset is an unnecessary duplication of efforts that would be more appropriate when the projects, benefits and actual costs are known and examined in a base rate case. In order to maximize the efficiency of the review process and minimize duplicative activities, ACE believes that any analysis of the expected benefits of the projects should be provided at the time a decision is made regarding the prudency of the specific projects and investment costs. ACE understands, however, the straw proposal is structured to make determinations on the prudency of investments only in the context of a base rate proceeding. Thus, the straw proposal appears to require such analysis twice: once when the program is approved, and then again when prudency is finally determined in a base rate case. ACE believes this is unnecessary and inefficient. Therefore, ACE recommends that the inclusion of a formal cost benefit analysis be eliminated from the straw proposal. Instead, ACE suggests this requirement be replaced with a discussion of customer benefits. ACE recommends the following language for paragraph eight:

The Infrastructure Program filing must include a presentation explaining how the proposed expenditures are reasonable and prudent and will benefit customers.

In paragraph nine, additional clarity and specificity should be provided regarding how the maximum annual two percent increase in rates will be calculated. ACE suggests that a sample calculation be prepared by Staff to illustrate how the maximum allowed increase will be determined. In addition, the regulations should clearly state that the annual two percent increase is calculated based on the total bill—not merely the distribution rate in the case of electric utilities. Applying the two percent cap to the total bill would bring the Infrastructure Program tracker into parity with the Distribution System Improvement Charge ("DSIC") which is capped at five percent of a water utility's total revenues. *See N.J.A.C.* 14:9-10.2.

With respect to paragraph twelve, the straw proposal includes a ten percent spending threshold for each semi-annual period before a utility is permitted to file a rate recovery petition. While some minimum spending threshold might be appropriate, ACE does not agree that ten percent is the correct level. Instead, a lower threshold should be set to recognize that capital construction projects are not placed into service in a uniform fashion but instead are influenced by the construction season, permitting and other variables. ACE recommends the following language for paragraph twelve:

> *The utilities will be allowed to file rate recovery petitions on a semi-annual basis provided infrastructure projects with costs totaling at least seven percent of the total Infrastructure Program were placed into service during the semi-annual period.*

ACE also strongly supports the ability of utilities to file semi-annually for an adjustment to the Infrastructure Program tracker mechanism. Such semi-annual filings would fairly balance the interests of utilities and their customers, and provide the Board with timely information regarding capital investments. Moreover, suggestions that semi-annual filings are too administratively burdensome can be addressed by streamlining those filings—not by making them more complex and effectively turning each filing into a rate case with the examination of O&M costs and performance metrics, as some parties have suggested. ACE has proposed several such streamlining measures in these comments, and encourages the Board to implement the Infrastructure Program tracker in a manner that is administratively efficient rather than simply precluding utilities from timely recovering their costs. Put another way, the Board is not faced with a choice between administrative efficiency and timely cost recovery by regulated companies. Instead, the Board can, and should, accomplish both objectives with the appropriate regulatory structures.

Paragraph fourteen contains the requirement for an annual earnings test. ACE believes an earnings test is appropriate and would suggest that the straw proposal include specific directions as to how an earnings study should be prepared, including the specific adjustments that would be permitted to the earnings calculation. Additional detail and direction on the preparation of the earnings test will help to ensure that all such calculations are performed in a consistent and uniform manner.

In addition to the comments above, ACE notes that the straw proposal does not contain a time period for the Board to act on a filing once it has been made and is considered complete. ACE is of the view that such a requirement should be set out in any final regulations similar to the requirements contained in the DSIC. While the DSIC regulations provide the Board with a ninety day review period, ACE believes a 120 day review period would strike the appropriate balance between allowing for a thorough review and facilitating timely cost recovery.

Finally, ACE supports the Board's efforts to develop and implement an efficient mechanism for cost recovery of capital investments needed to serve customers. ACE agrees with the comments made by the Director of the Division of Rate Counsel that capital spending should increase gradually over time to insure needed investments are made but rate shock is avoided. The Staff straw proposal is a solid framework to accomplish these goals, and ACE appreciates the opportunity to provide suggestions on ways to build upon and enhance that framework. ACE looks forward to working with the Board, its Staff and all interested parties to develop a mechanism that will support needed investment and timely cost recovery to benefit utilities, their customers and the State of New Jersey.