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AX17050469

**Re: PRN 2017-164 and BPU Docket # AX1750469  
AARP Comments Concerning the NJ Board of Public Utilities Proposed New Rules: N.J.A.C. 14:3-2A, Infrastructure Investment and Recovery**

Dear BPU Secretary Asbury,

On behalf of AARP's 1.3 million New Jersey members please accept these comments concerning PRN 2017-164. AARP is a non-profit, nonpartisan membership organization that believes no one's possibilities should ever be limited by their age and seeks to find new solutions so that more people can live and age as they choose. AARP works to protect all consumers against unreasonable utility rates and to help people save money on their utility bills. Especially in these difficult economic times, we, along with our members, continue to advocate on behalf of families struggling to pay their utility bills. We work to advance regulations and legislation that protects consumers from unfair rate increases, advances consumer protections and shields consumers from harmful cost shifting by utilities.

AARP has reviewed the BPU's PRN 2017-164 concerning Infrastructure Programs, N.J.A.C. 14:3-2A. AARP has been actively involved in consideration of these issues. On May 11, 2017, AARP commented on the April 26, 2017 BPU Straw Proposal on infrastructure programs<sup>1</sup> and AARP attended the May 4, 2017 stakeholder meeting at the BPU headquarters in Trenton. Additionally, AARP has intervened in several proceedings before the Board concerning infrastructure programs.

AARP is active on alternative ratemaking issues in many states and has studied these policy issues extensively. Our review of infrastructure trackers to date demonstrates that they are not needed to incent sufficient and prudent capital expenditure investments, and at the same time they provide a windfall to utilities.

<sup>1</sup> As the proposed rules have many elements in common with the straw proposal, these comments share a number of points with AARP's earlier comments.

Case mgmt

Ratepayers should be able to rely on high-quality energy, and other utility services. In fact this is what consumers pay for in their existing rates. AARP further believes that a utility's revenue requirement should be based on just and reasonable expenses necessary to provide service and investments that are prudent and used and useful to ratepayers. Rates should be stable, predictable, and understandable, with costs allocated fairly among customers.

PRN 2017-164 appears to be consistent with the currently ongoing utility industry effort to persuade decision makers that under traditional "cost-of-service" regulation, utilities will necessarily under earn, and that absent automatic and simultaneous rate increases they will lack the incentive to replace and repair aging infrastructure. There is no industry-wide evidence to support this proposition and none offered in PRN2017-164. In fact, the traditional ratemaking principles embodied in the tried and true cost-of-service process provides utilities with reasonable assurances of cost recovery and profit.

Cost-of-service ratemaking also ensures a transparent examination of utility costs based on intervenor and public participation, actual evidence and thorough analysis. Demands for instantaneous and single-issue rate increases essentially hold consumers hostage for investments the utilities should make in any event, and for which they are justly and fairly compensated.

Barring extreme or emergency circumstances, AARP opposes the use of trackers, surcharges and other cost recovery schemes outside the base rate case. For the reasons summarized here and discussed below AARP opposes PRN 2017-164 and urge it be rejected by the BPU:

1. The proposed IIP is not necessary to incent investment in any distribution plant, much less in critical safety and reliability upgrades. Utilities today can readily obtain financing at reasonable costs for these investments.
2. The proposed IIP is single-issue ratemaking at its worst.
3. The proposed IIP will fast-track rate increases, but not decreases leading to harmful rate impacts for consumers.
4. The proposed IIP undermines the comprehensive review of utility costs and prudence of investment decisions; consumers cannot be assured they are paying just and reasonable rates.
5. The proposed IIP lowers utility risk since cost recovery is guaranteed for all practical purposes. Therefore, if the IIP is implemented, the utility return on equity must also be lowered. However, PRN 2017-164 makes no provision for such adjustments.

### **A Solution in Search of a Problem**

Utilities have an obligation to make all necessary and prudent investments without the extraordinary treatment as outlined in the proposed new rules. Failing to do so amounts to holding consumers hostage, rather than fulfilling the utility's obligation to serve.

As stated in the announcement of the stakeholder meeting, the Board has approved in excess of \$3 billion in infrastructure programs. There has been no representation, much less proof, that needed infrastructure investments are not being made in New Jersey because the utilities do not receive the extraordinary accelerated recovery called for in this proposal.

The BPU's proposed new rules are not based on any cost/benefit analysis or economic research from New Jersey or other jurisdictions. Nor has the Board provided stakeholders with an economic impact analysis of the proposal as detailed in the "Common Sense Principles" of Executive Order No. 2.

### **An Undue and Dramatic Shift of Risk**

The Board's proposed IIP shift practically all investment risks on to consumers. However, the proposal does not lower allowed returns commensurately; rather, it pegs the allowable returns to the ROE allowed in a prior case, before extra-base-rate investments were considered or tracker recovery implemented. Once rates have been raised to provide instantaneous cost recovery, it becomes extremely difficult for a regulator to claw back investments that later prove to have been imprudent.

Further, even in a climate of stable or declining costs of capital, the proposed rules do not require the interruption of the accelerated recovery via the IIP unless the utilities earned return is 50 basis points above the rate approved in the last rate case.

PSE&G has enjoyed improved earnings year over year. Without the "incentive" of an IIP, PSE&G achieved these results against a background of substantial CapEx investments. As stated by Ralph Izzo, President and CEO of PSE&G,

PSEG's second quarter [2017] earnings demonstrate the benefits of our utility investment program and adherence to operating efficiently. We remain committed to providing customers with affordable and resilient energy in a manner that also provides investors with strong, sustainable returns on capital. That commitment includes improving New Jersey's aging infrastructure, as evidenced by our filing yesterday of a 5-year \$2.7 billion extension of our Gas System Modernization Program.

<http://investor.pseg.com/press-release/featured/pseg-announces-2017-second-quarter-results>

Under the proposed IIP, a utility is allowed automatic recovery of costs, but prudence evaluations are deferred to the next rate case, which can be as long as 5 years in the future (and after the utility has received revenues covering the projects). Under this and the Board's proposed new rules on interim rates, (PRN 2017-165), residential, commercial and industrial ratepayers could be faced with paying rates to a utility that is over-earning, paying provisional increases on those already

overpriced charges and paying for gold-plated infrastructure projects that are neither reasonable nor used and useful.<sup>2</sup>

PRN 2017-164 at 14:3-2A.5 (c) 2 proposes that in considering a utility's petition in support of an IIP, the Board may require the utility retain an independent IIP monitor. As further discussed below, a monitor cannot and should not supervise the actual investment and construction, and cannot identify all imprudence that may eventually lead to cost overruns, safety problems or wasted spending. Clearly this violates the Board's mission to ensure that safe, adequate, and proper utility services are provided at reasonable, non-discriminatory rates to all who desire such services

### **Affordability**

All consumers must be able to rely on the availability of safe, affordable, and high-quality services. The BPU's Straw Proposal, (Docket Number AX1750469), recommended that the maximum annual increase in rates attributable to an Infrastructure Program be two percent. At the time, AARP commented that two percent rate increases are not de minimis, and can adversely affect many customers struggling to keep pace with utility payments. Yet, PRN 2017-164 eliminates even this protection, leaving it entirely up to the Board whether to limit the IIP to investments that would create a given rate impact.

Home energy costs make up a sizable portion of household budgets.<sup>3</sup> One group particularly vulnerable to rapid increases in energy prices is older consumers. Although they consume approximately as much energy as younger people do, older Americans devote a higher percentage of their total spending to residential energy costs. They spend a greater proportion of their income to heat their homes (this is true even after statistics are adjusted for weather and home size).

Low-income older households spend an average of 10 percent of their income on residential energy. However, in about one out of four cases, low-income older households devote 15 percent or more of their income to home energy bills. Too often older adults with low incomes must choose between cutting back on energy expenditures and reducing spending for other necessities, and may thus end up risking their health or comfort.

Rate increases, including provisional rate hikes, are very burdensome to customers. A recent New Jersey Department of Human Services report, *Living Below the Line 2017*, finds that nearly six in ten NJ retired elder-only households' lack sufficient annual incomes to insulate them against poverty as they age. This report also notes that the "median annual incomes among NJ retired women vary greatly by race and ethnicity. Median income for White women elders (\$18,817) is approximately \$4,300 higher than median income for Black women elders (\$14,521), \$8,930 higher than median income for Hispanic women elders (\$9,883), and \$6,200 higher than median income for Asian women elders (\$12,605)". 30% of all NJ seniors rely on social security as their sole

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<sup>2</sup> If Congress were to reduce corporate tax rates during an IIP, the utility would face no pressure for 5 years to come in and have such reductions reflected in rates, at least not unless and until excess profit margins reach 50 basis points.

<sup>3</sup> AARP notes that the Housing Affordability Impact Analysis may understate the impact on housing affordability, in that the proposed rules allow for rate increases without the rate case standards that create a comprehensive net cost-of-service limit on rates.

income.

The New Jersey Board of Public Utilities must ensure service affordability for all— all utility rates should reflect the prudent use of ratepayer money and fairly distribute costs and savings among consumers, while taking into account households with lower incomes. PRN 2017-164 violates these principles and should be rejected

### **Excessive Earnings**

PRN 2017-164 proposes that “if the calculated Return on Equity (ROE) exceeds the allowed ROE from the last base rate case by fifty basis points, there will be no accelerated recovery applicable filing period.” AARP opposes this proposal for the following reasons:

1. The calculation of the Return on Equity is not adequately defined in the proposed rules. For example, the proposed new rules reference “actual net income,” and thus apparently call for an unadjusted cost and revenue calculation. Without adjustment, the cost and revenue study can contain single-issue costs and revenues, which distort the calculation’s value as an estimate of ongoing net revenues. Thus, for example, the utility can have experienced a major one-time expense that lowers the achieved ROE in a given year but that would not be considered in a base rate case when attempting to determine ongoing revenue requirements. PRN 2017-164 also does not contemplate anticipated reductions in expense, such as the proposed cuts in the federal corporate income tax rates, which could become effective after the IIP was set, but would not automatically spur a rate case or otherwise prevent overearning.
2. PRN 2017-164 provides the utility an enormous opportunity for over-earnings. For example, half a percent on a rate base of \$1.37 billion (see New Jersey Natural Gas testimony in September 2016 rate case) grossed up for taxes is over \$11 million for the customers of just this one utility. Suspending the accelerated recovery during the applicable filing period<sup>4</sup> does nothing to compensate customers for the excess net revenues they paid the utility leading up to the determination of the 50 basis points excess profits. Further, merely disallowing accelerated recovery does not prevent the utility from continuing to overcharge customers even though significant overearning has been established.
3. PRN 2017-164 defines the base for the purpose of determining the equity return as “the average of the beginning and ending common equity balances for the corresponding period.” The term “actual” is not a term of art in ratemaking. And common equity is not the same as rate base, meaning that the earnings test does not use the standard basis for determining a utility’s allowed return.

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<sup>4</sup> The proposed rule does not define the term “applicable filing period.” Presumably it refers to the period of the approved IPP. Proposed Rule 14:3-2A.4(a) provides that a utility may petition the Board for approval of “an Infrastructure Investment Program extending for a period of five years or less.” The “filing period” may be intended to refer to the remaining time up to the time limit before a base rate case must be filed. The term “applicable filing period” should be defined for clarity.

4. Finally, any limitation is pegged to the ROE from the last rate case, during which the Board may not have even considered the impact on risk of a Capital Cost surcharge proposed after that rate case.

### **PRN 2017-164 Weakens Critical Oversight & Consumer Protections**

A prudence review is a retrospective analysis of the decision-making process and the activities performed by a utility in the provision of service to its customers. Prudence evaluations of actual construction are a tool that only works once the project is completed, and it is possible to identify harm to consumers that justifies further regulatory examination. Otherwise the Board is trying to review all decisions, regardless of their ultimate result, almost in real time, an overwhelming, impossible and unnecessary task.

PRN 2017-164 eviscerates the Board's ability to identify imprudence, to correct for it, and to incent adherence to prudence going forward. Semi-annual status reports, as described at 14:3-2A.5 (e), are no substitute for prudence evaluations. More importantly, semi-annual status reports do not in reality give the Board a means to oversee project management. Boards cannot substitute review of periodic reports for management as a project goes along. It is inconsistent with the Board's role as a regulator to try to oversee or supervise the implementation of a utility capital project. Based on experience elsewhere, we submit that just reviewing the periodic filings for mathematical accuracy and fidelity to the accounting rules of the surcharge as proposed would likely be very time-consuming, but not helpful in protecting consumers in a substantive way.

No retained monitor can stand in the shoes of management and evaluate each decision as it is made, or determine all decisions that might be imprudent and (more importantly) that might have adverse consequences for service or cost-effectiveness. No paper reports, no matter how frequently, can enable the Board to identify actions that will become problems in completed projects. Substituting such oversight tactics deprives the Board and interested parties of a genuine opportunity to identify and challenge the result of imprudent decisions. It provides a false sense of accountability.

By contrast, base rate review, after project completion, is the only administratively feasible way to evaluate prudence and protect ratepayers. Given the myriad of construction decisions made each day, trying to oversee the projects in real time or near real time would bog the Board (or monitor) down and produce ineffective and inefficient reviews. Base rate consideration allows the Board, the public, and intervenors to identify decisions that in fact hurt consumers and that may have been imprudent, and devote their limited resources to consideration of these decisions and consequences. Hiring expert consultants to review projects at this point would be a much more effective use of funds than paying for a monitor without hiring/firing/contracting responsibilities and authority.

### **Additional Concerns**

1. AARP is concerned that the proposal to base the need for such extraordinary recoveries on the average capital expenditure of the last five years allows the utility to "game" the baseline

so as to justify the extraordinary rates. A higher-than-needed period of investment will support a larger IIP, and so forth.

2. The proposed new rules fail to define the benefits and costs established for the required benefit-cost study. AARP believes an unbiased and credible cost benefit study should be done prior to moving forward on proposed new rules or any other regulatory initiative.

Some in the industry suggest that reduced usage per customer and for electric utilities in particular, creates a one-sided regulatory lag. Whether this is accurate is an empirical question the answer to which varies over time. In the future there will be new uses of energy that may increase throughput in a societally desirable way. Indeed, new uses of electricity right around the corner may dramatically increase throughput – electric cars are the most notable example. Now is not the time to retreat even further from time-proven tools of regulatory oversight and balancing the concerns of customers and utilities

Few government agencies affect consumers' lives as thoroughly as the Commissions and Boards that regulate utility services. For the reasons state above, AARP urges the Board to reject PRN 2017-164.

Thank you for your careful consideration of AARP's comments. If you have any questions or would like additional information please do not hesitate to contact me at [eliebman@aarp.org](mailto:eliebman@aarp.org).

Sincerely,

Evelyn Liebman  
Director of Advocacy, AARP NJ

Cc: NJ Governor Chris Christie  
NJ BPU President Richard Mroz  
NJ BPU Commissioner Joseph L. Fiordaliso  
NJ BPU Commissioner Mary-Anna Holden  
NJ BPU Commissioner Dianne Solomon  
NJ BPU Commissioner Upendra Chivukula  
NJ Division of Rate Counsel Director Stefanie Brand

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