**STATE OF NEW JERSEY**
**BOARD OF PUBLIC UTILITIES**

| | | |
|---|---|---|
| **IN THE MATTER OF THE PETITION OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY FOR APPROVAL OF ITS CLEAN ENERGY FUTURE-ENERGY CLOUD ("CEF-EC") PROGRAM ON A REGULATED BASIS** | **)** | **BPU DOCKET NO. EO18101115** |

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**DIRECT TESTIMONY OF**

# DAVID E. PETERSON

**ON BEHALF OF THE**
**DIVISION OF RATE COUNSEL**

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**FILED: AUGUST 31, 2020**

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# I. INTRODUCTION

**Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.**

A. My name is David E. Peterson. I am the President of and a Senior Consultant with Chesapeake Regulatory Consultants, Inc. ("CRC"). My business address is 10351 Southern Maryland Blvd., Suite 202, Dunkirk, Maryland 20754.

**Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE IN THE PUBLIC UTILITY FIELD?**

A. I graduated with a Bachelor of Science degree in Economics from South Dakota State University in May of 1977. In 1983, I received a master's degree in Business Administration from the University of South Dakota. My graduate program included accounting and public utility courses at the University of Maryland.

In September 1977, I joined the Staff of the Fixed Utilities Division of the South Dakota Public Utilities Commission as a rate analyst. My responsibilities at the South Dakota Commission included analyzing and testifying on ratemaking matters arising in rate proceedings involving electric, gas and telephone utilities.

Since leaving the South Dakota Commission in 1980, I have continued performing cost of service and revenue requirement analyses as a consultant. In December 1980, I joined the public utility consulting firm of Hess & Lim, Inc. I remained with that firm until August 1991, when I joined CRC. Over the years, I have analyzed filings by electric, natural gas, propane, telephone, water, wastewater, and steam utilities in connection with utility rate and certificate

proceedings before federal and state regulatory commissions. A copy of my curriculum vitae is provided in Appendix A attached to my testimony.

**Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN PUBLIC UTILITY RATE PROCEEDINGS?**

A. Yes. I have presented testimony in 174 other proceedings before the state regulatory commissions in Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Indiana, Kansas, Maine, Maryland, Montana, Nevada, New Jersey, New Mexico, New York, Pennsylvania, South Dakota, West Virginia, and Wyoming, and before the Federal Energy Regulatory Commission. Collectively, my testimonies have addressed the following topics: the appropriate test year, rate base, revenues, expenses, depreciation, taxes, capital structure, capital costs, rate of return, cost allocation, rate design, life-cycle analyses, affiliate transactions, mergers, acquisitions, and cost-tracking procedures.

In addition, I testified twice before the Energy Subcommittee of the Delaware House of Representatives on the issues of consolidated tax savings and tax normalization. Also, I have presented seminars on public utility regulation, revenues requirements, cost allocation, rate design, consolidated tax savings, income tax normalization and other ratemaking issues to the Delaware Public Service Commission, to the Commissioners and Staff of the Washington Utilities and Transportation Commission, and to the Colorado Office of Consumer Counsel.

**Q. HAVE YOU TESTIFIED IN OTHER PROCEEDINGS BEFORE THE NEW JERSEY BOARD OF PUBLIC UTILITIES ("BOARD")?**

A. Yes, I have. I have submitted testimony in the following proceedings before the Board:

| Utility | Docket No. |
|---|---|
| South Jersey Gas Company | GR8704329 |
| | GR03050413 |
| | GR03080683 |
| | GR10010035 |
| New Jersey-American Water Company | WR88070639 |
| | WR91081399J |
| | WR92090906J |
| | WR94030059 |
| | WR95040165 |
| | WR98010015 |
| | WR03070511 |
| | WR06030257 |
| | WR17090985 |
| | WR1912516 |
| ACE/Delmarva Merger | EM97020103 |
| Atlantic City Electric Company | ER03020110 |
| | ER11080469 |
| | ER17030308 |
| | ER18020196 |
| FirstEnergy/GPU Merger (JCP&L) | EM00110870 |
| Jersey Central Power & Light | ER02080506 |
| | ER05121018 |
| | ER12111052 |
| | EM14060581 |
| | EM15060733 |
| | ER18070728 |
| Rockland Electric Company | ER02100724 |
| | ER06060483 |
| | ER09080668 |
| | ER19050552 |
| Public Service Electric and Gas | EM00040253 |
| | GR09050422 |
| | GO12030188 |
| Exelon/PSE&G Merger | EM05020106 |
| Exelon/Pepco Holdings Merger | EM14060581 |

| | |
|---|---|
| Conectiv/Pepco Merger (ACE) | EM01050308 |
| Elizabethtown Gas Company | GR02040245 |
| | GR09030195 |
| The Southern Company/AGL Resources | GM15101196 |
| United Water New Jersey, Inc. | WR07020135 |
| United Water Toms River | WR15020269 |
| New Jersey Natural Gas Company | GR07110889 |

**Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

A. My appearance in this proceeding is on behalf of the Division of Rate Counsel ("Rate Counsel").

## II. SUMMARY

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

A. I was asked by Rate Counsel to review and analyze the Petition, Testimonies and Schedules filed by Public Service Electric and Gas Company ("PSE&G" or "the Company") concerning its requests for the recovery of costs associated with its proposed Clean Energy Future – Energy Cloud ("CEF-EC") Program and the rate design it proposes to implement to recover such costs. The purpose of my testimony, therefore, is to present the results of my analyses and my recommendations relating to certain of PSE&G's revenue requirement and rate design proposals to Your Honor and the Board.

**Q. BEFORE YOU DISCUSS YOUR FINDINGS AND RECOMMENDATIONS, PLEASE PROVIDE A VERY BRIEF OVERVIEW ON PSE&G'S PROPOSALS IN THIS PROCEEDING.**

A. On April 1, 2020, PSE&G filed an Updated Verified Petition seeking the Board's approval of the Company's CEF-EC Program that specifically includes advanced metering infrastructure ("AMI"). PSE&G's proposed CEF-EC Program consists of the Company's deployment of 2.2 million AMI "smart" meters throughout its electric service territory over a five-year period, 2021 through 2025.[1] During this five-year period, PSE&G projects spending $714 million in capital costs and an additional $71 million in operating and maintenance ("O&M") expenses on the AMI deployment.[2] The Company proposes to begin recovering its investment related costs through semi-annual filings, subject to an earnings test and a prudence review, beginning in December of 2021.[3] PSE&G proposes that its CEF-EC Program related costs be recovered from its customers though increases in the monthly service charge.

In addition, PSE&G is requesting Board approval for the deferral and subsequent recovery of the $216 million undepreciated, "stranded" costs of the legacy meters that will be retired and replaced by the AMI meters. The Company proposes to accumulate the stranded meter costs in a regulatory asset account, without interest, until its next base rate case wherein it will begin to amortize the accumulated deferred asset balance over a five-year period.[4]

Similarly, PSE&G is requesting Board approval for the deferral and subsequent recovery of and an incremental $71 million of O&M expenses projected to be

[1] Updated Petition, page 9.
[2] Updated Petition, pages 4-5.
[3] Updated Petition, pages 12-13.
[4] Updated Petition, page 15.

incurred in connection with the proposed five-year AMI deployment. PSE&G proposes to defer its incremental AMI-related O&M expenses in a regulatory asset account, accumulate interest on the deferred balance, and recover the accumulated deferred balance plus interest over a five-year period beginning with its next base rate case. PSE&G proposes that the carrying charge on the deferred O&M expenses be set at the 7-year U.S. Treasuries rate plus sixty basis points.[5]

PSE&G claims that its proposed cost recovery mechanism for the CEF-EC Program is consistent with the Boards Infrastructure Investment Program ("IIP") regulations.[6]

**Q. WHAT IS YOUR GENERAL KNOWLEDGE OF THE BOARD'S IIP REGULATIONS?**

A. My understanding is the Board's IIP regulation N.J.A.C. §14:3-2A allows utilities accelerated cost recovery for qualifying projects to the extent they exceed the utility's "baseline" spending for utility plant and facilities that are designed to enhance safety, reliability, and/or resiliency. While utilities may request accelerated cost recovery on either an annual or semi-annual basis, qualifying IIP projects must be in-service before new rates are implemented. Each IIP request also must seek recovery for at least 10 percent of the overall program costs. IIP costs are to be recovered through a special rate rider and will include a return allowance on net investment in qualifying projects and an allowance for depreciation. The utility must also pass an earnings test before receiving accelerated cost recovery under the IIP. IIP rates are provisional and subject to refund, however, in that prudence for IIP projects will be examined in the context of future base rate proceedings.

[5] Updated Petition, page 15.
[6] Updated Petition, page 12.

**Q. PLEASE BRIEFLY SUMMARIZE THE ISSUES THAT YOU ADDRESS IN YOUR TESTIMONY AND YOUR RECOMMENDATIONS ON THOSE ISSUES.**

A. My testimony addresses some of the proposals made by PSE&G's witnesses Donna Powell and Stephen Swetz. On behalf of PSE&G, Ms. Powell seeks the Board's authorization to defer $216 million of undepreciated, "stranded" costs of the legacy meters that will be retired and replaced by the AMI meters. Ms. Powell proposes to accumulate the stranded meter costs in a regulatory asset account, without interest, until PSE&G's next base rate case wherein the Company will begin to amortize the accumulated deferred asset balance in rates over a five-year period.

Further, Ms. Powell seeks the Board's authorization for PSE&G to defer the projected $71 million of O&M expenses it expects to incur over the five-year AMI deployment period. Ms. Powell proposes that PSE&G defer its incremental AMI-related O&M expenses into a regulatory asset account, accumulate interest on the deferred balance, and recover the accumulated deferred balance plus interest over a five-year period beginning with its next base rate case. The carrying charge on the O&M expense deferral that Ms. Powell proposes is the 7-year U.S. Treasuries rate plus sixty basis points.

For reasons more fully explained later in my testimony, I oppose Ms. Powell's requests for deferred accounting treatment and subsequent deferred cost recovery in rates for both the stranded investment costs and the AMI-related O&M expenses and recommend that the Board reject both requests.

Concerning Mr. Swetz's rate design testimony, I oppose his plan to collect AMI revenue requirements by increasing only the monthly service charge. Instead, I

recommend that any approved AMI revenue requirement be collected from rate payers by increasing all charges (i.e., monthly customer charge, kWh charge, and demand charge, where appropriate) within the rate class by a uniform percentage amount.

The bases for my conclusions and recommendations follow.

## III. DEFERRED COST ACCOUNTING

**Q. WHAT ARE MS. POWELL'S PROPOSALS CONCERNING DEFERRED COST ACCOUNTING?**

A. Ms. Powell is requesting the Board's authorization to defer two categories of costs associated with its CEF-EC Program including the deferral of certain stranded costs that will result when the AMI meters replace the legacy meters and the deferral of incremental O&M expenses incurred during the AMI deployment process.

**Q. PLEASE EXPLAIN HOW STRANDED COSTS WILL ARISE IN CONNECTION WITH THE PROPOSED AMI DEPLOYMENT.**

A. In her Direct Testimony, Ms. Powell provides a detailed explanation of the accounting process that will give rise to stranded costs. Essentially, when PSE&G installs the 2.2 million AMI meters, the legacy meters will be removed from service. At the same time, accounting guidelines require that the original cost of the legacy meters be removed from the plant in service account and that accumulated depreciation on the legacy meters be removed from the reserve account. Since both the plant in service and the depreciation reserve accounts are included in PSE&G's rate base determination, the accounting removal process I just described will leave the undepreciated book value of the legacy meters

stranded because the undepreciated book value is no longer included in rate base. It is this stranded, undepreciated book value that Ms. Powell requests be deferred into a regulatory asset account and recovered in rates over a five-year period beginning with PSE&G's next base rate case.

**Q. SHOULD MS. POWELL'S REQUEST FOR DEFERRED ACCOUNTING TREATMENT FOR STRANDED COSTS BE APPROVED?**

A. No, it should not. Doing so would disrupt the fundamental regulatory balance between the separate roles of investors and utility customers. The proper regulatory balance is as follows. Investors, both debt and equity investors, put up the capital required to fund plant and equipment necessary for the utility to meet its service obligations to utility customers. In exchange, regulators authorize a return on investment for all plant and equipment that is used and useful to utility customers. Because there are risks that not all investments result in used and useful plant serving ratepayers, regulators authorize rates of return that exceed a pure risk-free interest rate to compensate investors for investment-related risks, including stranded costs. To allow stranded cost recovery for plant that is no longer used and useful and, therefore, not beneficial to utility customers, upsets the regulatory balance by shifting all of the cost recovery burden to ratepayers when investors already have been receiving compensation for investment risk throughout the useful life of the legacy meters through the Board's previously authorized return allowances in base rate proceedings.

Moreover, approval of Ms. Powell's request for deferred accounting treatment for stranded costs is inappropriate because, under Ms. Powell's proposal, PSE&G ultimately will recover more than its stranded costs. Once the legacy meters are prematurely retired, the associated undepreciated book value will be added to the deferred asset account. At that same time, depreciation expense on PSE&G's

financial statements also will cease for those retired assets. Yet, because there is no corresponding proposal to reduce base rates to reflect the retirement of these assets, i.e., by reducing rate base and reducing depreciation expense, PSE&G's ratepayers will continue to pay rates reflecting the costs of the retired legacy meters. This continued cost recovery will go on until PSE&G's next base rate case where a new rate base determination will be made. Consequently, PSE&G's ratepayers will continue to pay a return on and a depreciation expense associated with the legacy meters that are retired even though the full value of the undepreciated stranded cost will be transferred to the deferred asset account for recovery in rates, again, over the five years following PSE&G's next base rate case. The longer PSE&G delays its next base rate case, the greater the double-counting will be.

Finally, I object to Ms. Powell's stranded cost recovery proposal because it is not provided for in the Board's IIP regulations. Keep in mind that PSE&G claims its CEF-EC Program involving the deployment of 2.2 million AMI meters is consistent with the Board's IIP regulations.[7] Yet, the deferral and recovery of stranded costs, either now or in the next base rate case, is not mentioned anywhere in the IIP regulations. Had the Board wanted to include stranded cost recovery within the IIP, it certainly could have chosen to do so. But, the IIP regulations were clearly written to provide for accelerated investment cost recovery only for qualifying plant and equipment, without stranded cost recovery.

**Q. IF, DESPITE YOUR RECOMMENDATION, THE BOARD APPROVES SOME FORM OF STRANDED COST RECOVERY, WHAT CHANGES TO MS. POWELL'S PROPOSAL DO YOU RECOMMEND**?

[7] Updated Petition, page 12.

A. PSE&G stated that the average remaining book life for the legacy meters is 8.55 years.[8] Thus, without a premature retirement, the remaining book value of the legacy meters would have been fully recovered in rates, on average, over the next 8.55 years. Therefore, an 8.55-year amortization more closely matches the cost recovery period currently embedded in rates for the assets that will be retired. Consequently, I recommend that if any stranded cost recovery is permitted, the amortization period be set at 8.55 years rather than five years, as Ms. Powell proposed. In addition, before starting to amortize the deferred amounts in rates, the deferred balance should be adjusted to reflect the fact that PSE&G customers continued to pay a return on and a depreciation expense on the legacy meters after they were retired from service, yet prior to when the rate base reduction was recognized in a base rate proceeding. In his Direct Testimony, Mr. Alvarez provides additional reasons why recovering stranded costs from the legacy meters is not appropriate.

**Q. ARE YOU ALSO OPPOSED TO MS. POWELL'S REQUEST FOR DEFERRED ACCOUNTING TREATMENT FOR O&M EXPENSES INCURRED IN CONNECTION WITH THE PLANNED AMI DEPLOYMENT?**

A. Yes, I am. My objection is essentially the same as one of my objections to stranded cost deferral. Deferring incremental O&M expenses incurred under an IIP is not provided for in the Board's IIP regulations. In drafting its IIP regulations, the Board certainly would have contemplated that the utility will incur incremental expenses associated with its IIP investments. Yet, the IIP regulations do not include provisions for recovery of related incremental O&M expenses, either concurrent with investment related IIP costs or in the future through a deferral of such costs. The Board could have included incremental

[8] PSE&G's response to RCR-A-0008.

O&M expenses in its IIP regulations but chose not to. Rather, the clear intention of the Board's IIP regulations is to provide limited accelerated cost recovery for qualifying projects wherein only investment related costs (i.e., return of and a return on investment) are eligible for accelerated rate treatment. All other costs, including incremental O&M expenses, are to be addressed within a general base rate proceeding. Thus, if the incremental O&M expenses have a significantly detrimental impact on PSE&G's earnings, that deficiency can be addressed by PSE&G filing a base rate case.

## IV. RATE DESIGN

**Q. WHAT RATE DESIGN IS MR. SWETZ PROPOSING TO RECOVER APPROVED CEF-EC PROGRAM COSTS?**

A. The meters to be replaced as part of the CEF-EC Program are for the RS, RLM, and GLP rate classes. Since GLP meters are more expensive to purchase and to install than are residential meters, Mr. Swetz proposes to allocate to each rate class PSE&G's CEF-EC Program costs on a weighted average cost basis. Once the costs are appropriately allocated to each rate class Mr. Swetz proposes to collect the class revenue responsibility by increasing the monthly service charge in each rate class.

**Q. DO YOU AGREE WITH THIS APPROACH?**

A. No, not entirely. I agree that it is appropriate to allocate AMI meter related investment costs on a weighted average cost basis, as Mr. Swetz proposed. I do not agree, however, with Mr. Swetz's proposal to collect the entire class revenue responsibility for the approved AMI investment related costs by increasing the monthly service charge in each rate class.

**Q. WHY NOT?**

A. Mr. Swetz is correct in noting that the AMI investment costs will be classified to the Customer Access cost function for class cost of service purposes. It does not necessarily follow, however, that all costs classified to the Customer Access cost function should be recovered from PSE&G's customers through the monthly service charge.

PSE&G's current monthly service charges in the various rate classes are based, in part, on the cost of the existing stock of non-AMI meters. These meters were adequate to make service available and to record periodic consumption, which is what is reflected in the current monthly service charges. The function of AMI meters, however, goes far beyond mere service availability and periodic consumption recording. PSE&G claims that as part of the Board's IIP, its AMI deployment program is intended to enhance safety, reliability and/or resiliency of PSE&G's distribution system. If this claim is accurate, the benefits of AMI will be realized throughout all PSE&G's cost functions, not only the Customer Access function. Therefore, it is appropriate to recover AMI-related costs in rate class energy and demand charges as well at the customer service charge. Accordingly, after the appropriate weighting of meter investment costs among rate classes is completed, I recommend the Board require PSE&G to collect class IIP approved revenue requirements by increasing the energy, customer service and where appropriate demand charges by an equal percentage.

**Q. DOES THIS COMPLETE YOUR TESTIMONY AT THIS TIME?**

A. Yes, it does.

# APPENDIX

# STATEMENT OF EDUCATION AND EXPERIENCE
# FOR
# DAVID E. PETERSON

President and Senior Consultant
Chesapeake Regulatory Consultants, Inc.
10351 Southern Maryland Blvd. Suite 202
Dunkirk, Maryland 20754-9500
410.286.0503

Email: davep@chesapeake.net

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Mr. Peterson is employed as a public utility rate consultant by Chesapeake Regulatory Consultants, Inc. Mr. Peterson has over forty-two years of experience analyzing regulated public utility ratemaking and service matters including three years as a member of a state regulatory commission staff and thirty-nine years as a consultant. Mr. Peterson specializes in utility revenue requirement and cost of service analyses. He has presented testimony in more than 170 proceedings before twenty state regulatory commissions, the Delaware House Energy Subcommittee, and the Federal Energy Regulatory Commission. Utilities addressed in Mr. Peterson's analyses and testimonies have included electric, natural gas, propane, telephone, water, steam and sewer companies.

## EMPLOYMENT

| | |
|---|---|
| 1991 - Present | Senior Consultant<br>Chesapeake Regulatory Consultants, Inc.<br>Annapolis, Maryland |
| 1980 - 1991 | Consultant<br>Hess & Lim, Inc.<br>Greenbelt, Maryland |
| 1977 - 1980 | Rate Analyst<br>South Dakota Public Utilities Commission<br>Pierre, South Dakota |
| 1977 | Research Assistant<br>Economics Department<br>South Dakota State University<br>Brookings, South Dakota |

As a rate analyst and consultant, Mr. Peterson has served a diverse group of public utility consumers and governmental agencies on utility ratemaking and service-related issues. Clients have included state regulatory commissions and their staffs, consumer advocate agencies of state governments, federal agencies, municipalities, privately owned, municipally owned and cooperatively owned utilities, civic organizations, and industrial consumers.

## EDUCATION

| | |
|---|---|
| December 1983 | Master of Business Administration<br>University of South Dakota<br>Vermillion, South Dakota |
| May 1977 | Bachelor of Science Degree in Economics<br>South Dakota State University<br>Brookings, South Dakota |

## EXPERT TESTIMONY

Among the issues that Mr. Peterson has addressed in testimony are the appropriate test year, construction work in progress, cash working capital lead/lag studies, rate base, excess capacity, revenues, expenses, depreciation, income taxes, capital structure, rate of return, cost allocation, rate design, customer service charges, flexible rates, life-cycle analyses, cost tracking procedures, affiliate transactions, mergers, acquisitions and the consequences of industry restructuring. Mr. Peterson has presented testimony to the following regulatory bodies.

Alabama Public Service Commission
Arkansas Public Service Commission
California Public Utilities Commission
Colorado Public Utilities Commission
Connecticut Public Utilities Control Authority

Delaware Public Service Commission
Indiana Public Service Commission
Kansas State Corporation Commission
Maine Public Utilities Commission
Maryland Public Service Commission

Montana Public Service Commission
Nevada Public Service Commission
New Jersey Board of Public Utilities
New Mexico Public Service Commission
New York Dept. of Environmental Protection

New York Public Service Commission
Pennsylvania Public Utility Commission
South Dakota Public Utilities Commission
West Virginia Public Service Commission
Wyoming Public Service Commission

Delaware House of Representatives (Energy Subcommittee)
Federal Energy Regulatory Commission

In addition, Mr. Peterson has presented several utility training seminars, including the following:

Consolidated Tax Savings and Income Tax Normalization
Presented to Delaware Public Service Commission 2006

Public Utility Ratemaking Principles
Presented to Washington Utilities and Transportation Commission 2011

Electric Cost Allocation and Rate Design
Presented to Colorado Office of Consumer Counsel 2012

Public Utility Revenue Requirements
Presented to Delaware Public Service Commission 2012

Electric Cost Allocation and Rate Design
Presented to Delaware Public Service Commission 2013

# RELEVANT DISCOVERY RESPONSE

Public Service Electric and Gas Company
Case Name: CEF-EC
Docket No(s): EO18101115

Response to Discovery Request: RCR-A-0008
Date of Response: 5/7/2020
Witness: Powell, Donna
Depreciation Rates and Annual Depreciation Expense

Question:
Please identify the estimated remaining life of PSE&G's electric meters assuming continuation of current depreciation rates.

Attachments Provided Herewith: 1
Meters Remaining Life Calc.xlsx

Response:
The estimated remaining life of PSE&G's electric meters is 8.55 years. Please see the attached Excel file "Meters Remaining Life Calc.xlsx" for the supporting calculation.