PSEG Nuclear, LLC
ZEC 2 – Salem II
Docket No: ER20080558

Response to Discovery Request: SII-ZECJ-FIN-0020
Date: 10/1/2020

Question:
For Units that participated in the initial eligibility period, to the extent that the applicant has made any changes in the methodology or results related to calculating either (a) the costs of operational risks and market risks or (b) the risk-adjusted cost of capital, please provide an explanation of those changes.

Attachments Provided Herewith: NO

Response:

a) PSEG has not made any changes to the methodology used to calculate the cost of operational risks. The cost of operational risks was estimated at 10% of the total costs in PSEG's application for the initial ZEC eligibility period and is similarly estimated at 10% of the total costs in this application for the second ZEC eligibility period.

   PSEG has not made any changes to the methodology used to calculate the cost of market risks, other than adding an uncertainty factor for capacity market revenues. The reason for this change is that PSEG Power now bears capacity price risk for the energy years 2022/2023 through 2024/2025, given that PJM has yet to hold capacity Base Residual Auctions (BRA) for these energy years. By comparison, all of the PJM capacity Base Residual Auctions had already happened when PSEG applied for the initial ZEC eligibility period.

b) In PSEG's application for the initial eligibility period, PSEG indicated that PSEG was choosing not to use a risk-adjusted cost of capital in the application. However, PSEG provided its cost of capital and the associated calculation in the initial application in response to question GAIO-0020. In this application, PSEG has provided an updated view of its cost of capital in response to questions ZECJ-FIN-08 and ZECJ-FIN-19. The methodology is the same as was used in the initial application, with the exception that a size risk premium was added to derive the cost of equity to address the diminished size of PSEG Power's business, as measured by estimated equity value. The use of a size risk premium in the determination of cost of equity is a well-accepted practice for entities of relatively small size. The cost of capital reflects the addition of this adder as well as an update to the other inputs to the calculation. See responses to questions ZECJ-FIN-08 and ZECJ-FIN-19 for the specific inputs.