COMMENTS OF THE NEW JERSEY LARGE ENERGY USERS COALITION REGARDING THE BPU'S PROPOSED UTILITY INFRASTRUCTURE PROGRAM AND RATE SUSPENSION STRAW PROPOSALS

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The New Jersey Large Energy Users Coalition ("NJLEUC") files these comments in response to the Board's "Announcement of Stakeholder Processes" regarding the Board's utility infrastructure program and rate suspension proposals.

I. General Comments

As a preliminary matter, NJLEUC must express its surprise and deep concern that these proposals -- which would significantly reduce the scope and frequency of utility rate reviews -- emanate from the Board itself. If adopted, both the infrastructure and rate proposals would undermine fundamental, century-old ratepayer protections that are the hallmark of the Public Utility Law, N.J.S.A. 48:2-1 *et seq*. While increased reliance on clause mechanisms may or may not foster utility infrastructure projects, the programs volunteered by the Board surely will erode the Board's regulatory authority over the State's public utilities to the ultimate detriment of ratepayers.

NJLEUC has repeatedly expressed its concerns regarding over-reliance on clause mechanisms to recover utility infrastructure project costs. Repeated authorizations of clause-based recovery mechanisms will place substantial capital investments outside both the utility's rate base and the traditional ratemaking process. Individualized rate clauses represent a textbook example of single-issue ratemaking, a long-disfavored approach whose narrow focus fails to consider the many rate components and other financial and operational considerations that contribute to the development of just and reasonable rates. As a result, rate clause mechanisms inevitably impose "one-way ratchets" under which utility rates only ratchet upward, never downward.

The proposed infrastructure program would greatly expand, without limit, the already extensive class of utility assets that are developed through clause mechanisms rather than additions to rate base. Inevitably, more utilities will opt for the safe harbor of a clause mechanism's minimal prior review process rather than risk the full-blown regulatory scrutiny that precedes additions to rate base. This, in turn, will lead inexorably to the situation that is rapidly approaching for some utilities: these safe harbor assets actually exceed those included in rate base.

No immediate or compelling policy reasons justify the proposed infrastructure development and ratemaking programs. Indeed, the utility infrastructure programs developed to date have been indulgently treated by the Board and all stakeholders, with investments totaling several billions of dollars having been authorized since 2009. Given these significant investments, and the absence of emergent circumstances such as a major storm event or economic downturn, NJLEUC questions the need for the regulatory blank check that the

proposed infrastructure program would offer to the utilities. As discussed below, the same question can be posed regarding the Board's provisional rate proposal, as most utility rate cases settle promptly when the utility provides actual data in a timely manner. Thus viewed, the Board's proposals represent solutions in search of problems.

There should be no question, however, that the proposed utility investment and rate programs would diminish the Board's regulatory authority over utility assets and rates. State administrative agencies like the Board normally guard this core regulatory authority jealously, particularly at a time when the jurisdictional boundary lines between the Board, FERC and PJM have become increasingly blurred and pre-emption issues have become commonplace. By advancing these proposals, however, the Board has signaled a willingness to voluntarily abdicate, rather than zealously defend, its regulatory authority over the State's utilities. That regulatory authority has been consistently described by our courts as "broad", a product of the Legislature's "sweeping grant of power to the Board (which was) intended to delegate the widest range of regulatory power over utilities to the Board." *See*, Matter of Valley Road Sewerage Company, 154 N.J. 224 (1998). Ratepayers have come to rely on the Board's broad review powers to constrain utility rates to just and reasonable levels. The pending proposals, however, would erode this broad authority, so the Board's willingness to propose, let alone consider, such proposals is of concern to those who depend on the Board's diligent adherence to its statutory obligations.

In a word, the infrastructure proposal is too high a price to pay if its sole purpose is to enhance administrative efficiency in addressing infrastructure issues. If there is a larger, unstated purpose behind this exercise, it should be revealed and addressed in an appropriate stakeholder proceeding, rather than adopting, in summary fashion, a regime that authorizes an open-ended, multi-billion dollar utility spending spree subject only to light-handed regulation. Similarly, while rate cases are admittedly a significant undertaking for all involved, they are worth the effort from a ratepayer protection perspective, particularly if the alternative is single issue ratemaking or new, unwelcome "hurry up" rules that short-change ratepayers and force them to act as low-cost lenders to the utilities. Because no stated justification has been offered for these dubious measures, it remains uncertain why they are necessary and appropriate, or how they are calculated to result in just and reasonable rates.

One final general concern. NJLEUC objects to the process afforded to stakeholders to review and comment on the Board's proposals. The proposals emerged without prior notice or explanation and stakeholders have been afforded an extremely abbreviated period in which to offer oral and written comments. One stakeholder meeting was not attended by any Commissioner and the second by only a single Commissioner. No court reporter attended either session. Members of the Board's staff did not participate in any discussion of the proposals and merely took notes of the stakeholder comments. Beyond the brief time provided for oral and written comments, it is unclear what, if any, further process will occur after the written comments are received by the Board.

Considering the potential magnitude of the proposed programs, their dramatic departure from past regulatory practices, and impact on the Board's regulatory jurisdiction and customer rates, considerably more input should be afforded to all interested parties in an expanded stakeholder or rulemaking process that must be meaningful and fully transparent. As it now

stands, the expedited process thus far adopted by the Board denies stakeholders their due process rights and is therefore subject to challenge.

II. Specific Comments Regarding the Utility Infrastructure Proposal

NJLEUC adopts by reference the expansive comments offered by Rate Counsel at the stakeholder hearing. There are three particular areas of concern for which NJLEUC provides additional comment.

First, the size of the infrastructure program appears to be unlimited in scope and must be restricted in the manner described below. Since 2009, several billions of dollars of utility infrastructure proposals have been approved by the Board and stakeholders, who have been reliably receptive to necessary and prudent improvements to the State's energy infrastructure. Given the long history of significant infrastructure investment, there is no need to provide an open-ended, blanket authorization to utilities to pursue additional programs that may not be essential or prudent. Rather, future proposals must remain subject to appropriate regulatory scrutiny to require utilities to demonstrate that their future proposals are similarly necessary and prudent and that their chosen method of cost recovery is just and reasonable.

As noted, some utilities are approaching the point where more of their assets are held outside of rate base than within it. This should be a matter of concern to the Board, because this reduces the Board's authority over these assets and because alternative cost recovery mechanisms are inevitably included in utility infrastructure proposals. It is by no means clear that alternative cost recovery mechanisms are necessary or appropriate for utility infrastructure proposals, as they can provide an unwarranted incentive to pursue utility infrastructure projects that may not be necessary or prudent. Therefore, NJLEUC opposes that portion of the proposal that would permit accelerated cost recovery through a surcharge mechanism.

The Board's infrastructure proposal states that the maximum annual increase in rates attributable to an infrastructure program will be limited to two percent. This language is vague as it is unclear whether the increase would be tied solely to the utility's distribution rate or to the entire customer bill. It is critical that the maximum annual rate increase be tied to the utility distribution rate. To adopt the "whole bill" approach, which would include all supply charges, clause mechanisms and other costs and assessments within the cap, would open the floodgates to many billions of dollars of unconstrained utility investments. It is inconceivable that this is the Board's intention.

In addition to limiting annual rate increases attributable to infrastructure investment to no more than 2% of utility distribution costs, the Board should impose an additional requirement that at all times, more than half of a utility's infrastructure investment must be included in the utility's rate base.

Finally, NJLEUC adamantly opposes the proposal to permit utilities to wait up to five years after approval of an infrastructure program before undergoing prudence review in the context of a base rate case. If this proposal were to be adopted, it would provide the utilities a license to potentially over-recover their authorized rate of return for an extended period of time,

for the first time with the Board's imprimatur. From both a legal and ratemaking perspective, the proposal must be rejected.

When utilities fail to recover sufficient revenues to enable them to earn their authorized return, they have every incentive to seek additional revenues through a base rate case. Conversely, when utilities over-earn their authorized rate of return, they obviously have little incentive to bring a base rate case. The Board's infrastructure proposal enhances the likelihood that a participating utility will over-earn its authorized return due to the use of clause mechanisms that are approved without regard to either the overall financial condition of the utility or whether the utility is over-earning when the infrastructure program is approved. The proposed provision could permit a utility that is already over-earning to continue to do so for another five long years without obligation to bring a base rate case or risk of being compelled to do so.

It was the need to address the concerns associated with interim rates and clause mechanisms that "temporarily bypass the establishment of rate base and fair rate of return" that caused the Board and our courts to require the establishment of a "legal umbilical cord which ties them to the anticipated eventual determination of these fundamentals" in a base rate case. I/M/O Matter of Proposed Increased Intrastate Industrial Sand Rates by the Central Railroad Company of New Jersey, 66 N.J. 12, 25 (1974). *Industrial Sand* established the principle that interim rate mechanisms must be closely tied to base rate cases to insure that utility rates are ultimately determined in a manner consistent with the Legislature's delegation of the rate-making power to the Board.

The Board memorialized this long-held principle in the rules pertaining to water utilities at N.J.A.C. 14:9-7.3 as follows:

> (c) No initial purchased water adjustment clause shall be approved unless a water utility, with the prior three years, has had its base rates set by the Board in a decision and order which established base level data against which the new cost of purchased water can be measured...

This rule provided the basis for the Board's determination in I/M/O the Application of Shorelands Water Company for a Waiver or Relaxation of Certain Board Rules at N.J.A.C. 14:9-7.3(a)(2) Related to the Filing of a Purchased Water Adjustment Clause, BPU Docket No. WO09020145, Order dated May 15, 2009, to grant an application for relaxation of the time limitations of the rule to allow the utility to file a petition for a PWAC. The Board stated the following:

> ...Shorelands must have its rates tested in an appropriate rate-making procedure. Although Shorelands is not within the three year time frame provided in the rules to establish a link between a base rate case and the proposed PWAC filing. Shorelands has agreed to file a base rate case within two years of a final PWAC Board Order so that a "nexus" is established. One of the main purposes of the three year requirement in the PWAC rules is to link

> the interim rates of the PWAC to a base rate case so that, ultimately, the PWAC rates are reviewed in the context of a base rate proceeding which creates a legal "nexus".

(May 15, 2009 Order at 3).

The "umbilical cord" or "nexus" requirement was described by our Supreme Court in constitutional terms, rooted in a system of rate regulation and the establishment of rates "related to constitutional principles which no legislative or judicial body may overlook". Industrial Sand, *supra* at 23. The Supreme Court observed that timely rate cases were essential to assure that a utility receive fair value for the property included in rate base and the public to protection against unreasonable rates. *Id* at 22.

The "umbilical cord" requirement, recognized by our highest court to be of constitutional dimension, requires rejection of the proposed five-year "stay out" period following approval of a utility infrastructure program. The five-year period is improper because it unduly attenuates and prolongs the eventual determination of the justness and reasonableness of rates established on an interim basis. After five years, the evidence relevant to a prudency determination becomes stale. More fundamentally, however, the Board's approval of a five-year stay out will provide a license to utilities to potentially over-recover their allowed return for an extended period of time, without concern that they could be compelled to file a rate case that would reveal the over-recovery during that period. The last time a utility -- JCP&L-- was compelled to bring a rate case, the suspicions that the utility had for years been over-earning were confirmed. Thus, the potential harm to ratepayers is a real concern and should militate against adoption of the five year stay out period. The Board should continue to adhere to the three year umbilical cord period.

As noted above, NJLEUC joins in the Comments of Rate Counsel with regard to the remaining elements of the Board's infrastructure proposal.

III. Specific Comments Regarding the Provisional Rate Proposal

The Board's second set of proposals address possible regulations and filing requirements concerning "implementation of provisional base rates during the pendency of a rate case matter." Here again, NJLEUC finds itself in complete agreement with Rate Counsel. The Board's suggested "provisional rates" option represents an unnecessary solution in search of a nonexistent problem.

Rather than laying out circumstances that might justify its proposed approach, the Board's proposal inadvertently highlights the complete absence of such justification. The Board readily concedes that (i) most rate cases have been resolved within the existing eight-month suspension period, (ii) utilities already may implement their proposed rates once the suspension period has run, and (iii) utilities "rarely" avail themselves of this option. Presumably, were utilities experiencing financial prejudice from suspension of proposed rate increases, they would move with alacrity to implement those increases at the first possible moment; they have not done

so. Viewed in the light of its own observations and utility conduct to date, the Board's ensuing provisional rate proposals beg the obvious question, "Why?"

Aside from lacking a cogent rationale, the Board's provisional rate proposals reflect bad policy that would incentivize utilities to pursue lengthy rate cases at the literal expense of ratepayers. As Rate Counsel noted during the stakeholder hearing, utility rate filings historically have sought rate increases far in excess of what was ultimately approved by the Board, and those proceedings typically have run beyond the eight month suspension period only when utilities initially have relied on a bare three months of actual data to support their proposed rate increases. By inviting utilities to implement provisional rates, the Board would encourage utilities to pursue filing and litigation practices that extend the rate case process far beyond the eight-month suspension period. The prospect of implementing its full proposed rate increase through provisional rates would incent a utility to file for the highest increases possible, based on the least amount of actual data possible, and then to defend that filing through scorched-earth litigation tactics. After eight months, that sky-high rate increase would quickly become an open-ended, forced loan from ratepayers. The Board should discourage, rather than invite, such regulatory gamesmanship.

In addition, the Board's provisional rate proposals would undermine its longstanding policy favoring settlements. Most contested rate cases are resolved through settlements achieved within or close to the eight-month suspension period. These results are made possible by the fact that utilities and other rate case participants meet on a relatively level playing field. Neither side has a significant incentive to engage in obstructionist litigation tactics or to delay settlement negotiations. The Board's provisional rate proposals, however, would alter this delicate balance by permitting utilities to inflict massive "temporary" rate increases on ratepayers for an unlimited period of time, thereby substantially enhancing the utilities' negotiating leverage during settlement discussions. Over time, the incremental impact of these provisional cost increases would force ratepayers to accept otherwise unacceptable settlements in order to "get out from under" the weight of provisional rates. Refunds are a hollow victory after the burden of "provisional" rate increases has taken its toll on ratepayers forced to advance large loans to utilities on unduly favorable terms.

If, despite these evident shortcomings, the Board continues to consider its provisional rate proposals, it should modify those proposals to minimize, rather than incentivize, the use of provisional rates. To that end, NJLEUC offers the following modifications:

- A utility may implement provisional rates only if its original rate increase filing contains at least six months of actual data.

- A utility's provisional rate filing may seek to implement no more than 50% of its originally proposed rate increase.

- Any refund of provisional rates should return to ratepayers both the excessive rate paid plus interest at whatever overall rate of return the utility has received in the underlying rate case.

In sum, NJLEUC reiterates its strong opposition to both proposals. They are unnecessary and would result in a significant financial burden to ratepayers while eroding the Board's traditional authority over the State's utilities. These are certainly not proposals that should be advanced by the Board and NJLEUC strongly urges the Board to abandon them.

Respectfully submitted,

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