NEW JERSEY UTILITY SHAREHOLDERS ASSOCIATION

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February 6, 2020

Ms. Aida Camacho-Welch
Secretary of the Board of Public Utilities
44 South Clinton Avenue, 9th Floor
PO Box 350
Trenton, New Jersey 08625-0350

**Re: Cost Recovery Mechanism Comments**

Dear Secretary Camacho-Welch:

I am writing on behalf of the members of the New Jersey Utility Shareholders Association (NJUSA). NJUSA is a not-for-profit association of New Jersey residents who are investors in one or more of the publicly traded entities that have a subsidiary providing essential utility service in New Jersey. Our members choose to join NJUSA to learn more about and advocate with other interested New Jersey utility investors on issues that can affect the value of their investments. NJUSA membership is extended only to individual investors residing in the State; institutional investors are not eligible to be NJUSA members.

NJUSA members come from all regions of the State and from many walks of life. Many NJUSA members are senior citizens who rely on their utility investments to supplement their often limited income in retirement. As New Jersey residents and utility shareholders, NJUSA members are directly invested in New Jersey through their ownership of utility stock—utility shareholders essentially are the owners of the "rate base" assets through which service is provided and upon which a fair return on investment is expected. It is through these investments that utility shareholders make possible the essential electric, gas, water and wastewater utility services upon which New Jersey's health, quality of life and economy depend. It is these same shareholders who, if appropriately incentivized, can help provide the financial wherewithal for New Jersey's electric and gas utilities to make the all-important energy efficiency investments required by the Clean Energy Act of 2018 (CEA).

As shareholders, NJUSA members are often misunderstood to be among the most privileged and wealthy citizens. The truth is, NJUSA members are average New Jerseyans; many, although not all, are senior citizens. Some are former utility employees--retired secretaries, linemen and women, managers, customer service representatives and meter readers, among others. Some never worked for a utility, but have retirement funds in a pension or 401(k) plan that contain utility stocks. Or, as often happens, heard from a family member years ago that utility stocks are a good, stable investment that offer the opportunity to earn a fair return on the dollars invested with the possibility of dividend payments—a potential source of income in later years. Contrary to common perception, utility shareholders are not corporate "fat cats" feeding off the last dollar of others.

As residents, NJUSA members have the same needs for a healthy environment for themselves and their prodigy as all other residents. As utility ratepayers, they also care about the cost and reliability of their utility services. *Unlike other New Jerseyans, however, through utility stock ownership, NJUSA members provide in advance the financial resources necessary for the ongoing provision of safe and reliable utility service.*

The ability of New Jersey's utilities to meet their most fundamental obligation—to provide safe, adequate and proper service—would not be possible without utility shareholders. Utility shareholders are akin to a bank that gives loans. Instead of charging interest for the use of money, like a bank, when utility investors purchase utility shares, they are making cash available for the utility to meet its service obligations. They do so without a guarantee that they will make money on their investment, and without knowing if they are able to earn a return on their investments, how much of a return the Board of Public Utilities (the Board) will allow and whether it will be sufficient to make the investment worthwhile.

It is the potential disruption of this longstanding rate-base/rate-of-return rubric that makes the Energy Efficiency Transition (the Transition) of great interest and, in some respects, great concern, to NJUSA members. While the CEA laudably seeks to stem the effects of climate change, it radically shifts the energy utility regulatory framework in ways that could put shareholder investment at risk. As the Cost Recovery Proposal states:

> *"The CEA calls for a significant overhaul of New Jersey's energy system while growing the economy, building sustainable infrastructure, creating strong local jobs, reducing carbon emissions, and improving public health through a cleaner environment and better air quality."*

The Transition proposals for both EE performance targets and cost recovery appear to overlook or overestimate the critically important role of utility shareholders. The following excerpt from the Cost Recovery Proposal is illustrative:

> *"The proposal is intended to provide an opportunity for stakeholder feedback, with the goal of creating an equitable cost recovery framework that enables the State to reach its ambitious efficiency goals while being protective of ratepayers."*

This excerpt raises concern that the needs of shareholders are not among those to be considered in developing an equitable cost recovery framework. The Board has the obligation to balance the needs of utility shareholders with those of ratepayers in its decisions. However, the assumed reduction in risk upon which the proposed reduction in the ROE of 200 basis points identified in the Cost Recovery Proposal clearly demonstrates that the role of shareholders in making both traditional utility service and energy efficiency program delivery possible is not well understood, or is inadvertently undervalued.

<u>The Role of Utility Shareholders</u>

The choice shareholders make to invest in New Jersey utilities relies on the traditional rate-base/rate-of-return regulatory system, which is predicated on the paradigm that: it is in the public interest to make universal service available; the sizeable capital needed to deliver utility service and the ability to achieve economies of scale support allowing utilities to operate as "natural monopolies" by necessity attracting and relying upon private investment; in the absence of market competition, a regulatory authority (in New Jersey, the Board) sets utility rates taking into account the need for utilities to provide safe, adequate and proper service balancing the needs of ratepayers and shareholders.

It is under this system that NJUSA members choose to hold shares in, for example, New Jersey Resources and/or Public Service Enterprise Group, with the understanding that the capital contributed through their shareholder equity will be available for investment in subsidiary utilities New Jersey Natural Gas or PSE&G's rate base, and on those investments the opportunity to earn a fair rate of return is possible. Under this regulatory system, it follows that the allowed rate of return is a critically important, albeit not exclusive, determinant of whether investment in companies with operating utility subsidiaries makes financial sense. Uncertainty around the economics of utility regulation under the CEA's new and very aggressive mandates that shift the core mission and customer relationships away from selling (delivering) safe and reliable service to helping customers reduce energy use with specific performance targets and penalties, has the potential to put at risk the attractiveness of investments in New Jersey's energy utilities.

All aspects of the Transition, including program administration, cost recovery, performance targets and incentives and penalties must be carefully designed to ensure that the role of utility investors is recognized and rewarded and that the delivery of safe and reliable service is not compromised, while also ensuring that ratepayers' interests are protected. If in the interest of fulfilling the mandates of the CEA the role of shareholders is overlooked, or unintended negative consequences of the Transition's design result, the continued and increased investments needed to meet both the traditional service obligations and new clean energy mandates will be compromised.

Risk/Reward Construct of the Cost Recovery Proposal

The Cost Recovery Proposal states:

> *"The energy efficiency programs are also less risky than traditional infrastructure investment found in a base rate case because, generally, energy efficiency programs will not undergo several years of construction and spend with the risk that the Board will find the investment not to be used and useful. If these energy efficiency programs were accounted for in base rate ROE, which looks at a totality of utility investment not included in clauses, Staff expects that each utilities' base rate ROE would be reduced."* (Emphasis added.)

With respect to risk, the Cost Recovery Proposal further states:

> *"There is an inherent reduction in risk associated with the contemporaneous recovery available in this mechanism, where utilities are recovering a portion of costs as they are being incurred, as opposed to recovery in base rates where the utility may not be able to recover costs for years after they are incurred. The energy efficiency programs are also less risky than traditional infrastructure investment found in a base rate case because, generally, energy efficiency programs will not undergo several years of construction and spend with the risk that the Board will find the investment not to be used and useful. If these energy efficiency programs were accounted for in base rate ROE, which looks at a totality of utility investment not included in clauses, Staff expects that each utilities' base rate ROE would be reduced."*

These assumptions neglect the fact that cost recovery is not delayed for years for all other utility investments. When the Board has determined that it wants to encourage and accelerate utility investment as a policy priority, it has allowed contemporaneous cost recovery or cost recovery between rate cases, such as infrastructure upgrades. Given the many policy priorities already being implemented, clearly the Board will have to determine which are the most critical to achieve and in what order since there are clearly cost implications for ratepayers. However, given the speed with which the goals of the CEA are to be achieved, at a minimum, contemporaneous cost recovery is necessary if the capital is to be acquired and invested as desired. NJUSA does not view contemporaneous cost recovery in and of itself to be an offset to risk sufficient to automatically assume a lesser ROE is appropriate. Energy efficiency programs with mandatory targets subject to penalties is a risk unlike any that electric and gas utility shareholders have had to evaluate. The extent to which these investments might be deemed by investors as *riskier* than others is entirely possible.

Given this reality, it is not clear upon what evidence the proposed ROE reduction of 200 basis points has been chosen. The experience of other states are important data points, but they are not dispositive of what would work best in New Jersey. Additionally, it is our understanding that there are factual errors about the representation made in the proposal and that the referenced states do not in fact have a reduction in ROE for such investments.  We strongly urge the Board to verify the ROE data cited.  To build such an important new initiative on faulty premises will not only discourage investment in New Jersey, inappropriately penalize the utilities but also impede ultimate achievement of the energy efficiency goals.

From the perspective of NJUSA members, while one year for cost recovery is "contemporaneous" as compared to a potential 3 year or more period between base rate cases, the factors that bring uncertainty into the evaluation of energy efficiency investments are not limited to time to recovery. The extent to which the gas and electric utilities will be able to achieve the mandated targets, whatever the ultimate targets might be, is a significant uncertainty, impacted by the behavior and predilections of customers, not controlled solely by the level of effort or design of the utility efficiency programs.

Individual utility shareholders typically invest in utilities not because they are among the most lucrative, but because they are among the most stable and least risky.  If mandatory utility participation in energy efficiency is structured in a manner that increases shareholder uncertainty, notwithstanding the allowed contemporaneous cost recovery of efficiency investments, investors, who cannot earmark their dollars for specific investments, might be skittish and disincentivized to continue, much less increase, their investments in New Jersey utilities. Utility shareholders have other investment options, including investments in utilities in other states or in other sectors.  The adage, money goes where it's treated best, which is a variation of "(c)apital goes where it's welcome and stays where it's well treated"[1] is no less true for New Jersey utility shareholders than those who make other investment choices.

While NJUSA does not have the expertise to specify a more workable cost recovery mechanism, we must caution that to overlook the intrinsic value of shareholders as the Transition is developed puts at risk not only the achievement of the CEA's important clean energy goals, but also the attractiveness of New Jersey utilities as an investment option.  Increased uncertainty for investors can result in a perceived diminishment of the value of New Jersey's utility shares.  Perception of a potential reduction in the value of utilities is a potential unintended consequence against which the Board should carefully guard. To do otherwise could reduce the availability of capital needed to ensure the financial integrity of the utilities, with resulting harm not only to the future provision of essential services at the core of their mission for over a century, but also harm their ability to perform well to meet the challenges of the new clean energy mandates.

We appreciate the opportunity to offer comments on this important issue.

Sincerely,

Karen D. Alexander

Karen D. Alexander
President

[1] Attribution from numerous sources, including Wikipedia https://en.wikipedia.org/wiki/Walter_Wriston#Quotes