State of New Jersey
DIVISION OF RATE COUNSEL
140 EAST FRONT STREET, 4TH FL
P.O. BOX 003
TRENTON, NEW JERSEY 08625

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

STEFANIE A. BRAND
Director

May 12, 2017

Via Hand Delivery
Irene Kim Asbury, Secretary
New Jersey Board of Public Utilities
44 South Clinton Avenue, 3rd Floor
Suite 314
Post Office Box 350
Trenton NJ 08625-0350

Re: In the Matter of the Board of Public Utilities Infrastructure Programs Stakeholder Process
BPU Docket No. Pending

Dear Secretary Asbury:

Enclosed for filing please find an original and ten (10) copies of the Division of Rate Counsel's Comments in the above matter. These comments are being submitted pursuant to the Board of Public Utilities' ("BPU") Notice that was circulated in this matter on April 26, 2017 by the staff of the BPU. At the May 4th meeting held in this matter, BPU staff announced that all written comments received by Staff from interested parties will be posted and publically available shortly thereafter.

We have also enclosed one additional copy of the materials transmitted. Please stamp and date the copy as "filed" and return to our courier. Thank you for your consideration and attention to this matter.

Respectfully submitted,

Stefanie A. Brand
Director, Division of Rate Counsel

c: Service List (via e-mail distribution list only)
President Richard Mroz
Commissioner Joseph L. Fiordaliso
Commissioner Mary-Anna Holden
Commissioner Dianne Solomon
Commissioner Upendra Chivukula

Tel: (609) 984-1460 • Fax: (609) 292-2923 • Fax: (609) 292-2954
http://www.nj.gov/rpa E-Mail: njratepayer@rpa.state.nj.us

New Jersey Is An Equal Opportunity Employer • Printed on Recycled Paper and Recyclable

Announcement of Stakeholder Process
Infrastructure Program
BPU Docket No. Pending

Initial Comments of the Division of Rate Counsel

May 12, 2017

I. Introduction

The Division of Rate Counsel ("Rate Counsel") is pleased to provide these comments to the Board of Public Utilities (the "Board" or "BPU") pursuant to the notice e-mailed on April 26, 2017 by Staff ("Notice") in connection with this matter. Specifically, the notice invited parties to meet on May 4th and submit written comments by May 12, 2017.

The Notice set forth 16 areas for discussion during the stakeholder meeting on May 4th. Rate Counsel attended the meeting and expressed several areas of concern. The following are more extensive written comments on the Board's Straw Proposal for potential infrastructure program proposed regulations.

II. General Comments

A. A Comprehensive Stakeholder Process is Needed

At an Agenda meeting on April 21, 2017, BPU President Richard S. Mroz discussed convening a stakeholder process to "receive comments and proposals regarding potential regulations and filings requirements for additional infrastructure projects that will not be included as part of the utility's Capital Expenditures." Notice p. 1. In response, Board Staff issued two Straw Proposals on April 26, 2017. They indicated that a stakeholder meeting would be held on May 4, and that written comments would be received on May 12. At the May 4

hearing several commenters asked that additional process be held so that the Board could have the benefit of comprehensive input from all stakeholders.[1] The outcome of this rulemaking proceeding has the potential to impact rates in New Jersey dramatically, and a comprehensive stakeholder process like the one the Board convened to adopt the Distribution System Improvement Charge ("DSIC") is needed. As the Board is aware, DSIC is a water infrastructure program adopted by the Board based on its finding that "replacement of ageing water and wastewater infrastructure is of significant concern to the State." I/M/O the Petition of NJAW for Authorization to Implement a DSIC, Docket No. WO08050358 Order denying DSIC Petition and Instituting Stakeholder Process (October 20, 2010) p.8. Although the Board recognized that "[a]doption of a DSIC mechanism as part of the rate structure of water and wastewater public utilities would be a departure from traditional rate making procedures in this State," the Board determined that "some form of a DSIC type solution, which should promote faster replacement of ageing infrastructure, may be valuable in helping the water and wastewater utilities continue to provide safe, adequate and proper water and wastewater service at the lowest cost to ratepayers Id. at 7-8. Accordingly, the DSIC was developed based on a record compiled in a contested case followed by extensive discussions with various stakeholders.

The departure from normal ratemaking principles is even greater here, where there has been no evidentiary record developed to establish the need for a permanent infrastructure investment plan. As discussed below in these comments, many of the provisions of the Straw Proposal are vague and many terms are undefined. As stated by Rate Counsel Director Stefanie

---

[1] See also, I/M/O Petition of New Jersey Natural Gas Co. for Approval of the Safety Acceleration and Facility Enhancement Program, Docket No. GO12030255 Order (October 23, 2012) at 20, where the Board found that adjudicating the gas main replacement cases on a case-by-case basis was appropriate, but that had the Board determined that a rulemaking was required, "a stakeholder proceeding [would have been] opened as was done in connection with the New Jersey American Water petition and the DSIC rules...."

Brand and echoed by NJ Large Energy Users Coalition and AARP during the May 4th meeting, due process dictates that a thorough and deliberate process with all interested stakeholders must be convened to thoroughly vet the complicated issues raised by this infrastructure investment plan. Therefore, Rate Counsel respectfully requests that Staff be directed to have stakeholder meetings that will flesh out the issues and continue the dialogue so that – if needed - a fair and reasonable program can be developed.[2]

Before discussing the individual questions posed by the Board's Notice, Rate Counsel respectfully requests that the Board first address whether an infrastructure investment program is necessary at all for the utilities to meet their regulatory service obligations pursuant to N.J.S.A. 48: 3-1 et seq. In other words, is an enhanced investment program necessary in order to "insure safe and reliable service at just and reasonable rates," [3] a bedrock principle in utility ratemaking.

In the past, the Board has approved utility infrastructure programs pursuant to its existing statutory and regulatory authority but only when emergent circumstances warranted such measures. Prior programs addressed significant and identified issues such as safety or public emergencies. For example, following several major storms in New Jersey, including Hurricane Irene in 2011 and Superstorm Sandy in 2012, and millions of dollars spent to restore service from these events, the Board issued an order inviting the State's utilities to file proposals to upgrade and protect infrastructure from future major storm events. I/M/O the Board's

---

[2] Shortly after taking office, Governor Christie recognized the importance of the stakeholder process in effective rulemaking, issuing Executive Order No. 2. (Christie, January 20, 2010). In that Order, Governor Christie required that the state agencies conduct a stakeholder process prior to proposing new regulations. Id. at para. 1a. In fact, in the Red Tape Review Commission's February, 2012 Findings and Recommendations, the Commission recognized the requirement that agencies solicit opinions from stakeholders prior to proposing new rules. See "Red Tape Review Commission, Findings and Recommendations,: February, 2012, pp. 4 and 8. (http://www.nj.gov/state/pdf/red-tape-reports/2012-0208-red-tape-review-report.pdf).

[3] N.J.S.A. 48:2-21 and 48:2-23

Establishment of a Generic Proceeding to Review Costs, Benefits and Reliability Impacts of Major Storm Event Mitigation Efforts, BPU Docket No. AX13030197, Board Order, (March 20, 2013). The Board did so because of its determination that hardening of utility infrastructure was a significant policy issue that needed to be addressed immediately and proactively. The Board's Order was issued following a truly extraordinary series of storms that affected large portions of the State's utility infrastructure, left ratepayers without power or natural gas for days or weeks and caused unprecedented levels of damage. The Order sought to preserve the utilities' ability to maintain safe, adequate and proper service during major storms, something that is a basic obligation of a utility.

Similarly, BPU approvals of main replacement programs for gas utilities are aimed at addressing safety concerns that were the subject of a "call for action" by the federal government after a gas main explosions in California and elsewhere. They are designed to address a specific safety problem surrounding cast iron and unprotected steel mains that required immediate action. I/M/O the Petition of NJNG for Approval of its SAFE Program, BPU Docket No. GO12030255, Order (October 23, 2012).

The economic stimulus programs instituted by Governor Jon Corzine in 2008 were also based on a specific concern that needed to be addressed via swift action. I/M/O Public Service Electric & Gas Company for Approval of a Capital Economic Stimulus infrastructure Investment Program and an Associated Cost Recovery Mechanism Pursuant to N.J.S.A. 48:2-21 and 48:21.1, BPU Docket No. ER09010049 and GR09010050, Decision and Order Approving Stipulation, (April 28, 2009) and I/M/O the Petition of Atlantic City Electric Company for Approval of Certain Energy infrastructure Investments and Approval of Cost Recovery for Such Projects and Related Tariff Modifications Associated Therewith Pursuant to N.J.S.A. 48:2-21

and 48:21.1, BPU Docket No. ER09010049 and GR09010054, Decision and Order Approving Stipulation, (April 28, 2009). In those cases, the Board acknowledged that it was departing from normal ratemaking procedures but felt that "[t]hese difficult economic times require creative responses that respect the law but adapt to extraordinary circumstances." PSE&G Order at 8. It was careful to state, however, that its approval "in no way sets a new framework for future actions; instead it reflects the realities of today's economic situation." Id. at 11.

These lines of cases demonstrate that where emergency or extraordinary circumstances require immediate action, the Board's existing powers are sufficient to address them. The Board has the ability to respond to such emergent conditions on a case by case basis, ensuring that any necessary infrastructure mechanism is not overused and that its statutory mandate to ensure that the rates charged to ratepayers to pay for such programs remain just and reasonable.

Now, the Board is moving to make these programs permanent and divorce them from any emergent circumstances that might justify departing from the normal ratemaking process. The Board is taking this step without any record that supports the need to do so. Before taking this extraordinary step, the Board should at least take the time to investigate the need for such a program and whether the proposed Straw Proposal is appropriately tailored to meet any such need.

Insuring reliability is an integral part of managing any utility distribution system. The regulatory compact provides that in exchange for being granted a monopoly franchise area, a utility will provide safe and reliable utility service at reasonable rates. The obligation to provide safe and reliable service is a cornerstone of the utility's obligations. Thus, the concept of undertaking reliability improvements, when required, is not new or novel. Rather, this is a fundamental obligation of any utility, and should be paid for in the normal course through rates.

While the Board may have authority to allow interim rates via a clause mechanism under certain circumstances pursuant to N.J.S.A. 48:2-21.1, it should be "temporary and conditional" and not the normal course. I/M/O the Proposed Increased Intrastate Industrial Sand Rates, 66 N.J. 12 (1974). As the NJ Supreme Court stated in that case, "were N.J.S.A. 48:2-21.1 to be otherwise construed rates could be negotiated by the utility with the Board on a permanent basis, completely without regard to the resultant rate of return to the utility and absent any other legislative standards indispensable to a proper delegation of the rate-making power." Id. at 20, 22.

This Straw Proposal could result in annual rate increases of up to 2% per year for at least five years without any demonstration of exigent circumstances or comprehensive review in a rate case. The increases are hardly "temporal and conditional" and they stretch the language and intent of N.J.S.A. 48:2-21.1 beyond any reasonable interpretation. Given that there is no record to establish that an alternative recovery mechanism is even necessary in order to undertake the infrastructure investments needed to provide safe and reliable utility service, the level of investment contemplated by this Straw Proposal should be recovered pursuant to the base rate case methodology that has traditionally been used by the Company to recover its cost of service.

At the very least, a complicated issue such as the appropriate ratemaking process for future infrastructure projects for electric, gas and water utilities should be the subject of a more extensive stakeholder process to establish whether changes are needed or permitted by statute. As discussed in greater detail below, much of the language in the Straw Proposal is vague and needs clarification or further explanation. Many terms are undefined and are capable of multiple meanings. For example, unlike DSIC, the specific projects that can be included in the program are not specifically defined. The Notice does not explain what the Board anticipates in terms of

"resiliency or redundancy projects," which could be broadly interpreted as allowing unneeded duplication of the distribution system. The term "critical interconnections of a utility plant" is also extremely broad and must be better defined. The specifics of the cost benefit analysis and the annual earnings test are not explained. A comprehensive stakeholder process would allow such details to be crystallized, leading to better and clearer regulations. As with the DSIC, all stakeholders should be permitted to participate to discuss and debate the issues so that all aspects of the new regulation can be analyzed and vetted.

B. The Acceleration of Cost Recovery in the Straw Proposal is Contrary to Public Policy and May Exceed the Board's Statutory Authority

The Straw Proposal's cost recovery mechanism is vague but clearly contemplates accelerated recovery that will require ratepayers to pay for certain costs earlier than they would under traditional ratemaking. In addition, perhaps because of its vagueness, the Straw Proposal allows the possibility of further accelerated recovery by forcing ratepayers to pay for projected expenditures that are not used and useful.

Ratemaking is a transparent process, well tested to produce a fair outcome which, if done correctly, allows for matching and balancing of costs and revenues, to determine an overall reasonable rate. Petition of Public Service Coordinated Transport, 5 N.J. 196, 216 (N.J. 1950). It avoids single issue ratemaking, in which one of the factors that must be reviewed to determine if a rate is reasonable is addressed in isolation and not matched with corresponding costs and expenses. While temporary accommodation of extraordinary costs or costs outside of the utility's control may be justified, long-term "interim" rates to address a single issue are not consistent with ratemaking requirements. Id.

In addition, contrary to economic theory and good ratemaking practice, the proposed recovery mechanism will increase shareholder return while significantly reducing risk. Shareholders earn a return to compensate for the risks they take to support investments made by the utility. Since shareholders benefit from every investment dollar that is spent by a utility, the infrastructure investment program will increase overall return to shareholders and accelerate recovery of that return. The risk of regulatory lag and a finding of imprudence will be shifted to ratepayers with no commensurate reduction in the shareholders' return. This is inequitable and also contrary to appropriate ratemaking practices, as it removes important incentives to avoid excessive spending or goldplating of utility infrastructure. As the allowed return is one of the three factors used to determine just and reasonable rates, this aspect of the Straw Proposal will lead to rates that are neither just nor reasonable.

While the Straw Proposal indicates that the utilities will be allowed accelerated recovery, it does not specify that they will only be allowed recovery once the utility plant is used and useful. In order for a utility's property to be recoverable in rates, it must be used and useful in the public service. Id. See also, In re New Jersey Power & Light Co., 9 N.J. 498, 509 (1952) ("It is established that the rate base in a proceeding of this nature is the fair value of the property of the public utility that is used and useful in the public service at the time of its employment therein…."); Atl. City Sewerage Co. v. Board of Public Util. Comm'rs., 128 N.J.L. 359, 365 (1942) ("The rate base is the fair value of the property used and useful in the public service."). Prior infrastructure programs approved by the Board have not permitted interim rates to go into effect to pay for plant that was not yet used or useful. Any cost recovery mechanism here should also not permit accelerated recovery of plant that is not yet used or useful.

Rate Counsel also believes that these programs must be limited in size to avoid a large shift in revenues from rates to surcharges. As drafted, the straw proposal presents a clear danger that the infrastructure mechanism will allow more costs to be recovered through the infrastructure surcharge than through base rates. Because the accelerated recovery mechanism will permit utilities virtually guaranteed recovery – with only an after-the-fact prudency review five years later, important safeguards against excessive spending and goldplating will be lost. Utilities should not spend more than necessary on capital to ensure safe and reliable service. Since they earn on what they spend, without proper safeguards they may be tempted to spend more than is necessary. By requiring utilities to spend their own funds initially on capital projects and face a prudency review before they recover, there are clear ratepayer protections in a base rate case proceeding that encourage utilities to spend wisely. Those protections are not present with a clause mechanism, which shifts the risk of bad utility business judgments on to ratepayers.

As will be discussed further below, allowing the infrastructure surcharge to become the primary vehicle for recovery of capital costs would be a profound and fundamental change in the way the Board fulfills its duty to ensure that rates are just and reasonable. Even if the Board goes forward with this proposal, it should ensure that base rate recovery through the traditional rate case process remains the primary method for recovery of capital costs.

C. The Allowance of Provisional Rates For Five Years Before Prudency is Determined is inconsistent with Board precedent and contrary to the Public Interest and Applicable Law.

The infrastructure Straw Proposal allows utilities to propose programs to be implemented over a period of five years or less. (Notice, para. 1) It states that prudency of the program will "be determined in the next base rate case, which will be required to be filed no later than five

years after the approval of the infrastructure program." (Notice, para 13). While the Board has certainly approved five-year programs previously,[4] the length of the program can lead to stale evidence when the prudency review finally occurs. There is also a concern that with so much time between rate cases a utility may be overearning for that period of time.[5] To address this, the Board has consistently in the past required utilities- even if they have 5 year programs – to come in for a base rate case within 3 years. Not only does this ensure that the Board has sufficient fresh evidence to review the prudency of the program measures and their implementation, the three year requirement has been viewed as necessary to comply with the requirement of an "umbilical cord" to a rate case mandated by the Supreme Court in I/M/O Proposed Increased Intrastate Industrial Sand Rates, 66 N.J. 12(1974). The Board's departure from this well-established and consistently applied requirement is unexplained. While, as discussed below, the Board has authorized "creative responses that respect the law but adapt to extraordinary circumstances,"[6] this proposal transforms previous limited departures from normal ratemaking principles into the normal course. It has gradually become so far removed from legal requirements that it will lead to rates that are neither just nor reasonable.

Industrial Sand Rates is the seminal New Jersey Supreme Court decision regarding the establishment of interim rates under the "negotiation statute," N.J.S.A. 48:2-21.1, which provides the authority for the Board to allow interim rates such as those contemplated by the

---

[4] See, e.g. I/M/O the Petition of New Jersey Natural Gas Co. for Approval of the Safety Acceleration and Facility Enhancement Program, Docket No. GO12030255 (October 23, 2012); I/M/O the Petition of Public Service Electric and Gas Company for Approval of Electric and Gas Base Rate Adjustments Pursuant to Energy Strong Program, Docket Nos. ER17030324 and GR17030325 (May 21, 2014)

[5] Rate Counsel recognizes the straw proposal includes an annual earning test, however, the current language is vague and any test may be insufficient to protect from over earning as only a full review in a base rate case can do.

[6] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for all Gas and Electric Utilities, Docket No. EO09010049, GO09010050 Decision and Order approving stipulation, (April 28, 2009) at p 8.

Straw Proposal. In that case, the Court reviewed and clarified the "basic principles involved in the rate-regulation function and authority" of the Board. Id. at 19. The Court found that ratemaking is a legislative function, and that:

> For the delegation of the legislative function to be valid under our Constitution it is essential that adequate standards be prescribed by the Legislature and adhered to by its agent, in this instance the Board.The statutory standard prescribing the rate-making powers of the Board is to be found in *R.S. 48:2-21(b)(10)*, which provides that the Board may "Fix just and reasonable individual rates...." Id. at 21.

Citing prior New Jersey Supreme Court cases and long-standing U.S. Supreme Court jurisprudence on ratemaking, the Court held that determining the justness and reasonableness of a particular rate can only be determined "after an examination of a company's property valuation which constitutes its rate base; its expenses, including income taxes and an allowance for depreciation; and the rate of return developed by relating its income to the rate base." Id. at 21-22. The Court noted that the determination of an adequate rate base "is fundamental" because a utility is entitled to a return only upon "the fair value of the property of the public utility that is used and useful in the public service." Id. at 22. A rate based on an excessive valuation of the utility's property would not be reasonable, the Court cautioned, noting that the theory that "in emergent circumstances... there could sometimes be a valid rate increase, on a permanent basis without exploring the rate base and considering the consequent rate of return thereon," or that the Board could order "a surcharge on newly established rates, to recoup revenue deficiencies..." had been clearly rejected. Id. The Court concluded that "The law has thus developed, no doubt because the system of rate regulation and the fixing of rates thereunder are related to constitutional principles which no legislative or judicial body may overlook." Id. at 23.

> Turning to the validity of the "negotiation statute" under these legal principles, the Court held:The vital justification for the "negotiation statute" and rates established under it, temporarily bypassing the establishment of rate base and fair rate of return, rests upon the legal

> umbilical cord which ties them to the anticipated eventual determination of these fundamentals; at which time the temporary rates, their legitimacy having been validated, merge into the PUC judgment ordaining the final rate structure or, if and to the extent found to have been excessive, are refunded to the consumers who paid them. Such interim relief permits the utility to escape the unfair and sometimes confiscatory impact of "regulatory lag," *i.e.*, the considerable time necessary for final resolution.... Id. at 25.

The New Jersey Supreme Court had an opportunity to review its decision in Industrial Sand Rates the following year. In In re Board's Investigation of Telephone Companies, 66 N.J. 476 (1975), the Court upheld the Board's allowance of a "Comprehensive Adjustment Clause" ("CAC") for New Jersey Bell Telephone Company, allowing the Company to recover certain costs on an interim basis. At the same time that case was being adjudicated, the Board opened a proceeding to investigate Bell's financial situation and thereafter Bell filed for a rate increase. The Court found that, although the CAC was not technically established in a rate case, the three contemporaneous cases, viewed as a whole, provided a sufficient nexus to allow the clause to be upheld. The Court stated,

> We are thus convinced that, so far as protection to the public is concerned, these proceedings (as they involve the validity of the comprehensive adjustment clause) should be viewed as a unit, to the end that the recovery of expenses through the CAC shall be conditionally permitted subject to final validation in the terminal phases of the proceeding in which PUC will be required to fix just and reasonable rates on a permanent basis; at that time PUC should provide for appropriate adjustments, customer credits or refunds, if the evidence indicates that any excessive revenues have been produced by the operation of the clause. Id. at 492.

The Court then went on to reaffirm that the ultimate validity of the amounts charged in the CAC must be verified in the rate case pursuant to Industrial Sand Rates. The Court stated:

> This Court recently commented on the indispensable "legal umbilical cord" between a temporarily increased rate and the final adjudication of the firmly established and traditional components which enter into the

> determination of "just and reasonable" rates. *In re Intrastate Industrial Sand Rates, supra*, 66 *N.J.* at 25. Fortuitously, as we have seen, the state of the present litigation is such as to accommodate such a firm and unimpeachable relationship.
>
> In a rate proceeding utility expenses, to be allowable, must be justified. Good company management is required; honest stewardship is demanded; diligence is expected; careful, even hard, bargaining in the marketplace and at the negotiation table is prerequisite. And so it must be with regard to expenses recaptured by "flow through" to consumers by dint of a comprehensive adjustment clause. Tested in the scrutiny of final rate determination and only in that way (despite the impressive monitoring devices built into the instant clause) can such expenses be validated and become demonstrably honest components in the ascertainment of "just and reasonable" rates. Lacking that validation, certainty and justification, the rates would have been unjustly charged and to the extent of that injustice must be refunded to the customers. Id. at 495.

Since that time, the Board has adhered to the requirement of such an "unimpeachable and firm relationship" between interim rate increases in clauses and the rate case validating the justness and reasonableness of those rates. See, In re Redi-Flo Corp., 76 N.J. 21, 41 (N.J. 1978) (Remanding to the BPU to determine whether the fuel adjustment clause in that case was just and reasonable, but holding that: "Since a fuel adjustment clause would cause an increase in the consumer's out-of-pocket expenditure for fuel, it plainly falls within the statutory definition of a rate increase. Accordingly, we hold that a fuel adjustment clause can be implemented only after a rate proceeding in accordance with N.J.S.A. 48:2-21 or 48:2-21.2,"). For the most part, the early adjustment clauses related to matters, such as rising fuel prices or the cost of purchased water that were outside the utility's control.

In 2006, the Board modified its regulations on Purchased Water Adjustment Clauses ("PWACs") and Purchased Sewer Treatment Adjustment Clauses ("PSTACs") to explicitly require the utilities to establish the nexus to a rate case by ensuring that the utility had been in for a rate case within at least 3 years of filing for an initial PWAC or PSTAC. See, N.J.A.C. 14:9-

7.3, 38 N.J.R. 1538(a). This provision was reviewed by the Board in its 2009 Order allowing Shorelands Water Company to file a petition for a PWAC. The Board granted a waiver of the regulation's three year prior base rate case requirement, imposing instead a requirement that the Company file a base rate case within two years from the date of the final PWAC Order. The Board reasoned:

> ...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." The Board's ability to set interim rates in conjunction with this "nexus" requirement has been addressed in several New Jersey Supreme Court cases. In In re Industrial Sand Rates, 66 N.J. 12 (1974), the Court made clear that the authority granted to the Board to negotiate with a utility for an adjustment of rates is confined to interim relief pending a proceeding to determine justness and reasonableness of an existing or proposed rate. Likewise, in In re Investigation of Tele. Cos., 66 N.J. 476 (1975), the Court upheld the Board's implementation of a "comprehensive adjustment clause" which permitted the company in that matter to recover certain expenses as they increased, finding that there was a nexus to the Board's review in that company's rate case. The Court acknowledged the Court's ruling in Industrial Sand that the "legal umbilical cord" between a "temporarily increased rate and the final adjudication of the firmly established and traditional components which enter into the determination of 'just and reasonable' rates" is indispensable. Id. at 495. Therefore, to ensure that a nexus exists, Shorelands will be required to file a petition for a rate adjustment within two years from the date of the final PWAC Board Order.

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), BPU Docket No. WO09020145 Order Granting Waiver Request. (May, 19, 2009) p.3.

At about the same time as the Board's Order in Shorelands, the Board increased its use of clauses and surcharges to address specific emergent issues. In October, 2008, in response to a

worldwide economic downturn, then- Governor Jon Corzine called on New Jersey's gas and electric utilities to accelerate already-planned investments in "necessary and beneficial" utility infrastructure. I/M/O a Proceeding for infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities, BPU Docket Nos. EO09010049- 10053 (January 28, 2009). The cost recovery mechanism for those investments was through capital investment charges that allowed for annual recovery through provisional rates. Each of those charges was required to be reviewed in a base rate petition consistent with the nexus requirement established in Industrial Sand Rates.[7] In its April 28, 2009 Order approving PSE&G's program, the Board recognized that the cost recovery mechanism was unusual because it allowed recovery outside of a rate case, but found that the requirement agreed to by the parties that the company would file a rate case within two years was sufficient to "respect the law but adapt to extraordinary circumstances." I/M/O the Proceeding for infrastructure Investment and a Cost Recovery Mechanism for all Gas and Electric Utilities, BPU Docket No. EO09010049, GO09010050 (April 28, 2009) at pp. 5, 8. The Board concluded:

> Accordingly, the Board will, in this case, allow the Company to begin recovery of capital expenses for these Qualifying Projects on an interim basis subject to refund pending the filing of the Company's base rate case as contemplated by Paragraph 21 of the Stipulation. This authorization in no way sets a new framework for future actions; instead, it reflects the realities of today's economic situation. Id. p. 10.

Other emergency conditions caused the Board to approve additional programs calling for surcharges and interim rates. After the severe storms of 2012, the Board issued an Order asking the utilities to propose programs to enhance resiliency in the face of potential future storms. Several companies filed for such programs. While once again allowing for interim provisional rate increases, all of the Stipulations and subsequent Board Orders approving them included

[7] See Exhibit A- Chart entitled "Gas and Electric Utility Infrastructure Programs Links to Base Rate Proceeding"

terms providing that the Companies would have their provisional rates reviewed within three years.[8] Additionally, in response to gas explosions in California and elsewhere, the U.S. Department of Transportation, Pipeline and Hazardous Materials Safety Administration ("PHMSA") issued a "call to action" to encourage utilities to accelerate the replacement of cast iron and unprotected steel mains in their system. In response the Board approved a series of programs designed to accelerate the replacement of such pipes, as deemed necessary to reduce leaks and maintain public safety. These programs were also funded through clause mechanisms that required the utilities to come in for a review of their provisional rates in a base rate case within three years.[9]

In 2008, an application was filed with the BPU by New Jersey America Water ("NJAW") seeking approval to accelerate the replacement of aging water mains. The Company cited the need to replace aging water mains, and the critical need to do so to enhance safety, reliability and water quality. I/M/O the Petition Of New Jersey American Water Company For Authorization To Implement A Distribution System Improvement Charge, BPU Docket No. WO08050358 Order denying DSIC Petition and Instituting Stakeholder Process, (October 20, 1010). The company sought approval to recover its investments through a Distribution Service Investment Charge (DSIC). During the course of that proceeding, Board Staff recommended allowing the program as a pilot. Board Staff, through the brief filed by the Attorney General's office ("Staff's DSIC Brief"), stated that the Board did have authority under the negotiation statute, N.J.S.A. 48:2-21.1 to order the DSIC, but that to ensure compliance with that statute, it should require the Company to "file a rate case no later than three years from the date of a Board Order approving a

[8] Id.
[9] Id.

DSIC...." See, Initial Brief of the Staff of the Board of Public Utilities, IMO the Petition of NJAW for Authorization to Implement a DSIC, BPU Docket No. WO08050358 April 17, 2009 at p. 34 (attached). Staff understood the nexus requirement established in Industrial Sand Rates and I/M/O Telephone Cos., and the need "to ensure that the DSIC expenses are scrutinized in a final hearing." Id. at p. 36. Staff's Brief stated:

> Consistent with the Board's statutory authority and the nexus requirements in both Tele. Cos. and Industrial Sand, the Board has the authority to implement a DSIC mechanism for NJAW in the form of a pilot program. The Board would be within its authority to implement this pilot program for a period of two years....The pilot program that Staff is proposing would be for an interim period with interim relief until these temporary rates in the pilot program are merged into a base rate case to be filed within three years from the final decision rendered by the Board herein....

While the Board did not grant NJAW's petition, it proceeded instead to develop and promulgate regulations to establish the DSIC. Consistent with its long-standing interpretation of Industrial Sand Rates and Staff's recommendation in the NJAW DSIC petition, the Board included the three-year nexus requirement in the DSIC regulations. N.J.A.C. 14:9-10.4(c) ("No DSIC foundational filing shall be approved unless a water utility has had its base rates set by the Board within the past three years.")

With this Straw Proposal, the Board now seeks to allow interim rates not as part of a response to an emergent issue, but as an institutionalized program in the normal course. It also seeks to extend the already generous three-year base rate case requirement to five years. While it may not seem such a large stretch from the prior three-year requirement, the fact is that a nexus once described by the Supreme Court as an "umbilical cord," will now be able to stretch to half a decade. Rate Counsel submits that the review that would occur a half decade later cannot be comprehensive enough or based on fresh evidence to meet the requirements of Industrial Sand Rates and I/M/O Telephone Cos. The use of clauses and provisional rates has exploded in the

last several years to the point where some utilities have nearly half of their distribution revenue coming from provisional clauses rather than rates that have been reviewed in a rate case. This Straw Proposal moves even further away from the "firm and unimpeachable relationship" required between provisional rates and the full scrutiny of a rate case. Even worse, is that no explanation is given whatsoever for the change in long-standing policy, which, according to Staff and the Attorney General's Office was based on governing case law.[10] A five year period between the establishment of provisional rates of the magnitude contemplated by this Straw Proposal and the review of those rates in a base rate proceedings does not satisfy the requirement of an "umbilical cord' to a rate case and results in unjust and unreasonable rates.

D. If the Board Goes Forward with Regulations for Infrastructure Programs, the Regulations Should Include a Sunset Provision, Proformance Metrics and a Provision requiring Public Hearings.

a. The Regulations Should Sunset.

If regulations are adopted, they should include a Provision like that included in DSIC providing that the regulations sunset after a period of time. This would allow the Board to reexamine and potentially fix any issues with the regulations. Rate Counsel recommends a Sunset after 5 years.

b. The Regulations Should Require Performance Metrics.

Rate Counsel recommends that performance metrics be included in the regulations to ensure that the program objectives are being met. For example, O&M Savings should be required and tracked and ratepayers should be credited for the O&M savings of the program through an O&M offset. Other performance benchmarks/metrics for natural gas companies

[10] Staff DSIC Brief supra, at 35.

would include but not be limited to: leak reduction targets, main replacement targets, service replacement targets, outage reduction targets; and incident reduction targets.

For electric companies, performance metrics could include specific improvements in reliability metrics.

In addition, it is important that performance standards be tied to the cost recovery of any infrastructure program. Failure to tie any performance standards to the infrastructure program creates an improper "heads we win, tails you lose" situation favoring the utility. If the utility's program investments result in efficiency improvements/cost reductions, the utility will be able to fully recover its investment costs and pass those savings along to its shareholders for as long as the utility does not file a rate case. However, if the utility's program investments fail to result in efficiency improvements or cost reductions, the utility simply continues to fully recover its costs through the cost tracker, without any loss, at least until the next rate case. A penalty should be implemented if a utility fails to perform. Penalties could include a set dollar amount, a reduction in ROE, or restricting the utility's ability to recover the costs through a cost tracker until such standards are met. For example, most recently the Board approved the stipulation in South Jersey Gas's Accelerated infrastructure Replacement Program II ("AIRP II"), which provided that if the Company fails to meet its base replacement targets and/or leak reduction targets the Company will forego recovery of the costs from ratepayers and shareholders must pay for the costs necessary to reach the reduction targets.[11]

[11] In the Matter of the Petition of South Jersey Gas Company to Continue its Accelerated Infrastructure Replacement Program ("AIRP") Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-2.1 and for Approval of a Base Rate Adjustment to Reflect AIRP Investments in Base Rates; Docket No.: GR16020175, Order dated October 31, 2016, pp. 4-10 and adopted Stipulation of Settlement, October 3, 2016, pp. 6 -14.

c. The Regulations Should Make Clear that Public Hearings are Required.

Because this Program will result in an increase in rates, public hearings are required before those rates can be implemented. N.J.S.A. 48:2-32.4. The regulations should make this clear.

III. Specific Comments

Rate Counsel offers the following specific comments on the provisions of the Straw Proposal. The numbers in the headings below correspond to the paragraph numbers in the Notice.

1. The infrastructure program may be for a period of five (5) years or less.

If the Board goes forward with developing regulations for infrastructure programs, Rate Counsel does not object to programs that would last up to five years. Rate Counsel recognizes that this may have benefits for the utilities in terms of planning. Indeed, some of the individual infrastructure programs that have been approved by the Board have been five year programs. However, as set forth in detail in these comments, Rate Counsel does object to allowing provisional rates to be implemented by the utilities for five years before those rates are reviewed in a full rate case. Rate Counsel also objects to potentially waiting for five years for the Board to review the prudency of a utility's projects and spending. It would be very difficult to ensure that the evidence will be fresh after five years. It is also hard to believe that the Board will not allow the passage of time and the fact that the projects have been completed for such a long period of time to influence any decision on whether to allow the utility to recover its costs. It is essential to the Board's obligation to ensure that rates are just and reasonable for the prudency review to be a genuine review of the Company's decision to implement a project and its actions in implementing that decision. In addition to the reasons discussed above, the five year gap before prudency is reviewed threatens the Board's ability to ensure that a thorough and objective prudency review will occur. Thus, although Rate Counsel does not object to programs of up to five years, it does maintain that a review of prudency must occur before five years.

2. The infrastructure programs are voluntary.

If the Board proceeds to establish the program described in the Straw Proposal, Rate Counsel does not object to the programs being voluntary, *i.e.*, no utility should be required to implement an infrastructure program. However, if regulations are promulgated and a gas or electric utility decides to implement an accelerated infrastructure program, it must do so pursuant to the regulations with respect to water utilities, they should be limited to DSIC rules as set forth in section 16 infra.. At the May 4 stakeholder meeting the representative from NJUA suggested that utilities should be allowed to choose between instituting a program pursuant to these regulations and seeking approval of infrastructure programs on a case-by-case basis as they do now. This cannot be permitted. If this is permitted, several provisions of the Board's regulations, such as the annual cap and the annual earnings test requirement could simply be avoided. That would be inconsistent with the regulations and the Board's intent in promulgating them, rendering the regulations to nothing more than an advising opinion. Utilities should not be permitted to choose the means by which the Board regulates them. If regulations are promulgated, they must govern all electric and gas infrastructure programs.

3. Any infrastructure program must be incremental to the Utility's average CapEx over the prior five years.

The infrastructure Straw Proposal does not indicate how the incremental amount of capital expenditures ("CapEx") will be determined. Rate Counsel recommends that "base spend" be measured by examining historical capital expenditures excluding previous capital expenditures from specific infrastructure programs approved by the Board and "special" projects. Amounts allowed in previous accelerated infrastructure programs and/or "special" projects approved by

the Board were determined to be incremental to the utilities' normal or base spending.[12] The use of the utility's base spending as a reference point is consistent with the definition of an eligible project under the terms of the New Jersey Distribution System Improvement Charge ("DSIC") implemented by water utilities.[13] Specifically, those terms define an eligible project as a distribution system project and projected costs that are in excess of the utility's base spending.[14] The infrastructure programs that are the subject of the instant proceeding should require a demonstration that the costs of the program are not already being recovered through the utility's current base rates.[15] The terms of any infrastructure program should also take into consideration that base spending should increase over time as the types of replacements made under an accelerated replacement programs would decline as utilities' replacement programs slow down and move toward completion.

In addition, as part of the utility's filing it should be required to provide information demonstrating that the infrastructure program will improve reliability, resiliency, operations and management beyond normal base spending/replacements. For example, if a utility claims that the infrastructure program will improve reliability, the utility should be able to provide data or details on the level of improvement to reliability such as a reduction in leak rates and associated cost savings.

---

[12] In the Matter of the Petition of Public Service Electric and Gas Company for Approval of the Energy Strong Program, Docket Nos.: EO13020155 and GO13020156, Order Approving Stipulation and Settlement, May 21, 2014, p. 3.

[13] N.J.A.C. §14:9-10.2 and §14:9-10.3.

[14] N.J.A.C. §14:9-10.2 and §14:9-10.3, DSIC eligible project, (3).

[15] N.J.A.C. §14:9-10.2.

4. A filing in support of an infrastructure program must:

(a) include annual CapEx budgets for a five-year period broken down by major category of expenditures.

The multi-year infrastructure plan should include predefined plan terms and capital expenditures as well as a well-defined list of criteria for determining the investments included in the plan. The proposed multi-year infrastructure plans should also incorporate existing five or ten-year distribution plans currently undertaken by the utilities. The proposed multi-year plans should be not viewed separately from existing distribution planning and in fact should be a complement to existing planning and prioritization processes at the utilities. Ultimately, the utilities should provide the Board and intervenors with a business case justifying the need for any proposed multi-year infrastructure plan. The Board needs to have enough information to determine that the utilities are not over-investing in distribution capital projects that would not serve to improve reliability and/or safety of the distribution system.

Annual capital expenditures estimates for the term of the program should be included for each program and project to be implemented under the infrastructure program. These costs should be shown at FERC Uniform System of Account level, including both primary accounts and subaccounts, if available. In addition, cost data should be provided by major categories of expenditures, including but not be limited to: material; labor; construction; surveying costs; traffic control costs; administration; engineering; contractor; permitting; municipal and local government costs; restoration costs; and any other defined category.

However, the annual capital expenditures should not be viewed as an adequate performance metric. Using annual capital investment projections as a performance metric would inappropriately shift the focus of performance from the objective the infrastructure program is

designed to achieve (i.e., improved reliability, resiliency, state policy goals) to the amount of money spent). The goal of an infrastructure program or any other investment tracker, should never be based upon ensuring that a utility has enough financial resources to spend on capital projects. Otherwise, the ultimate goal of improving reliability, resiliency, or meeting state energy policies would be secondary, and possibly ignored. Setting goals on spending money facilitates the kind of "gold-plating" and over-capitalization that traditional regulation has clearly recognized and attempted to avoid. Accordingly, annual capital expenditures cannot serve as a meaningful benchmark of performance for regulatory purposes. As the infrastructure Straw Proposal does not address any performance metrics or benchmarks that should be implemented as part of an infrastructure program, Rate Counsel strongly recommends the infrastructure filing should also include performance metrics and standards in order to track the utility's progress and evaluate prudence in future review proceedings.

For the electric companies, the utilities should prepare and file with the Board infrastructure investment plans that describe the companies' investment and operational strategies for the proposed infrastructure investment plans. The plans should complement existing distribution planning efforts. The plans should also incorporate prioritization efforts used by individual electric distribution companies (EDCs) for planning purposes. EDCs must also provide a narrative and supporting analysis of how the proposed infrastructure plan fits within the context of the utilities' overall distribution planning. The narrative and supporting analyses should include, but not be limited to: project prioritization, independent alternatives analyses, and project justification. The proposed infrastructure Program budget should also include annual spending budgets to ensure that annual caps are adhered to.

The proposed multi-year infrastructure plans should not be an opportunity for EDCs to implement projects that do not meet the company's own planning criteria. In the accelerated infrastructure proceedings approved during the 2008 recession, [16] the Board clearly articulated that:

> Only capital projects which enhance the reliability, safety and security of each utility's distribution system are eligible under these programs as Qualifying Projects. These are projects originally scheduled for future years which can be brought forward into the 2009-2010 time period because they have already been researched and planned by the companies. In the absence of this program, most of the projects would be completed, but only in future years.
>
> In identifying projects to be included in their infrastructure programs, projects using New Jersey-based employees were strongly favored; in contrast, projects not expected to affect employment in New Jersey, such as replacement of vehicles or computers, were eliminated from utility proposals. Projects without an obvious benefit to justify their costs were excluded as well.[17]

In that proceeding, the Board recognized that the accelerated infrastructure projects had already been vetted through each EDC's prioritization process. The proposed multi-year investment plans should undergo the same rigor.

The proposed infrastructure budget should also ensure that there is transparency and separation between the proposed distribution infrastructure program and ongoing distribution capital spending. This information should be maintained and provided separately for the length of the program. Detailed cost estimates should be expressed both in terms of total project costs and annual project costs for projects that span over one year. The major categories of expenditures should be transparent to reviewers with non-overlapping categories so that

---

[16] See: Exhibit A, items 1-5.

[17] I/M/O the proceeding for infrastructure investment and a lost recovery mechanism for all gas and electric utilities, BPU Docket Nos. EO09010049 and EO09010050 Decision and Order approving stipulation (April 28, 2009) Page 8.

proposed spending can be clearly mapped to a single major category. The filing should provide a clear explanation of each major category.

Ultimately each utility will have to weigh the costs, benefits, and maturity of various kinds of technologies to prioritize its investment decisions, and the multi-year infrastructure plan must include the rationale for the prioritization. A company's multi-year infrastructure plan should factor in and discuss any characteristics that are unique or specific to the system and service territory.

In addition, as previously noted, the projects approved in those 2009 economic stimulus programs were chosen to promote the hiring of New Jersey contractors during a period of economic uncertainty. The utilities should provide the BPU with contractor information to ensure the availability of contractors, preferably New Jersey based firms. Likewise, the proposed multi-year projects should be projects that benefit employment in New Jersey. Projects that do not result in material benefit for New Jersey employment should be avoided if a goal of the multi-year investment programs is to encourage New Jersey employment.

(b) The program must specify the projects, and include descriptions of project objectives and detailed cost estimates.

A comprehensive list and description of each project should be provided as part of the infrastructure program. The utility should identify objectives for each project implemented under the program. Details of the utility's filing should include but not be limited to: clearly-defined individual investments, the purpose of each investment, and quantification of benefits associated with the proposed investments. The utility must identify the benefits of the proposed investments and must quantify those benefits for all investments on an annual basis. The utility should also explain how projects will be prioritized and identify how each project will meet its purported goals (e.g. reliability; resiliency; modernization; enhancement;

etc.). Rate Counsel recommends that information similar to that required in the DSIC Foundational Filing should also be required, including: 1) a description of the condition or type of infrastructure that will be replaced, 2) a description of the enhanced/reinforced, or renewed project; 3) the duration and location of the project; 4) the project's in-service date; and 5) project identification numbers so the projects can be easily tracked in the review process.[18]

If a utility seeks to substitute projects once a program is approved, it should be required to submit its request to the Board and Rate Counsel for approval, similar to their requirement imposed in the DSIC regulations. N.J.A.C. 14:9-10.4(b)(5). Also as required in the DSIC regulations, if Rate Counsel or Board staff object to any project included by a utility in its Initial filing or request for substitution, the utilities should be required to delete the project or seek specific Board approval overturning the objection. N.J.A.C. 14:9-10.5(b).

(c) The program budget is the maximum (or "cap") that can be spent, however, year to year variations of ten percent will be allowed, and larger variations will require Board approval.

The approved budget of any infrastructure program should be the maximum that can be spent over the term of the program. If a cap is not imposed it could result in overcapitalization or investment inefficiencies. Similar caps and year over year variations have been established in prior gas infrastructure programs. For instance, Elizabethtown Gas' AIR program allow for annual variances in the incremental construction cost target. The incremental construction cost target could be over or under spent annually by 10 percent in any given year of the program. However, any over-spending on incremental expenditures in a given year must be accompanied

[18] N.J.A.C. §14.9-10.4(2).

by a reduction of an equal amount in one or more subsequent periods.[19] Rate Counsel recommends that as part of this rulemaking the Board establish an over or under annual budget benchmark of 10 percent. In addition, it should be specified that if a cap is implemented the utility cannot exceed the approved total budget and the Company must seek recovery of any amount that exceeds the program cap in a normal base rate case proceeding.

(d) Include similar projects within the utility's CapEx budget equal to ten percent of the amount of the infrastructure program; and be supported with semi-annual status reports for project management oversight purposes.

The meaning of this provision is unclear. This provision appears to suggest that 90% of capital expenditures could be recovered through the infrastructure surcharge mechanism, with only 10% being recovered through base rates. Rate Counsel is opposed to any mechanism that would result in more costs being recovered through the Infrastructure surcharge than through base rates. Any infrastructure surcharge should be ancillary and incremental to base rate recovery,[20] not the primary mechanism for recovery. Allowing the infrastructure surcharge to become the primary vehicle for recovery of capital costs would be a profound and fundamental change to the ratemaking process used not only in New Jersey, but across the country. Thus, base rate recovery through the traditional rate case process should be the primary method for recovery of capital costs.

If the Board decides to go forward with this Program, Rate Counsel maintains that there must be parameters and benchmarks for infrastructure surcharge recovery relative to base rate recovery. Rate Counsel believes that there are two critical threshold financial issues – how large

---

[19] I/M/O the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of An Accelerated Infrastructure Replacement Program and an Associated Cost Recovery Mechanism, BPU Docket No.: GO12070693, Order, August 21, 2013, Final Stipulation p. 6, ¶18.

[20] Base rate recovery and base rate spending refer to amounts spent pursuant to, and recovered through, the traditional base rate case process.

should any infrastructure program be on an absolute dollar basis and what is the relationship between the magnitude of the infrastructure program expenditures relative to the magnitude of expenditures recovered in base rates?

First, as discussed above, since the infrastructure program is intended to accelerate the completion of necessary capital projects in addition to the cost recovery of these projects, it is important for the utilities to at least maintain their current base rate spending levels if an infrastructure program is approved. Therefore, Rate Counsel recommends that annual recovery of any infrastructure program surcharge be approved only if the utility has met a benchmark level of base rate capital spending (to be recovered through the traditional rate case process) in any given year. Rate Counsel recommends that the benchmark be based on the average base rate spending for distribution projects for the five year period preceding approval of the infrastructure program. Spending on new customer installations, major storm costs, and general plant and blankets would be excluded from the calculation. In addition, the infrastructure program should exclude any projects that are currently being recovered through a surcharge mechanism. Thus, the benchmark would be based on distribution reliability projects and distribution infrastructure upgrade projects paid for through base rates.

Second, any new infrastructure program should be limited to no more than 50% of the annual benchmark calculated above. For example, assume that over the past five years, a utility had total average annual base rate spending of $300 million. Further assume that $80 million annually related to new customers, major storm damage spending, and general plant additions. The resulting annual benchmark would be $220 million ($300 million - $80 million) meaning the utility should be required to continue to spend $220 million annually through the base rate spending process in order to qualify for an annual infrastructure program surcharge. The amount

of any annual surcharge would be limited to the revenue requirement associated with $110 million ($220 million X 50%).

Rate Counsel's recommendation achieves two objectives. First, it ensures that the utility will not neglect its base rate spending in favor of emphasis being placed on infrastructure program spending. Second, it ensures that the traditional rate case process will continue to be the primary recovery mechanism for capital expenditures required by the utility. Since blanket projects are excluded from recovery through the infrastructure surcharge mechanism, one would expect that a substantial amount of capital spending would continue to flow through base rates in any case.

5. The projects within the infrastructure program must be related to reliability, resiliency and/or replacement and may include, but are not limited to:

(a) Replacement of all Gas Cast Iron mains:

Cast iron mains should be targeted for replacement in all pressure systems of gas utilities, not just in Utilization Pressure systems. In fact, higher-pressure cast iron can carry higher safety risks. For natural gas pipelines, (i.e. "high-risk" pipeline infrastructure) safety is the most important reason to justify an accelerated program and therefore should be listed first. PHMSA recommends all cast iron be considered for replacement.[21] The implementation of a cast iron replacement program may become obsolete as the gas utilities in New Jersey have been implementing accelerated replacement programs for a number of years to replace the majority of their cast iron pipelines. New Jersey Natural Gas has already replaced its cast iron pipelines.

[21] The Pipeline and Hazardous Materials Safety Administration ("PHMSA") issued a Call to Action to State Regulators in 2009 with the goal of accelerating the rehabilitation, repair, and replacement of high risk pipeline infrastructure. This effort came on the heels of several high profile pipeline accidents, including two gas distribution line explosions in Pennsylvania that resulted in multiple deaths. See: https://opsweb.phmsa.dot.gov/pipelineforum/docs/PHMSA%20111011-002%20NARUC.pdf

South Jersey Gas anticipates that it will have replaced all of its cast iron pipeline by the conclusion of its current AIRP II program.

(b) Replacement of Gas bare steel and unprotected coated steel mains and services: The word "unprotected" was omitted from the infrastructure Straw Proposal. New Jersey has not permitted the replacement of protected coated steel in any settlements since it is not one of the materials recommended for replacement by PHMSA. In fact SJG's recent Settlement for AIRPII removed 570 miles of their proposed replacement mileage of 1,170 miles since it was for protected coated steel pipe. The Board should not include protected coated steel if this program is adopted.

(a) Installation of Gas Excess Flow Valves where necessary:
EFV's are "necessary" for all replaced services. However they are not approved or available for many types of customers such as multi-unit housing, commercial, or industrial customers. Any regulations related to the Straw Proposal should make this clear.

(b) Electric distribution automation investments, for example, SCADA equipment, relays, reclosers, Volt/VAR control, communications networks, and Distribution Management System Integration

This list generally includes projects that may improve reliability of the distribution system. However, the EDCs will need to demonstrate how their multi-year investment plans complements existing and future distribution planning both in the near term and in the long-term. Many of the proposed investments will have service lives beyond the five-year window of the plan. As such, the EDCs should provide the Board and intervenors with information on how each investment fits into the EDC's long-term planning.

(c) Resiliency or Redundancy Projects:

The definition of "resiliency" and "redundancy" are unclear. In the last four years, three of the New Jersey's EDCs have filed storm hardening petitions. Examples of projects proposed by EDCs in those filings include: distribution automation, selective undergrounding, federal circuit hardening, substation mitigation, and circuit reconfiguration, etc.

Within the specifics of individual resiliency filings, Rate Counsel has found that some program elements have resiliency benefits while others have questionable resiliency benefits. The EDCs must be required to demonstrate that there is a sufficient business case for multi-year infrastructure programs to justify spending and ultimately recovery from ratepayers. Furthermore, the proposed programs must have a clear nexus to improved resiliency or redundancy. For natural gas companies, it is questionable whether or not resiliency or redundancy projects should be included under an accelerated infrastructure program as they are not primarily safety projects. Non-safety related resiliency or redundancy projects should be handled in the normal course.

(d) Projects deemed by the Board to involve critical interconnections of a utility plant:

This proposed language is unclear and could potentially encompass a broad range of projects. Any proposed project should have clear demonstrable ratepayer benefits. The language is so broad that projects that are not cost effective may still be approved if deemed by the Board to involve "critical interconnections of a utility plant." As stated in other sections, the utilities must provide a "business case" for each proposed program in future multi-year investments.

6. **The Projects must be non-revenue producing. Blanket infrastructure programs will not be eligible.**

If the Board proceeds with regulations implementing the Straw Proposal, Rate Counsel agrees that revenue producing projects and blanket programs should not be eligible. This is consistent with the DSIC and current infrastructure programs.

7. **Cost recovery will be through a surcharge mechanism that will allow accelerated recovery.**

Item (7) of the Straw Proposal states that the utility shall be permitted to recover program investments through a surcharge that can be implemented on an accelerated basis. This is clearly a central feature of the Multi-Year infrastructure program and likely the primary reason for such enthusiastic utility support. While the straw proposal does not set forth any details on how such a mechanism would operate, Rate Counsel notes that New Jersey utilities in recent years have used Board-approved tracker-type cost recovery mechanisms for infrastructure spending programs. The salient feature of such surcharge mechanisms is that they provide the utility with single-issue ratemaking cost recovery, and they do so at greatly diminished, very low risk for shareholders as compared to base rate case standard ratemaking.

Rate Counsel does not support the inclusion of an accelerated surcharge mechanism and believes that utilities can receive appropriate cost recovery through standard base rate cases which permit a comprehensive review of the utility's entire cost of service and earnings position. Standard base rate cases provide full cost recovery for prudent utility costs and avoid the problem of single issue ratemaking.

To the extent that an infrastructure program with accelerated recovery is authorized, then Rate Counsel recommends that recovery be through an annual surcharge mechanism. As discussed in detail below, neither Rate Counsel nor other parties have the resources to process

semi-annual filings, especially when one considers the multitude of other rider and surcharge mechanisms that have been adopted in New Jersey over the past several years. In addition, the surcharge should be listed as a separate charge on customers' bills. Ratepayers should know the amount they are paying for utility infrastructure improvements.

The revenue requirement collected through the surcharge associated with the upgrades should be based on plant that is completed and placed into service. Once a project is completed and placed into service, the utility should then stop accruing an allowance for funds used during construction ("AFUDC") and instead the Company should begin to depreciate the project. The revenue requirement should reflect the rate base at the end of the annual period (e.g. December 30th), including plant in service, accumulated depreciation, and accumulated deferred income taxes. The revenue requirement should also include depreciation expense on the related plant additions. The depreciation expense included in the surcharge can either be based on a composite rate that is developed for each utility during the infrastructure project approval process, or on approved depreciation rates for each account. (The use of a composite rate would facilitate review of the annual filings while the use of individual depreciation rates will require a more extensive review). As discussed above, utilities should begin to recognize depreciation expense once a project is completed and placed into service. Depreciation accruals should be based on the same methodologies used for projects recovered through base rates. For purposes of calculating the surcharge, a composite depreciation rate may be used if approved as part of the initial approval of the infrastructure program.

The revenue requirement should also include applicable taxes and uncollectibles, if recovered through base rates, based on statutory tax rates and on uncollectible rates approved in the utility's last base rate case.

In addition, the annual surcharge should be based on projects that have been completed and placed into service. As an illustration, utilities could make a preliminary filing on October 15, showing completed projects through September 30th and projections for the last three months of the year. The preliminary filing should be based on the most realistic projections available. Utilities should not include speculative contingencies (which some utilities do now in their preliminary filings) but instead should be based on what the utilities actually project their plant in service additions to be by the end of the year. This preliminary filing could be reviewed by Rate Counsel and other parties and the discovery process initiated. As soon as possible after the end of the year (ideally by January 30th), the utility could file actual plant in service additions for the entire annual period, and the parties should then have at least 30 days to review the update and identify any concerns. If actual plant additions deviate from the preliminary filing by more than some percentage (e.g. 10%), then the review period could be extended. The new annual surcharge would take effect upon BPU approval. There would be no statutory requirement to process these filings within a certain period of time, but every attempt would be made to obtain prompt BPU approval.

Finally, if the Board decides to go forward with this proposal, Rate Counsel recommends the following features should be incorporated into the Surcharge mechanism calculation: (1) use the utility's approved capital structure from its last rate case; (2) use the utility's current embedded cost of long-term debt and actual short-term debt cost rate (for utilities that include short-term debt in capital structure); and (3) include the utility's approved return on equity ("ROE") from its most recent rate case **minus** a reasonable risk decrement. The first two of these recommendations are straight forward and consistent with past practice with tracker mechanisms. The last approved capital structure has been deemed by the Board to be reasonable and is known.

A current utility capital structure that differs significantly from that most recently approved by the Board could be unreasonable and imprudent. Similarly, there should be no objection to the use of the current embedded cost of debt in place of a stale figure that potentially could be several years old and overstate the current actual cost.

Furthermore, Rate Counsel believes that as a matter of balance and fairness the ROE used in a surcharge mechanism should be lower than the ROE awarded in the utility's most recent rate case. There are three reasons why such a decrement would be proper. First, the accelerated surcharge is a much less risky method of cost recovery than the use of standard base rate cases. The accelerated surcharge recovery removes essentially all cost recovery risk other than the utility's "execution risk" in carrying out its approved program. While Rate Counsel is not asserting that there is no investment risk with an infrastructure program, it is clear that there is much less risk than under the rate case method of cost recovery. This is precisely why utilities so enthusiastically favor such programs and the associated cost recovery mechanism. Unless an ROE decrement is implemented, the risk reduction benefit would go entirely to shareholders. The inclusion of an ROE decrement would both provide the utility with a fair and compensatory rate of return while providing customers with at least some savings in return for accepting the burden of the surcharge. It is also important to keep in mind that the ROE decrement would only apply for the period of time that the utility is receiving cost recovery through the surcharge. For example, if an asset is completed in year two and has a 30 year life, it could be recovered in the surcharge for three years (assuming a rate case filed in five years)and the other 27 remaining life years in base rates. Thus, the ROE decrement only applies over a small percentage of the infrastructure asset's life.

A second reason for the rate of return decrement is that it helps to discourage excessive investment or "gold-plating" in order to maximize earnings (or earnings in excess of its cost of equity). Rate Counsel is concerned that absent a reasonable ROE decrement, utilities may find the accelerated surcharge mechanism so attractive as to create an incentive to overinvest in order to maximize surcharge revenue and earnings. The ROE decrement would help to mitigate such distorted incentives by better aligning the surcharge ROE with the actual cost of equity relevant to the surcharge mechanism. The Board should be concerned that a program that is too attractive to utilities may induce uneconomic capital spending.

Third, Rate Counsel acknowledges that the appropriate reduction in the cost of equity associated with the favorable accelerated cost recovery is hard to reliably quantify. However, the fact that a reliable cost of equity risk reduction estimate is hard to quantify does not justify ignoring the problem and implicitly assuming no risk/cost of equity reduction. In that light, it should be noted that the straw proposal includes a 50 basis point premium in the annual earnings test (Item 15 under the straw proposal). Rate Counsel does not take issue with the use of that ROE premium. However, as a matter of balance if a 50 basis point premium is allowable under the earnings test, at least a 50 basis point decrement to the allowed ROE should be required under the accelerated cost recovery surcharge.

8. The Infrastructure Program must include a cost benefit analysis.

Rate Counsel agrees that a cost benefit analysis is important for purposes of assessing the need and prudence of any replacement program. However, in most recent utility infrastructure replacement programs, the utilities have not explicitly quantified benefits but rather provided only a general description of benefits that could arise from the program implementation. For example, some utilities have discussed the benefits associated with the reduction of leaks, but do

not provide a detailed analysis of how leak reductions correlate to their pipeline replacement efforts. In addition, most utilities in past infrastructure program petitions have generally argued that the construction aspects of their programs will result in local employment and other economic benefits, but rarely have attempted to quantify these benefits in any detail.

Each utility should provide information supporting its proposed investments that would include a description of each quantifiable cost and benefit, the associated net present value and the key assumptions that went into each value, along with a sensitivity analysis. Any costs and benefits of the proposed investment that the utility believed should be considered but which could not be reasonably quantified would also be presented and explained.

To calculate benefits and costs, utilities must use both baseline and projected data. Baseline data will establish the status of the utilities' distribution system during the project period, assuming no multi-year investment program spending. The projected data will forecast expectations about the distribution system with the implementation of the proposed multi-year investment plan. The value of a benefit and cost assessment will be the difference between the utility's baseline and its projected data for a given point in time. [22]

Any cost-benefit analysis should be performed on a total program and subprogram basis. Although the program as a whole may be cost effective one or more subprogram may provide little or no benefit. Therefore each subprogram should be evaluated individually to determine its cost effectiveness. In addition to the filing of a cost-benefit analysis, Rate Counsel recommends

[22] Many of the infrastructure investments undertaken in an accelerated infrastructure program are projects that would have been carried out in the normal course of a utility's business. Therefore, the cost benefit analysis should also analyze the benefit of accelerating the program and not just merely the program itself. In addition, it should be incumbent upon the utility to show that the program and capital investments are necessary to meet state energy policy, reliability, or resiliency needs and are still the least cost method for meeting those policies, even if the investments themselves may not pass typical cost-benefit tests.

that the utilities also be required to provide details on the annual rate impacts associated with each infrastructure program. For gas infrastructure filings, the cost-benefit analysis should include but not be limited to the following items:

- Cost of infrastructure spending;
- Avoided O&M costs;
- Avoided leaked gas;
- Reduction in supply costs from a reduction in unaccounted for natural gas;
- Avoided accidents and damage to property;
- Avoided Greenhouse Gas Emissions;
- Avoided outages; and
- Jobs created.

9. The maximum annual increase in rates attributable to an Infrastructure Program will be two percent.

Initially, Rate Counsel believes that if the Board moves forward with this program, an annual limit of 2% would be appropriate, given the current low interest rate, low inflation economy. A 2% limit would allow a total increase of 10% over the course of a five-year infrastructure program, in addition to any increases that would take effect due to base rate case filings.

However, Rate Counsel believes that it is crucial that staff clarify that any limitation should be based on base distribution rates, not on total revenues. The infrastructure program is an alternative to recovery through base distribution rates and the normal rate case process used to recover distribution spending. Therefore, there is no rationale for linking the level of infrastructure spending to amounts that are impacted by other factors. For example, total

revenues are largely dependent on revenues received for Basic Gas Supply Service ("BGSS") and/or Basic Generation Service ("BGS"). These revenues are not related to the provision of distribution service. In addition, these revenues are significantly impacted by market forces that have nothing to do with the distribution business, such as market prices for natural gas, etc. In addition to BGSS and BGS revenues, total revenues also include recovery for other programs that are unrelated to distribution, such as solar financing programs, energy efficiency programs, societal benefit programs, and others.

Moreover, if the 2% limitation was applied to total revenues instead of to base distribution rates, the resulting base distribution increases resulting from the infrastructure program rider would be very large. Following is an estimate of the annual revenue increases that would result, given annual increases of 2% of distribution revenues vs. 2% of total revenues:[23]

[23] These figures are based on publicly available financial information over the past 24 months and assume that the annual revenue requirement impact is approximately 13% of plant additions. The BPU should request updated revenue data from each utility so that the specific impacts for each utility can be quantified more precisely.

BASED ON 2% OF TOTAL REVENUES ($000)

	Annual Increase	Annual Plant Additions
PSE&G (Gas)	$39,700	$305,400
NJNG	$11,900	$91,500
SJG	$9,100	$70,000
Etown	$5,700	$43,800
PSE&G (Electric)	$117,400	$903,000
JCP&L	$39,400	$303,100
ACE	$26,500	$203,800
RECO	$3,400	$26,200

BASED ON 2% OF DISTRIBUTION REVENUE ($000)

	Annual Increase	Annual Plant Additions
PSE&G (Gas)	$19,800	$152,300
NJNG	$6,100	$46,900
SJG	$5,300	$40,800
Etown	$3,200	$24,600
PSE&G (Electric)	$38,700	$297,700
JCP&L	$25,200	$193,800
ACE	$7,500	$57,700
RECO	$1,600	$12,300

For example with respect to PSE&G Electric, the annual revenue requirement increase based on 2% of total revenues would be $117.4 million (annual plant additions of $903 million). On the other hand, based on 2% of distribution revenues, the annual revenue requirement increase would be $38.7 million (with annual plant additions of $297.7 million). As demonstrated above, the amount of the increase permitted to be recovered through the rider mechanism will vary significantly depending on whether total revenues or distribution revenues is used as the

standard. Rate Counsel believes that the infrastructure program should be based on a percentage of distribution revenues, since the infrastructure program is an alternative to recovery through base distribution rates. Also, as noted earlier in these comments, using total revenues as the benchmark would make the infrastructure program dependent on factors that have nothing to do with the distribution business, including the market price of BGSS and BGS service.

10. For combination utilities, separate gas and electric infrastructure programs may be established, each with their own respective spending caps.

Rate Counsel agrees that in the case of a combination utility such as PSE&G, separate electric and gas caps should apply. Rate Counsel recommends that the electric and gas programs be calculated, developed, and reviewed independently from one another.

11. Allowance for Funds Used During Construction ("AFUDC") would be allowed but not deferred accounting once facilities are in service.

Rate Counsel agrees that AFUDC accrual would be allowed while plant is under construction in accordance with the utility's standard accounting rules and procedures. This means that once construction is complete and the project is in-service, AFUDC must cease and the utility must begin at that time to reflect depreciation expense. Moreover, not all Construction Work in Progress ("CWIP") is eligible for AFUDC accrual. This is the same treatment that would be used for plant expenditures recovered in base distribution rates. Rate Counsel recommends that AFUDC reflect the same equity cost rate as the return on equity used in the infrastructure cost recovery mechanism calculation. In addition, the AFUDC rate should also include short-term debt, in the same manner as normally used by the utility. For example, all New Jersey electric utilities use the "FERC formula" for directly assigning actual short-term debt to CWIP for AFUDC purposes.

12. The utilities will be allowed to file rate recovery petitions on a semi-annual basis provided at least ten percent of the infrastructure program's costs were in-service during the semi-annual period.

As noted above, Rate Counsel recommends that any infrastructure program surcharge be implemented on an annual basis. All of the gas and electric utilities file numerous annual petitions for cost recovery due to commodity costs, societal benefit clause initiatives and various tariff provisions. Specifically, the gas utilities have historically also filed infrastructure petitions to respond to weather-related events, such as Hurricane Sandy, and federal pipeline safety mandates. (See Exhibit A, Items 17 – 23; and PHMSA[24]).

Presently, a review of the current tariffs of PSE&G[25], New Jersey Natural Gas[26], Elizabethtown Gas[27] and South Jersey Gas[28] reveal that Board Staff and Rate Counsel must respond – on an individual versus generic basis – to the following rate recovery clauses: Basic Gas Supply Service ("BGSS"), Conservation Initiative Program ("CIP"), Remediation Adjustment Clause or Manufacturing Gas Plant Clause ("RAC/MGP"), Societal Benefits Charge Clause ("SBC"), Weather Normalization Clause or Temperature Adjustment Clause ("WNC/TAC"), Energy Efficiency Tracker ("EET"), Universal Service Fund charge ("USF") and Regional Greenhouse Gas Initiative ("RGGI") charges for renewable energy and distributive energy resource programs. Each of these tariff filings requires Rate Counsel and Board Staff to analyze the petitions for accounting and program/policy issues with the assistance of expert consultants. Further, if a rate increase is requested, at least 2 public hearings are required within

---

24 http://www.phmsa.dot.gov/staticfiles/PHMSA/DownLoadableFiles/110404%20Action%20Plan%20Executive%20Version%20_2.pdf

25 https://www.pseg.com/family/pseandg/tariffs/gas/pdf/gas_tariff.pdf

26 https://www.njng.com/regulatory/pdf/Tariff-05012017-correct.pdf

27 https://www.elizabethtowngas.com/-/media/Files/ETG/Rates-Tariff/NJ-TARIFF-NO-14-5-4-17.pdf

28 https://www.southjerseygas.com/getattachment/About-South-Jersey-Gas/Regulatory-Compliance-Tariff-Information/Tariff-No-11-May-1-2017.pdf.aspx?lang=en-US

the service territories of the utilities. For example, due to the configuration of PSE&G's service territory, no less than 6 public hearings are held whenever a petition is filed requesting a rate increase. Rate Counsel and Board Staff attend all public hearings. If the Board allows semi-annual cost recovery filings for infrastructure projects filed pursuant to the proposal, the strain on already stretched resources for Rate Counsel and Board Staff would be enormous and counter-productive.

It must also be recognized that many of the existing infrastructure and tariff filings mentioned above require the utilities to supplement their initial schedules for actual data. This requirement frequently necessitates the implementation of provisional rates by the Board when ratepayers are due a refund or rate decrease. This procedure often results in these matters being completed in 7 to 10 months or within about 4 to 6 weeks before the next cost recovery filing has to be filed. If the Board were to allow semi-annual petitions that require no less scrutiny than the numerous annual petitions currently filed, the result would be unavoidable regulatory lag in both Rate Counsel and Board Staff performing their duties. Pursuant to N.J.S.A. 52:27EE-46 *et seq.*, Rate Counsel has a statutory mandate to scrutinize utility filings to protect the best interests of ratepayers. Adoption of a regulatory scheme which establishes unrealistic procedural deadlines – regardless of detailed minimum filing requirements – would result in ineffective regulation and improper oversight of the utility industry to the detriment of ratepayers.

In the past, the Board has required minimum filings requirements for the annual or semi-annual filings in approved infrastructure investment programs. Rate Counsel recommends minimum filing requirements be imposed for these programs as well: Required information should include detailed project cost reports, change orders and the estimated quantity of work completed to date or, if the project cannot be quantified with numbers, the major tasks

completed, e.g., design phase, material procurement, permit gathering, phases of construction, etc.

13. Rates will be provisional, with prudency to be determined in the next base rate case, which will be required to be filed no later than five years after the approval of the infrastructure program.

Rate Counsel agrees that any interim rate increases provided through this program would necessarily be provisional, subject to refund. N.J.S.A. 48:2-21.1 Rate Counsel has already expressed its concerns above regarding the necessity for the provisional rates and prudency to be reviewed in a rate case sooner than five years particularly if it has been a number of years since the utility has had a rate case prior to program approval and inception. In addition, it is assumed that "provisional" means that any cost recovery under a surcharge mechanism would be subject to refund, not just disallowed going forward. See Toms River Water Co. v. N.J. Bd. of Public Util., Comm'ls., 82 N.J. 201, 213 (1980). Any such refund should be subject to interest accrual on the over-recovery of imprudent costs.

Presumably, the five-year rate case filing is based on the assumption of a five-year program. For example, if a three-year program is approved, then the five year deadline on a rate case filing makes no sense. The rate case filing requirement should be no later than the conclusion of the program. The rule should also make it clear, that even though the Board may approve a petition (possibly as modified by the Board), the utility has a "continuing prudence" obligation. This means that even though projects are preapproved as appropriate, needed and beneficial by the Board, the utility retains the obligation to assess those projects during the course of the program in light of relevant changing circumstances. This is the normal obligation of management to make reasonable business decisions based on the facts and circumstances at

the time investments are made, not just when a program is initially approved. Finally, it must be clearly set out in future regulations how this would work when there is a rate case filed, especially if the rate case is filed in the middle of the program (e.g. rate case in year 3 of a five-year infrastructure program). This provision needs further clarification.

14. An annual earnings test shall be required, which shall include an unadjusted cost and revenue study.

At the outset, if the Board goes forward with infrastructure regulations, Rate Counsel would strongly support the concept of including annual earnings tests. This is because the Straw proposal framework contemplates the approval of a "tracker" type of cost recovery mechanism that would provide for single issue ratemaking that is highly advantageous to utility shareholders. Consequently, it is an important consumer protection (and a matter of basic fairness) that the infrastructure surcharge rate increases only be permitted upon a showing that the utility's actual earnings (as discussed below) are not unreasonably excessive. That is, the infrastructure surcharge cost recovery mechanism should not be used to further increase utility earnings that already are excessive.

While we support this concept, Rate Counsel is not sure what is meant by an "unadjusted cost and revenue study". Rate Counsel does recommend that the implementation of an annual infrastructure program surcharge be contingent upon a finding that the utility did not unreasonably overearn in the year in question on its jurisdictional utility operations. For example, an infrastructure program surcharge to reflect 2019 plant additions would not be permitted if the Company earned more than the authorized ROE, as adjusted pursuant to the infrastructure program proposal discussed above.

In order for such an "overearnings" study to be relevant to the concept of "regulatory earnings," the utility's study should incorporate, to the extent practicable, standard Board ratemaking policies and practices. As examples at this time, Rate Counsel recommends that the actual utility earnings be utilized, with the following standard regulatory adjustments: 1) charitable contributions and lobbying expenses would be excluded from the calculation, 2) rate base would not include assets or liabilities associated with pensions or OPEB costs, 3) only 50% of incentive compensation costs would be included as operating expenses, (4) the inclusion of a consolidated tax adjustment using the Board's methodology,[29] and (5) the utility's most recently approved capital structure be used to calculate the ROE. Rate Counsel reserves the right to supplement this list of well-known examples.

There should be no other adjustments permitted for such factors as normal weather, storm damage, extraordinary operating costs, etc. Such adjustments are controversial and their inclusion would greatly complicate what appears intended to be a streamlined review of actual utility earnings. Moreover, these potentially contentious adjustments are really not needed for the purpose at hand. For example, if a utility achieves extraordinarily high actual earnings during a year due to (for example) extreme weather, then there is simply no need for a between rate case surcharge the following year as earnings absent the surcharge already are more than adequate. The exclusion of such adjustments is fair to the utility since it is a symmetric treatment. For example, there would also be no adjustment to the earnings test due to unusually mild weather which has the effect of reducing reported earnings for the earnings test.

[29] Subject to any ultimate decision by the Appellate Division in I/M/O the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment; Docket No. A-1153-14T1

15. If the calculated Return on Equity ("ROE") exceeds the allowed ROE from the last base rate case by 50 basis points, there will be no accelerated recovery for the next six months and until a new calculation shows no return over the fifty basis points.

Item 15 in the staw proposal suggests that utility earnings may exceed the last rate case authorized ROE by up to 50 basis points and the surcharge for the subsequent year will be implemented. While it could be argued that no ROE premium be permitted under the earnings test (a test that Rate Counsel believes is a vital consumer protection), Rate Counsel at this time does not dispute the inclusion of this premium. In part, this is because we recognize that an earnings test is not necessarily a precise and perfect indicator of going forward earnings, and to make the earnings review process manageable, normalization adjustments should be excluded as stated above. Further, in response to the design of the infrastructure cost recovery surcharge mechanism, Rate Counsel strongly recommends that a risk decrement of at least 50 basis points be imputed to the "rate case" ROE used to calculate revenue requirements.

16. The water utilities already have an accelerated infrastructure program with the DSIC and should not be permitted to choose between the DSIC and the infrastructure Straw Proposal.

The DSIC regulations, N.J.A.C. 14:9-10.1 et. seq., provide an accelerated infrastructure program for the water utilities. The DSIC regulations have been in place for approximately five years, and were only proposed following a contested case that the Board found established the need for a DSIC and a stakeholder process that lasted at least one year. This stakeholder process sought input from a variety of stakeholders including Board Staff, Rate Counsel, the various water utilities, and ratepayers such as the large water users. As part of this stakeholder process, the water utilities were required to demonstrate that their water systems actually needed accelerated investment. Eventually the parties reached agreement on the regulatory scheme that eventually became the DSIC regulations.

Under DSIC, a water utility is only permitted to seek recovery for specific eligible projects:

1) Water main replacement and rehabilitation;
2) Water main cleaning and lining;
3) Valve and hydrant replacement;
4) Service line replacement (from main to curb or meter pit); and/or
5) Un-reimbursed utility relocation costs associated with relocation required by governmental entities.

Recovery through the DSIC mechanism is for non-revenue producing, and, by and large, non-expense reducing additions that are already providing utility service to water utility customers. Similarly, the types of projects covered under the infrastructure Straw Proposal must be well defined and limited.

The DSIC regulations cap annual DSIC investment at 5% of annual revenues as set in a utility's last base rate case. While some of the water utilities have reached the cap at different points in the last five years, most have not. Accordingly, it is hard to envision why the water utilities would need the infrastructure Straw Proposal if they are not reaching their DSIC caps.

Furthermore, the DSIC program appears to be meeting the needs of the water utilities, as evidenced by the current DSIC rule re-adoption. Comments in that matter were filed on March 17, 2017. Rate Counsel is not aware of any water utility that filed comments recommending that DSIC be eliminated. Nor is Rate Counsel aware of any comments recommending that DSIC be replaced with or complemented by a different program such as the infrastructure Straw Proposal. Indeed, in its comments to the Board on the DSIC rule re-adoption, Suez Water Company hailed DSIC as a "vital program to rehabilitate and replace our critical infrastructure." The National Association of Water Companies likewise noted that DSIC "provide[s] water utilities with the means to replace and rehabilitate eligible water infrastructure in a timely and cost-effective manner…." These are just two examples of the water utilities' apparent satisfaction with the

current DSIC program. If there was a core problem with current DSIC regulations, the water utilities would have advised the Board of this during the comment period. That they did not shows that DSIC is addressing their needs adequately, rendering the infrastructure Straw Proposal superfluous and unnecessary.

Despite this, the Straw Proposal would allow the water utilities to choose to use either the DSIC or the Straw Proposal for infrastructure investment. In order to ensure consistent application of the Board's regulations, the water utilities should not be allowed to choose between the DSIC program and the Straw Proposal. As it is currently written, the water utilities would be allowed to switch back and forth between DSIC and the infrastructure Straw Proposal as often as they would like. It may be possible for the water utilities to file for three months of DSIC investments and three months of investments made under the infrastructure Straw Proposal in each six month filing. This has the potential for creating regulatory chaos. Board Staff and Rate Counsel simply do not have the resources to handle these programs being implemented differently by each water utility, possibly simultaneously and potentially in a haphazard, inconsistent fashion. There are also unanswered questions as to how the combination of these two programs would even work. For example, if a water utility uses the infrastructure Straw Proposal for a period of time and then switches to DSIC, does the investment under the Infrastructure Straw Proposal count towards the 5% DSIC cap? Presumably it would, but at a minimum, these types of issues must be clarified before proceeding with a rulemaking.

The Board should limit the water utilities to using the DSIC exclusively. Unlike the Straw Proposal, the DSIC regulations state the specific categories of non-revenue producing plant that are eligible for rate recovery. N.J.A.C. 14:9-10.3(a). The DSIC also requires the water utilities to file a base rate case within three years of the effective date of a DSIC foundational

filing. N.J.A.C. 14:9-10.4(e). The infrastructure Straw Proposal does not (but should) have these safeguards. The DSIC regulations are specifically designed to address water utilities' needs, contain appropriate safeguards to protect ratepayers, and accordingly are the best use of water ratepayers' dollars. The water utilities should be required to follow the DSIC at least until such time as the current re-adoption of DSIC sunsets in the future.

Conclusion

For the foregoing reasons, we respectfully request that the Board find that there is no need for a rulemaking at this.

EXHIBIT A

GAS AND ELECTRIC UTILITY INFRASTRUCTURE PROGRAMS
LINKS TO BASE RATE PROCEEDINGS

	Utility/Program	Date Approved	Link to Base Rate Case
	ORIGINAL ECONOMIC STIMULUS		
1	NJNG Accelerated Energy Infrastructure Investment Program ("AIP")[i]	April 2009	Company's 2007 base rate case was re-opened for consideration of base rate increases associated with infrastructure investments through August 31, 2011.
2	SJG Capital Investment Recovery Tracker ("CIRT")[ii]	April 2009	Base rate petition to be filed on or before April 1, 2011.
3	PSE&G Capital Infrastructure Investment Program ("CIP")[iii]	April 2009	Base rate petition to be filed between April 3, 2009 and April 1, 2011
4	ETG Utility Infrastructure Enhancement ("UIE") Program[iv]	April 2009	Rate increases associated with infrastructure investments to be considered in Phase II of pending 2009 base rate case
5	ACE Infrastructure Investments Surcharge ("IIS")[v]	April 2009	Base rate petition to be filed on or before April 1, 2011.
	ECONOMIC STIMULUS EXTENSION		
6	NJNG AIP II[vi]	March 2011	Company's 2007 base rate case to remain open to consider infrastructure improvements through October 2012, after which the base rate case will close.
7	SJG CIRT II[vii]	March 2011	Company's 2010 base rate case to remain open for infrastructure investments through October 2012, with recovery for later investments to be considered in subsequent base rate or other proceeding.
8	ETG UIE II[viii]	May 2011	Phase II of Company 2009 base rate case to remain open to consider investments through October 2012, with recovery for later investments to be considered in a subsequent base rate or other proceeding.
9	PSE&G CIP II[ix]	July 2011	Company's 2009 base rate case to remain open for projects to be completed by December 2012, with recovery for later investments to be considered in the Company's next base rate case.

	GAS PIPELINE SAFETY AND MODERNIZATION		
10	ETG Pipeline Replacement Program ("PRP")[x]	Aug. 2006	Previously issued BPU Order approving Company's merger with AGLR required a base rate filing no later than March 2009.
11	NJNG Safety Acceleration and Facility Enhancement ("SAFE") Program[xi]	Oct. 2012	Base rate case to be filed no later than November 15, 2015
12	SJG Accelerated Infrastructure Replacement Program ("AIRP")[xii]	Feb. 2013	Base rate case to be filed no later than December 15, 2015.
13	ETG Accelerated Infrastructure Replacement ("AIR") Program [xiii]	Aug. 2013	Base rate case to be filed no later than September 1, 2016
14	PSE&G Gas System Modernization Program ("GSMP")[xiv]	Nov. 2015	Company previously committed to file a base rate case no later than November 1, 2017.
15	NJNG SAFE II[xv]	Sept. 2016	Base rate case to be filed no later than November 2019.
16	SJG AIRP II[xvi]	Oct. 2016	Company previously committed to file base rate case no later than October 1, 2017. Next base rate case to be filed no later than three years following the Board Order in the 2017 base rate case.
	STORM HARDENING/ RESILIENCE		
17	PSE&G for Approval of the Energy Strong Program[xvii]	May 2014	PSE&G will file its next base rate case no later than November 1, 2017.
18	JCP&L Major Storm Events in 2011 and 2012[xviii]	March 2015	Company is directed to file a base rate case no later than April 1, 2017.
19	RECO Major Storm Events in 2011 and 2012[xix]	May 2014	2011 and 2012 Major Storm Costs recovery to be determined in pending Base Rate Case (ER13111135).
20	RECO Storm Hardening Program[xx]	Jan. 2016	These costs will be subject to review in the next Base Rate Case which the Company has committed to filing by July 31, 2018.
21	ETG Natural Gas Distribution Utility Reinforcement Effort ("ENDURE") Program[xxi]	July 2014	Base rate case to be filed by September 1, 2016.

22	NJNG Reinvestment Enhancement Program ("RISE")[xxii]	July 2014	Company previously committed to file a base rate case no later than November 15, 2015.
23	SJG Storm Hardening and Reliability Program ("SHARP")[xxiii]	Aug. 2014	Company's 2013 base rate case pending at time program approved, and next base rate case to be filed no later than October 1, 2017.

---

[i] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities and I/M/O the Petition New Jersey Natural Gas Company for Approval of an Accelerated Energy Infrastructure Investment Program Pursuant to N.J.S.A. 48:2-23, and for Approval of Necessary Changes to Gas Rates and Changes in the Company's Tariff for Gas Service Pursuant to N.J.S.A. 48-2-21, BPU Dkt. Nos. EO09010049 & GO09010052 (Apr. 28, 2009).

[ii] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities and I/M/O the Petition of South Jersey Gas Company for Approval of a Capital Investment Recovery Tracker Pursuant to N.J.S.A. 48:2-21.1 and N.J.S.A. 48:2-21, BPU Dkt. Nos. EO09010049 & GO09010051 (Apr. 28, 2009).

[iii] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities and I/M/O the Petition of Public Service Electric & Gas Company for Approval of a Capital Economic Stimulus Investment Program and an Associated Cost Recovery Mechanism Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, BPU Dkt. Nos. EO09010049 & GO09010050 (Apr. 28, 2009).

[iv] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities and I/M/O the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of a Utility Infrastructure Enhancement Cost Recovery Rider, BPU Dkt. Nos. EO09010049 & GO09010053 (Apr. 28, 2009).

[v] I/M/O the Petition of Atlantic City Electric Company for Approval of Certain Energy Infrastructure Investments and Approval of a Cost Recovery For Such Projects and Related Tariff Modifications Associated Therewith Pursuant to N.J.S.A. 48:2021 and 48:21.1, BPU Dkt. No. GO09010054, Decision and Order Approving Stipulation (Apr. 28, 2009).

[vi] I/M/O the Petition of New Jersey Natural Gas Company for Approval of an Extension of the Accelerated Energy Infrastructure Investment Program Pursuant to N.J.S.A. 48:2-23 and for Approval of Necessary Changes in the Company's Tariff for Gas Service Pursuant to N.J.S.A. 48:2-21 et seq., BPU Dkt. Nos. GR07110889 & GR10100793 (Mar. 30, 2011).

[vii] I/M/O the Annual Filing of South Jersey Gas Company to Adjust its Capital Investment Recovery Tracker ("CIRT") and for Approval of an Extension of the CIRT Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and I/M/O the Petition of South Jersey Gas Company for Approval of Base Tariff Rates and Charges for Gas Service and Other Tariff Rvisions, BPU Dkt. Nos. GR10100765 & GR10010035 (Mar. 31, 2011).

[viii] I/M/O Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas to Extend its Utility Infrastructure Enhancement Program and Revise its Utility Infrastructure Enhancement Rate and I/M/O Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of Increased Base Tariff Rates and Charges for Gas Services and Other Tariff Revisions, BPU Dkt. Nos. GO10120969 & GR09030195 (May 16, 2011).

[ix] I/M/O the Petition of Public Service Electric and Gas Company for Approval of an Extension of the Electric Capital Economic Stimulus Infrastructure Investment Program and Associated Cost Recovery Mechanism and to Roll Into Rate Base the Net Capital Investment for All the Qualifying Projects From the Initial Capital Economic Stimulus Infrastructure Investment Program Upon Completion Pursuant to N.J.S.A. 48:2-23, 48:2-21 and 48:2-21.2 and for Changes in the Tariff for Electric Service, B.P.U.N.J. No. 15 Electric, and the Tariff for Gas Service, B.P.U.N.J. No. 15 Gas Pursuant to N.J.S.A. 48:2-21 and I/M/O the

Petition of Public Service Electric and Gas Company for Approval of an Extension of the Gas Capital Economic Stimulus Infrastructure Investment Program and Associated Cost Recovery Mechanism and to Roll Into Rate Base the Net Capital Investment for All the Qualifying Projects From the Initial Capital Economic Stimulus Infrastructure Investment Program Upon Completion Pursuant to N.J.S.A. 48:2-23, 48:2-21 and 48:2-21.2 and for Changes in the Tariff for Electric Service, B.P.U.N.J. No. 15 Electric, and the Tariff for Gas Service, B.P.U.N.J. No. 15 Gas Pursuant to N.J.S.A. 48:2-21, BPU Dkt. Nos. EO11020088 & GO10110862 (Jul. 14, 2011).

[x] I/M/O the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas Company to Establish a Pipeline Replacement Program Cost Recovery Rider, BPU Dkt. No. GR05040371 (Aug. 18, 2006).

[xi] I/M/O the Petition of New Jersey Natural Gas Company for Approval of the Safety Acceleration and Facility Enhancement Program Pursuant to N.J.S.A. 48:2-23 and for Approval of the Associated Recovery Mechanism Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, BPU Dkt. No. GO21030255 (Oct. 23, 2012).

[xii] I/M/O the Petition of South Jersey Gas Company to Implement an Accelerated Infrastructure Replacement Program and Associated Recovery Mechanism Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, BPU Dkt. No. GO12070670 (Feb. 20, 2013).

[xiii] I/M/O the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of an Accelerated Infrastructure Replacement Program and an Associated Cost Recovery Mechanism, BPU Dkt. No. GO12070693 (Aug. 21, 2013).

[xiv] I/M/O the Petition of Public Service Electric and Gas Company for Approval of a Gas System Modernization Program and Associated Cost Recovery Mechanism, BPU Dkt. No. GR15030272 (Nov. 16, 2015).

[xv] I/M/O the Petition of New Jersey Natural Gas Company for Approval of an Increase in Gas Base Rates and for Changes in its Tariff for Gas Service, and Approval of SAFE Extension and NJ RISE Rate Recovery Mechanism Pursuant to N.J.S.A. 48:2-21, 48:2-21.1 and for Changes to Depreciation Rates for Gas Property Pursuant to N.J.S.A. 48:2-18, BPU Dkt. No. GR15111304 (Sept. 23, 2016).

[xvi] I/M/O the Petition of South Jersey Gas Company to Continue Its Accelerated Infrastructure Replacement Program ("AIRP") Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and for Approval of a Base Rate Adjustment to Reflecr AIRP Investments in Base Rates, BPU Dkt. No. GR16020175 (Oct. 31, 2016).

[xvii] I/M/O Public Service Electric and Gas Company for Approval of the Energy Strong Program, Dkt. Nos. EO13020155 and GO13020156, Order Approving Stipulation of Settlement (5/21/14).

[xviii] I/M/O the Board's Establishment of a Generic Proceeding to Review the Prudence of Costs Incurred By New Jersey Utility Companies in Response to Major Storm Events in 2011 and 2012, BPU Dkt. No. AX13030196 and I/M/O the Board's Review of the Prudence of the Costs Incurred By Jersey Central Power and Light Company in Response to Major Storm Events in 2011 and 2012, BPU Dkt. No. ER13050391, Order (3/26/15).

[xix] I/M/O the Board's Review of the Prudency of the Costs Incurred by Rockland Electric Company in Response to Major Storm Events in 2011 and 2012, BPU Dkt. No. EO13070611, Decision and Order Approving Stipulation (May 21, 2014).

[xx] I/M/O the Board's Establishment of a Generic Proceeding to Review the Costs, Benefits and Reliablity Impacts of Major Storm Even Mitigation Efforts, BPU Dkt. No. AX13030197 and I/M/O the Verified Petition of Rockland Electric Company for Establishment of a Storm Hardening Surcharge, BPU Dkt. No. ER14030250, Decision and Order Approving Stipulation (1/28/16).

[xxi] I/M/O the Board's Establishment of a Generic Proceeding to Review the Costs, Benefits and Reliability Impacts of Major Storm Event Mitigation Efforts and I/M/O the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of the Elizabethtown Natural Gas Distribution Utility Reinforcement Effort Program and Deferred Accounting Treatment, BPU Dkt. Nos. AX13030197 & GO13090826 (July 23, 2014).

[xxii] I/M/O the Board's Establishment of a Generic Proceeding to Review the Costs, Benefits and Reliability Impacts of Major Storm Event Mitigation Efforts and I/M/O the Petition of New Jersey Natural Gas Company for Approval of the NJ RISE Program and Associated Rate Recovery Mechanism, BPU Dkt. Nos. AX13030197 & GO13090828 (July 23, 2014).

[xxiii] I/M/O the Board's Establishment of a Generic Proceeding to Review the Costs, Benefits and Reliability Impacts of Major Storm Event Mitigation Efforts and I/M/O the Petition of South Jersey Gas Company for Approval of a Storm Hardening and Reliability Program (SHARP) and Associated Recovery Mechanism, BPU Dkt. Nos. AX13030197 & GO13090814 (Aug. 20, 2014).

EXHIBIT B

EXCERPT

STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE PETITION OF NEW JERSEY AMERICAN WATER COMPANY FOR AUTHORIZATION TO IMPLEMENT A DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC")	BPU DOCKET NO. WO08050358

INITIAL BRIEF OF THE STAFF OF THE BOARD OF PUBLIC UTILITIES

ANNE MILGRAM
ATTORNEY GENERAL OF NEW JERSEY
Attorney for the Staff of the
Board Of Public Utilities
124 Halsey Street
P.O. Box 45029
Newark, New Jersey 07102

Jessica Campbell, Deputy Attorney General
Anne Marie Shatto, Deputy Attorney General
Caroline Vachier, Deputy Attorney General
On the Brief

Date: April 17, 2009

TABLE OF CONTENTS

PAGE

PRELIMINARY STATEMENT 1

PROCEDURAL HISTORY 2

SUMMARY OF PARTIES'S POSITIONS 3

COMPANY'S POSITION 4

1. Proposed Need for and a Justification of a DSIC 4

2. DSIC Eligible Plant 8

3. The DSIC Mechanism

A. The Level of the DSIC Mechanism 10

B. The Timing and Frequency of the DSIC 10

4. The Methodology of the DSIC 11

5. Earnings Test 13

6. Interest on DSIC Over- and Under-Recoveries 14

RATE COUNSEL'S POSITION 14

1. The Need for and Justification of a DSIC 14

2. DSIC Eligible Plant 19

3. DSIC Implementation Procedures and Mechanism 19

4. Earnings Test 19

5. Interest on DSIC Over- and Under-Recoveries 21

PAGE

THE POSITION OF THE NAWC INTERVENORS 21

1. The NAWC Supports a DSIC 21

2. DSIC Eligible Plant 22

3. The DSIC Mechanism

A. The Level of the DSIC Mechanism in Neighboring States 23

B. The Timing and Frequency of the DSIC 24

4. Methodology of the DSIC Mechanism 25

THE POSITION OF THE BULK PURCHASERS COALITION (BPC) 27

COMMENTS FROM THE PUBLIC HEARINGS 29

STAFF'S DSIC PROPOSAL 30

POINT I

BECAUSE NJAW HAS ESTABLISHED THAT A SUBSTANTIAL PORTION OF ITS MAINS ARE OVER 50 YEARS OLD, STAFF RECOMMENDS THAT THE BOARD IMPLEMENT A DSIC ON A PILOT BASIS AND THAT THE BOARD COMMENCE A GENERIC RULEMAKING CONSISTENT WITH APPLICABLE LAW 31

POINT II

BOARD STAFF RECOMMENDS, AMONG OTHER THINGS, THAT THE BOARD LIMIT THE DSIC ELIGIBLE PLANT TO MAINS THAT ARE OVER 50 YEARS OLD, CAP THE DSIC SURCHARGE AT 3% OF ANNUAL GROSS REVENUES BETWEEN RATE CASES, ALLOW INTEREST ON ANY OVER COLLECTION, AND REQUIRE THE COMPANY TO FILE QUARTERLY REPORTS AND ANNUAL FILINGS. 39

A. DSIC Rate Cap....................40

B. DSIC Methodology....................41

C. Earnings Test....................42

D. Over Recoveries....................42

E. Initial Filing....................42

F. Annual True-up and Quarterly Reports....................43

G. Minimum Filing Requirements....................44

H. No Self-Implementing Rates....................44

CONCLUSION....................46

TABLE OF AUTHORITIES

CASES CITED

Airwork Serv. Div., Etc., v. Director, Div. of Taxation,
97 N.J. 286 (1983)....................36

Communication Workers of America, AFL-CIO v. N.J. Dept. of Personnel
154 N.J. 121 (1998)....................35

County of Bergen v. Dept. of Public Utilities of the State of N.J.,
117 N.J. Super. 304 (App. Div. 1971)....................33

PAGE

Crema v. New Jersey Dept. of Environmental Protection, 94 N.J. 286 (1983) 36

In re Industrial Sand Rates, 66 N.J. 12 (1974) 34

In re Investigation of Tele. Cos., 66 N.J. 476 (1975) 34, 35

Metromedia, Inc. v. Director, Div. of Taxation, 97 N.J. 313 (1984) 36-39

In re Petition of New Jersey American Water Co. for an Increase in Rates for Water and Sewer Service, 169 N.J. 181 (2001) 33

In re Petition of Pub. Serv. Coordinated Transp., 5 N.J. 196 (1950) 33

In re Solid Waste Utility Customer Lists, 106 N.J. 508 (1987) 38

STATUTES CITED

N.J.S.A. 48:2-13 32

N.J.S.A. 48:2-21.1 34

N.J.S.A. 48:2-21(d) 33

N.J.S.A. 48:2-23 33

N.J.S.A. 48:2-32.4 .... 42, 43

N.J.S.A. 52:14B-1 36

REGULATIONS CITED

N.J.A.C. 14:9-7.4 42

At the Westfield Public Hearing, Mr. Tom Getzendanner, an elected official for the Town of Summit, commented that the self-implementing DSIC rate be capped at a percentage lower than 7.5%, such as at 3%, in light of the Company's recent rate increases. (Westfield Public Hearing Transcript 15-6 to 12). No members of the public spoke at the Maplewood and Westhampton public hearings.

STAFF'S DSIC PROPOSAL

Staff proposes that the Board adopt a DSIC mechanism that would permit NJAW to recover expenditures on the replacement of main that is at least 50 years of age, up to a total of 3% of the Company's annual gross revenues, between rate cases. Staff recommends that in order to collect a DSIC charge from ratepayers, the Company must first file a petition with the Board on or about October 2009 outlining the DSIC-eligible plant that was or is to be placed in service between December 31, 2008 and December 31, 2009. Beginning in 2010, the Company is to submit quarterly reports to reflect DSIC eligible plant that was placed in service after each period.[6] Staff proposes that on or about October 2010, the Company submit a petition for DSIC eligible plant that was or is to be placed in service between December 31, 2009 and December 31, 2010. The Company will also be required to file its "true up" petition which will reconcile the DSIC-eligible plant that was placed in service during the previous year up to and including December 31, 2009, along with a depreciation reserve true up for the associated plant.

Through Staff's proposal, DSIC rates would be changed annually with a filing that includes a public hearing and a Board Order. Staff recommends that the Company be required to file a base rate case no later than three years, but with rates effective no sooner than two years after the Board Order in this docket. At the conclusion of the base rate proceeding, which will

[6] Staff proposes that a January 2010 quarterly report reflect eligible plant placed in service for the fourth quarter of 2009, the April 2010 report reflect activity during the first quarter of 2010, the July 2010 report reflect activity during the second quarter of 2010, and the October 2010 report reflect activity from the third quarter of 2010.

include a prudency review of all DSIC-eligible projects, all DSIC-related costs deemed just and reasonable will be made permanent, and the DSIC clause will be reset to zero. Staff also proposes all over recoveries collected under the DSIC charge be refunded to ratepayers with interest. Moreover, Staff supports the concept of an earnings test.

Additionally, Staff recommends that the implementation of the DSIC be done within the context of a pilot program for at least two years and no more than three years. Furthermore, Staff recommends that the Board begin a generic rulemaking proceeding in order to develop rules to be applied to all regulated water and wastewater utilities within the Board's jurisdiction.

Staff recommendations, including a discussion of method of calculating the DSIC charge, will be further addressed below.

POINT 1

BECAUSE NJAW HAS ESTABLISHED THAT A SUBSTANTIAL PORTION OF ITS MAINS ARE OVER 50 YEARS OLD, STAFF RECOMMENDS THAT THE BOARD IMPLEMENT A DSIC ON A PILOT BASIS AND THAT THE BOARD COMMENCE A GENERIC RULEMAKING CONSISTENT WITH APPLICABLE LAW.

The Board should adopt a DSIC, because the need for one is necessary to address New Jersey's aging water and wastewater infrastructure. According to NJAW, 15% or 1250 miles of its water mains will be in service for 100 years or more by the year 2020 unless they are replaced before then. (PT-2 3-21 to 22). Additionally, mains installed before 1965 account for over 50% of NJAW's water main system. Mains installed during this period pre-dates the common use of cement-lined ductile iron pipe material. (PT-2 10-2 to 8). Moreover, these mains have been subjected to years of corrosion, increased weight loading from heavier vehicles, street repavings and impacts from installation of other underground utilities. (PT-2 10-2 to 8). Further, the mains installed within the NJAW system in the 1920s and those installed between 1945 and 1955 may reach the end of their useful lives at the same time within the next 25-35 years due to factors

such as age, localized conditions, design standards and manufacturing techniques. (PT-2 5-9 to 6-3). Relative to NJAW's collection systems, Ms. Chiavari notes that these mains were constructed 50 to over 100 years ago and that they will reach the end of their useful lives within the next 5-25 years. (PT-2 3-14 to 17).

NJAW argues that traditional ratemaking alone cannot address the growing need to replace and rehabilitate aging water and wastewater infrastructure that is nearing its useful life (PT-2 16-7 to 11) and the implementation of a DSIC would relieve the uncertainly inherent in a rate case and allow the Company to pursue an aggressive replacement and rehabilitation program. (PT-2 19-10 to 13). Staff believes that a DSIC would allow the Company to accelerate its pace of infrastructure replacements at a reasonable cost, resulting in improved water quality, improved pressure and service reliability that will benefit customers. Staff also believes that the replacement and upgrade of deteriorating water and wastewater mains could reduce the number of main breaks, service interruptions, unaccounted for water; improve water quality; and enhance fire protection. Staff agrees with the Company that the DSIC will permit the Company to address its aging infrastructure on a more timely basis and that a DSIC, when properly implemented, can accelerate the replacement of older mains.

Staff notes Rate Counsel's argument that the existing ratemaking mechanism is sufficient to address an accelerated infrastructure program. (2T 94-24 to 95-3). Staff believes that the parameters set forth below address the parties's positions.

First, the Board should find that it is within its authority to order the implementation of a DSIC to customers of NJAW, a public utility under the Board's jurisdiction. Under N.J.S.A. 48:2-13, the Board has general jurisdiction over all public utilities and their "property, property rights, equipment, facilities and franchises so far as may be necessary for the purpose of carrying

out the provisions of [Title 48]." It has been stated in case law that the Board was "intended by the Legislature to have the widest range of regulatory power over public utilities," and that the provisions under N.J.S.A. 48 "are to be construed liberally." County of Bergen v. Dept. of Public Utilities of the State of N.J., 117 N.J. Super. 304, 312 (App. Div. 1971).

Moreover, the Legislature has granted the Board broad discretion to exercise its rulemaking authority to ensure just and reasonable utility rates. In re Petition of Pub. Serv. Coordinated Transp., 5 N.J. 196, 214 (1950). As stated in N.J.S.A. 48:2-21(d), "the Board, either upon written complaint or upon its own initiative, shall have power after hearing, upon notice, by order in writing to determine whether the increase, change or alteration is just and reasonable."

The BPU also has the authority to implement a DSIC because the DSIC is germane to the Board's authority delegated under the provisions of Title 48, including the power to require any public utility to provide safe, adequate and proper service under N.J.S.A. 48:2-23. In In re Petition of New Jersey American Water Co. for an Increase in Rates for Water and Sewer Service, 169 N.J. 181, 197 (2001), the Court reversed the Board's granting of a 50/50 sharing between ratepayers and shareholders of the utility's charitable contributions, because, in part, there was no nexus between utility's charitable contributions and the claimed benefits to ratepayers to justify inclusion of contributions in the utility's operating expenses. Here, the record establishes that the implementation of a DSIC will allow the Company to accelerate on an incremental basis the replacement of aging mains. This will in turn provide improved water quality, pressure and service reliability to NJAW customers. (PT-2 16-9 to 11). Because the record supports a nexus between the implementation of a DSIC and benefit to the ratepayers, and because the Board has the statutory authority to order a DSIC, the Board should find that it is within its power to implement a DSIC under its broad ratemaking authority over public utilities.

Furthermore, there is a line of case law that permits the Board, pursuant to N.J.S.A. 48:2-21.1, the "negotiation statute," to adjust rates on an interim basis pending final review within a rate case, but any such adjustments cannot be regarded as "contractual." Staff proposes that the DSIC charge be implemented under the authority of the negotiation statute. Accordingly, Staff recommends that the Company file a rate case no later than three years from the date of a Board Order approving a DSIC, but with rates to be effective no earlier than two years from the date of a Board Order in this docket, in order to ensure compliance with the N.J.S.A. 48:2-21.1.

The Board's ability to utilize the negotiation statute had been addressed in In re Industrial Sand Rates, 66 N.J. 12 (1974), in which the Court made clear that the authority granted to the Board to negotiate with the utility for an adjustment of rates is confined to interim relief pending a proceeding to determine justness and reasonableness of an existing or proposed rate, and it, therefore, set aside permanent rates negotiated by the Board with the utility without requisite rate base and rate of return findings. The Court explained that

> [t]he vital justification for the "negotiation statute" and rates established under it, temporarily bypassing the establishment of rate base and fair rate of return, rests upon the legal umbilical cord which ties them to the anticipated eventual determination of the fundamentals; at which time the temporary rates, their legitimacy having been validated, merge into the [Board] judgment ordaining the final rate structure or, if and to the extent found to have been excessive, are refunded to the consumers who paid them.
>
> [Id. at 19-20.]

Likewise, in In re Investigation of Tele. Cos., 66 N.J. 476 (1975), the Court upheld the Board's implementation of a "comprehensive adjustment clause," which permitted the company in that matter to recover certain expenses as they increased, finding that there was a nexus to the Board's review in that company's rate case. The Court acknowledged the Court's ruling in Industrial Sand that the "legal umbilical cord" between a "temporarily increased rate and the

final adjudication of the firmly established and traditional components which enter into the determination of "just and reasonable' rates" is indispensable. Tele. Cos., 66 N.J. at 495. The Court further explained that even expenses that "flow through" to consumers must be "[t]ested in the scrutiny of final rate determination and only in that way (despite the impressive monitoring devices built into the instant clause) can such expenses be validated and become demonstrably honest components in the ascertainment of 'just and reasonable' rates." Ibid.

Consistent with the Board's statutory authority and the nexus requirements in both Tele. Cos. and Industrial Sand, the Board has the authority to implement a DSIC mechanism for NJAW in the form of a pilot program. The Board would be within its authority to implement this pilot program for a period of two years. In Communication Workers of America, AFL-CIO v. N.J. Dept. of Personnel, 154 N.J. 121 (1998), the Supreme Court found that appellant, Department of Personnel, had not exceeded its authority when it adopted new pilot programs for determining eligibility of candidates for civil service appointments without first conducting a rulemaking proceeding. The pilot program that Staff is proposing would be for an interim period with interim relief until these temporary rates in the pilot program are merged into a base rate case to be filed within three years from the final decision rendered by the Board herein. The pilot program is merely interim relief and will aid the Board and Staff in evaluating the efficacy of the processes and procedures for implementation of a DSIC. As discussed below, the Board, while evaluating this pilot program, should concomitantly institute a rulemaking procedure. Therefore, Staff recommends that the Board implement the DSIC on a pilot basis.

Based on the above case law, Staff recommends that the Board require that the Company file a rate case no later than three years from the date of a Board Order approving a DSIC, but with rates to be effective no earlier than two years from the date of a Board Order approving the

DSIC, in order to ensure that the DSIC expenses are scrutinized in a final hearing. *See* Tele. Cos., 66 N.J. at 496.

Staff also recommends that the general implementation of the DSIC process and procedures be promulgated pursuant to a rulemaking under the Administrative Procedure Act, N.J.S.A. 52:14B-1 et seq. (the "Act"). Under the Act, administrative rule is defined as follows:

> "Administrative rule" or "rule" when not otherwise modified, means each agency statement of general applicability and continuing effect that implements or interprets law or policy, or describes the organization, procedure or practice requirements of any agency. The terms includes the amendment or repeal of any rule, but does not include: (1) statements concerning the internal management or discipline of any agency; (2) intra-agency and inter-agency statements; and (3) agency decisions and findings in contested cases.
>
> [N.J.S.A. 52:14B-2(e).]

Administrative rulemaking requirements are grounded in notions of fairness, notice and procedural due process. Crema v. New Jersey Depart. of Environmental Protection, 94 N.J. 286 (1983); Airwork Ser. Div., etc. v. Director, Div. of Taxation, 97 N.J. 290 (1984). They are designed to ensure that affected parties are provided sufficient notice with respect to actions to be taken against them prospectively or which may affect substantial rights including the rights of persons not party to the action.

The statutory definition of administrative rule has been further examined in Metromedia, Inc. v. Director, Div. of Tax'n, 97 N.J. 313 (1984). There, the Supreme Court identified six factors to be weighed in determining whether an agency action must be rendered through formal rulemaking procedures. The Court held that an agency action could be considered an administrative rule:

> If it appears that the agency determination, in many or most of the following circumstances: (1) is intended to have wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group; (2) is intended to be applied generally and uniformly to all similarly

situated persons; (3) is designed to operate only in future cases, that is, prospectively; (4) prescribes a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization; (5) reflects an administrative policy that (i) was not previously expressed in any official and explicit agency determination, adjudication or rule or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter; and (6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy.

[Id. at 331-32].

The six factors "can, either singly or in combination, determine in a given case whether the essential agency action must be rendered through rule-making or adjudication." Id. at 332. The applicability of the Metromedia factors to the case at bar becomes most evident when one attempts an analysis under the six factor test.

The first Metromedia factor is whether the Board's decision to implement a DSIC is "intended to have wide coverage encompassing a large segment of the regulated or general public." Metromedia, supra at 331. The implementation of a DSIC will encompass a large segment of the general public, as it will be applicable to all water companies in New Jersey and their ratepayers.

The next factor, whether the implementation of a DSIC is "intended to be applied generally and uniformly to all similarly situated persons," is met since all water companies and their ratepayers will be generally and uniformly affected by the procedures required by the Board for implementation of a DSIC mechanism. The third factor, whether the agency policy "is designed to operate only in future cases, that is, prospectively," has been met. If adopted, the Board will be approving the implementation of a DSIC for all future cases. The application of the DSIC is, therefore, prospective in nature.

The fourth <u>Metromedia</u> factor is equally satisfied by the case at bar. The implementation of a DSIC mechanism is not "clearly and obviously inferable from the enabling statutory authorization." In <u>In re Solid Waste Util. Cust. Lists</u>, 106 <u>N.J.</u> 508, 518 (1987), although "all six of the <u>Metromedia</u> factors need not be present to characterize agency action as rulemaking," these factors "should not merely be tabulated but weighed." In that case, an order of the Board of Public Utilities was found to satisfy three of the six <u>Metromedia</u> criteria. Nonetheless, the New Jersey Supreme Court determined that the Board's order did not constitute an administrative rule because it was clearly inferable from the applicable enabling legislation and neither changed nor interpreted Board policy concerning solid waste utilities.

As discussed previously, there is no explicit statutory language providing for the process and procedures associated with the implementation of a DSIC. The statutory scheme does not specifically provide statutory guidance on the process and procedure for implementation of a DSIC. The Board's statutory authority allowing it to establish a DSIC is grounded in very broad and all-encompassing statutory language and the more general statutory language addressing the Board's broad discretionary power over all public utilities is applicable. Therefore, the fourth factor in <u>Metromedia</u> has been met, and the Board should promulgate rules in this case. Further, as discussed below, the Board will be interpreting its policies to make a determination as to the process and procedure for the DSIC.

The fifth factor considered in <u>Metromedia</u> is whether the policy "(i) was not previously expressed in any official and explicit agency determination, adjudication or rule or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter." The Board has never previously addressed the DSIC in any official and explicit

agency determination, adjudication or rule. Therefore, the fifth Metromedia factor has been satisfied.

The last Metromedia factor, whether the Board's decision to implement a DSIC mechanism "reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy," is applicable to the case at bar. Here, the Board would be making a decision in the nature of the interpretation of law or general policy. To establish the DSIC mechanism, the Board will be interpreting the law and its general policies to formulate the process and procedure for the DSIC mechanism for all water companies in the State of New Jersey.

From the foregoing, it is clear that the Board's ultimate decision to implement a DSIC mechanism in New Jersey can be readily applied to the six factor test of Metromedia and, therefore, should be written through formal rulemaking procedures.

POINT 2

STAFF RECOMMENDS, AMONG OTHER THINGS, THAT THE BOARD LIMIT THE DSIC ELIGIBLE PLANT TO MAINS THAT ARE OVER 50 YEARS OLD, CAP THE DSIC SURCHARGE AT 3% OF ANNUAL GROSS REVENUES BETWEEN RATE CASES, ALLOW INTEREST ON ANY OVER COLLECTION, AND REQUIRE THE COMPANY TO FILE QUARTERLY REPORTS AND ANNUAL FILINGS.

As Ms. Chiavari testified, 50% of the Company's 8,330 miles of water was installed prior to 1965 and 30% of its pipe was installed before World War II, making a substantial portion of the Company's water main system over 50 years old. (PT-2 10-2 to 5). In light of the age of main in NJAW's system and Staff's recommendation that the Board's initial implementation of a DSIC be a simple process involving one type of plant, Staff proposes that the Board allow only replacement of mains 50 years of age or older to be considered DSIC-