



Agenda Date: 10/23/12  
Agenda Item: 2C

**STATE OF NEW JERSEY**  
**Board of Public Utilities**  
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ENERGY

IN THE MATTER OF 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. 2-21.1 )  
ORDER  
DOCKET NO. GO12030255

**Tracey Thayer, Esq.**, New Jersey Natural Gas Company  
**Stefanie A. Brand, Esq.**, Director, New Jersey Division of Rate Counsel  
**Martin Rothfelder, Esq.**, Public Service Electric and Gas Company  
**Steven S. Goldenberg, Esq.**, Fox Rothschild LP, for New Jersey Large Energy Users Coalition  
**Jim Dieterle, Director**, for AARP New Jersey

BY THE BOARD<sup>1</sup>:

This matter comes before the New Jersey Board of Public Utilities ("Board") on a petition filed by New Jersey Natural Gas Company ("NJNG" or "Company") on March 20, 2012 ("March Filing"), seeking the Board's approval of a "Safety Acceleration and Facility Enhancement" program ("SAFE Program"). As proposed in the March Filing, under the SAFE Program the Company would replace infrastructure, such as unprotected steel and cast-iron mains, and related services and meters on an accelerated basis and then recover such costs on an expedited basis through a special ratemaking mechanism. NJNG requested expedited treatment of the March Filing, and also requested that the Board retain jurisdiction over this matter, assign a Commissioner as a presiding officer, and process the petition as a contested case. By this Order, the Board considers certain procedural issues that have been raised as well as a proposed settlement of this matter.

NJNG is subject to regulation by the Board for the purposes of assuring that safe, adequate and proper natural gas service is provided to its customers. N.J.S.A. 48:2-23. As such, the Company is obligated to maintain its utility infrastructure in such condition as to enable it to meet its regulated obligations to provide the requisite service. That infrastructure is comprised of the property, plant, facilities and equipment within the Company's natural gas distribution and transmission system throughout its service territory. NJNG is also subject to regulation by the Board for the purposes of setting its retail rates to assure safe, adequate and proper natural gas service, N.J.S.A. 48:2-21, and subject to the regulatory standards authorized by the U.S. Department of Transportation, including the Pipeline and Hazardous Materials Safety Administration.

<sup>1</sup> Commissioner Mary-Anna Holden did not participate.

Specifically, the March Filing requested Board approval to implement a five-year capital investment program through which the Company would invest approximately \$204 million prior to the capitalization of Allowance For Funds Used During Construction ("AFUDC") to replace cast iron and unprotected steel<sup>2</sup> distribution lines, services and meters. Many of NJNG's older mains and services were constructed of cast iron and/or unprotected steel, the most popular and readily available materials used in the industry prior to 1970. The Company maintains that its cast iron and unprotected steel infrastructure is generally more susceptible to corrosion damage, leaks, and material failure than the Company's other mains and services. While NJNG has been consistently addressing the replacement of such assets in its annual capital construction planning for many years, the Company's testimony maintains that an accelerated approach is necessary now to shorten the overall time it will take to replace this aged infrastructure. Additionally, there are national efforts underway to increase the safety, reliability and integrity of the country's pipeline infrastructure. NJNG noted in its filing that U.S. Secretary of Transportation, Ray LaHood, in his "Call to Action," encourages an increased focus on pipeline replacement and the associated cost recovery. As a result, significant efforts are being made to address older pipelines that have a greater likelihood of corrosion damage or leaks.

NJNG proposed a five-year program for accelerated replacement of cast iron and unprotected steel infrastructure. By relying on a multi-year approach, the Company maintains that it and its ratepayers would benefit from cost and scheduling efficiencies. It was proposed that through SAFE the Program, cast iron and unprotected steel distribution lines, services and, as necessary, associated meter sets be replaced in a coordinated and systematic manner over the proposed five-year time period.

NJNG asserts that it has been making a concerted effort to replace cast iron and unprotected steel infrastructure in order to maintain reliability to best serve customers and to ensure the continuation of safe, adequate and proper service. However, at this time, the Company believes that an accelerated replacement program will lessen NJNG's exposure to operational risk, increase operational efficiencies and reliability while improving safety throughout the service territory.

In the March Filing, NJNG also sought approval to use, for the SAFE Program investments, the same cost recovery mechanism that was previously approved by the Board for its Accelerated Infrastructure Program ("AIP") investments.<sup>3</sup> That mechanism defers construction costs for a period of time, generally one year, and then seeks Board approval of a rate increase on a provisional basis to reflect the investment in customers' base rates pending inclusion in the rate base during a rate base case.

On April 19, 2012, Public Service Electric and Gas Company ("PSE&G") submitted a Motion to Participate stating that since the decision in this proceeding could have an impact on all of the energy utilities, including PSE&G and its customers, it would therefore be directly and specifically affected by a decision on the March Filing ("PSE&G Motion"). On April 25, 2012, NJNG submitted a response to PSE&G's motion indicating that NJNG did not object to

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<sup>2</sup>Included in the category of "unprotected steel" is pipe that is uncoated or that is coated but not cathodically protected. For convenience, these two categories of steel pipe are referred to as unprotected steel.

<sup>3</sup>In the Matter of the Petition of 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 Docket Nos. GO09010052, GR070110889 Board Approval Date: April 28, 2009.

PSE&G's motion to be a participant provided that all the conditions set forth in N.J.A.C. 1:1-16.6 were met. No other responses were received<sup>4</sup>.

On April 20, 2012, the New Jersey Division of Rate Counsel ("Rate Counsel") filed a letter with the Board requesting that the Company's petition be transferred to the Office of Administrative Law ("OAL") as a contested case. On April 24, 2012, NJNG responded to Rate Counsel's April 20, 2012 letter agreeing that the petition be treated as a contested case, but asking that the Board retain jurisdiction and not transfer the petition to the OAL.

On June 18, 2012, the Board issued an Order retaining jurisdiction of the March Filing and appointed Commissioner Mary-Anna Holden to serve as the presiding officer with authority to rule on all motions and set and modify any schedules as necessary ("June 18 Order"). The Board also directed that a threshold question be addressed in light of the nature of the Company's request, specifically, "...whether the request for approval of a multi-year program for accelerated replacement of cast iron and unprotected steel infrastructure on an expedited basis with recovery of the costs through a special rate mechanism should be addressed through a contested case proceeding or through a rulemaking as in the recently approved Distribution System Improvement Charge (DSIC)." June 18 Order at 2.

On July 19, 2012, Commissioner Holden issued an Order establishing July 30 and August 8, 2012 as the dates for the submission of briefs and reply briefs, respectively, by interested parties on the question of whether rulemaking or contested case proceedings were required for review of the March Filing and similar requests ("Threshold Issue"). Commissioner Holden's Order permitted any interested party to submit its comments on this question without the need for the submission of formal motions to intervene or participate.

By letter motion dated July 27, 2012, Rate Counsel requested that the procedural schedule in the July 19, 2012 Order be suspended, and that a telephone conference be scheduled to clarify the scope of the issues to be addressed, the method of providing notice, and revisions to the schedule. By e-mail dated July 30, 2012, the procedural schedule was stayed pending further action.

On July 31, 2012, the New Jersey Large Energy Users Coalition ("NJLEUC") joined in Rate Counsel's request. By letter dated August 8, 2012, the American Association of Retired Persons ("AARP") also supported suspending Commissioner Holden's initial procedural schedule.

A teleconference was held on August 16, 2012, to address the scope of the Threshold Issue to be briefed, the method of notice to interested parties, and revisions to the procedural schedule. Following that call, Commissioner Holden issued an amended scheduling Order on August 21, 2012, providing for the submission of initial briefs on August 30, 2012 and reply briefs on September 7, 2012, and directing that the revised schedule be posted on the Board's website. On August 30, 2012, initial briefs were submitted by the following: NJNG on behalf of six of the State's natural gas distribution utilities and electric distribution utilities (hereinafter collectively referred to as the "Energy Utilities")<sup>5</sup>, Rate Counsel, NJLEUC and AARP. Thereafter, on September 7, 2012, reply briefs were submitted by NJNG on behalf of the Energy Utilities and by Rate Counsel.

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<sup>4</sup> Action on the PSE&G Motion was suspended pending determination of the Threshold Issue as discussed in this Order.

<sup>5</sup> The joint filing was made on behalf of the following natural gas distribution utilities and electric distribution utilities: NJNG; South Jersey Gas Company ("South Jersey Gas"), Public Service Electric and Gas Company ("PSE&G"); Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas Company ("E'Town"); Jersey Central Power & Light Company ("JCP&L"); and Rockland Electric Company ("Rockland").

In the interim, after public notice, two public hearings on the March Filing were held on August 7, 2012, in Freehold Borough, and two public hearings on August 8, 2012, in Rockaway Township. No members of the public appeared at any of the public hearings, nor were any comments received by the Board in writing from interested parties.

Pending a determination on the Threshold Issue, after discovery and discussions, on October 11, 2012, the Company, Rate Counsel and Board Staff reached a settlement on the issues raised by the March Filing which has been submitted for Board approval. While the main points of the stipulation are described below, the Board will consider this settlement only if it determines that no rulemaking proceeding is required at this time<sup>6</sup>.

**Proposed Stipulation<sup>7</sup>:**

- "SAFE Projects" represent the efforts by the Company to reduce, through replacement, the Company's existing inventory of cast iron or unprotected steel mains and services.
- For the construction work in the first year (12 months) in which the SAFE Program is applicable, the Company will prepare a detailed listing of the specific SAFE Projects to be addressed, including estimated costs, locations of the infrastructure replacement and the expected schedule within which the work will be completed. That information will be provided to Board Staff and Rate Counsel within ninety (90) days of the effective date of the Board Order approving the Company's SAFE Program. Subsequently, NJNG will provide Board Staff and Rate Counsel with anticipated schedules, along with the estimated cost and projected timeline and completion dates, on an annual basis on or about October 1st of each of the subsequent years the SAFE Program is in effect.
- The SAFE Program spending levels will not include the replacement of associated gas meter sets.
- The SAFE Program is to be in effect for four (4) years to replace a significant number of cast iron and/or unprotected steel mains and services in a cost-efficient manner.
- At least \$39.2 million will be invested annually by the Company in SAFE Projects for four years with a target of reducing 276 miles of unprotected steel and cast iron mains and replacing approximately 19,605 associated services.
- During the four (4) year SAFE Program period the estimated total SAFE Program investments of \$39.2 million will be comprised of \$6.7 million of non-incremental capital investment spending and \$32.5 million of incremental capital investments. NJNG can annually apply the accounting procedures set forth in Paragraph 7 of the Stipulation to the estimated \$32.5 million of incremental capital investments up to a cumulative total of no more than \$130 million Program total, for SAFE Projects beginning as of the effective date of the Board Order approving this Stipulation in this proceeding. The annual \$32.5 million and \$130 million four (4) year total amounts are exclusive of AFUDC accruals.

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<sup>6</sup> The proposed settlement differs from the March Filing to the extent that but for the existence of additional outstanding petitions similar to NJNG's, there would be no need to address the Threshold Issue at this time.

<sup>7</sup> Should there be any conflict between this summary and the provisions of the stipulation, the terms of the stipulation control subject to the findings and conclusions of this Order.

- The Company's incremental construction cost target of \$32.5 million annually may be under or over spent by 15 percent in any given year. Any over spending in a given year will be accompanied by a reduction of an equal amount in one or more future periods. Similarly, any under spending in a given year may result in additional spending that exceeds the annual target in one or more future periods. In either event, the amount of incremental investment that is subject to the accounting procedures set forth in Paragraph 7 of the Stipulation during any given year will be the Company's actual total SAFE investment costs less \$6.7 million. In no event will the total incremental SAFE Project expenditures, subject to the accounting treatment procedures set forth in the Stipulation, exceed the total SAFE Program incremental capital investment spending limit of \$130 million over four years.
- All reasonable and prudently incurred incremental investment costs, in amounts determined as described above and in paragraph 6 of the Stipulation, associated with SAFE Projects including, but not limited to, the costs of engineering, design and construction, including labor, materials and other overheads, will be subject to the following accounting treatment for ratemaking purposes:
  - (i) During construction, the AFUDC rate will be based on the Federal Energy Regulatory Commission ("FERC") modified formula currently in use by NJNG.
  - (ii) AFUDC will be accrued on a monthly basis.
  - (iii) At the time a SAFE Project is in-service, when natural gas is reintroduced to the Company's gas distribution system, the AFUDC rate will be 6.9 percent.
  - (iv) SAFE Projects that are in-service will include a ratable monthly deduction for Accumulated Deferred Income Taxes ("ADIT") prior to calculating monthly AFUDC.
  - (v) As proposed by the Company in its filing, the calculation of ADIT will include the United States Internal Revenue Service repair allowance deduction for 50 percent of the tax basis, with Modified Accelerated Cost Recovery System ("MACRS") depreciation for the remainder of the balance.
  - (vi) The depreciation expense for SAFE Projects will be based upon NJNG's depreciation rates. During the deferral period when SAFE Projects are closed to Plant in Service, depreciation expense will be charged (debited) with a corresponding credit to the accumulated depreciation reserve. The recorded depreciation expense will then be deferred in a separate regulatory asset account by charging (debiting) a regulatory asset and crediting the depreciation expense. At the time SAFE Projects are recognized in rate base within a regulatory proceeding, the regulatory asset related to the deferred depreciation expense that had been created pursuant to the accounting treatment set forth herein will be eliminated by crediting the balance with a corresponding charge (debit) to the accumulated depreciation reserve and, therefore, the regulatory asset related to the depreciation expense and the accumulated depreciation reserve related to the SAFE investments that were created for this purpose will have no impact on income or rate base. As a result of these entries there will be no recovery of depreciation expense or adjustments to rate base associated with the accumulated depreciation reserve until the deferred SAFE Project investments are included in rate base within a regulatory proceeding.

- (vii) The rate to be used for calculating AFUDC accruals for book accounting purposes after construction applicable to SAFE Projects will be 6.9 percent per annum. For ratemaking purposes this rate, including the application of the FERC formula described above in Paragraph 7(i) includes an equity component in the capital structure of 53.5 percent and a Return on Equity of 9.75 percent.
- SAFE Program investment costs will be subject to review in the Company's next base rate case. A base rate case shall be filed no later than November 15, 2015.
  - The Company's next base rate case filing will be filed based upon three (3) months of actual data and nine (9) months of projected data for the test year which test year will be updated throughout the course of the proceeding for twelve (12) months of actual data.
  - No rate increase for SAFE Projects shall be put into effect until the issuance of an Order by the Board establishing base rates for the Company in the prospective base rate case proceeding.
  - The Company's current base rates reflect an Operation and Maintenance (O&M) expense related to leak repair of approximately \$690,000. The Company agrees to record and defer in a separate regulatory liability account any amount below \$690,000 per year for O&M expense associated with leak repair. At the time SAFE Projects are recognized in rate base within a regulatory proceeding, the regulatory liability associated with leak repair will be amortized into rates over a four-year period.
  - The continuation of the NJNG SAFE Program beyond those investments reflected in rates at the conclusion of the Company's next base rate case will be subject to review and consideration by the Board in that rate case or a subsequent proceeding.
  - NJNG will provide a quarterly report to Board Staff and Rate Counsel in a format similar to that currently being used for the Company's AIP, and will include the information set forth in Exhibit A of the Stipulation.
  - The Company's leak reports demonstrate an active leak inventory as of December 31, 2011 at 453 leaks as set forth in the Company's 2011 United States Department of Transportation Annual Report.
  - The Company will use best efforts to annually reduce the inventory of open leaks by 15 percent. This level of leak reduction is based upon the SAFE Program spending level set forth above.
  - The Company represents and warrants that it will use best efforts to reduce that active leak inventory by 272 leaks (68 per year) or approximately 60 percent during the SAFE Program term. This metric is irrespective of incremental, new, post-2011 leaks which will not be counted in such metric.
  - During the Company's next base rate case proceeding, the Parties shall review the relevant reports, and such discovery requests as may be appropriate, to determine whether the Company's leak inventory has been reduced by 272 or more from December 31, 2011 through the conclusion of the next base rate proceeding. If it is reduced by less than 272 the amount of AFUDC to be included in rates shall be reduced. The amount of AFUDC to be included in rates shall equal the total amount of the AFUDC accrual on SAFE Projects from the date of the Board Order accepting this Stipulation

until the effective date of the Company's prospective base rate case multiplied by a fraction. The numerator of that fraction will be the amount of leak reduction actually obtained expressed numerically, without giving any recognition to new leaks arising subsequent to December 31, 2011. The denominator of said fraction will be 272.

## **POSITIONS OF THE PARTIES AND OTHER INTERESTED COMMENTATORS ON THE THRESHOLD ISSUE <sup>8</sup>:**

### **Initial Brief- NJNG on behalf of the Energy Utilities:**

According to the Energy Utilities, the Board's existing statutory authority, regulations and prior decisions provide the proper regulatory framework for the Board to consider individual company requests for approval of accelerated infrastructure programs. They allege that no useful purpose would be served by attempting to develop more specific rules of general applicability for these types of filings that contain both utility specific requests and needs based on the unique infrastructure in each individual utility's service territory. They recommend that the Board avoid attempting to establish generic rules that would be applicable in all circumstances. According to the Initial Brief, each of the State's gas and electric utilities face somewhat different facts and circumstances that would unnecessarily complicate any rules of generic applicability, resulting in unintended negative outcomes. The gas and electric utilities point out that the Board has consistently reviewed gas and electric accelerated infrastructure programs and associated cost recovery mechanisms without conducting a rulemaking proceeding, and there is no legal reason for the Board to do so now.

The Energy Utilities further assert that whether a State agency's determination must be considered within a rulemaking and follow the procedures set forth in the Administrative Procedure Act ("APA")<sup>9</sup> has been considered and analyzed in the case of *Metromedia Inc. v. Dir. Division of Taxation*, 97 N.J. 313 (1984) ("*Metromedia*"). Additionally, the gas and electric utilities note that, in the opinion of the Court, in many cases the question of whether an agency decision is required to be by adjudication or by a rulemaking is a close call but that nevertheless adjudication and rulemaking are not interchangeable. *Id.* at 332. For example, when an agency's determination alters the *status quo*, persons who are intended to be reached by the finding, and those who will be affected by its future application, should have the opportunity to be heard and to participate in the formulation of the ultimate determination.

*Metromedia* synthesized the precedent established in many other cases on this question and set forth six factors to be analyzed when considering if an agency determination requires a rulemaking. The Court found that if an agency's determination meets "many or most" of these factors then it should be considered a rulemaking. The factors to be considered are whether the agency decision:

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

<sup>8</sup> The following is a summary of the commenter's positions and arguments. Please refer to the formal submissions for the actual and complete version of the positions presented by each entity.

<sup>9</sup> *N.J.S.A.* 52:14B-2e.

- 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 interpretation of law or general policy.

Metromedia at 331-32.

The gas and electric utilities then apply the *Metromedia* factors to the question presented and assert that the analysis demonstrates that Board approval of the accelerated infrastructure programs does not meet “many or most” of the factors that dictate when a rulemaking approach should be followed. They also point out that Metromedia provides a roadmap to consider when an agency’s determination requires a rulemaking as opposed to when a determination can be handled through other formal or informal processes. *Metromedia* does not mandate that every action of an agency be pursuant to a scripted rule that has been adopted in accordance with the APA. Rather, the Supreme Court has found that regulatory law “...has [an] elasticity that permits it to adapt to changing circumstances and conditions”<sup>10</sup> “and a flexibility that allows agencies ‘the ability to select those procedures most appropriate to enable the agency to implement legislative policy,’”<sup>11</sup> and that “[a]dministrative agencies enjoy great leeway when selecting among rulemaking procedures, contested hearings, or hybrid informal methods in order to fulfill their statutory mandates.”<sup>12</sup>

The Energy Utilities contend that an agency has flexibility to select from the various tools that it has available under the APA.<sup>13</sup> For example, the APA defines a “contested case” and an “Administrative Rule” and distinguishes between the two. A “contested case” is defined by the APA as:

a proceeding ... in which the legal rights, duties, obligations, privileges, benefits or other legal relations of specific parties are required by constitutional right or by statute to be determined by an agency by decisions, determinations or orders, addressed to them or disposing of their interests, after opportunity for an agency hearing[.]

N.J.S.A. 52:14B-2(b).

However, an “Administrative Rule” is defined by the APA as:

...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 term 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 interagency statements; and (3) agency decisions and findings in contested cases. N.J.S.A. 52:14B-2(e).

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<sup>10</sup> *In the Matter of the Provision of Basic Generation Service for the Period Beginning June 1 2008*, 205 N.J. 339, 347 (2011), citing *Glukowsky v. Equity One, Inc.*, 180 N.J. 49, 67, cert. denied, 543 U.S. 1049, 125 S.Ct. 864, 160 L.Ed.2d 770 (2005).

<sup>11</sup> *Id.*, citing *In re PSE&G's Rate Unbundling, Stranded Costs & Restructuring Filings*, 167 N.J. 377, 385, quoting *Texter v. Dep't of Human Servs.*, 88 N.J. 376, 385 (1982).

<sup>12</sup> *Id.*, citing *Nw. Covenant Med. Ctr. v. Fishman*, 167 N.J. 123, 137 (2001).

<sup>13</sup> N.J.S.A. 52:14B-2(c).



Accordingly, the Energy Utilities posit that the greater part of the Metromedia factors are not present in the instant situation. Therefore, the Board need not proceed by rulemaking before considering NJNG's accelerated infrastructure and associated cost recovery filing or any other such filing made, or to be made, by the State's other gas and electric utilities.<sup>14</sup>

With respect to the first two factors, the Energy Utilities state that individual infrastructure and related cost recovery proposal filings are just that – individual, company specific proposals that take into account the unique needs and operational differences of the particular utility. The distinct and varying needs of each of the individual gas and electric utilities make it impractical and virtually impossible to establish uniform rules of general applicability to each of these companies. While the filings made by the individual utilities may be somewhat similar in nature, they do not or presumably would not request a decision that would apply to any party other than the single petitioning utility.

Moreover, the Energy Utilities note that the infrastructure programs and corresponding cost recovery proposals are or would be designed to operate on a prospective basis. They assert that New Jersey's courts have recognized that ratemaking is a legislative and not a judicial function, and the Board is vested with broad discretion in the exercise of its authority. Hudson & Manhattan Railroad Co. v. Board of Public Utility Commissioners, 16 N.J. Super. 396, 401 (App. Div. 1951), certif den., 17 N.J. 459 (1955) ("Hudson & Manhattan"). According to the Energy Utilities, the fact that ratemaking is legislative eliminates the significance of the question of whether the Board intends its decision to operate prospectively from the analysis of whether Metromedia would require the Board to proceed by rulemaking. All rate decisions issued by the Board operate prospectively because retroactive ratemaking is not permitted by the Board's enabling legislation. In re Elizabethtown Water Co., 107 N.J. 440, 449, (1987).

Turning to the fourth factor, the Energy Utilities assert that the March Filing and those filed by utilities in other similar infrastructure proceedings do not request the Board to prescribe a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization. Instead, approving accelerated infrastructure programs is completely consistent with the Board's broad authority over utilities and their rates.<sup>15</sup> They state that the New Jersey Supreme Court observed that "the Board of Public Utilities . . . to which the legislature has delegated its rate making power, is vested with broad discretion in the exercise of that authority."<sup>16</sup> The Board is not required to employ any particular mode of computing rates, but it must reach a result that is supportable.<sup>17</sup> In exercising its discretion over individual utility rates, the Board is free to make pragmatic adjustments. Township Committee of Lakewood v. Lakewood Water Co., 54 N.J. Super. 371, 381, (App. Div. 1959). This delegation of the legislative ratemaking function to the Board is

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<sup>14</sup> Accelerated infrastructure and cost recovery proposal filings similar to that made by NJNG were also submitted to the Board by E'Town and South Jersey Gas on or about July 23, 2012. See, *In the Matter of the Petition of South Jersey Gas Company to Implement an Accelerated Infrastructure Investment Program ("AIRP") and Associated Recovery Mechanism Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1*, BPU Docket No. GO12070670 and *In the Matter of 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.

<sup>15</sup> See N.J.S.A. 48:2-13, 48:2-21, and 48:2-21.1.

<sup>16</sup> Public Service Coordinated Transport v. State, 5 N.J. 196, 214 (1950). The Board's rulings are entitled to presumptive validity and will not be disturbed unless there is a lack of reasonable support. See also Petition of Public Service Electric and Gas Company for an Approval of an Increase in Electric and Gas Rates and for Changes in Tariffs for Electric and Gas Service, 304 N.J. Super. 247, 264 (App. Div. 1997).

<sup>17</sup> *Id.* at 265.

valid specifically because the legislative standards governing the exercise of the Board's authority are sufficiently precise. Hudson & Manhattan, supra, 16 N.J. Super. at 401. The Energy Utilities assert that, as long as the Board evaluates rate proposals within the statutory parameters established by the legislature, there is no need for the Board to limit the exercise of its discretion further by adopting special regulations applicable to accelerated infrastructure program cost recovery mechanisms. Indeed, the Board is well within its authority to continue to approve or reject such mechanisms by applying the legal standards set forth in N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 to the facts and circumstances presented in individual utility proceedings.

In addition, the Energy Utilities assert that a Board decision concerning NJNG's petition or those of other utilities would not reflect an administrative policy that was not previously expressed in a prior determination nor constitute a material and significant change from a clear, past agency position on the identical subject matter. In fact, the Board has previously authorized gas and electric utilities to undertake accelerated infrastructure programs without the need for a rulemaking proceeding.<sup>18</sup> The current filings made by NJNG, E'town and South Jersey Gas are essentially extensions of accelerated infrastructure programs that have been previously approved by the Board pursuant to N.J.S.A. 48:2-21.1 and N.J.S.A. 48:2-21 in 2009, 2011 and 2012. As such, these requests to accelerate investments in gas infrastructure and recover the associated costs through adjusted rates address issues that previously have been considered and decided by the Board without the need for a rulemaking.

According to the Energy Utilities, the filings made by NJNG, E'Town and South Jersey Gas are not proposing that the Board address generic issues or items significantly different from those considered in relation to the filings previously approved by the Board in 2009, 2011 and 2012. The submissions are or would be filed with supporting testimony and exhibits, public notice has been or would be provided for scheduled public hearings, discovery has or would be propounded and answered, and interested parties would be given the opportunity to participate. Parties to each gas and electric utilities' independent filings are free to agree to certain terms and conditions applicable to the individual infrastructure investment programs and/or related

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<sup>18</sup> *In the Matter of New Jersey Natural Gas Company for Approval of an Accelerated Energy Infrastructure Investment Program, and for Approval of Necessary Changes to Gas Rates and Changes in the Company's Tariff for Gas Service*, BPU Docket Nos. GR07110889 and GR09010052. Approved by Board Order dated April 28, 2009. *In the Matter 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 to Gas Rates and Changes in the Company's Tariff for Gas Service Pursuant to N.J.S.A. 48:2-21 et seq.*, BPU Docket Nos. GR07110889 and GR10100793. Approved by Board Order dated March 30, 2011. *In the Matter of 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*. Docket No. GO09010051. Approved by Board Order dated April 28, 2009. *In the Matter of 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*. Docket No. GR10010035. Approved by Board Order dated March 31, 2011. *In the Matter of the Petition of South Jersey Gas Company to Modify and Extend its Existing Capital Investment Recovery Tracker ("CIRT II") Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1*. Docket No. GO11100632. Approved by Board Order dated May 1, 2012. *In the Matter of the Petition of 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 48:2-21.1*, BPU Docket Nos. EO09010049 and GO09010050. *In the Matter of the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of a Utility Infrastructure Enhancement Cost Recovery Rider*, BPU Docket No. GO09010053. Approved by Board Order dated April 28, 2009. *In the Matter of the 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*, Docket Nos. GO10120969 and GR09030195. Approved by Board Order dated May 16, 2011.

rate mechanisms. Those agreements would then be addressed in a stipulation submitted to the Board for its review and consideration. To the extent that the parties fail to reach agreement on the terms of these individual company programs, evidentiary hearings would be held, the matter would be briefed, and a decision on the merits of that specific case's evidence would be issued.

The Energy Utilities cite to various determinations in which the Board has applied the Metromedia evaluation process. According to them, most relevant is the 2009 determination by the Board where it decided that procedures for handling similar infrastructure investment and rate recovery petitions were to be handled as individual contested cases. Re: Infrastructure Investment and a Cost Recovery Mechanism, Docket No. EO09010049, EO09010050 *et al.* Order Designating Commissioner (January 29, 2009). In that matter, petitions by many of the Energy Utilities requested that the Board approve certain accelerated infrastructure investments pursuant to N.J.S.A. 48:2-21.1 *et seq.* and simultaneously approve the recovery of costs for such projects through the implementation of rate mechanisms. After public notice, and public hearings, these contested cases were resolved through stipulations of settlement among the parties. Parties who could potentially be impacted by those proceedings were given notice and had the opportunity to participate. The Board reviewed and separately approved the stipulations of settlement and authorized the programs and rate mechanisms supporting the proposed infrastructure work while creating needed jobs and enhancing the provision of safe, adequate and proper service. These proceedings did not require a rulemaking, but rather, the Board relied on its well-established authority to review and approve rates with appropriate conditions to ensure that those rates satisfy the statutory requirements. The Board exercised these powers in the review and consideration of the petitions and the resulting stipulations including base rate recovery for one gas utility and rider-type recovery for the other three gas utilities.<sup>19</sup>

Each of these infrastructure investment programs was then separately extended by the filing of subsequent company-specific petitions which were approved by orders of the Board. These extended programs were also subject to public notice, an opportunity for impacted parties to participate, and an opportunity for hearing. Each proceeding was resolved through company-specific settlements that were approved by the Board pursuant to its statutory authority and without the need for a generic rulemaking.

Further, in 2011, the Board determined that a rulemaking was not necessary for the Board to direct New Jersey's gas utilities to make compliance filings to ensure that their tariffs provided for specific guidance to customers seeking discounted rates for bypass or other specified conditions.<sup>20</sup> In making this determination, the Board published notice of the proceeding, held hearings, accepted written comments on the issue and ultimately found that a rulemaking was not necessary. In that proceeding, the Board found:

The courts have recognized that the Board has broad discretion in the exercise of its Legislatively delegated rate making authority, In re: Public Service Electric and Gas Company's Rate Unbundling, Stranded Costs and Restructuring Filings, 167, N.J. 377, 384 (2001) ("PSE&G Unbundling"). In determining whether to approve any rates, under a tariff or under a special contract, the Board is guided by the statutes and by certain time honored principles. Public utility rates are

<sup>19</sup> As described by the Court in *Dragon v. New Jersey Dept. of Environmental Protection*, 405 N.J. Super. 478, 491 (App.Div.2009), an agency unquestionably has the power to settle contested matters under the APA. After all, "parties to a dispute are in the best position to determine how to resolve a contested matter in a way which is least disadvantageous to everyone. (citations omitted)." *Id.*

<sup>20</sup> In The Matter of a Generic Proceeding to Consider Prospective Standards for Gas Distribution Utility Rate Discounts and Associated Contract Terms and Conditions, Docket Nos. GR10100761 and ER10100762 Order (August 18, 2011) ("Discount Gas Order").

valid so long as they enable the utility to operate successfully, maintain its financial integrity, attract capital and compensate its investors for the risk assumed. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). On the other hand, public utility rates can only be valid if they are "just and reasonable," N.J.S.A. 48:2-21, and are not "unjustly discriminatory or unduly preferential." N.J.S.A. 48:3-1.

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... the courts have recognized that the Board must have flexibility in choosing the appropriate approach for resolving the complex problems presented in the exercise of its jurisdiction. "Generally, an administrative agency has discretion to exercise its statutory authority either by adjudication or rule-making. *Case-by-case determinations are preferable where, as here, it is doubtful whether any generalized standard could be framed which would have more than marginal utility.*" *In re: Dept. of Community Affairs Order of March 15, 1988*, 232 N.J. Super. 136,143 (App. Div. 1989) (citations omitted). The Board is persuaded that this is particularly appropriate when dealing with Discount Agreements, and that rulemaking is not required. (emphasis added)

The Board, in then applying the Metromedia analysis, found that a rulemaking was not necessary under those standards either.

According to the Energy Utilities, in the current SAFE proceeding, NJNG has filed for expedited approval of an accelerated infrastructure program and associated rate recovery mechanism. The Energy Utilities maintain that this filing is similar to NJNG's current economic stimulus infrastructure and Compressed Natural Gas ("CNG") filings that were approved by the Board in 2009, 2011 and in 2012. NJNG's filing requests authorization to accelerate certain company-specific investments in gas infrastructure, and seeks recovery of the associated costs through base rates, and NJNG's filing is not proposing that the Board address generic issues or items significantly different from those considered in relation to NJNG's economic stimulus infrastructure and CNG programs previously approved by the Board. The Energy Utilities assert that this process and the traditional base rate issues that would be presented bear no resemblance to the facts that were present in Metromedia, and do not require a rulemaking which would establish a level of standardization that is not necessary or relevant and would have only marginal utility. Additionally, sufficient procedural and informational requirements remain in place such that the Board retains its regulatory oversight in a fully transparent proceeding while ensuring the continued provision of safe, adequate and proper utility service.

The Energy Utilities further submit that the delay inherent in initiating a rulemaking at this point, and the economic harm that delay would likely encompass, should be an additional factor that leads the Board to reject the rulemaking procedure at this time. A typical rulemaking at the Board often takes at least a year, with several months involved in developing a proposed rule, and then several additional months for parties to provide comments, and for the Board to consider comments, decide on a final rule and publish the final rule. This delay of perhaps a year would be to the detriment of not only the safety and reliability objectives of infrastructure programs but would also be to the detriment of the substantial New Jersey employment and stimulus these programs provide. Particularly when the economy is in its current post-recession but still very slow growth stage, such a potential negative impact on employment is an additional substantial reason to not proceed via a rulemaking.

Based on the Metromedia analysis and the case law implementing that analysis, the Energy Utilities argue that the Board's determination in this matter or in other utility infrastructure investment filings does not need to be subject to a rulemaking proceeding. In addition, from a statutory standpoint, the Board "is afforded considerable discretion in choosing the method by

which is fulfills its legislative duties.” Gonzalez v. New Jersey Property Liability Insurance Guaranty Assoc., 412 N.J. Super. 406, 418 (App. Div. 2010). The Court in Dragon<sup>21</sup> added:

This flexibility includes the ability to select those procedures most appropriate to enable the agency to implement legislative policy. In that regard, an agency has the discretion to choose between rulemaking, adjudication, or any informal disposition in discharging its statutory duty.

Accordingly, the gas and electric utilities contend that, since the determinations in this matter are simply a continuation of long-standing State and Board policy, the Board has the authority to proceed without a rulemaking.

#### Initial Brief - Rate Counsel:

According to Rate Counsel, the petition filed in this matter by NJNG seeks Board approval for an infrastructure “tracker” that would result in the implementation of rate increases outside of the normal base rate case process. Rate Counsel asserts that NJNG’s Petition affects the rights guaranteed to New Jersey’s ratepayers under New Jersey statutes and the New Jersey Constitution. Accordingly, the Petition must be handled as a “contested case” in which the parties are accorded the right to discovery, evidentiary hearings, argument, and an agency decision based on the record. N.J.S.A. 52: 14B-9; N.J.A.C. 1:1. Rate Counsel states that the parties to this matter, NJNG, Rate Counsel, and the Board’s Staff, have proceeded under the assumption that this is a contested case<sup>22</sup>. Until the issuance of the Board’s June 18 Order, there was no indication that the Board might think otherwise.<sup>23</sup> According to Rate Counsel, this matter is a contested case as there has been no showing of a need for the Board to consider a rulemaking to implement a special rate mechanism to facilitate the accelerated replacement of natural gas distribution infrastructure on a statewide basis.

Rate Counsel argues that the circumstances that led the Board to adopt its DSIC rules for water utilities are not present for the natural gas utilities’ infrastructure filings. The DSIC rules were promulgated following the adjudication of a contested case in which the applicant set out to demonstrate a need for a special rate mechanism to address a serious statewide problem with New Jersey’s water infrastructure. In the Matter of the Petition of New Jersey American Water Company for Authorization to Implement a Distribution System Improvement Charge (DSIC), BPU Dkt. No. WO08050358, Order Denying DSIC Petition and Instituting Stakeholder Process (October 20, 2012) (“NJAW DISC Order”).

While Rate Counsel believes a rulemaking is not warranted in this proceeding, it recognizes that the Board has the authority to convene an informal process to further investigate infrastructure

<sup>21</sup> Dragon v. Dept. of Environmental Protection, 405 N.J. Super. 478, 492 (App. Div. 2009).

<sup>22</sup> Rate Counsel notes that PSE&G has filed a Motion to Participate in NJNG’s filing but at the time of the submission of its Initial and Reply Briefs that motion has not been acted upon by the Board.

<sup>23</sup> N.J.A.C. 1:1-4.1 provides:

(a) After an agency proceeding has commenced, the agency head shall promptly determine whether the matter is a contested case. If any party petitions the agency head to decide whether the matter is contested, the agency shall make such a determination within 30 days from receipt of the petition and inform all parties of its determination.

(b) When a question arises whether a particular matter is a contested case, legal advice shall be obtained from the Attorney General’s office.

According to Rate Counsel, given Rate Counsel’s and NJNG’ s agreement that this is a contested case, there was no reason for the parties to think that this issue had been questioned.

replacement programs and related ratemaking issues. This does not, Rate Counsel asserts, eliminate the requirement that this matter be litigated as a contested case. If the Board were to find, based on a future record before it, that the infrastructure needs of gas utilities extend beyond the limited problem sought to be addressed here and require a special ratemaking mechanism, the Board could order that a rulemaking process commence at that time. According to Rate Counsel, it may not do so as part of this docket.

Rate Counsel asserts that since NJNG's petition seeks relief that would result in rate increases, the affected ratepayers are entitled to a hearing. The requirement for a hearing is founded upon constitutional principles. As established by the New Jersey Supreme Court, if the rate for a utility service supplied should be unreasonably low it is confiscatory of the utility's right of property, and if unjustly and unreasonably high ... it cannot be permitted to inflict extortionate and arbitrary charges upon the public. In re: Industrial Sand Rates, 66 N.J. 12, 23-24 (1974). The utility bears the burden of proving that the rate increase it seeks is just and reasonable. N.J.S.A. 48:2-21. Further, utility customers have a statutory right to rates and other terms of service that are not "unjustly discriminatory or unduly preferential," and a right to a hearing before rates are increased. N.J.S.A. 48:3-1, N.J.S.A. 48:2-21. Thus, in establishing rates the Board is defining the property rights of parties, and accordingly must provide due process.

The APA specifies the procedures an administrative agency must follow when a party is entitled to a hearing. The APA defines a "contested case" as a proceeding:

in which the legal rights, duties, obligations, privileges, benefits or other legal relations of specific parties are required by constitutional right or by statute to be determined by an agency by decisions, determinations or orders, addressed to them or disposing of their interests, after opportunity for an agency hearing.  
N.J.S.A. 52:14B-2(b).

According to Rate Counsel, NJNG's Petition addresses issues that entitle its ratepayers to a hearing on the record. Therefore, Rate Counsel maintains that this matter must continue as a "contested case" in accordance with the APA and the Uniform Administrative Procedure Rules.

Rate Counsel does not support the initiation of a rulemaking process to develop rules for the natural gas utilities that are similar to the Board's DSIC rules for the water utilities. The Board developed the DSIC rules based on findings by the Board that there was a statewide need to replace the State's aging water infrastructure, and that such replacement was of "significant concern to the State." NJAW DSIC Order at 3. Rate Counsel notes that, in its Order commencing a stakeholder process to consider a DSIC rule, the Board made specific mention of the New Jersey Clean Water Council's then pending proceeding on Water Infrastructure Management and Financing. The Clean Water Counsel later issued recommendations in which it found a critical need for repairs to the State's water infrastructure.

In this proceeding, Rate Counsel points out that there has been no finding of critical statewide deficiencies in New Jersey's natural gas infrastructure. There is no widespread leakage of natural gas, and no "non-revenue gas" problem. Rate Counsel argues that NJNG's Petition is aimed at addressing a finite problem that would be over once the relevant pipe is replaced. Further, while the potential consequences of natural gas leaks are serious, Rate Counsel asserts that there has been no demonstration that the State's natural gas distribution system is inherently unsafe overall.

Furthermore, Rate Counsel supports the principle of encouraging the utilities to make necessary investments to ensure the continued provision of safe, adequate and proper service. Those investments should, however, be based on a thorough and deliberate assessment of each

individual utility system. Until such assessments are complete, consideration of statewide infrastructure “trackers” may, according to Rate Counsel, be premature.

Rate Counsel goes on to assert that there also has been no demonstration that the State’s gas utilities need a special rate mechanism to finance the necessary work on their systems. Even assuming substantial capital expenditures are needed to address leak-related risks, there has been no showing that the utilities will be unable to finance those expenditures through the normal ratemaking process. Further, even assuming there are challenges in financing the necessary improvements, it may well be that remedies short of cost trackers would be sufficient.

According to Rate Counsel, unlike the circumstances that led to the adoption of the Board’s DSIC regulations, there has been no showing, and no finding on a record, that there is a widespread long-term issue that the State’s natural gas utilities will be unable to address through the normal ratemaking process. A contested case proceeding is required first to determine whether there is such a need, and, if so, whether that need should be addressed through a program of broad applicability that must be implemented through rules. Until the need for and scope of such programs are determined, the Board should not initiate a rulemaking proceeding to implement gas infrastructure “trackers” on a statewide basis. Without a demonstrated need for an agency pronouncement having “widespread, continuing and prospective effect,” there is no reason for the Board to proceed with a rulemaking. Metromedia, supra., 97 N.J. at 329.

A rulemaking, Rate Counsel argues, unlike a contested case, does not involve the granting of individualized relief. A rulemaking results in the establishment of rules of general applicability for prospective application. N.J.S.A. 52: 14B-2(e); Id. at 328-29, 331-32. As explained in Metromedia, “the fact finding process that characterizes rule-making is much more flexible and expansive than that governing quasi-judicial adjudication.” 97 N.J. at 330-31. Rather than a trial like proceeding, the agency conducts a proceeding in which input is solicited from the general public.

According to Rate Counsel, the Board’s DSIC rules provide an example of an appropriate result of the open process that characterizes rulemaking. The DSIC rules established criteria and procedures for utilities wishing to implement a DSIC, but did not create a DSIC for any individual utility. In order to establish a DSIC, a utility must make a separate filing in accordance with the procedures set forth in the rule. N.J.A.C. 14:9-10.4 and N.J.A.C. 14:9 - 10.5. If the Board were to issue a similar rule for natural gas utilities, a utility seeking to implement any special rate mechanism provided for in rules would need to file an individual petition. That petition, like the present Petition filed by NJNG, would implicate ratepayers’ statutory and constitutional rights and therefore would have to be handled as a contested case. What the Board did not do in the context of the DSIC rules, and what it may not do now, is employ an open notice-and-comment process to consider NJNG’s request for individualized relief.

As stated in the Board’s June 18 Order, the New Jersey Supreme Court has afforded New Jersey government agencies the flexibility to choose the procedures they wish to follow in carrying out their statutory duties. In re Request for Solid Waste Util. Customer Lists, 106 N.J. 508, 519 (1987). This flexibility is not, however, unlimited. It is “[s]ubject to the strictures of due process and of the Administrative Procedure Act ....” if a proceeding implicates a party’s right to a hearing, then one must be provided. 106 N.J. at 521. The process that applies to rulemaking does not meet the requirements of due process in cases, such as this one, in which parties possess constitutional and statutory rights to a hearing on the record.

Rate Counsel further asserts that a contested case, once initiated, may not be transformed into something else. “Contested case” is a specifically defined term in the APA and the Uniform



Administrative Procedure Rules. If a case meets the definition, the “contested case” procedures apply. This is implicitly recognized in N.J.A.C. 1:1-4.1(a), which provides that “[a]fter an agency proceeding has commenced, the agency head shall promptly determine whether the matter is a contested case.” In other words, an agency is obligated to determine whether a matter is a contested case based on the issues as they appear from the petition or other pleading initiating the proceeding before the agency. This is not a determination that should change in the middle of the case. Rate Counsel notes that, in the context of the Board’s DSIC rules, the Board did not attempt to convert a contested case proceeding to an informal process or a rulemaking.

Rate Counsel submits that the Board should conduct the proceedings on the March Filing, and other similar petitions, as contested cases. Rate Counsel opposes the initiation of a rulemaking process, as the need for a rule has not been demonstrated. Should the Board determine to commence a rulemaking process based on a future record, according to Rate Counsel, it must do so in a separate proceeding.

#### Initial Brief – NJLEUC:

NJLEUC also recommends that NJNG’s petition should be determined by the Board as a contested case. NJLEUC asserts that there are certain facial similarities between the circumstances that led to the Board’s adoption of the DSIC rules to facilitate and expedite critical infrastructure upgrades by all of the State’s water utilities and NJNG’s petition. However, according to NJLEUC, there are measurable and qualitative differences between the viability and overall condition of the distribution infrastructure of the water and gas utilities and the nature and extent of the improvements required by each respective industry. According to NJLEUC, these differences fully justified the use of a generic rulemaking approach to foster the water utility infrastructure upgrades while a contested case approach is more appropriate for the gas utility infrastructure upgrades.

NJLEUC notes that the DSIC rulemaking was prompted by emergent circumstances that required New Jersey American Water Company, and ultimately the State’s other water utilities, to quickly mobilize to rehabilitate and replace substantial portions of their aging and deteriorating water main distribution systems. According to NJLEUC, the same dire situation simply does not exist for NJNG. NJLEUC notes that NJNG’s petition argues the need for further infrastructure upgrades, there is no suggestion that NJNG’s system is immediately unsafe or that the NJNG is not currently providing safe, adequate and proper service to its customers. NJLEUC asserts that there is simply no parallel presented to the extraordinary circumstances that led to the adoption of the DSIC rules and, therefore, no need to address NJNG’s petition in a generic, rulemaking proceeding together with the petitions filed by other gas utilities.

Furthermore, NJLEUC notes that the relief requested is company-specific and based upon the circumstances unique to its system, therefore the petition should be evaluated on its own merits in a contested proceeding.

NJLUEC relies upon Metromedia as the case that guides determinations whether administrative decision-making should be deemed adjudicative between the parties to a specific proceeding or a generic administrative rule making. NJLUEC asserts that application of the Metromedia factors do not support the use of a generic rulemaking proceeding to assess the merits of NJNG’s request for relief.

#### Initial Brief – AARP:

AARP believes NJNG’s petition for accelerated infrastructure replacement should be addressed through a contested case proceeding. According to AARP, a contested case proceeding, unlike



a DSIC type rulemaking process, protects ratepayers by requiring that these threshold questions be thoroughly examined, allowing the Board to independently review the evidence and make determinations that appropriately balance the interests of ratepayers and the company.

AARP asserts a DSIC type surcharge, by focusing on selected elements of the ratemaking formula, could produce rate increases without capturing all offsetting factors including expense reductions due to improved efficiency, reliability, etc. Conceivably, according to AARP, ratepayers could be subject to a DSIC type surcharge during periods between rate cases while their utility company is earning in excess of its authorized rate of return.

A DSIC type surcharge would produce an additional rate increase in an unbalanced manner that considers only select components of the revenue requirement. According to AARP, there is nothing in our current regulatory environment that would preclude NJNG or any other gas utility from filing requests for general base rate increases as needed to address the needs of its distribution system in order to provide safe, adequate and reliable service at reasonable rates and in a proceeding that provides adequate protections for all ratepayers.

AARP asserts that the growing use of numerous alternative ratemaking mechanisms and surcharges can defeat some of the critically important principles of utility rate setting. AARP states that the Board must also consider the cumulative impact of surcharges on base rates, and the overall affordability of utility services for residential and business consumers in this and any other proceeding.

#### Reply Brief -NJNG on behalf of the Energy Utilities:

The Energy Utilities asserted in their reply brief that all initial briefs submitted took the identical position: the Board should treat NJNG's petition, as well as other natural gas or electric utilities' requests for accelerated infrastructure programs and associated rate recovery mechanisms, as a contested case proceeding and not address such requests through a rule making process similar to that employed to develop the DSIC rules at N.J.A.C. 14:9-10. Therefore, based on the fact that no initial brief recommended that the Board conduct a rule making proceeding, the natural gas and electric utilities recommended that a rule making is not warranted for petitions requesting approval of accelerated infrastructure investment programs and associated rate recovery mechanisms filed by the State's natural gas and electric utilities. In fact, the Board should continue to review and act on pending and future petitions requesting approval of accelerated infrastructure investment programs and associated rate adjustment mechanisms submitted by individual companies pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1.

#### Reply Brief - Rate Counsel:

While Rate Counsel does not agree with all of the arguments contained in the Initial Briefs submitted, Rate Counsel does note that all of the commenters agree with the Rate Counsel position that there is no need for the Board to initiate a rulemaking process at this time. Rate Counsel further notes there is also agreement that the Petition filed in this matter by NJNG should continue to be handled as a contested case.

### **DISCUSSION AND FINDINGS**

As stated in the July 18, 2012 Order, the Board has the flexibility to determine how to proceed in matters presented to it, and it may use its discretion to choose the most appropriate manner including by contested case, rulemaking or informal process, based on the issues raised and

the potential effects of the resolution. See, In re Request for Solid Waste Util. Customer Lists, 106 N.J. 508 (1987); In re the Petitions of MP Real Estate LP, Studebaker Submetering, Inc. and the New Jersey Apartment Association for Permission to Check-Meter Water Service, BPU Dkt Nos. WO00040254, WO00060360, WO00070510 (June 24, 2004). "Generally, an administrative agency has discretion to exercise its statutory authority either by adjudication or rule-making. Case-by-case determinations are preferable where... it is doubtful whether any generalized standard could be framed which would have more than marginal utility." In re Dept. of Community Affairs Order of March 15, 1988, 232 N.J. Super. 136, 143 (App. Div. 1989) (citations omitted). The issue is one that must be decided by the Board, notwithstanding any agreement by the parties<sup>24</sup>.

In making the determination of what procedures to follow in any matter, the Board looks to the factual basis of the request as well as the scope of the relief requested. Only then can the Board look for guidance in the Administrative Procedure Act ("APA")<sup>25</sup> and determine what procedures most appropriately fit the case. As discussed at length by Rate Counsel, the Energy Utilities, NJLEUC and AARP, Metromedia Inc. v. Dir., Div. of Taxation, 97 N.J. 313 (1984) ("Metromedia") provides guidance on when rulemaking, and not contested case proceedings are required, by outlining the factors to be considered, factors which are dependent on the expected applicability of the agency decision:

1. is it 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 it intended to be applied generally and uniformly to all similarly situated persons;
3. is it designed to operate only in future cases, that is, prospectively;
4. does it prescribe a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization;
5. does it reflect 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. does it reflect a decision on administrative regulatory policy in the nature of interpretation of law or general policy.

Metromedia at 331-32.

As noted in the briefs, the Board recently addressed the applicability of the Metromedia factors to the issue of discounted gas rate agreements and there found that the unique nature of those agreements made rulemaking unnecessary and inappropriate, especially since a rule governing the approval of off-tariff agreements already exists. See, In re: a Generic Proceeding to Consider Prospective Standards for Gas Distribution Utility Rate Discounts and Associated Contract Terms and Conditions, BPU Dkt. No. GR10100761 (August 18, 2011). The Board must

<sup>24</sup> NJNG requested that Commissioner Holden decide the Threshold Issue subject to ratification by the full Board. However, N.J.S.A. 48:2-32 specifically authorizes a member of the Board to sit singly for the purpose of taking testimony. The Order designating Commissioner Holden delegated authority over the conduct of any hearings as well as scheduling. Determination of policy issues related to the matter can only be by vote of a majority of the Board. N.J.S.A. 48:2-40. The decision on whether to proceed by rulemaking or adjudication fits within this latter category an issue of both law and policy.

<sup>25</sup> N.J.S.A. 52:14B-2e.

determine whether that same reasoning applies to accelerated infrastructure petitions such as the March Filing.

With respect to the first two factors, based on the representations of the Energy Utilities, any infrastructure and related cost recovery filings will be individual company specific proposals that take into account the unique needs and operational differences of the particular utility without reliance on generalized industry statistics. While the filings made by the individual utilities may be similar in nature, each will seek relief based on the specific infrastructure and financial needs of the petitioning company that would not be generalized to other utilities. The distinct and varying needs of each of the individual gas and electric utilities make it impractical to establish uniform rules of general applicability to each of these companies where requests are grounded solely in company specific information.

With respect to the third factor, each gas and electric utilities' infrastructure program and corresponding cost recovery proposal would be designed to operate on a prospective basis. All rate decisions issued by the Board operate prospectively because retroactive ratemaking is not permitted by the Board's enabling legislation and supporting case law. In re: Elizabethtown Water Co., 107 N.J. 440, 449, (1987). The satisfaction of this factor alone does not mandate the use of rulemaking.

Turning to the fourth factor, approving accelerated infrastructure programs is consistent with the Board's broad authority over utilities and their rates.<sup>26</sup> The New Jersey Supreme Court observed that "the Board of Public Utilities . . . to which the legislature has delegated its rate making power, is vested with broad discretion in the exercise of that authority."<sup>27</sup> The Board is not required to employ any particular mode of computing rates, but it must reach a result that is supportable.<sup>28</sup> In exercising its discretion over individual utility rates, the Board is free to make pragmatic adjustments as long as its determinations are supported by the record. Township Committee of Lakewood v. Lakewood Water Co., 54 N.J. Super. 371, 381 (App. Div. 1959).

With respect to the fifth and sixth factors, a Board decision concerning NJNG's petition would not reflect an administrative policy that was not previously expressed in a prior determination nor constitutes a significant change from past agency position on the subject matter. As noted by the Energy Utilities in their initial brief, the Board has previously authorized gas and electric utilities to undertake accelerated infrastructure programs without the need for a rulemaking proceeding.

Rate Counsel and NJLEUC note that the circumstances that led the Board to adopt its DSIC rules for water utilities are not present for the natural gas utilities. The DSIC rules were promulgated following the adjudication of a contested case in which the applicant set out to demonstrate a need for a special rate mechanism to address a serious statewide problem with New Jersey's water infrastructure. See, In re Petition of New Jersey American Water Company for Authorization to Implement a Distribution System Improvement Charge ("DSIC"), BPU Dkt. No. WO08050358, Order Denying DSIC Petition and Instituting Stakeholder Process (Oct. 20, 2012) ("NJAW DSIC Order"). The Board developed the DSIC rules based on findings by the Board that there was a statewide need to replace the State's aging water infrastructure, and that such replacement was of "significant concern to the State." NJAW DSIC Order at 3. In its Order commencing a stakeholder process to consider a DSIC rule, as noted by Rate Counsel, the Board took specific consideration of the New Jersey Clean Water Council's then pending proceeding on Water Infrastructure Management and Financing. The Clean Water Council later

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<sup>26</sup> See N.J.S.A. 48:2-13, 48:2-21, and 48:2-21.1.

<sup>27</sup> Public Service Coordinated Transport v. State, 5 N.J. 196, 214 (1950).

<sup>28</sup> *Id.* at 265.

issued recommendations in which it found a critical need for repairs to the State's water infrastructure. No such proceedings are pending concerning the Energy Utilities, and as noted, there has been no determination of a generalized need for infrastructure replacement on an expedited basis for these utilities. As previously stated, any petition for accelerated replacement of infrastructure by an Energy Utility must be supported by company specific information supporting its request.

Based upon the foregoing analysis and comments submitted, the Board is persuaded that no rulemaking is required at this time to deal with company specific requests by Energy Utilities for accelerated infrastructure programs. Each proposal must be supported by company specific information and tailored to each company's infrastructure and financial needs. Therefore, the Board **HEREBY FINDS** that a rulemaking is not warranted to govern requests for accelerated infrastructure investment programs and associated rate recovery mechanisms which are filed by the State's Energy Utilities at this time, based on the representation that each Energy Utility petition will be fully supported by company specific information and will satisfy the requirements of the appropriate provisions of N.J.A.C. 14:1:5.<sup>29</sup> Accordingly, the Board **HEREBY FINDS** that the March Filing should be treated as a contested case proceeding. The Board **FURTHER FINDS** that, absent any change in circumstances as described above, it will continue to review and act on petitions for accelerated infrastructure investment programs and associated rate adjustment mechanisms submitted by Energy Utilities pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 as contested case proceedings.

Because the Board has determined that it will treat the March Filing as a contested case, it will address both the PSE&G Motion and the proposed settlement. While no party objected to allowing PSE&G to participate in this proceeding, in light of the proposed settlement which the Board will address below, ruling on the motion at this time would not provide PSE&G with any additional rights. PSE&G is one of the Energy Utilities and as such was afforded the right to be heard in connection with the Threshold Issue. The Board's treatment of the proposed settlement is not to be considered precedential as decisions on any Energy Utility accelerated infrastructure filings will be based solely on the merits of those cases.

Turning to the proposed settlement, the Board has carefully reviewed the attached Stipulation and its terms as described earlier in this Order, and **FINDS** it to be reasonable and in the public interest and in accordance with law. The Board believes that an accelerated replacement program for unprotected steel infrastructure, if prudently implemented, will lessen the Company's exposure to operational risk, increase operational efficiencies and reliability while improving safety throughout the service territory. Many of NJNG's older gas mains and services were constructed of cast iron and/or unprotected steel, the most popular and readily available materials used in the industry prior to 1970. The Company's cast iron and unprotected steel infrastructure is generally more susceptible to corrosion damage, leaks, and material failure than the Company's other mains and services. The Board recognizes that NJNG has been addressing the replacement of such assets in its annual capital construction planning for many years. The Board agrees with the Company that an accelerated approach will shorten the overall time it will take to replace this aged infrastructure.

The Board believes it is appropriate to approve the accounting treatment proposed in the Stipulation. The Board has previously authorized the use of deferred accounting treatment in prior proceedings.<sup>30</sup> Moreover, similar accounting treatment was previously approved by the

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<sup>29</sup> Had the Board determined that rulemaking was required, the March Filing would have been denied without prejudice, and a stakeholder proceeding opened as was done in connection with the New Jersey American Water petition and the DSIC rules which were previously described.

<sup>30</sup> See, In the Matter of Public Service Electric and Gas Company's Request for Deferral Accounting

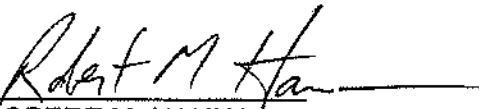
Board in the Company's AIP proceeding.<sup>31</sup> The major difference between the previously approved treatment and the instant matter is that the Company will not seek any periodic or annual increases in rates during the multi-year SAFE Program but rather will make the investments subject to the future base rate case proceeding that the Company has committed to file where the SAFE Program investment costs will be subject to review. Additionally, some aspects of cost recovery are dependent on a showing of the effectiveness of the program on leakage reduction. The Company will also provide quarterly reports to permit oversight by Staff and Rate Counsel of the progress of the program.

Accordingly, the Board **HEREBY ADOPTS** the terms of the Stipulation in their entirety, as if fully set forth herein.

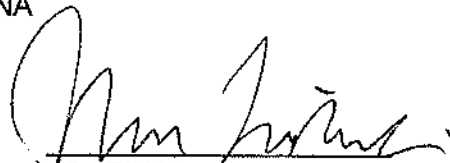
The Board **HEREBY RATIFIES** the procedural orders issued by Commissioner Holden as Presiding Officer for the reasons stated in those orders.

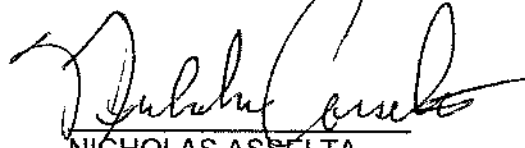
DATED: 10/23/12

BOARD OF PUBLIC UTILITIES  
BY:

  
ROBERT M. HANNA  
PRESIDENT

  
JEANNE M. FOX  
COMMISSIONER

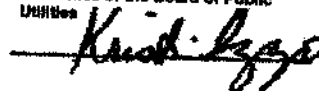
  
JOSEPH L. FIORDALISO  
COMMISSIONER

  
NICHOLAS ASSELTA  
COMMISSIONER

ATTEST:

  
KRISTI IZZO  
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities



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Authority for the Energy Information and Control Network Pilot Program, Decision and Order Authorizing Deferred Accounting Treatment of Pilot Program Costs, Docket No. EO04060395 (August 24, 2004) and In the Matter of the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas Company to Establish a Pipeline Replacement Program Cost Recovery Rider, Docket No. GR05040371 (August 18, 2006).

<sup>31</sup>In the Matter of New Jersey Natural Gas Company for Approval of an Accelerated Energy Infrastructure Investment Program, and for Approval of Necessary Changes to Gas Rates and Changes In the Company's Tariff for Gas Service, BPU Docket Nos. GR07110889 and GR09010052. Approved by Board Order dated April 28, 2009. In the Matter 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 to Gas Rates and Changes in the Company's Tariff For Gas Service Pursuant to N.J.S.A. 48:2-21 et seq., BPU Docket Nos. GR07110889 and GR10100793. Approved by Board Order dated March 30, 2011.

IN THE MATTER OF 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. 2-21.1

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

<b>IN THE MATTER OF THE PETITION OF</b>	)	
<b>NEW JERSEY NATURAL GAS COMPANY</b>	)	
<b>FOR APPROVAL OF THE SAFETY</b>	)	
<b>ACCELERATION AND FACILITY ENHANCEMENT</b>	)	<b>STIPULATION OF</b>
<b>PROGRAM PURSUANT TO N.J.S.A. 48:2-23, AND</b>	)	<b>SETTLEMENT</b>
<b>FOR APPROVAL OF THE ASSOCIATED</b>	)	
<b>RECOVERY MECHANISM</b>	)	<b>DOCKET NO.</b>
<b>PURSUANT TO N.J.S.A 48:2-21 and 2-21.1</b>	)	<b>GO12030255</b>

**STIPULATION OF SETTLEMENT**

**APPEARANCES:**

**Tracey Thayer, Esq.**, New Jersey Natural Gas Company for the Petitioner, New Jersey Natural Gas Company

**Felicia Thomas-Friel, Esq.**, Managing Attorney, **Sarah H. Steindel, Esq.**, **Henry Ogden, Esq.**, and **James W. Glassen, Esq.**, Assistant Deputy Rate Counsels, New Jersey Division of Rate Counsel (**Stefanie Brand, Esq.**, Director)

**Veronica Beke** and **Alex Moreau**, Deputy Attorneys General, for the Staff of the New Jersey Board of Public Utilities (**Jeffrey S. Chiesa**, Attorney General of New Jersey)

**TO: THE HONORABLE MARY-ANNA HOLDEN, COMMISSIONER**

**BACKGROUND**

On March 20, 2012, New Jersey Natural Gas Company (“NJNG” or the “Company”) filed a petition with accompanying exhibits and supporting testimony from Mark R. Sperduto, Vice President, Regulatory and External Affairs and Craig A. Lynch, Vice President, Energy

Delivery ("March Filing"), requesting that the New Jersey Board of Public Utilities (the "BPU" or "Board") approve NJNG's Safety Acceleration and Facility Enhancement ("SAFE") Program and associated rate recovery mechanism pursuant to N.J.S.A. 48:2-23, 48:2-21 and 48:2-21.1. NJNG requested expedited treatment of the petition and also requested that the Board retain jurisdiction over this matter, assign a Commissioner as a presiding officer and process the petition as a contested case.

NJNG is subject to regulation by the Board for the purposes of assuring that safe, adequate and proper natural gas service pursuant to N.J.S.A. 48:2-23 is provided to its customers. As such, the Company is obligated to and does maintain its public utility infrastructure in such condition as to enable it to meet its regulated obligations to provide the requisite service. That infrastructure is comprised of the property, plant, facilities and equipment within the Company's natural gas distribution and transmission system throughout its service territory. NJNG is also subject to regulation by the Board for the purposes of setting its retail rates to assure safe, adequate and proper natural gas service, N.J.S.A. 48:2-21 et seq. and subject to the regulatory standards authorized by the U.S. Department of Transportation, including the Pipeline and Hazardous Materials Safety Administration (PHMSA).

Specifically, the petition requested, on an expedited basis, Board approval to implement a five-year capital investment program through which the Company would invest approximately \$204 million prior to the capitalization of Allowance For Funds Used During Construction ("AFUDC") to replace cast iron and unprotected steel<sup>1</sup> distribution lines, services and meters. Many of NJNG's

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<sup>1</sup> Included in the category of "unprotected steel" is pipe that is uncoated or that is coated but not cathodically protected. For convenience, these two categories of steel pipe are referred to as unprotected steel throughout this Stipulation of Settlement ("Stipulation").



older mains and services were constructed of cast iron and/or unprotected steel, the most popular and readily available materials used in the industry prior to 1970. The Company's cast iron and unprotected steel infrastructure is generally more susceptible to corrosion damage, leaks, and material failure than the Company's other mains and services. While NJNG has been consistently addressing the replacement of such assets in its annual capital construction planning for many years, the Company's testimony maintains that an accelerated approach is necessary now to shorten the overall time it will take to replace this aged infrastructure. Additionally, there are national efforts underway to increase the safety, reliability and integrity of the country's pipeline infrastructure. NJNG noted in its filing that U.S. Secretary of Transportation, Ray LaHood, in his "Call to Action," encourages an increased focus on pipeline replacement and the associated cost recovery. As a result, significant efforts are being made to address older pipelines that have a greater likelihood of corrosion damage or leaks.

#### SAFE Program

NJNG proposed a five-year program through which the Company will replace cast iron and unprotected steel infrastructure, and by relying on a multi-year approach, the Company maintains that it and its ratepayers would benefit from cost and scheduling efficiencies. It was proposed that through SAFE, cast iron and unprotected steel distribution lines, services and, as necessary, associated meter sets be replaced in a coordinated and systematic manner over the proposed five-year time period.

NJNG has been making a concerted effort to replace cast iron and unprotected steel infrastructure in order to maintain reliability to best serve customers and to ensure the

continuation of safe, adequate and proper service. However, at this time, the Company believes that an accelerated replacement program will lessen NJNG's exposure to operational risk, increase operational efficiencies and reliability while improving safety throughout the service territory.

In the March Filing, NJNG also sought approval to use, for the SAFE Program investments, the same cost recovery mechanism that was previously approved by the Board for its Accelerated Infrastructure Program ("AIP") investments.

#### **Procedural History**

On April 19, 2012, Public Service Electric and Gas Company ("PSE&G") submitted a Motion to Intervene as a Participant ("PSE&G motion"). On April 25, 2012, NJNG submitted a response to PSE&G's motion indicating that NJNG did not object to PSE&G's motion to be a participant provided that all the conditions set forth in N.J.A.C. 1:1-16.6 were met.

On April 20, 2012, Rate Counsel filed a letter with the Board requesting that the Company's petition be transferred to the Office of Administrative Law ("OAL") as a contested case. On April 24, 2012, NJNG responded to Rate Counsel's April 20, 2012 letter agreeing that the petition be treated as a contested case, but asking that the Board retain jurisdiction and not transfer the petition to the OAL.

On June 18, 2012, the Board issued an order retaining jurisdiction of the Company's petition and appointed Commissioner Mary-Anna Holden to serve as the presiding officer ("June 18 Order"). The Board also directed that a threshold question be addressed in light of the nature of the Company's request, specifically, "...whether the request for approval of a multi-year

program for accelerated replacement of cast iron and unprotected steel infrastructure on an expedited basis with recovery of the costs through a special rate mechanism should be addressed through a contested case proceeding or through a rulemaking as in the recently approved DSIC.” See June 18 Order at 2.

On July 19, 2012, Commissioner Holden issued an order establishing July 30 and August 8, 2012 as the dates for the submission of briefs and reply briefs, respectively, by interested parties on the aforementioned question. Commissioner Holden’s Order permitted any interested party to submit their respective comments on this question without the need for the submission of formal motions to intervene or participate.

On July 27, 2012, the New Jersey Division of Rate Counsel (“Rate Counsel”) requested that the procedural schedule, set forth in Commissioner Holden’s July 19, 2012 Order be suspended, and that a telephone conference be scheduled to clarify the scope of the issues to be addressed, the method of providing notice, and revisions to the schedule. By e-mail dated July 30, 2012, the procedural schedule was stayed pending further action.

On July 31, 2012, the New Jersey Large Energy Users Coalition (“NJLEUC”) joined in Rate Counsel’s request. By letter dated August 8, 2012, the American Association of Retired Persons (“AARP”) also submitted correspondence in support of suspending Commissioner Holden’s initial procedural schedule.

A teleconference was scheduled for August 17, 2012 to address the scope of the procedural issues to be briefed, the method of notice to interested parties, and revisions to the procedural schedule. Following that call, Commissioner Holden issued an amended scheduling order on August 21, 2012, providing for the submission of Initial Briefs on August 30, 2012 and

Reply Briefs on September 7, 2012. Initial Briefs were subsequently submitted by NJNG, on behalf of itself and five other electric and gas utilities, and by Rate Counsel, the New Jersey Large Energy Users Coalition and AARP. Reply Briefs were submitted by NJNG, on behalf of itself and five other electric and gas utilities, and by Rate Counsel.

After appropriate public notice, two public hearings on this petition were held on August 7, 2012 in Freehold Borough and two public hearings on August 8, 2012 in Rockaway Township. No members of the public appeared at any of the public hearings, nor were any comments received by the BPU in writing by interested parties.

Following several settlement discussions among representatives from Rate Counsel, Board Staff and the Attorney General's Office, counsel for Board Staff ("the Parties"), to address resolution of this petition, the Parties have reached the following agreement.

Specifically, in consideration of the terms, covenants, conditions and agreements contained herein, it is hereby **STIPULATED AND AGREED** by representatives of NJNG, BPU Staff and Rate Counsel (the "Signatory Parties") as follows:

### **STIPULATED ISSUES**

#### **The SAFE Projects**

1. "SAFE Projects" represent the efforts by NJNG to reduce, through replacement, the Company's existing inventory of cast iron or unprotected steel mains and services. The Signatory Parties stipulate and agree that for the construction work in the first year (12 months) in which SAFE is applicable, NJNG will prepare a detailed listing of the specific SAFE Projects to be addressed, including estimated costs, locations of the infrastructure

replacement and the expected schedule within which the work will be completed. That information will be provided to BPU Staff and Rate Counsel within ninety (90) days of the Board Order approving the Company's SAFE Program. Subsequently, NJNG will provide BPU Staff and Rate Counsel with anticipated schedules, along with the estimated cost and projected timeline and completion dates, on an annual basis on or about October 1st of each of the subsequent years the SAFE Program is in effect.

**Exclusion of Meter Set Costs**

2. The Signatory Parties stipulate and agree that the SAFE program spending levels addressed in paragraphs 4 through 7 below will not include the replacement of associated gas meter sets.

**Duration/Term of the SAFE**

3. The Signatory Parties stipulate and agree that the SAFE Program is to be in effect for four (4) years to replace a significant number of cast iron and/or unprotected steel mains and services in a cost-efficient manner. As such, the Signatory Parties herein stipulate and agree that the design and construction of SAFE Project work commence on and after the effective date of the Board Order approving the SAFE Program and said SAFE Program be authorized for four (4) years from that date.

SAFE Program Spending Levels

4. The Signatory Parties stipulate and agree that at least \$39.2 million will be invested annually by the Company in SAFE Projects for four years with a target of reducing 276 miles of unprotected steel and cast iron mains and approximately 19,605 associated services.
5. The Signatory Parties stipulate and agree that during the four (4) year SAFE Program period the estimated total SAFE Program investments of \$39.2 million will be comprised of \$6.7 million of non-incremental capital investment spending and \$32.5 million of incremental capital investments. NJNG can annually apply the accounting procedures set forth below in Paragraph 7 to the estimated \$32.5 million of incremental capital investments up to a cumulative total of no more than \$130 million Program total, for SAFE Projects beginning as of the effective date of the Board Order approving this Stipulation in this proceeding. The annual \$32.5 million and \$130 million four (4) year total are exclusive of AFUDC accruals.
6. The Signatory Parties stipulate and agree that given potential delays in start-up, receiving the necessary regulatory permits and approvals and in order to achieve efficiency in construction and SAFE Project cost control, the Company's annual incremental construction cost target of \$32.5 million annually may be under or over spent by 15 percent in any given year. Any over spending in a given year will be accompanied by a reduction of an equal amount in one or more future periods. Similarly, any under spending in a given year may result in additional spending in one or more future periods that exceeds the annual target. In either event, the amount of incremental investment that is subject to the accounting procedures set forth in Paragraph 7 during any given year will be the Company's actual total

SAFE investment costs less \$6.7 million. In no event will the total incremental SAFE Project expenditures, subject to the accounting treatment procedures set forth below, exceed the total SAFE Program incremental capital investment spending limit of \$130 million as agreed to by the Signatory Parties.

**Proposed Accounting Treatment for SAFE Program**

7. The Signatory Parties herein stipulate and agree that all reasonable and prudently incurred incremental investment costs, in amounts determined as described in paragraph 6 above, associated with SAFE Projects including, but not limited to, the costs of engineering, design and construction, including labor, materials and other overheads, will be subject to the following accounting treatment for ratemaking purposes:
  - (i) During construction, the AFUDC rate will be based on the Federal Energy Regulatory Commission ("FERC") modified formula currently in use by NJNG.
  - (ii) AFUDC will be accrued on a monthly basis.
  - (iii) At the time a SAFE Project is in-service, when natural gas is reintroduced to the Company's gas distribution system, the AFUDC rate will be 6.9 percent.
  - (iv) SAFE Projects that are in-service will include a ratable monthly deduction for Accumulated Deferred Income Taxes ("ADIT") prior to calculating monthly AFUDC.
  - (v) As proposed by the Company in its filing, the calculation of ADIT will include the U.S. Internal Revenue Service repair allowance deduction for 50

percent of the tax basis, with Modified Accelerated Cost Recovery System ("MACRS") depreciation for the remainder of the balance.

- (vi) The depreciation expense for SAFE Projects will be based upon NJNG's depreciation rates. During the deferral period when SAFE Projects are closed to Plant in Service, depreciation expense will be charged (debited) with a corresponding credit to the accumulated depreciation reserve. The recorded depreciation expense will then be deferred in a separate regulatory asset account by charging (debiting) a regulatory asset and crediting the depreciation expense. At the time SAFE Projects are recognized in rate base within a regulatory proceeding, the regulatory asset related to the deferred depreciation expense that had been created pursuant to the accounting treatment set forth herein will be eliminated by crediting the balance with a corresponding charge (debit) to the accumulated depreciation reserve and, therefore, the regulatory asset related to the depreciation expense and the accumulated depreciation reserve related to the SAFE investments that were created for this purpose will have no impact on income or rate base. As a result of these entries there will be no recovery of depreciation expense or adjustments to rate base associated with the accumulated depreciation reserve until the deferred SAFE Project investments are included in rate base within a regulatory proceeding.
- (vii) The rate to be used for calculating AFUDC accruals for book accounting purposes after construction applicable to SAFE Projects, will be 6.9 percent



per annum. For ratemaking purposes this rate, including the application of the FERC formula described above in Paragraph 7(i) includes an equity component in the capital structure of 53.5 percent and a Return on Equity of 9.75 percent.

**Base Rate Case Filing**

8. The Signatory Parties herein stipulate and agree that NJNG's SAFE Program investment costs will be subject to review in the Company's next base rate case. A base rate case shall be filed no later than November 15, 2015.
9. The Signatory Parties also stipulate and agree that the Company's next base rate case filing will be filed based upon three (3) months of actual data and nine (9) months of projected data for the test year which test year will be updated throughout the course of the proceeding for twelve (12) months of actual data.
10. The Signatory Parties further stipulate and agree that no rate increase for SAFE Projects shall be put into effect until the issuance of an Order by the Board establishing base rates for the Company in said prospective base rate case proceeding. Such prospective base rate case review will be conducted as a contested case in accordance with the New Jersey Administrative Procedure Act, N.J.S.A. 52:14B-1 et seq.
11. The Signatory Parties further stipulate and agree that the Company's current base rates reflect an O&M expense related to leak repair of approximately \$690,000 (RCR-P-58 UPDATE). The Company agrees to record and defer in a separate regulatory liability account any amount below \$690,000 per year for O&M expense associated with leak

repair. At the time SAFE Projects are recognized in rate base within a regulatory proceeding, the regulatory liability associated with leak repair will be amortized into rates over a four-year period.

12. The Signatory Parties further stipulate that the continuation of the NJNG SAFE Program beyond those investments reflected in rates at the conclusion of the Company's next base rate case will be subject to review and consideration by the Board in that rate case or a subsequent proceeding.

#### **Quarterly Reporting**

13. NJNG will provide a quarterly report to BPU Staff and Rate Counsel in a format similar to that currently being used for AIP. The report will include the information set forth on the attached Exhibit A.

#### **Leak Reduction**

14. The Company's leak reports demonstrate an active leak inventory as of December 31, 2011 at 453 leaks as set forth in the Company's 2011 U.S. Department of Transportation Annual Report.
15. The Signatory Parties stipulate and agree that the Company will use best efforts to annually reduce the inventory of open leaks by 15 percent. This level of leak reduction is based upon the SAFE Program spending level set forth above.
16. The Company represents and warrants that it will use best efforts to reduce that active leak inventory by 272 leaks (68 per year) or approximately 60 percent during the SAFE Program

term. This metric is irrespective of incremental, new, post-2011 leaks which will not be counted in such metric.

17. During the Company's next base rate case proceeding, the Signatory Parties shall review the relevant reports, and such discovery requests as may be appropriate, to determine whether the Company's leak inventory has been reduced by 272 or more from December 31, 2011 through the conclusion of the next base rate proceeding. If it is reduced by less than 272 the amount of AFUDC to be included in rates shall be reduced. The amount of AFUDC to be included in rates shall equal the total amount of the AFUDC accrual on SAFE Projects from the date of the Board Order accepting this Stipulation until the effective date of the Company's prospective base rate case multiplied by a fraction. The numerator of that fraction will be the amount of leak reduction actually obtained expressed numerically, without giving any recognition to new leaks arising subsequent to December 31, 2011. The denominator of said fraction will be 272.

#### **Further Provisions**

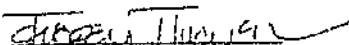
18. This Stipulation represents a mutual balancing of interests, contains interdependent provisions, and, therefore, is intended to be accepted and approved in its entirety. In the event any particular aspect of this Stipulation is not accepted and approved in its entirety by the Board, any Signatory Party aggrieved thereby shall not be bound to proceed with this Stipulation and shall have the right to litigate all issues addressed herein to a conclusion. More particularly, in the event this Stipulation is not adopted in its entirety by the Board, in any applicable Order(s), then any Signatory Party hereto is free to pursue its

then available legal remedies with respect to all issues addressed in this Stipulation as though this Stipulation had not been signed.


19. The Signatory Parties agree that they consider the Stipulation to be binding on them for all purposes herein.
20. It is specifically understood and agreed that this Stipulation represents a negotiated agreement and has been made exclusively for the purpose of these proceedings. Except as expressly provided herein, NJNG, Board Staff, and Rate Counsel shall not be deemed to have approved, agreed to, or consented to any principle or methodology underlying or supposed to underlie any agreement provided herein. All rates are subject to audit by the Board. The Signatory Parties recommend that the Board issue an order adopting the terms of the Stipulation and recommend that the Board issue an order approving this Stipulation. The Signatory Parties further acknowledge that a Board Order approving this Stipulation will become effective upon the service of said Board Order, or upon such date after the service thereof as the Board may specify, in accordance with N.J.S.A. 48:2-40.

WHEREFORE, the Signatory Parties hereto do respectfully submit this Stipulation and request that the Board issue an Order approving it in its entirety, in accordance with the terms hereof, as soon as reasonably possible.

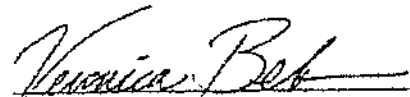
**NEW JERSEY NATURAL GAS COMPANY  
PETITIONER**

By:   
TRACEY THAYER, ESQ.  
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Date: October 11, 2012

## SAFE Reporting Requirements

The Company agrees to file, in electronic format (i.e. excel where available), the following information as part of its SAFE Reporting Requirements:

- 1.) The data and information analogous to that provided in the Quarterly Report, Appendix C on Capital Expenditures and Job Creation in Connection with the Company's Board approved AIP Program (BPU Docket Nos. GR10060384 and GR10100793). This report will be entitled Quarterly Report on Capital Expenditures and Job Creation in Connection with SAFE Program.
- 2.) The following additional information will be provided with the information supplied in 1.) above:
  - a. Projected and actual number of services replaced by material type on a quarterly basis.
  - b. Remaining number of services inventory by material type on a quarterly basis.
  - c. Projected and actual miles of mains replaced by material type on a quarterly basis.
  - d. Remaining miles of mains inventory by material type on a quarterly basis, if available.
  - e. Projected and actual cost of services replacements by material type on a quarterly basis.
  - f. Historic replacement cost per services replaced by material type and diameter on a semi-annual basis (past five years), if available.
  - g. Projected and actual cost of mains replacements by material type and diameter on a quarterly basis.
  - h. Historic replacement cost per mile for mains by material type on a semi-annual basis (past five years), if available.
  - i. A detailed explanation for deviations from budgeted (estimated) costs in excess of 10 percent from actual and from updated estimated costs for services on a semi-annual basis.
  - j. A detailed explanation for deviations from budgeted (estimated) costs in excess of 10 percent from actual and from updated estimated costs for mains on a semi-annual basis.
  - k. An explanation for deviations from budgeted (estimated) miles of mains and services in excess of 10 percent from actual on a semi-annual basis.
  - l. An explanation for deviations from budgeted (estimated) number of services in excess of 10 percent from actual on a semi-annual basis.
  - m. Explanation of the prioritization of each SAFE replacement project on a semi-annual basis.

n. Leak rates from prior year by County for unprotected steel and cast iron mains on a semi-annual basis.

o. Leaks repaired or cleared by County on a semi-annual basis.

3.) Any other documents containing information not provided in SAFE Reporting Requirements A through O submitted to upper management in connection with the SAFE program, such as change orders for example.