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TRENTON, NJ

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

PHIL MURPHY
Governor

SHEILA OLIVER
Lt. Governor

STEFANIE A. BRAND
Director

January 18, 2019

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BOARD OF PUBLIC UTILITIES
TRENTON, NJ

Via UPS Overnight Delivery and Electronic Mail
Honorable Jacob S. Gertsman, ALJ
Office of Administrative Law
Quakerbridge Plaza, Bldg. 9
3444 Quakerbridge Road
Mercerville, New Jersey 08619

Re: In the Matter of the Petition of New Jersey-American Water Company Inc. for Approval of Increased Tariff Rates and Charges for Water and Wastewater Service, Changes in Depreciation Rates and Other Tariff Modifications
BPU Docket No.: WR17090985
OAL Docket No.: PUC 16279-2018S

Dear Judge Gertsman:

On behalf of the Division of Rate Counsel ("Rate Counsel"), please accept this letter brief in lieu of a more formal brief on the limited issue of acquisition adjustments proposed by New Jersey American Water Company ("NJAWC" or "Company") in connection with the base rate case referenced above.

Case mgmt
list copied

Tel: (609) 984-1460 • Fax: (609) 292-2923 • Fax: (609) 292-4991
http://www.nj.gov/rpa E-Mail: njratepayer@rpa.nj.gov

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PROCEDURAL HISTORY AND BACKGROUND

On September 14, 2017, NJAWC filed with the New Jersey Board of Public Utilities ("Board") a petition, testimony and exhibits (collectively, "Petition") requesting an increase in operating revenues of $129.3 million, or approximately 17.54% over projected pro-forma rate revenues.

NJAWC serves approximately 631,000 water and fire service customers and approximately 41,000 sewer service customers. The Company proposed that the increase become effective on October 15, 2017.[1] In the Petition, NJAWC proposed a test-year ending March 31, 2018. The Petition as originally filed was based upon five months of actual and seven months of estimated data. On January 15, 2018, NJAWC filed an update based on nine months actual and three months estimated data. NJAWC filed an additional update on April 23, 2018 based on 12 months actual data. Both updates included supplemental testimony.

On September 27, 2017, the Board transmitted this matter to the Office of Administrative Law ("OAL") as a contested case and on October 20, 2017, the Board issued an Order suspending NJAWC's proposed rate increase until February 15, 2018. By a second suspension order dated January 31, 2018, the proposed rate increase was suspended until June 15, 2018. This matter was assigned to Administrative Law Judge ("ALJ") Jacob S. Gertsman, who issued a Prehearing Order on December 18, 2017, establishing procedures and hearing dates for the conduct of this case. ALJ Gertsman issued an Order Establishing Revised Prehearing Submission Deadlines on May 23, 2018.

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[1] On September 22, 2018, the Company filed a letter with the Board via electronic mail stating that it would not implement rates on an interim basis prior to the effective date of the Board's suspension Order resulting from the Board's October 20, 2017 agenda meeting. However, the Company stated that it did not waive its "right to implement the proposed rates at the conclusion of the eight month suspension period on June 15, 2018 should the Board not issue a final Decision and Order by that date."

Motions to intervene were filed by the following parties (collectively, "Intervenors") and were unopposed: Rutgers, the State University ("Rutgers"), Princeton University, Phillips 66 Company, Johanna Foods, Inc., and Cogen Technologies Linden Venture, L.P.'(collectively, "OIW"); Middlesex Water Company ("Middlesex"); Mount Laurel Township Municipal Utilities Authority ("Mount Laurel"); Aqua New Jersey, Inc. ("Aqua"); and City of Elizabeth. The motions to intervene filed by the OIW, with the exception of Rutgers, Middlesex, Aqua, and the City of Elizabeth, were granted by Orders dated December 18, 2017, which were subsequently amended on January 16, 2018. Rutgers and Mount Laurel were granted intervenor status by Orders dated January 16, 2018 and February 28, 2018, respectively. On May 31, 2018, AARP filed a motion to participate, which was unopposed. ALJ Gertsman granted AARP leave to participate on June 8, 2018. On July 2, 2018, the New Jersey Utility Shareholders Association ("NJUSA") filed a motion to participate. On August 1, 2018, ALJ Gertsman entered an Order granting NJUSA's motion to participate, which Order was amended on August 3, 2018 to correct a typographical error.

After proper notice to the general public and affected municipalities and counties within NJAWC's service area, four public hearings were held. One public hearing was held on January 8, 2018 in Westfield, New Jersey; two public hearings were held on January 10, 2018 at 1:00 p.m. in Ocean City, New Jersey and at 6:00 p.m. in Howell Township, New Jersey; and one public hearing was held on January 16, 2018 in Haddonfield, New Jersey. A representative of NJUSA attended the hearing in Haddonfield and entered a statement on the record that requested that the process for granting NJAWC new rates be fair and balanced, taking into account the interests of New Jersey utility shareholders and ratepayers. Members of the public also attended and spoke at the Howell Township hearing in general opposition to the proposed rate increase.

No members of the public attended the Westfield or Ocean City hearings. In addition, the Board received over 100 written comments in opposition to the Petition.

On February 8, 2018, NJAWC filed supplemental direct testimony related to the Tax Cuts and Jobs Act of 2017. On April 13, 2018, Rate Counsel and certain Intervenors filed direct testimony and on May 11, 2018, NJAWC filed rebuttal testimony. Evidentiary hearings took place on June 11, 13, 14, 18 and 25, 2018. Prior to the June 15, 2018 expiration of the second suspension period, NJAWC provided notice that it would implement interim rates. On May 18, 2018, Rate Counsel filed a motion requesting the Board issue an Order rejecting the Company's proposed provisional Rates. The motion was opposed by the Company. The Board issued an Order denying Rate Counsel's request on June 22, 2018. The Company implemented interim rates that included a $75 million increase, effective June 15, 2018, in accordance with N.J.A.C. 14:1-5.12(f). This resulted in a 12.323% increase applied equally to all rate classes using the existing rate design for the utility approved by the Board, pursuant to N.J.A.C. 14:1-5.12(e)(2).

On July 3, 2018, Rate Counsel submitted a letter to ALJ Gertsman alerting him of a report that the Staff of the New York Public Service Commission ("PSC"), Department of Public Service ("DPS") had issued ("Staff Report") regarding certain oral testimony and discovery responses that employees of American Water Works Service Company, Inc. ("Service Company") submitted to the PSC in connection with the base rate case of New York-American Water Company, Inc. ("NYAWC"). One implicated Service Company employee had submitted pre-filed testimony, answered discovery, and testified at the evidentiary hearings in this case. Another had submitted pre-filed testimony and answered discovery, and his pre-filed testimony was adopted by a different witness in this case. Both such employees separated from the Service Company before the conclusion of the evidentiary hearings here. In its letter, Rate Counsel

requested that, as a result of the Staff Report, ALJ Gertsman order NJAWC to review the testimonies of the two witnesses and provide a certification that their testimonies were complete and free of errors or omissions. Board Staff sent a separate letter on July 10, 2018 requesting that ALJ Gertsman order NJAWC to verify all testimony and discovery responses submitted in evidence in this case (collectively, Board Staff and Rate Counsel letters are referenced as "Letters").

On July 25, 2018, the Board held its regularly scheduled Board meeting at which time President Joseph L. Fiordaliso ordered NJAWC to conduct an independent certification of the numbers that NJAWC had submitted in support of its Petition.

ALJ Gertsman held a limited-purpose hearing on August 1, 2018 regarding the issues raised by Rate Counsel and Board Staff in the Letters. At the August 1, 2018 hearing, NJAWC moved additional exhibits into evidence, including a certification of the accuracy of the record by NJAWC President Deborah A. Degillio, which appended supporting certifications. Ms. Degillio also provided direct testimony and was cross-examined. Thereafter, NJAWC retained its auditor, PriceWaterhouse Coopers ("PwC"), to perform an Agreed Upon Procedures Engagement regarding the Schedules, applicable SIRs, and utility plant asset records in Power Plant for the Haddonfield and Shorelands acquisitions for which NJAWC requested recognition in connection with the Petition. PwC subsequently agreed to include in its engagement those discovery responses received in evidence in this proceeding. PwC agreed to reconcile all of these items to NJAWC's general ledger to the extent applicable. It also determined the extent to which NJAWC's proposed post-test year plant additions were recorded on NJAWC's books and records. As to Haddonfield and Shorelands, PwC agreed to verify that correct amounts were transferred when entered into NJAWC's books and records. On August 31, 2018, PwC issued a

Report of Independent Accountants, which was subsequently admitted into the record.

After discovery and comprehensive settlement discussions, on October 16, 2018, the Company, Board Staff, Rate Counsel, and OIW (collectively, "Parties") reached a stipulation of settlement with regard to all issues in the base rate case except the issue of plant acquisition adjustments ("Partial Stipulation"). On October 18, 2018, ALJ Gertsman issued an Order to Bifurcate Partial Initial Decision Settlement ("Initial Decision") in this matter, recommending adoption of the Partial Stipulation executed by the Parties, finding that the Parties had voluntarily agreed to the Partial Stipulation and that the Partial Stipulation fully disposed of all issues, except for the acquisition adjustment. On October 29, 2018 the Board issued an Order adopting the Order to Bifurcate Partial Initial Decision Settlement and Remand the Proposed Plant Acquisition Adjustment Issues ("Order").

Rate Counsel submits this letter brief in accordance with the Initial Decision and Order.

ARGUMENT

The Requested Adjustments For the Shorelands Water and Haddonfield Acquisitions Should Be Denied As the Company Has Failed to Demonstrate Net Benefits to Ratepayers From the Acquisitions, and Neither System Was a Troubled Utility When Acquired.

1. Board Policy Confines Acquisition Adjustments to the Limited Circumstances Where A Utility Has Shown Tangible Benefits to Existing Ratepayers or Has Acquired a Distressed System That Cannot Provide Safe, Adequate & Proper Service to Ratepayers.

Normally, when a utility acquires another system, it receives a return in rates based on the acquired system's book value, which represents the original cost of the system's assets less accumulated depreciation. Acquisition adjustments, if permitted, allow for rate recovery of the full amount that a utility chose to pay to acquire a system, which is almost always in excess of that system's current book value.

The Board's policy regarding acquisition adjustments was set forth in I/M/O Petition of Elizabethtown Water Co. For an Increase in Rates, BPU Docket No. 8312-1072, 64 P.U.R. 4th 613 (N.J.B.P.U. 1984) ("Elizabethtown Acquisition Order") (copy attached). In that case, the Board found that an acquisition adjustment is appropriate only when a utility can demonstrate specific benefits to existing customers, finding that "[w]e will continue to recognize the appropriateness of acquisition adjustments where a specific benefit can be shown, such as the acquiring of needed facilities which benefit the entire system." In denying the acquisition of the Peapack and Gladstone Water System in that case, the Board accepted the analysis of the ALJ, whose Initial Decision found that "existing customers received no benefit from the Peapack-Gladstone acquisition…petitioner offered no evidence as to why existing ratepayers should bear the cost associated with a purchase that may be in the public interest, but does not particularly aid existing customers of the system." The Board also noted an additional circumstance where acquisition adjustments may be appropriate, which was a utility's acquisition of a troubled small water company. The Board made it clear that its policy was limited to distressed systems that are "hard-pressed to provide safe, adequate and proper service" consistent with "the intent of the Small Water Company Takeover Act, N.J.S.A. 58:11-59 et seq."

The Board affirmed its policy on acquisition adjustments in I/M/O Petition of South Jersey Gas Co. For Approval of Increased Base Tariff Rates & Charges, BPU Docket No. 843-184, Order dated 12/30/85 ("South Jersey Gas Order") (copy attached). In that matter, South Jersey Gas Company sought an acquisition adjustment for its purchase of the Cape May portion of its system from New Jersey Natural Gas Company. Noting that "[t]he Board's policy on this issue was clearly set forth in [the Elizabethtown Acquisition Order]," the Board reiterated that acquisition adjustments would be recognized "only where it was proven that a specific and

tangible benefit inured to ratepayers from the acquisition." South Jersey Gas Order at 4. The Board made it clear that benefits must inure to ratepayers of the existing system, noting that "[i]n his Initial Decision, Judge Sullivan properly recognized the Board's policy in this area and correctly rejected the Company's position that the Board should look to both utilities and their ratepayers in determining if any benefits were created by the transaction." Id. In denying the requested acquisition adjustment, the Board found that "the Company bears the burden of proof with regard to any benefits from its acquisition" and "the Company failed to carry its burden of proof as to whether any specific and tangible benefits resulted from its acquisition from New Jersey Natural." Id.

Good public policy dictates that acquisition adjustments be limited to the narrow circumstances outlined in the Board's policy. Allowing the Company to receive acquisition adjustments in this matter above the system's current book value would send a signal to both sellers and purchasers regarding future acquisitions. Acquisition adjustments are an exception to the rule that utilities can only recover a rate of return on the book value of their assets. Without any tie to the book value of the system, water utilities could purchase systems at any inflated price, knowing that they will recover any excess costs from ratepayers. This will almost certainly raise the future purchase price of acquisitions, as the seller will know there is little to no ceiling on cost and the purchaser can increase their earnings by overpaying for a system. For this reason, acquisition adjustments must only be granted in very limited circumstances, such as those outlined in the Board's acquisition adjustment policy.

2. The Company Has Failed to Demonstrate Net Benefits to Existing Ratepayers From the Shorelands Acquisition.

The Company is seeking an acquisition adjustment for the approximately $26.9 million over book value it paid to acquire the Shorelands Water Company. *RC-30*. As explained below, the Company has failed to carry its burden of proving that its existing ratepayers should pay for the Company's decision to pay such a substantial sum for Shorelands. First, it is important to note that the decision to acquire Shorelands was made purely by the Company and its Board of Directors. Ratepayers had no say in whether to acquire Shorelands, or in the Company's decision to pay $26.9 million in excess of book value for the system. The Company has a heavy burden to prove that its ratepayers should now pay a return on and a return of this $26.9 million premium, and it is a burden that the Company has failed to meet.

The Company offered an analysis attempting to show that the alleged benefits of the acquisition outweigh the cost of the acquisition adjustment. The Company claims that it will avoid $29 million of planned capital costs and defer an additional $18.9 million of capital costs for a period of 5-10 years. *P-8* at 38. The Company asserts a net present value benefit of $6.6 million as a result of the acquisition. Id. at 39.

There are a number of reasons why the Company failed to meet its burden of proving net benefits to existing ratepayers. First, the alleged benefits of the acquisition are based solely on the Company's claims that it will avoid spending on certain capital projects. *RC-1* at 31. Although the Company claims that it will avoid certain capital costs, it has never committed to doing so. Absent a commitment, there is no guarantee that these capital costs will actually be avoided, or result in lower rates for ratepayers.

Secondly, as Mr. Woods testified, the Company's analysis contains certain assumptions that may not be realistic, and absent such assumptions, the Shorelands acquisition ends up as a net liability to existing ratepayers. One example of a flawed assumption in the Company's

analysis relates to its Navy Tank. *RC-1* at 32-35. The Navy Tank is a 1.2 million gallon standpipe with operating range between 240 feet and 278 feet. Id. at 32. Replacement of the Navy Tank is one of the avoided projects under the Company's analysis, with an avoided cost of $3,700,000. *P-8*, Schedule FXS-1. The Company's analysis assumes that the Navy tank will remain in service for the next forty years, without needing replacement during that time. *RC-1* at 33. The flaw in the Company's analysis is that the Navy Tank was built in 1951, and is already 67 years old. Id. at 34. In other words, the Company's analysis assumes the Navy Tank will continue in service until it is 107 years old, despite its current depreciation rate of only 72 years. Id. Mr. Woods' testimony illustrates the sensitivity of the analysis offered by the Company simply by examining its assumption about the Navy Tank. As Mr. Woods demonstrated, if the Navy Tank needs to be replaced in 2023 – the end of its 72 year depreciation life – then the Shorelands acquisition transforms from an acquisition with a $6.6 million net benefit to ratepayers under the Company's analysis, to a $197,000 net cost to ratepayers. Simply with one reasonable change to the Company's analysis, altering this one project on the list of projects that the Company claims will be avoided, Mr. Woods demonstrated that the Company's claim of net benefits from the Shorelands acquisition does not stand scrutiny.[2] The Company's analysis is based upon hopeful, speculative assumptions. If any of those assumptions prove inaccurate, the result of the cost benefit analysis changes dramatically.

Furthermore, as Mr. Woods testified, unless the Company's overall capital spending is somehow capped, there is no guarantee that ratepayers will actually experience lower rates, even

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[2] Mr. Woods also examined other projects that the Company claimed could be avoided or deferred, such as the Englishtown Wells in Lakewood and the storm protection project for the Newman Springs Clearwell. *RC-1* at 35. Mr. Woods testified that if the Company finds these projects must be built as planned, and not delayed, then together with the Navy Tank construction the Shorelands acquisition would result in a net present cost to ratepayers of approximately $25.5 million. Id. at 36.

if the capital projects contained in the analysis remain avoided. *RC-1* at 37. Indeed, the Company has never claimed that its capital spending will be reduced as a result of acquiring Shorelands. The Company has aggressively invested in new plant in its service territory, in the amount of $868 million since its last rate case only three years ago. Id. As Mr. Woods testified, absent a cap it is likely that any avoided costs will simply shift dollars elsewhere, with ratepayers being asked to pay for both the acquisition premium and the new investment. Id.

Finally, the Company's analysis ignores certain costs related to the Shorelands acquisition. The analysis does not consider the cost of any internal improvements that will need to be made to the Shorelands system over time, nor does it consider any of the capital integration costs necessary to integrate Shorelands with the existing New Jersey American system. Id. Since these are costs that never would have been incurred absent the Company's acquisition of Shorelands, the Company should have included them in its analysis of whether the acquisition produced net benefits to existing ratepayers. The Company did not, and for this and all the other reasons noted above, failed to meet its burden of proving that it should receive an acquisition adjustment for the Shorelands system. Accordingly, the Company's request for an acquisition premium in excess of Shorelands' book value should be denied.

3. Haddonfield Was Not a Troubled Utility, Nor Did Its Acquisition Benefit Existing New Jersey American Ratepayers. Accordingly, Per Board Policy the Proposed Acquisition Adjustment for Haddonfield Should Be Denied.

The Company is seeking an acquisition adjustment of $1,588,911 for the Haddonfield system.[3] *RC-1*, Schedule HJW-10. The Board's policy, as set forth in the Elizabethtown Acquisition Order, requires that a utility demonstrate a specific benefit to existing customers

[3] This amount reflects the difference in the purchase price of $28.5 Million and the value of the Haddonfield system of $26,911,089 contained in the testimony of Stephanie Cuthbert, *P-36* at 10.

from an acquisition in order for an acquired system to be eligible for an acquisition adjustment. The Company has failed to meet its burden in this case of showing that the Haddonfield acquisition benefited existing customers. The Company asserts various benefits such as the decommissioning of Haddonfield's Centre Street water treatment plant and Haddonfield's Cottage Avenue Standpipe. *P-24* at 4-5. However, as Mr. Woods testified, these asserted benefits inure only to Haddonfield customers, not other New Jersey American ratepayers as is a pre-requisite to receiving an acquisition adjustment under the Elizabethtown Acquisition Order. *RC-1* at 23.

The Company does assert one benefit to existing ratepayers from the Haddonfield acquisition, the Haddonfield water allocation permit. Id. at 6. Through the testimony of Mr. Shields, the Company claims that this allocation will be useful in addressing water quality requirements associated with perfluorinated compounds (PFCs). *P-7* at 18. However, Mr. Woods successfully rebutted Mr. Shields' testimony. As Mr. Woods testified, "three years after the acquisition of the Haddonfield system, [the Company] still cannot quantify the impact of these groundwater quality issues or the impact that the Haddonfield acquisition may or may not have on the solution to these problems." *RC-84* at 3. When asked in discovery to quantify the impact of the Haddonfield acquisition on the Company's ability to address the new PFC standards, the Company could not answer, instead stating that it "is still evaluating the overall impact of the new PFC standards on the company wells and does not have an overall impact developed at this time." *RC-18, RC-19*. The Company bears the burden of proving any alleged benefits to existing ratepayers from the Haddonfield acquisition. Since the Company could not quantify the impact that the Haddonfield acquisition had on its ability to address PFCs, the

Company failed to meet this burden of proof, and per Board policy its request for an acquisition adjustment for Haddonfield should be denied.

Additionally, while the Board has occasionally granted acquisition adjustments for acquisitions of utilities that cannot provide safe, adequate and proper utility service to customers, the Company has failed to prove that Haddonfield was a "troubled" utility at the time of its acquisition. As a preliminary matter, the Company's Petition and Direct Testimony never asserted that the Haddonfield was troubled. The Company made this assertion for the first time in the *rebuttal* testimony of Ms. Cuthbert, filed eight months after its Petition and more than three years after Haddonfield was acquired. Furthermore, Ms. Cuthbert's entire argument is based on the definition of the "emergent conditions" set forth in the Water Infrastructure Protection Act ("WIPA"), a statute that was not enacted until after the Haddonfield purchase. The Company itself confirmed the irrelevance of the WIPA to Haddonfield in its cross-examination of Mr. Woods:

> Q. So, you offer some testimony about a troubled water system. And you make the point that WIPA – the Water Infrastructure Protection Act – does not apply to the Haddonfield system. Is that correct?
>
> A. Yes.
>
> Q. And that's because the Haddonfield acquisition took place before – and I'll refer to it as WIPA – before WIPA was passed. Correct?
>
> A. Correct.
>
> Q. And, you don't understand that Ms. Cuthbert was saying that WIPA did apply to the Haddonfield acquisition. Is that correct?
>
> A. I understand her rebuttal testimony to mean that if the definitions from the [WIPA] were applied to the Haddonfield system, that some of the five criteria might apply to Haddonfield.
>
> Q. But she wasn't saying that WIPA did apply to Haddonfield?

A. I don't think she was. No.

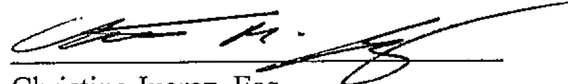
T160:L3 – T160:L23 (6/11/18).

This testimony demonstrates that the WIPA definitions are not relevant to the Haddonfield acquisition. Haddonfield was not acquired under WIPA; indeed, WIPA was not even enacted at the time of the Company's purchase of Haddonfield. Therefore, Ms. Cuthbert's testimony regarding WIPA is irrelevant, and the Company's claim that Haddonfield is a troubled utility because of WIPA should be disregarded. The Company has failed to meet its burden of proof that Haddonfield was a troubled utility at the time of its acquisition. The proposed acquisition adjustment of $1,588,911 for Haddonfield should therefore be denied.

For the reasons stated above, Rate Counsel respectfully requests Your Honor issue an Initial Decision recommending that the Board deny the acquisition adjustments proposed by the Company.

Respectfully submitted,

STEFANIE A. BRAND
DIRECTOR, DIVISION OF RATE COUNSEL

By: 
Christine Juarez, Esq.
Assistant Deputy Rate Counsel

c: OAL Service List (via UPS Overnight Mail)
BPU Service List (Electronic and USPS Regular Mail)

In the Matter of the Petition of New Jersey American Water Co. Inc. for Approval of Increased Tariff Rates and Charges for Water and Wastewater Service, Change in Deprecation Rates and Other Tariff Modifications

OAL Dkt. No. PUC 16279-2018 S
BPU Docket No. WR17090985
Service List

Christine Juarez, Esq,
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Susan E. McClure, Esq,
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Ira G. Megdal, Esq.
Cozen O'Connor
457 Haddonfield Road
Cherry Hill, New Jersey 08002

Alex Moreau, DAG
Division of Law
124 Halsey Street
P.O. Box 45029
Newark, NJ 07101

Andrew Kuntz, DAG
Division of Law
124 Halsey Street
P.O. Box 45029
Newark, NJ 07101

Donna Lee-Thomas
Case Management
Board of Public Utilities
44 South Clinton Ave.
P.O. Box 350
Trenton, New Jersey 08625-0350

Jay L. Kooper
Vice President, General Counsel & Secretary
Pinelands Water Company
P.O. Box 400
Iselin, NJ 08830

In the Matter of the Petition of New Jersey American Water Co. Inc. for Approval of Increased Tariff Rates and Charges for Water and Wastewater Service, Change in Deprecation Rates and Other Tariff Modifications
BPU Docket No. WR17090985
Service List

Stefanie A. Brand, Director
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Maria Moran, Director
Board of Public Utilities
Division of Water
44 South Clinton Ave. – Suite 314
P.O. Box 350
Trenton, New Jersey 08625-0350

Andrew Kuntz, DAG
Division of Law
124 Halsey Street
P.O. Box 45029
Newark, NJ 07101

Brian Lipman, Esquire
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Jason Andersen
Division of Law
124 Halsey Street
P.O. Box 45029
Newark, NJ 07101

Meagan Lupo
Board of Public Utilities
44 South Clinton Ave.
P.O. Box 350
Trenton, New Jersey 08625-0350

Debra F. Robinson, Esquire
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Mona Mosser
Board of Public Utilities
44 South Clinton Ave. - 9th floor
P.O. Box 350
Trenton, New Jersey 08625-0350

Emma Xiao, DAG
Division of Law
124 Halsey Street
P.O. Box 45029
Newark, NJ 07101

Susan McClure, Esquire
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Dr. Son-Lin Lai
Office of the Economist
44 South Clinton Ave.
P.O. Box 350
Trenton, NJ 08625

Dr. Ben Witherell, Chief Economist
Board of Public Utilities
44 South Clinton Avenue, Suite 314
P.O. Box 350
Trenton, NJ 08625

Christine Juarez, Esquire
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Matthew Koczur
Board of Public Utilities
44 South Clinton Ave., Suite 314
P.O. Box 350
Trenton, NJ 08625

Alex Moreau, DAG
Division of Law
124 Halsey Street
P.O. Box 45029
Newark, NJ 07101

Kathryn A. Hart, Legal Assistant
Division of Rate Counsel
140 East Front Street, 4th Floor
P.O. Box 003
Trenton, NJ 08625

Michael Kammer
Board of Public Utilities
Division of Water
44 South Clinton Ave. - 9th floor
P.O. Box 350
Trenton, New Jersey 08625-0350

Robert J. Brabston, Esquire
New Jersey American Water
1025 Laurel Oak Road
Voorhees, NJ 08043

Dante DeStefano
New Jersey American Water
1025 Laurel Oak Road
Voorhees, NJ 08043

Suzana Duby, Esquire
New Jersey American Water
167 John F. Kennedy Parkway
Short Hills, NJ 07078

John Tomac
Director of Rates & Regulations
New Jersey American Water
1025 Laurel Oak Road
Voorhees, NJ 08043

Christine Soares, Esquire
Cozen O'Connor
457 Haddonfield Road
Cherry Hill, New Jersey 08002

Ira G. Megdal, Esquire
Cozen O'Connor
457 Haddonfield Road
Cherry Hill, New Jersey 08002

Michael J. Majoros, Jr.
Snavely, King, Majoros &
Associates, Inc.
P.O. Box 727
Millersville, MD 21108

Brian Kalcic
Excel Consulting
225 S. Meramec Avenue
Suite 720T
St. Louis, MO 63105

Howard J. Woods, Jr., P.E.
Howard J. Woods, Jr.
& Associates LLC
49 Overhill Road
East Brunswick, NJ 08816

Robert J. Henkes
Henkes Consulting
7 Sunset Road
Old Greenwich, CT 06870

David Peterson
Chesapeake Regulatory
Consultants Inc.
10351 Southern Maryland Blvd
Suite 202
Dunkirk, MD 20754-9500

Marlon Griffing, Ph.D
Senior Consultant
938 June Avenue
St. Paul, Minnesota 55102

Aida Camacho-Welch, Secretary
Board of Public Utilities
44 South Clinton Ave.
P.O. Box 350
Trenton, NJ 08625

Justin Cederberg
44 South Clinton Avenue
P.O. Box 350
Trenton, NJ 08625

Kyle Felton
Board of Public Utilities
44 South Clinton Avenue, Suite 314
P.O. Box 350
Trenton, NJ 08625

April Costello, Legal Assistant
Szaferman, Lakind, Blumstein
& Blader, P.C.
101 Grovers Mill Road, Suite 200
Lawrenceville, NJ 08648

Anthony R. Francioso, Esq.
Foranaro Francioso LLC
1540 Kuser Road, A-1
Hamilton, NJ 08619

Janine Bauer, Esq.
Szaferman, Lakind, Blumstein,
Blader, P.C.
Attorneys at Law
101 Grove Mill Road, Suite 200
Lawrenceville, NJ 08648

Martin Rothfelder

mrothfelder@rothfelderstern.com

e-mail only

Rich Preiss

richard.preiss@gabelassociates.com

e-mail only

James Garren

jgarren@snavely-king.com

e-mail only

Tina Lee

tlee@starwestgen.com

e-mail only

A. Bruce O'Connor
aboconnor@middlesexwater.com
e-mail only

Stephen B. Genzer, Esquire
sgenzer@saul.com
e-mail only

John Pryor
jbu_pe@yahoo.com
e-mail only

William R. Holzapfel
wholzapfel@elizabethnj.org
e-mail only

Kofi Ocansey
Kofi.Ocansey@bpu.nj.com
e-mail only

Steven Gabel
steven@gabelassociates.com
e-mail only

Anthony Zengaro
azengaro@elizabethnj.org
e-mail only

Jay L. Kooper, Esquire
jkooper@middlesexwater.com
e-mail only

Patricia A. Krogman
Patricia.Krogman@dol.lps.state.nj.us
e-mail only

Kyle Felton
Kyle.Felton@bpu.nj.gov
e-mail only

William Agee
William.Agee@bpu.nj.gov
e-mail only

Bradford M. Stern, Esquire
bstern@rothfelderstern.com
e-mail only

John Hildabrant, President
jhildabrant@aquaamerica.com
e-mail only

Susan Rauth
strauth@aquaamerica.com
e-mail only

Anthony Visco
Anthony.Visco@bpu.nj.gov
e-mail only

Magdy Mekhaeil
Magdy.Mekhaeil@bpu.nj.gov
e-mail only

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IN THE MATTER OF THE PETITION OF ELIZABETHTOWN WATER COMPANY FOR AN INCREASE IN RATES

Initial Decision: July 12, 1984
Final Agency Decision: September 24, 1984
New Jersey Supreme Court Decision Appears
at 107 *N.J.* 440 (1987)

SYNOPSIS

Petitioner requested a 17.6 percent increase in rates for water service. The matter was transmitted to the Office of Administrative Law for a hearing.

In determining rate base, the administrative law judge assigned to the case concluded that he should consider expenses that would be incurred after the conclusion of the test year, provided petitioner could demonstrate substantial likelihood that the items allowed would be in service during the rate period in question. Accordingly the judge took into account costs of some construction projects that would be completed in the near future. Regarding appropriate rate of return, the administrative law judge calculated that it should be 14.6 percent on common equity and 11.07 percent overall. Despite petitioner's excellent service record, the judge declined to raise the rate of return as a "premium" for good management. No allowance above a reasonable and fair rate of return should be allowed.

Another issue was petitioner's unusually high earnings in recent years, caused in part by weather conditions. The judge determined that the appropriate method for calculating potential growth rate should take into account historical data over a reasonable period of time. In this case, a five-year average reflected reasonable investor expectations while also accounting for recent high earnings, which were unlikely to be repeated, although earnings were projected to remain higher than they had been in the past. The allowed rate of return would be fair and take into account the interests of both investors and consumers.

Upon review, the Board of Public Utilities affirmed this initial decision with some modifications.

First, regarding appropriate test year, the Board disagreed with the use of a "substantial likelihood" test in the initial decision. The Board's policy has been and remains that the test year should be as current as possible and reflect actual test year data. That data can

be adjusted for "known and measurable" changes outside the test year.

The Board also modified the rate of return set in the initial decision, based on its review of the evidence. The Board noted its obligation to establish rates sufficient to encourage good management and enable a utility to maintain its credit, while also providing a return to the equity holder that is commensurate with investments having corresponding risks. The Board set the return on equity at 14.1 percent and the overall return at 10.9 percent.

Finally, the Board considered petitioner's high earnings in recent years and concluded that the prohibition against retroactive ratemaking did not preclude the Board from reviewing whether a utility has achieved an unreasonable rate of return on equity. Furthermore, the Board may fashion a remedy. Since petitioner had achieved rates of return significantly higher than had been set, the Board concluded that ratepayers should receive recognition for over-earnings. To achieve this, the Board ordered the new rates set in this case to be held in abeyance until the difference in revenues between those that would be earned under the new rates, as against those received under the current rates, equaled the amount of the over-earnings. The Board would monitor petitioner's earnings to determine when new rates could go into effect.

The Appellate Division, 205 *N.J. Super.* 528, reversed and remanded. The Supreme Court affirmed as modified.

William R. Holzapfel, Esq.,
(Holzapfel, Perkins & Kelly, attorneys)
Walter M. Braswell, Esq., for petitioner
Helene S. Wallenstein and **Mumtaz Bari-Brown,** Assistant Deputy Public Advocates, for Public Advocate, Division of Rate Counsel
(Joseph H. Rodriguez, Public Advocate of New Jersey, attorney)
Edward D. Beslow, Esq., Regulatory Officer, **Jerry Westreich,** Accountant II, **Dr. Joseph Bowring,** Research Economist I, and **Thomas Serzan,** Rate Analyst III, for Staff, Board of Public Utilities

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PENN, ALJ:

On December 2, 1983, Elizabethtown Water Company, hereinafter (Company), filed a petition with the Board of Public Utilities request-

ing a 17.6 percent increase in rates for water service. The increase was calculated to yield an increase in annual revenues of approximately $9,191,258. The increase in annual revenue, as originally proposed, was subsequently revised downward by the Company to $8,661,580 (April 30, 1984 hearing).

Orders suspending the increase were entered by the Board of Public Utilities on December 27, 1983 and May 4, 1984. The latest suspension period terminates on September 3, 1984. A pre-transmittal conference was conducted at the Board of Public Utilities between the parties on December 19, 1983. At that time, it was determined that Middlesex Water Company and Commonwealth Water would be allowed intervenor status in the case. The parties also agreed to stipulate the "test year" in this case as the annual period ending March 31, 1984. The parties further agreed that the Company could present proofs with respect to known and forseeable changes through June 30, 1985, although changes through March 31, 1985, were to be submitted at the request of Rate Counsel. Thereafter, a prehearing conference was held in the case on January 17, 1984. Hearings were held on March 2, 7, 8 and 30, and April 4, 5, and 30, 1984. At the conclusion of the proceedings, the briefing scheduled was set by the court. The last brief was received on June 7, 1984, and the record was closed on that date.

PUBLIC HEARING

Edward Murphy, Township Administrator for the Township of Cranford, noted that the requested increase will have a drastic effect upon the budget of the township. He noted that the "Cap" law precludes municipalities from operating under a deficit budget. Mr. Murphy noted that in 1976 the township utilized 416 fire hydrants. At that time, the Company was charging $27.30 per hydrant. That figure remained constant until 1979, when it increased to $27.64. In 1981, the price for service per hydrant increased to $57, and in 1982 it increased to $94. As a result of the Company's last rate case, the charges for hydrant service paid by the Township of Cranford, increased to $115. Under the proposed petition, the cost per hydrant for the 440 hydrants now being utilized by Cranford would be $181 per hydrant. Mr. Murphy went on to note that the municipal budget has increased only 66 percent since 1977, while the cost of service per fire hydrant had increased 663 percent. He noted that in order to meet the high cost of providing fire service to the community, the township

has been forced to decrease personnel, equipment and projects in other departments. Leonard Dolan, Chief of Cranford Fire Department, projected that the requested increase would result in an inability of the Fire Department to purchase needed equipment and to maintain its current manpower levels. Sandra Weks, Public Safety Commissioner, noted that the increase in cost is definitely resulting in the diversion of monies from needed areas in order to provide fire service to the community. Joseph Caroselli, Linden Transportation Inspector, objected to the increase on behalf of the citizens of Linden. Lawrence Newcomb of Scotch Plains agreed with the comments of Mr. Murphy and noted that the increase requested is two times the Cap increase afforded the municipalities. He noted that the proposed increase would impose severe hardship on the Township of Scotch Plains. The letter read by Mr. Newcomb indicated that the citizens were not complaining, however, of poor service from the Company. Frederick R. Bostel, Superintendent of Water and Sewers for Elizabeth and Lawrence Ansovino of Dunnellen, objected to the proposed increase for their municipal citizenry. No objector voiced a complaint regarding the quality of service being provided by the Company.

TEST YEAR

The parties have agreed to the use of a test year ending March 31, 1984. The parties have also agreed to allow the Company to submit proof on known and forseeable changes through June 30, 1985. At the request of the Public Advocate, data through March 31, 1985 was also submitted by the Company. The Company advocates use of a variation of an emergent theory in public utility regulation regarding the use of a base year-rate year. The Company asserts that use of a "rate year" ending June 30, 1985, (the year during which rates will actually be in effect), should be used as the measuring device for calculating rate base, revenues, and expenses. The Company asserts that a projection of foreseeable changes through June 30, 1985, is essential if the Board is to recognize the proper matching between revenues, expenses, and rate base, during the year that the rates are actually in effect. The Company notes that the projection through June 1985 does not recognize that rates will, in all probability, be set by the Board on or before September 3, 1984, when the current suspension period terminates. The Company recognizes that the projection through June 1985 is, in reality, only 10 months of the year during which the rates will be in effect.

Rate Counsel, on the other hand, asserts that the Company should not be allowed to project rate base and line items to a period extending some 15 months beyond the close of the test year. In essence, they urged that the projections must not extend beyond the test year. The Rate Counsel takes the position that revenue and expenses should be matched accordingly, after considering known and measurable changes.

The Advocate notes that the instant case is structured around the inclusion of extensive speculative adjustments beyond the actual March 31, 1984 levels of rate base. The Advocate urges that it has followed the Board's prior policy of recognizing only known and measurable changes from an acutal test year. Projections for rate base and revenues and expenses are unreliable, and cannot be considered. Counsel noted that rate base changed substantially between the original forecast and the filing of the December petition, when compared to actual data for the period ending March 31, 1984. A comparison of the nine months actual/three months projection figures, with the actual figures supplied by the Company, presents a striking contrast. Rate Counsel notes that there was more than a $1,000,000 difference in rate base predicated upon examination of these figures.

Rate Counsel goes on to note that the $1,000,000 differential is not surprising given the susceptibility of forecasts to unpredictable and unforeseeable changes. Citing several examples of unforeseen changes which inevitably create inaccuracies in projections, Rate Counsel urges this tribunal to disregard the projections advanced by the Company beyond the test year. The use of the proposed adjustments advanced by the Company 15 months beyond the conclusion of the test year, is tantamount to the utilization of a forecast test year, according to Rate Counsel.

Board Staff asserts the position that after careful consideration of the record in the case, it concurs with the position of Rate Counsel that rate base should be calculated based upon actual data available as of March 31, 1984, with revenues and expenses adjusted for known and foreseeable changes concurrent to that date.

The test year issue in this case is perhaps the most crucial element of the case. The wide range of variance between the petitioner's request for in excess of $8,000,000 in rate relief, and the Public Advocate's position that rates should be rolled back to recoup approximately $900,000, is predicated upon projections of expenses, revenue, and rate base, beyond the test year. Therefore, the merits of the various positions of the parties require more than a cursory examin-

ation. Historically, the Board has limited rate base items to actual data ending at the conclusion of the test year, adjusted for known and foreseeable changes. This latter recognition of providing for known and foreseeable changes, evidences a recognition of the Board of the need to set equitable rates and maintain consistency in Board rulings. *In the Matter of Elizabethtown Water Company,* BPU Dkt. No. 802-76 (November 19, 1980); *In the Matter of the Hackensack Water Company,* BPU Dkt. No. 815-447 and *In the Matter of New Jersey Bell Telephone Company,* BPU Dkt. No. 7711-1136 (January 31, 1978). It is this latter concern with "known and measurable changes" that creates the essential problem in this matter. Not only has the Board of Public Utilities recognized the need to achieve equitable rates, but the courts of the State of New Jersey have also recognized the necessity of setting rates in the context of reliable projections. For example, our Supreme Court has noted that utility rate making is the "making of a rule for the future." *In re Intrastate Industrial Sand Rates,* 66 *N.J.* 12 (1974). In a 1959 New Jersey Bell Telephone case, Justice Berling speaking for the New Jersey Supreme Court, stated:

> We recognize that rate making is by necessity a predictive science, for the rates of tomorrow are fixed on the facts of today. The Board is obliged, as an ultimate standard, to establish rates "sufficient to encourage good management and to furnish a reward for efficiency, to enable the utility, under efficient and economical operation, to maintain and support its credit; and enable it to raise money necessary for the proper discharge of its public duties." Matter of New Jersey Bell Telephone, 30 *N.J.* 16 (1959), (citation omitted).

Early on, our courts recognized the "requisite that there be 'an honest and intelligent forecast' of the probable future values" in determining rates established in the test year, if they are to measure up to par during the year they become effective. In order to achieve a degree of stability, those rates must measure up to that standard for a *reasonable time* thereafter. (Emphasis supplied) *Atlantic City Sewerage Company v. Board of Public Utilities Commissioners,* 128 *N.J.L.* 359, 366 (S. Ct. 1942) aff'd on opinion below, 129 *N.J.L.* 401 (E. & A. 1943).

It is clear from the foregoing that the critical question for purposes of rate making is not so much whether you term the period of recognition for purposes of rate base operating expenses and revenues as historic or future but, rather, given the fact that rate making as a futuristic process, to what extent does one recognize future projections

of rate base. A substantial likelihood that the customer will be receiving the benefit in terms of service, the Company will be receiving a benefit in terms of economic recovery during a reasonable time rates are in effect, is crucial. As the predictability of, for example, utility plant in service at a given date increases, the probability of it appropriately being considered as a portion of rate base in terms of recognizing investments and corresponding revenue and expenses, increases proportionately. Rate Counsel and Board Staff have cut off the point of recognition of items in rate base at the conclusion of test year March 1984. Notwithstanding, the Company asserts that it is entitled to recognize both major and minor construction projects which are due to be in service during the year that rates are in effect (ending June 1985). Of course, one of the advantages of future projections regarding rate base and other such items is that to the extent the projections become more and more foreseeable *and* the likelihood of the implementation becomes more certain, the ability to match appropriately, revenues, investment and expenses so that the Company has a fair chance of earning its rate of return, increases substantially. On the other hand, future projections, if ultimately in error, result in ratepayers having to pay for service before it is provided.

Gross Utility Plant

The position of Rate Counsel and Staff overlooks the primary requisite of ratemaking. That requisite consists of a consideration and fair prediction of probable values during a reasonable period in the immediate future. *Atlantic City v. Board of Public Utility Commissioners, supra* at 366, *Denver Union Stock Yard Co. v. United States,* 304 *U.S.* 470 (1938). The estimation of the fair rate base is a matter of "reasonable judgment" grounded in a "proper consideration of all relevant facts." *Simpson v. Sheppard,* 230 *U.S.* 352, 434 (1912) and *Atlantic City, supra.* "An arbitrary date is as unlawful as an arbitrary rate." *Hackensack Water Company v. Board of Public Utility Comm.,* 98 *N.J.L.* 41, 42 aff'd 100 *N.J.L.* 177 (E & A 1923). For purposes of this proceeding, I have chosen not to abandon use of the historic test year, consistent with long established Board policy. *In re New Jersey Bell Telephone Co.,* BPU Dkt. No. 7711-1136 (January 1978). However, I have chosen to allow projections of rate base items and associated expenses, revenues, to the period of September 30, 1984, provided there is an affirmative demonstration of a *substantial* likelihood that the items allowed will be in service before that time. This

latter condition reduces the likelihood that construction schedule delays will require ratepayers to pay for plant not in service and increases the company's ability to actually earn a fair return on an investment. I note that this results in a projection of some items of rate base, etc. to the period a rate increase (if ultimately granted), will be in effect.

Rate Counsel has refused to recognize at least the Company's completed or near complete major construction. According to the testimony of Mr. Cawley, several major construction items consisting of three projects, will be in service by June 30, 1984. The total amount of those items is approximately $3,975,000. The three projects under consideration are the Southern Area Reinforcements III, the Southern Area Reinforcements IV, and lime facilities. The completion dates for the projects are April 1984, and May or June 1984, respectively. Mr. Effron indicated that if the Board is to include any portion of the major construction items, only actual expenditures for the projects at March 31, 1984 should be allowed. That total amount of expenditures is $3,436,000. As noted by the Company, this amount does not include all cost necessary to complete the projects and falls approximately $500,000 short of the total expenditures by the Company by the time the projects will be completely in service. I am satisfied after reviewing the testimony of Mr. Cawley that, indeed, the three major projects under consideration will be complete on or before September 1984. At least $3,436,000 has been expended toward the three major projects and the lime facilities project is substantially complete, according to the witnesses' testimony. Even if one used the March 31, 1984 test year concept agreed upon by the parties, that does not preclude recognition of these projects, particularly here, where it is substantially certain that the projects will be in service prior to a Board decision in the case. The failure to so recognize the expenditures will result in the Company not receiving a return on the investment until its next rate proceeding. While that is not the dispositive issue by any means, the critical determination upon which recognition should be based is the substantial likelihood that the projects will be completed within a reasonable time. Accordingly, I disagree with Board Staff and the Public Advocate that the three major projects should not be recognized in rate base.

The Company also suggested that the Hillside-Union reinforcement project be included in rate base. Total construction cost of the project is approximately $600,000. According to Mr. Cawley, three of the segments of the project are already in service, and as of April 5, 1984,

the Company was awaiting the Easter break in order to pave two segments to complete the construction. He went on to indicate that three segments of the construction remain to be started. Those segments consist of a cost of approximately $329,000. He noted that a $127,000 segment was going to commence construction within two weeks (of April 5, 1984) to be followed by a $202,000 segment. The remaining segment, consisting of approximately $85,000 in construction costs, cannot be completed until the Company secures a right-of-way. While this latter construction appears to be somewhat speculative, Mr. Cawley indicated that it could "be several months before that starts, but it is a very short project, as you can see."

Mr. Cawley indicated that the Charles Street well treatment facility is scheduled to start in May 1984 and be completed by September. It is a well treatment facility to treat contaminated ground water. Estimated costs of the project are approximately $400,000.

The Southern Area Reinforcement Project V is expected to serve customers in the area of Manville, and is expected to be in service during the spring of 1985. Mr. Cawley noted that his Company still has to acquire rights-of-way for some portions of the construction. Construction is not scheduled to commence until October 1984. The Southern Area Reinforcement VI project is scheduled to cost approximately $1,600,000. The cost estimate increased during the course of the hearing according to Mr. Cawley, due to the high cost of pavement replacement in the Township of Princeton and also due to an overhead adjustment. Therefore, he revised the price and increased it 25 percent. There is also some growth potential for this area of the region which consists of West Windsor, Plainsboro and the Princetons. According to Mr. Cawley, small parts of this project can be placed into service as they are completed. Only $15,000 has been expended on the project to date, and the estimated in service date is May 1985.

The Drake's Corner storage project, originally estimated to cost $200,000, was increased to a figure of $300,000 during the testimony of Mr. Cawley. Mr. Cawley related that the price increase was occasioned by increases in the size of the tank's storage capacity, as well as increases in overhead costs. Mr. Cawley indicated that this project will take a relatively short time to complete, and the Company accounted for unforeseeable delays in its estimate of an on-line service date of June 1985. The Company has not been given permission to replace the tank by the Princeton University.

The Company also intends to place on line some time in the future,

the portion of major construction designated as the Southern Area Reinforcement VII. This project originally cost in excess of $1,000,000. The figure was substantially reduced to $100,000 during the testimony of Mr. Cawley. The $100,000 represented the acquisition cost of a right-of-way in the development of plans and specifications for the project. Mr. Cawley indicated that this project would not be in service by June 30, 1985.

The intake improvements are scheduled to be completed in June 1985. Construction should begin in October 1984. The flood protection plan, Raritan Millstone Project, originally scheduled to cost $650,000, was increased to $850,000. The construction of the project has been delayed until the railroad gives its permission to the Company to do some work on their land. Construction should begin in the latter part of the summer. The Stony Brook reconstruction, originally scheduled to cost $700,000 was reduced to $200,000 by Mr. Cawley, predicated upon his observation that the reconstruction portion of the capital improvement will not be completed by June 1985. Mr. Cawley noted that the $200,000 represents the cost of a system control which is scheduled to be installed by June 1985. However, the reconstruction will not take place until the Southern Area Reinforcement VII is completed.

In my view, the capital program expenditures for the Southern Area Reinforcement V, VI and VII, intake improvements, Raritan Millstone flood protection, Stony Brook reconstruction and Drake's Corner, are too speculative to allow in rate base at this time. Most of these projects are due to be completed in or about June 1985. In the event the predictions are off and there is a delay, the delay may result in a delay in placing plant in service for a period in excess of June 1985. While I do not consider June 1985 to be a magical cut-off date for the inclusion of items in rate base, I have given independent consideration to the likelihood of items being placed in service based upon amounts of money previously expended, and schedules of construction. I pause to note that those items which are scheduled to be placed in service by June 1985 would appear to be more susceptible to adverse impact and speculation resulting from a delay in placing plant in service. While Mr. Cawley did not envision any delays, in my view, the completion date for these projects is projected too far into the future to be recognized for rate making purposes. Several projects are not yet started and rights of way must be secured. After considering these factors, **I CONCLUDE** that inclusion into rate base

is not appropriate. Accordingly, I have disallowed those major capital program expenditures.

The Company also seeks to include $6,415,625 in rate base for routine construction commencing the quarter following March 31, 1984. I agree with Rate Counsel and Board Staff that routine construction should not be recognized in rate base consistent with Board policy. In the event the Company wishes to recognize its routine capital expenditures, they should do so by capitalizing AFDC. In addition, petitioner should not be allowed to include approximately $1,323,274 as construction work in progress balance at June 30, 1985. This amount represents the balance of expenditures in the routine construction projects which would not be in service as of June 30, 1985. Petitioner takes the view that it is appropriate to include routine construction work in progress (CWIP) in rate base since Company policy does not provide for the capitalization of AFDC. The capitalization of AFDC will result in higher charges for customers in the future based upon the deferred recognition of expenditures. Rate Counsel takes the view that CWIP should not be included in rate base because CWIP is not used and useful in providing utility service at a specific point in time. Rate Counsel advances the view that AFDC should be accrued on construction work in progress. The Board Staff takes the position that construction work in progress should not be allowed in rate base. Board Staff properly recognizes that it has been a policy of the Board of Public Utilities to allow CWIP in rate base based only in unusual instances. Usually when the financial integrity of the Company is in jeopardy, the Board relaxes its policy and allows a certain amount of CWIP in rate base. Here, however, there has been no showing by the Company that CWIP is necessary in order to maintain its financial integrity. Even if it has been shown to be necessary, I am not of the view that CWIP should be recognized by the Board.

Rate Counsel and Board Staff propose to adjust the utility plant in service balance by reducing it by $128,000. This figure represents the disallowance of an acquisition adjustment related to the purchase of the Peapack and Gladstone Water System. While the parties agree that the adjustment related to Washington Valley System should be recognized since petitioner acquired a well and storage tank that it would have had to construct in order to meet the supply and demand on the existing system, and the ratepayers benefitted from the acquisition, existing customers received no benefit from the Peapack-Gladstone acquisition. Notwithstanding that the purchase of a small water

company by a major water company is a policy that the Board favors, petitioner has failed to substantiate the inclusion of the adjustment as relates to the Peapack-Gladstone System because petitioner offered no evidence as to why existing ratepayers should bear the cost associated with a purchase that may be in the public interest, but does not particularly aid existing customers of the system. In addition, the public should not pay the net amount of the acquisition adjustment less accumulated amortization.

WORKING CAPITAL

Schedule 3 reflects petitioner's position regarding a working capital requirement of $6,512,017. Petitioner's cash working capital calculation is predicated upon a lead-lag study showing 68.14 days lag for revenues, 18.91 days for operation and maintenance expenses, 59.2 days for federal income taxes and 307.2 days for other taxes. Cash working capital predicated upon the lead-lag study amounts to $1,399,270 with a net lag of 9.59 days. Petitioner submits corresponding adjustments for the following:

Unamortized Taxes	$1,580,048
Materials and Supplies	$1,247,682
Prepayments	$ 940,156
Minimum Bank Balances.	$ 509,334
Deferred Charges	$ 835,527

Rate Counsel and Board Staff agree with petitioner's proposal for materials and supplies and minimum bank balances. However, they recommend adjustments to unamortized taxes, prepayments, and deferred charges.

WORKING CAPITAL AND DEDUCTIONS

Cash Working Capital—Lead-Lag Study

Rate Counsel disagrees with petitioner's calculation of cash working capital. Rate Counsel's calculation adjusts the lag for other taxes to 244.75 days. The adjustment was computed by including the prepaid portion of gross receipts and franchise taxes (GRFT) in the lag for other taxes. As a result, Rate Counsel's lag in GRFT is shorter than the lag payment calculated by petitioner, which was 307.20 days. Board Staff agrees with Rate Counsel regarding inclusion of the lag for the prepaid portion of GRFT.

The Company asserts that the excise-special tax is never an expense, but always remains as a prepayment on the books of the Company. Since it is a permanent deposit with the State of New Jersey, it should not be included in the lead-lag study. Accordingly, the Company has made an appropriate adjustment to delete this portion of the excise-special tax from the study. The Company's calculation decreasing the working capital requirements by $349,000 and adding $311,000 back into prepayments, is reflected in the Company's exhibit.

I agree with Board Staff that the appropriate lag for other taxes is 244.75 days. This treatment is consistent with the Board's treatment of a similar issue in *Public Service Gas and Electric Co.,* BPU Dkt. No. 837-620.

Rate Counsel also adjusted the lag study for invested capital to include a lag for interest of 80.5 days. Counsel advances the position that since a lag in the collection of revenues to pay interest is incorporated into the study, it is consistent to include a lag in payment of interest. Since the Company has included in its request, all elements of return on invested capital in the expenses, the Company should take into account, the lag associated with the payment of the expense itself.

The Company disagrees and asserts that it is appropriate not to include the lag in interest, in light of the Board's decision in *Public Service Gas and Electric Company,* BPU Dkt. No. 837-610 and *Atlantic City Electric Co.,* BPU Dkt. No. 822-116 (January 13, 1983).

The language of Judge Joseph Rosa, Jr., A.L.J. in the *Public Service Gas and Electric Co.* case is most appropriate. Therein, he noted:

> I find that the Company is correct in its assertion that the zero payment lag is appropriate for long and short term debt, preferred stock, and common dividends. All of these payments come from operating income which is the property of the investor, be it a common shareholder or a debtholder. I agree with the Company and Staff that the return is earned when service is provided. At that point in time these funds become the property of the investor. The investors are the ones who chose management, and theoretically management could make these payments to the debt and equity holders immediately upon their receipt by the Company. Management, however, has chosen to retain them for a certain period of time, just as they can choose whether to reinvest these earnings or disburse them as dividends. This being so any advantage that may be gained by paying the dividends or debt payments on a quarterly, semiannual or annual basis, rather than on a weekly or daily basis, as theoretically would be possible, should inure to the debt and equity holders. Therefore, the appropriate procedure is to ascribe a zero-payment lag to the return on invested capital.

I agree with the analysis of Judge Rosa and note that the Board adopted his initial decision in that regard. (Decided March 23, 1984.) Accordingly, the appropriate lag for invested capital is zero days. The resulting adjustment increases working capital by $1,091,000.

Rate Counsel also adjusts cash working capital by $536,000 to reflect accruals of vacation pay, which is not reflected in the study. Counsel urges that the lag in time between recognition of vacation pay and the disbursement of cash for vacation pay should be taken into consideration. Board Staff agrees.

Petitioner notes that a lag in time exists, but asserts that the study should only recognize the difference between the receipt of cash and the payment of cash and not the difference between recognition of liability to pay and actual payment.

I concur with Board Staff and Rate Counsel that vacation pay accrual should be reflected in the study. Since the Company accrues vacation pay, the only appropriate treatment is to deduct it from working capital. This approach recognizes that the rate payers have provided the vacation pay accrual before cash is actually disbursed.

In accordance with the recommendation of Board Staff, based on the above adjustments, petitioner's cash working capital requirement should be $2,211,000.

Rate Counsel also seeks to adjust petitioner's calculation which includes unamortized taxes in working capital. The Company includes unamortized taxes as a result of a change from cash to accrual accounting. No incremental outlay of cash was required. The Company began accruing GRFT in 1968, for ratemaking purposes, before recently changing to accrual accounting for book purposes. Since the changes in GRFT for book purposes had no effect on ratemaking treatment, it is inappropriate to include the effect of the book transaction in working capital. In my view, it would therefore be improper to consider the "drop year" of GRFT in the absence of a cash outlay, notwithstanding the contrary view expressed by petitioner. There has been no cash investment associated with the accounting change and there has been no ratemaking consequence as a result of the accounting treatment change.

Rate Counsel and Board Staff propose adjustments to prepayments associated with GRFT. Both parties urge that since the prepaid portions of GRFT are considered in the lead-lag study, it is a duplicative function to include a separate allowance for these items in prepayments. Prepayment balance of $940,156 should be reduced by

$718,000 associated with prepaid GRFT. The appropriate prepayment balance is $222,156.

Petitioner also proposes to include deferred charges in the working capital calculation. More specifically, petitioner proposes to include rate base treatment for abandonments of the Somerville and Pottersville filter plants. Customers will be paying for the unamortized balance of the old plants and the new mains which are a replacement for those plants. Since the situation presented is unlike abandonments of plants never placed into service, the unamortized balances should be included in the rate base, according to petitioner.

Rate Counsel and Board Staff agree that the prior policy of the Board with respect to water companies disallows these deferred charges.

Petitioner's position must be rejected since it fails to recognize that inclusion of deferred charges in working capital or as an addition to rate base, results in ratepayers paying an amortization of these costs in expenses and a return on unamortized balances included in rate base.

Customer Advances for Construction and Contributions in Aid of Construction

Petitioner proposes customer advances for construction and contributions in aid of construction balances in the amounts of $13,368,295 and $7,440,874 respectively, for the period ending June 30, 1985. This projected balance is in agreement with petitioner's use of a rate year concept for measuring rate base.

Consistent with their respective positions that rate base be calculated as of March 31, 1984, Rate Counsel and Board Staff proposed use of actual data. Both parties utilize balances of $11,856,000 (advances) and $7,411,000 (contributions).

In line with my previous discussion to allow test year calculations adjusted through September 30, 1984 for foreseeable and measurable changes and concurrent rate base treatment, I have allowed customer advances for those major projects which will be substantially complete before September 30, 1985. Accordingly, I have adopted the Company's adjustment of $568,000 for advances on projects completed before September 30, 1984. The remaining adjustment of $944,000 advocated by the Company is not allowed since the vast majority of the expenditure is related to major construction not recognized in rate

base in accordance with my previous discussions. Total customer advances should be $12,424,000 ($11,836,000 plus $568,000).

Contributions in aid of construction is not affected by a rate year analysis and is therefore $7,441,000.

Unamortized Investment Credit

Petitioner proposes an unamortized investment tax credit of $564,935. Petitioner advances the view that the unamortized investment credit balance is reduced by the amortization of the pre-1971 tax credit and is consistent with the treatment sanctioned in prior rate cases. Rate Counsel and Board Staff do not question petitioner's methodology. However, their respective positions regarding test year precludes recognition of the credit beyond March 31, 1984. Thus, Rate Counsel and Board Staff utilize the March 31, 1984 amount of $587,000.

In accordance with my decision to measure rate base as of September 30, 1984 (if certain conditions are met), I recommend utilization of that balance in determining the appropriate credit. Therefore, I have utilized $578,392 as the appropriate number: 587, 392, 920 (3/31/84 bal.) less amortization through September 30, 1984 of (1/2 x 17,966).

Deferred Taxes—ADR and ACRS

Petitioner proposes the weighted average balance of deferred federal income taxes, calculated as of June 30, 1985 be used. That amount is $5,449,023. Consistent with their previous positions, Rate Counsel and Board Staff utilize the average balance of $3,584,000 (March 31, 1984).

In accordance with my previous findings, I have chosen to recognize one-quarter of petitioner's $1,866,000 adjustment (through 6/30/85). Accordingly, I have calculated the balance at September 30, 1984 as being ($1,399,500 plus $3,584,000), $4,983,500.

Other Deferred Taxes

Petitioner proposes to adjust additional deferred taxes in the amount of $446,850 to reflect deferred taxes associated with unamortized balances for tank painting and the Somerville and Pottersville Filter Plant abandonment losses as of June 30, 1985, which petitioner includes in its working capital requirements as deferred

charges. Consistent with my decision not to include deferred charges in working capital, I have disallowed the adjustment reflecting inclusion of associated deferred taxes.

Rate Counsel submits that an adjustment of $2,178,000 is appropriate. Consistent with its position on deferred charges in working capital, Rate Counsel urges the inclusion of unamortized tax balances totaling $141,000 and additional deferrals for taxes related to the Company's inclusion of unbilled revenues for income tax purposes, in the amount of $2,037,000. Rate Counsel asserts that petitioner is not required to include unbilled revenues for income tax purposes and, accordingly, recommends their exclusion from current taxes. The resulting accumulated deferred taxes associated with unbilled revenues should be deducted from rate base. This combined treatment, posits Rate Counsel, results in a proper matching.

I pause to note that Rate Counsel's position must be rejected in light of the fact the Internal Revenue Service rejected petitioner's attempt to change its accounting method to include unbilled revenues for income tax purposes. A summary of my **FINDINGS** on rate base and other items are included in the schedules attached to the decision. In the event the mathematical computations are in error, the parties may address them in exceptions to the Board.

OPERATING REVENUES

Petitioner proposed operating revenues on June 20, 1985, in the amount of $52,885,005. The Company proposed operating expenses for the test year ending March 31, 1984 in the amount of $52,350,925. Actual test year revenues for the period were $53,281,000. The difference in the two figures represents the Company's attempts to normalize test year revenue to reflect abnormal weather conditions consisting primarily of the drier than normal summer of 1983. The Company's testimony in this regard was presented by Mr. Edward Cash. In his original testimony, Mr. Cash estimated the revenues for the test year and the rate year for general metered service (GMS) based upon the actual amounts for the 12 months ending June 30, 1983. He excluded high consumption for the hot and drier summer under the theory that this consumption was not normal.

Thereafter, Mr. Cash presented his rebuttal testimony. Therein, he analyzed in greater detail the weather conditions of 1983, including the wet spring, dry summer, and other factors concerning all classes of service in an attempt to normalize operating revenues for the

period. With regard to the normalization of general metered service, Mr. Cash noted they used a five-year period (1978-1982) to develop the average increase in gallons used per bill between a winter period (not affected by weather), and the spring and summer period. Predicated upon this analysis, Mr. Cash concluded that the average increase in gallons used per bill, was approximately 2,751 gallons. Using the same methodology, Mr. Cash then calculated the increased usage per bill by comparing the usage patterns of 1983 for the same periods, 1978-82. This resulted in an increase of 4,824 gallons per bill. The resulting increase of 2,073 gallons per bill (4,824 minus 2,751) represented the effect of the wet spring and dry summer of 1983 on actual revenues. This factor resulted in an adjustment to actual test year revenues of $808,674. Other classes of revenues were similarly normalized, which resulted in a normalization or a reduction in revenues of $181,000. Actual test year revenues, as adjusted by the Company, are $52,291,326. Petitioner then calculated additional growth in revenues for new customers for the rate year ending June 30, 1985, in the amount of $534,000. The proposed operating revenue for the period ending June 30, 1985, according to the Company, was thus $52,885,005.

Rate Counsel proposes operating revenues in the amount of $53,512,000. Rate Counsel's proposal includes the actual test year revenues of $53,281,000 adjusted by $231,000 to reflect the customer growth, which occurred for the 12 months included in the test year ending March 31, 1984. Mr. Effron employed a similar methodology utilized by the Company in calculating customer growth for the 12 months included in the test year. Rate Counsel's position regarding proposed operating revenues is reflective of his view that test year results should be representative of normal conditions unless positively demonstrated otherwise by the Company. In Rate Counsel's view, the Company made no quantification of the effects of the "drier than normal summer" of 1983, and has not demonstrated that the test year consumption was abnormally high. Petitioner's proposal is inconsistent, according to Rate Counsel, since it eliminates the effects of the drier than normal summer of 1983, yet includes the effects of the wetter than normal spring of 1983. Petitioner's use of the 12 months ending June 30, 1983, reflects drought restrictions to a greater extent than the use of the later test year period.

Staff of the Board of Public Utilities concurred with the views expressed by Rate Counsel predicated upon several observations.

First, Staff notes that although the summer of 1983 was a period of infrequent rainfall in which accumulations fell below the normal level, the summer of 1982, included in petitioner's proposal, was similarly below the norm. In fact, according to staff, rainfall during August 1983 exceeded that of August 1982 by approximately .39 inches. Staff supports the view of Rate Counsel that the results of the drought experienced in 1980 would have a greater effect on the position proposed by the petitioner than the use of actual test year data. Staff further agrees with Rate Counsel's position that petitioner's use of the wet spring of 1983, while eliminating the summer of 1983, is inconsistent and should be disregarded. For all of the foregoing reasons, Staff concurred with Rate Counsel and proposed operating revenues in the amount of $53,512,000.

I reviewed the rebuttal testimony of Mr. Cash with respect to his calculation regarding the normalization of actual test year revenue for the period ending March 31, 1984. My review of his testimony convinces me that in all probability, the five-year average as utilized by Mr. Cash in his rebuttal testimony, is perhaps more reflective of the typical amounts of revenue generated by the Company considering the weather conditions which prevailed during the period. In addition, that five-year average takes into account the wet spring of 1983 and the calculation of the average increase in usage per bill which is reflective of Mr. Cash's total consideration of prevailing weather conditions and his attempts to normalize the test year revenues. Accordingly, I **FIND** that his testimony is most reasonable and is supported by the preponderance of the credible evidence. It should be noted, as pointed out by the Company in its brief, that Rate Counsel has not calculated any adjustments for new customers beyond March 31, 1984. Instead, Rate Counsel has adjusted test year revenues to reflect the acquisition of the Kingston Water Company, notwithstanding the Company's stated position that the acquisition was not included in the financial exhibits submitted in the course of this hearing. Under ordinary circumstances it may be proper to include new customers from the acquisition of the Kingston Water Company. However, without any matching recognition of expense items associated with the acquisition, the new customers and the revenue should not be recognized. Rate Counsel's second adjustment is apparently predicated upon a newspaper article which appeared in the Star Ledger. The rules of evidence concerning the admission of hearsay in administrative proceedings provides that hearsay is admissible. *N.J.A.C.* 1:1-15.8(a). If the judge finds that the hearsay is otherwise unreliable,

he may, nonetheless, reject it. *Evid. R.* 4. In my view, reliance upon an unsupported news article for purposes of calculating a recognition in revenue for approximately 150 customers is inappropriate. The Company has advanced the view that these customers will not be connected for a considerable period of time. For all of these reasons, I reject the two adjustments to test year revenues as proposed by Rate Counsel.

Rate Counsel properly points out, however, that, undoubtedly, the Company will experience some growth in revenues during the period that the new rates would be in effect. The only evidence in the record to support any calculation of additional growth in revenues for new customers as presented by the Company, is the figure of $534,000 for the rate year ending June 30, 1985. Consistent with my previous position regarding rate base, I refuse to recognize additional projected growth through June 1985. However, for purposes of determining a reasonable increase in revenues to be expected from new customers, I have divided by two, the additional growth in revenues for new customers as projected by the Company in order to reflect projected growth for six months beyond March 31, 1984 to September 30, 1984. Accordingly, I have added an adjustment of $267,000 to test year revenues of $52,291;326. Accordingly, the appropriate and most reasonable operating revenue figure, for purposes of this case, is $52,558,326.

OPERATION AND MAINTENANCE EXPENSES

Wage and Salary Expense

Consistent with its previous position regarding the use of a rate year ending June 30, 1985, petitioner proposes wage and salary expenses of $8;651,190. Petitioner's proposal includes adjustments for a 6.5 percent increase in labor expenses effective February 1, 1984, and a 6.25 percent increase in labor expenses effective February 1, 1985. The hiring of additional employees beyond the test year of March 31, 1984, is also part of the petitioner's calculations in this regard. Petitioner's annualized wage and salary expense on March 31, 1984 is $8,111,237. Petitioner's labor expense as of June 30, 1984, is predicated upon the employment of 295 employees. Mr. Effron and Rate Counsel have made an adjustment of approximately $109,000, recognize only 288 employees, the number of employees employed by the Company in the test year March 31, 1984. This figure is consistent with Rate

Counsel's previous position regarding the use of a historical test year for rate making purposes.

The Board Staff concurs with Rate Counsel and proposes a wage and salary expense predicated upon 288 employees who were employed during March 31, 1984.

I reject Rate Counsel and the Board Staff's computation of labor expenses predicated upon 288 employees. It should be noted that Mr. Cawley testified regarding the need for additional employees predicated upon the changing modes of operation within the Company and the changing regulatory requirements placed upon water purveyors throughout the State. Mr. Cawley described in detail the need for, and the duties of, the additional employees to be employed by the Company no later than June 30, 1984. Mr. Cawley also testified that all new employees were in the process of being hired and would, in fact, be hired by June 30, 1984. This date is more than two months prior to the effective date that the rates requested in this proceeding will go into effect. Rate Counsel and Board Staff's approach to the exclusion of the additional employees overlooks the testimony of Mr. Cawley, which I find to be credible and supportive of the Company's position regarding the need for additional employees. Rate Counsel also asserts the position that the allowance of employee salaries at this particular point in time will result in ratepayers being charged for employees that will be hired at some point in the future. To the contrary, Mr. Cawley indicated that all new employees were expected to be hired by June 30, 1984. That date has already passed and, accordingly, I am directing the Company to supply the Board within one week after the date of this initial decision with proof positive regarding whether or not the employees have, in fact, been hired. In the event the employees have not been hired, the wage and salary adjustments effectuated by Rate Counsel should be made, and the Company should be credited for only 288 employees. I am satified from my review of Mr. Cawley's testimony that the Company is in need of additional employees, and that these employees will, in all likelihood, have been hired no later than June 30, 1984. Accordingly, I reject the Public Advocate's characterization that the ratepayers will be paying for employees who will be employed at some unspecified time in the future. Of course, as previously indicated, should the Company not be able to substantiate the hiring of the employees within one week after the filing of this initial decision, then the expense should be adjusted accordingly.

Petitioner's wage and salary expenses are also predicted upon recognition of an employee raise effective February 1, 1984, made between the Company and the Utility Worker's Union of America, AFL-CIO, Local 423. The raises effective on the above date indicate that the employees employed by the union are to receive an increase of 6.5 percent effective February 1984, and a 6.25 percent raise effective February 1, 1985. The Company advanced the view that the percentage increase in wages represents a reasonable wage settlement and should be fully allowed in order to determine the proper labor expense for this case. The Company asserts in its brief that "any situation such as this, when a Company has an *undisputed* known and contractual expense, there is no justification for disallowing the full amount of that expense." The statement overlooks the Board's jurisdictional powers of deciding which expenses, whether they are contracted for or not, are reasonable and in the public interest, in determining proper recognition of expenses in rate cases. This tribunal, and certainly the Board of Public Utilities, does not regard itself as being bound by contractual agreements entered into by the Company and its employees, unless those contractual agreements are shown to be otherwise reasonable and in the public interest.

Rate Counsel has proposed wage and salary expenses of $7,743,000. Other than using the actual level of employees employed by the Company as of March 1984, Rate Counsel adjusts the wage increase effective February 1, 1984, down to 5 percent due to Mr. Effron's understanding that the Board in recent cases has limited wage increases passed on to ratepayers to a 5 percent amount. The only support supplied to Rate Counsel in this regard is the recently litigated Public Service Electric & Gas case, *In the Matter of the Petition of Public Service Electric and Gas Co.,* OAL DKT. NO. PUC 4930-83 Feb. 14, 1984), *adopted,* Board of Public Utilities (March 23, 1984), during which the Board allowed the Company to increase employee salaries by 5 percent. Utilization of the Public Service Electric & Gas case as an example fails to distinguish the fact that the Board allowed a 5 percent wage increase in recognition of future wage levels, even though there was no signed contract as of the date of the decision. While it is clear that the Public Service Electric & Gas decision must be distinguished on the aforenoted basis, it is also clear that the allowance of a 5 percent wage increase by the Board, may be said to be reflective of the Board's position regarding recognition of future wage levels. The nonexistence of a contract is not dispositive for purposes of determining the reasonableness of a wage increase.

I have considered the respective positions of the parties with respect to the proposed inclusion of the full 6.5 percent wage increase effective February 1984. I am of the view that good service and efficiency should be rewarded within the rate structure. Rates should be sufficient to encourage good management and furnish a reward for efficiency. *N.J. Bell Tel. Co. v. Bd. Pub. Utility Com'rs.,* 12 *N.J.* 568 (1953). In my view, the best way to reward efficiency and, indeed, to encourage the maintenance of outstanding service to the public is to recognize reasonable expenses offered by the Company. In this regard, any company is only as good as the employees who work under its tutelage, and provide actual service to the customers. Petitioner, in its proofs, has documented extensively situations where the Company has served the public interest by coming to the aid of the municipal and investor owned water companies, and by providing outstanding services to its customers. In addition, as stated by the Board in its decision dated October 12, 1979 (BPU Dkt. No. 796-533), "Elizabethtown has been commended on many occasions for its extraordinarily high standards of service, both in normal times and in periods of crisis." In approving that decision, the Board once again took into account Elizabethtown Water Company's record of superior service. I, too, have taken into account Elizabethtown's record of superior service, as set forth in the documentation supplied by the Company. Accordingly, I have viewed the Board's approval of a 5 percent wage increase in the Public Service Electric & Gas case as a starting point for an examination of the reasonableness of employee salaries. In addition, after considering the outstanding service rendered by the Company, I am of the view, contrary to Rate Counsel and Board Staff, that the 6.5 percent wage increase, effective February 1984, should be allowed as a reasonable expense incurred by the Company. Not only is it a reasonable expense, but the Company is obliged to pay out the increase in wages, notwithstanding any rate increase which may or may not be afforded by the Board of Public Utilities. While the Public Service Electric & Gas decision is persuasive, it is not dispositive to the question of the reasonableness of the employee salaries advanced by petitioner. For all of these reasons, I **FIND** that the 6.5 percent increase effective February 1, 1984, is reasonable. For similar reasons, I also **FIND** that the 6.25 percent increase, effective February 1, 1985, is also reasonable. However, I will not allow total recognition of the increase in the rate year, as projected by petitioner. Instead, I have recognized one-half of the

$540,000 petitioner seeks to include in rate year expense (2/1/85 to 6/30/85) to reflect two months of actual expenses rather than as calculated by petitioner. The expense is a known and measurable change. *Hackensack Water Co.*, 161 *N.J. Super.* 132 (App. Div. 1980).

Rate Counsel further adjusts the annualized wage/salary expense of $8,111,237 at March 31, 1984, to reflect an adjustment of $50,000 based upon Rate Counsel's belief that the officers' salaries, as being paid by the company, exceed an appropriate level. Rate Counsel's justification for the $50,000 adjustment is based exclusively on a comparison of salaries of the 10 highest paid officers of Elizabethtown to the salaries of the 10 highest paid officers of Hackensack Water Co. Board Staff rejects Rate Counsel's view in this regard.

The Company advances the view that a comparison of salaries between the top officers of Elizabethtown and Hackensack is a meaningless exercise of mental gymnastics. Noting that the annual gross revenues of both companies exceed $50,000,000 a year, the Company correctly notes that Mr. Effron revealed that he did no studies regarding the duties of the officers or management of either of the two companies for purposes of making the comparison. In addition, Mr. Effron was not aware that the salaries of the management of Hackensack Water Co. had been frozen for the period of time between October 1981 through January 1983 per directive of the Board. Accordingly, I agree with the Company that the comparative basis for a $50,000 adjustment in salaries should be rejected. In addition, I pause to note that, in my view, the total amount of moneys being paid for each officer of the corporation is reasonable and is in the public interest. As previously indicated, a utility service is only as good as the officers and management of the company. The Board has not been reluctant in the past to reward good management and efficient service. Accordingly, I reject the $50,000 a year adjustment as proffered by the Public Advocate.

Rate Counsel also makes a $17,000 adjustment to a particular officer's salary because Mr. Effron asserted that the officer's duties consisted mainly of lobbying. The job title of the officer in question is "Assistant Vice President-Governmental Affairs." The testimony at the hearing reflected that the officer's duties involved, to a small portion, lobbying. The majority of his time is spent monitoring and informing the company of regulatory and legislative enactments and serving as a liaison with the officials of the municipalities. All of these duties serve the public interest in ensuring consistently efficient management and complying with the recent directive from Commissioner

Curran regarding the establishment of citizens' advisory councils in order to air any grievances the particular utilities may have with the public that it services. I am satisfied after review of the testimony that the primary duties of the assistant vice president in charge of governmental affairs are not lobbying and that his duties as acting liaison between the company and the various municipalities as well as the citizens advisory council is reasonable and is in the public interest. Accordingly, I have allowed the full salary of this particular officer of the corporation.

In summation, I have accepted the revised company position of an expense of $8,000,651.00 for wage and salary expenses, less $270,000 which I fail to recognize as extending too far into the future and, indeed, over one year beyond the test year ending March 31, 1984. Accordingly, I **FIND** that the most reasonable expense for wages and salaries is $8,381,000.

PURCHASED WATER

The parties do not dispute petitioner's expense for purchased water in the amount of $4,054,000. I am satisfied that this expense is reasonable and in the public interest, and it has not been contested by the parties.

POWER

Petitioner quantifies rate-year power expense in the amount of $4,977,075. This represents an adjustment of $29,569 over last year's expense of $4,947,506. Petitioner's proposal in this regard is consistent with his rate-year proposal and his previous position regarding operating revenues.

Rate Counsel and Board Staff both agree that the test-year power cost should be adjusted to reflect known and measurable changes occurring after the test-year period. In order to adjust test-year expenses, with a reasonable pro forma figure, Rate Counsel computes a factor of power costs in relation to historic revenues of .09450 percent. Rate Counsel then uses this expense to adjust the test-year expense consistent with its position on operating revenues. The resulting adjusted power expense as proffered by Rate Counsel is $5,157,000.

I reviewed the evidence submitted by petitioner with respect to the justification of the $29,569.00 increase over test-year expenses. In my view, the position of Rate Counsel and Board Staff, which computes

a factor of power costs in relation to revenues is more reasonable for figuring the most likely pro forma increase in power costs predicated upon available historic data. Accordingly, I have adopted rate counsel's use of the .09450 percent increase as reflective of the factor which is most appropriate to adjust test-year expenses. Consistent with my findings regarding operating revenues, I have adjusted the power expense by multiplying the factor times the operating revenues as found above. Calculation of the end result is a pro forma power expense of $4,966,760.

CHEMICALS

Petitioner proposes a pro forma chemical expense using rate-year theory in the amount $1,081,493. Petitioner's pro forma includes an adjustment of $6,421 to test-year expenses of $1,075,067 to reflect projected usage consistent with their position on operating revenues and consistent with their rate-year theory.

Rate Counsel and Board Staff performed an adjustment on test-year expense by noting that the ratio of chemical expense to actual revenues historically is a factor of .0205:1 and adjusts petitioner's test-year expense consistent with this position. Staff, in agreement with Rate Counsel regarding operating revenues, is of the opinion that Rate Counsel's proposed adjustment best exemplifies an appropriate level of chemical expense. I agree that the use of a chemical expense factor is most appropriate for accurately reflecting known and foreseeable changes occurring after the conclusion of the test year. Accordingly, I adopt Rate Counsel's methodology and use the Chemical Expense Factor of .0205 for purposes of determining the appropriate adjustment to test-year expenses. Calculation of the pro forma adjustment results in a pro forma chemical expense of $1,077,446 ($52,558,326 x .0205).

TANK PAINTING

Petitioner proposes a tank painting expense of $52,573. This reflects a $7,878 adjustment of the test year amount of $44,695. It appears that petitioner's increases are due primarily to additional tank painting which will occur during 1985.

Rate Counsel and Board Staff agree that the projected increase in the cost of tank painting reaches beyond the test year and is not a known and measurable change which should be allowed as part of

the rate case. Accordingly, Staff and Rate Counsel concur that the tank painting expense should be $45,000.

After careful review of the testimony and exhibits submitted in the case, I agree with Staff and Rate Counsel that petitioner's adjustment for tank painting does not constitute a sufficiently known and measurable change to be allowed as part of the rate case. It also appears that petitioner's increase due to additional tank painting which will occur in 1985 is more unspecified in nature than other items which I found to be known and measurable changes properly included in calculation of expenses. Therefore, I concur with Staff and Rate Counsel that the pro forma tank painting expense of $45,000.00 is most reasonable.

EMERGENCY DROUGHT PROJECTS

Petitioner proposes that the company be allowed to recover monies to be expended for emergency drought projects in the amount of $135,009.00. This figure represents the company's amendment to its initial proposal once the actual charges for the emergency drought project became available. This expense doubtlessly represents petitioner's portion of emergency water supply projects initiated by the Department of Environmental Protection during the drought experience late in 1980. Six other purveyors of water services are responsible for these costs. Petitioner's portion of this payment is appropriately 5.6 percent of $14,582,754, or $819,915 as principal. An interest rate of 9.2 percent is to be charged to the unpaid balance for a term of ten years. Payments are to be made quarterly but the first payment is due once all seven surveyers have rates in effect to recover these costs. The first payment must be made no later than January 17, 1985.

Rate Counsel proposes disallowance of this expense predicated upon its belief that since payments would not commence until early 1985, the time frame is too attenuated into the test year to allow recovery as an expense item. Staff disagrees.

Upon review of the appropriate regulation and the testimony presented in the case, I agree with the Company's position that the $135,000 expense associated with the projects constitutes a known and measurable expense that the Company will be faced with "no later than January 17, 1985." In my view, this is a known and measurable change which should be properly recognized as an expense item since a payment would clearly have to be made no later than January 17,

1985, within one year after the end of the test year. Accordingly, I agree with Staff and petitioner that the expense item is appropriate and the expense should be allowed as part of the rate case. However, I also agree with Staff's view that given the uncertainty of the first date of the payment and the fact that the Board has no control over rates charged by three of the purveyors which affect the payment, minimal constraints should be placed upon the Company to insure that revenues collected for this purpose are set aside. Accordingly, I recommend that the Board order petitioner to place these funds into an escrow account until such time as the first payment is actually made by the company. Once the payment is made, petitioner should be entitled to abolish the escrow and proceed with payments as scheduled.

COMMERCIAL EXPENSE

Annualized test-year commercial expense as proffered by the company was $448,364. Pro forma, petitioner proposes a commercial expense of $449,936. The $1,572 above the annualized test-year amount represents petitioner's pro forma adjustment.

Rate Counsel reduces one element of petitioner's test-year expense, *i.e.*, the base computer, by $10,000. Rate Counsel's adjustment in this regard is a result of recalculation of the expense based upon the contracted monthly costs effective October 1, 1984, as opposed to the average monthly rate for 48 months which is proposed by the company. Accordingly, Rate Counsel recommends pro forma commercial expense of $438,000.

Board Staff rejects Rate Counsel's proposals and recommends that a figure of $448,000 be utilized in computing commercial expense pro forma. Staff's position in this regard is predicated upon observation that the increase occurring after the test year is not attributed to one particular change. In particular, the Company has amortized $9,000 in the test year as the final year amortization of prepaid computer costs. Petitioner proposes to amortize $9,228 in the rate year representing the cost for conversion and implementation of an on-line accounting system program. This amortization will occur over a period of 39 months. Staff adjusts to reflect amortization one year after the end of the test year and recommends that the normalization of the nine months' amortization be allowed. Accordingly, Staff calculates the accounting system expense at $6,923 ($769 x 9 months).

After careful reflection and analysis of the exhibit supplied by the

Company, I agree with Staff that amortization extended by the Company is extended too far into the future. It is appropriate to adjust the expense item out one year after the end of the test year and normalize the nine months' amortization. Accordingly, I concur with the Board Staff that the accounting system expense is properly $6,923. In addition, the remaining increase proposed by the petitioner is for communications equipment rentals estimated to become effective April 1, 1985. This estimate occurs substantially after the test year and accordingly I reject it for being projected too far into the future to constitute a known and measurable change occurring within a reasonable period of time.

It is noteworthy that Rate Counsel's $10,000 adjustment to the base computer contract expense must be rejected. The rationale advanced by Mr. Effron was that the reduction in the expense should be based on the increasing term payments for the years 1983 to 1987. The evidence at the hearing indicated that the computer company based its calculations of the cost of the annual contract on average increase over a four-year period of time. I agree with the Company that if they elected to pay increasing terms each year then the total amount payable over the four-year contract would be much higher. Moreover, the average amounts payable for the base computer more accurately reflect the leveling of the expense and displays a more realistic cost of the expense over which period the contract will be in effect. Accordingly, I **FIND** that Staff's recommendation regarding the use of the test year figure of $448,000 is most reasonable considering the above observations and the amortization of the on-line accounting system program and rejection of the estimated increase for equipment rental effective April 1, 1985.

Test Year Telephone Expenses

According to petitioner, test-year telephone expenses were $257,333. Petitioner adjusts telephone expenses pro forma by an amount of $40,047 in an attempt to reflect increases in telephone rates of 7.5 percent to occur in April 1984 and 1985. Rate Counsel recommends the use of the test-year telephone expense amount although Mr. Effron recognizes that the telecommunications rate cases were pending before the Board at the time of the hearing and conceded that it would be appropriate to adjust the expense item accordingly if the updated tariffs were on file at the Board by the time the Board of Public Utilities renders a decision in this case. However, until the updated

tariffs are filed and approved by the Board, Rate Counsel took the position that the projected adjustments should not be allowed.

Staff advanced the view that petitioner's proposal to include speculative telephone increases for April 1985 was inappropriate and should not be allowed. I agree with Staff that the projected increase of 7.5 percent for April 1985 is projected too far into the future from the close of the test year to result in a known and measurable change which should be properly recognized in the rate case.

With respect to the remaining estimate of increases projected by the Company, it is noteworthy that on May 23, 1984, the Board of Public Utilities rendered a decision on the pending telecommunications rate increases for revenue requirements only. In its decision, according to Board Staff, the Board granted New Jersey an overall increase of 3.6 percent and granted AT&T an overall increase of 7.5 percent. To date, I do not believe that tariffs have been approved by the Board. It may render a decision in the matter prior to final decision in this case.

Staff's position regarding the uncertainty of the rates which will be specifically charged to petitioner, most reasonably proposes an average of 4.7 percent be applied to petitioner's test year figure in arriving at an appropriate level of telephone expenses pro forma. Once these actual rates become known the adjustment should be made to the actual increase to reflect the increases granted to the telephone companies. Predicated upon application of the average increase of 4.7 percent to petitioner's test year figure, I concur with Board Staff that the resulting pro forma telephone expense item of $269,000 is most reasonable and should be adopted for purposes of this rate proceeding. In addition, I note that once the final increases become known then those increases should be applied to test-year expenses in order to more accurately reflect the new rates which petitioner will have to pay for telephone services provided.

Uncollectibles

Petitioner proposes test-year uncollectible expense at $156,208. This figure represents the actual expense at the conclusion of the test year annualized to include the effect of one-quarter of the 6.9 percent rate increase effective January 1, 1983. Petitioner's rate-year expense of $183,554 is due to the estimated rate increase of this proceeding. Board Staff agreed with petitioner's adjustment to reflect the effect of the one quarter of the 6.9 percent rate increase effective January 1, 1983,

but rejected petitioner's adjustment for rate-year expense of $183,544 predicated upon the estimated rate increase of this proceeding. Rate Counsel did not take issue with petitioner's quantification. However, in accordance with its previous position regarding test year expenses, it adopted petitioner's test year amount of $156,000.

After reviewing the evidence and testimony submitted by the Company, I am in agreement with Staff that the inclusion of one-quarter of the Company's prior increase is proper and indeed necessary in order to give an actual annual effect to the increase. However, I do not agree with petitioner's inclusion of the rate-year expense of $183,544 predicated upon the estimated rate increase of this proceeding. In my view, the final action of the Board on this matter is too uncertain to speculate regarding the estimated rate increase. It is noteworthy that the petitions of the parties run the gambit from a roll back in rates as advocated by the Public Advocate, to an increase of over $8,000,000 as advocated by petitioner. Under these circumstances and given the Board's final decision making power and its ability to reject, modify, or affirm the recommendations of the administrative law judge, the rate-year expense item is too uncertain to be properly classified as a known and measurable change which should be accounted for within the instant rate structure. Accordingly, I **FIND** that the use of petitioner's annualized test year amount $156,208 is reasonable.

Overhead Capitalization

Petitioner proposes to reduce total operating and maintenance expenses in the amount of $1,019,200. This reduction relates to capitalized wages and benefits and administrative expenses charged to petitioner's subsidiary, Mount Holly Water Company. Rate Counsel, in accordance with its previous position regarding test-year salary and wages, proposes an adjustment of $68,000 and a reduction of operation and maintenance expenses related to overhead capitalization in the amount of $1,008,000. Staff, consistent with its recommendation on test year and salaries, proposes a reduction to total operation and maintenance expenses referring to overhead capitalization in the amount of $1,014,000.

Analysis of the position of the parties indicates that apparently there is no disagreement among the parties regarding the methodology employed by petitioner in arriving at the reduction in total operation and maintenance expenses. The parties are at disagreement only as

it relates to their respective petitions regarding test-year salaries and wages. In accordance with my previous findings on test-year salaries and wages, I agree with the Company that the proper reduction of the total operation and maintenance expenses is $1,019,200. This amount is consistent with my previous findings regarding expenses associated with wages and salaries and the test year.

Outside Services

Petitioner proposes $265,500 for outside services as of June 30, 1985. This figure is $8,400 less than petitioner's test-year figure of $273,900. Petitioner bases these amounts upon current fees plus increases supplied by each consultant.

Rate Counsel proposes two adjustments to petitioner's test year amount relating to disallowances for public affairs counsel and financial consultants. The disallowance for public affairs counsel ($26,000) is based upon the public advocate's review indicating that this expense is for lobbying. Once again, Rate Counsel advances the view that lobbying is not a necessary expense for provision of public utilities services and is an associated expense which should not be included in the determination of rate requirements. In defense, the Company pointed out several instances to support their position that lobbying serves to benefit both the Company and the ratepayer. Staff, in connection with their recommendations on lobbying discussed earlier, emphasized that the examples given by the Company support recovery of these expenses and the expenses are otherwise reasonable and nonexcessive. I agree. The Company presented testimony in the record sufficient to establish its burden of proof of proving that the lobbying activities engaged in by the public affairs counsel benefit both the Company and ratepayers. Accordingly, I **FIND** that the inclusion of these lobbying expenses is not unreasonable and should be allowed in this particular case.

In addition, Rate Counsel proposes disallowance of consulting fees totalling $15,000 to reflect the fees associated with the 1983 common stock issuance by the Company. As noted by Board Staff, the Company has in fact reduced this expense by $15,000 in its pro forma adjustments. The test year expenses should be reduced accordingly. Therefore, the most reasonable pro forma expense determination for outside services is $258,900 ($273,900–$15,000).

Capitalized Employee Benefits and Pension

The respective positions of the parties with respect to employee pensions and benefits corresponded with their respective theories regarding salaries, wages and number of employees. Accordingly, petitioner proposes an employee pension and benefit expense of $1,784,384. This proposal is consistent with the Company's position regarding the use of a June 30, 1985 rate year and the request for salary increases previously described. Rate Counsel, consistent with its previously discussed position, proposes an adjustment of $124,347, with a resulting employee pension and benefit expense of $1,660,000. Staff adjusted test-year figures to reflect $98,095 in accordance with its previous position.

Based upon my independent findings regarding number of employees, salaries and wages, and my treatment to normalize the first two months of the 1985 salary expense, I have calculated an adjustment of $24,000 in order to reflect the two months of employee pension and benefits associated with the February 1, 1985 wage increases. The Company, in its proposed rate-year adjustments, postulated an increase of $48,000 for the four months reflected from February 1 through June 30, 1985.

Regulatory Commission Expense

Petitioner proposes a regulatory expense pro forma in the amount of $230,555. Petitioner's proposal in this regard includes a one-year amortization of the rate case expenses totalling $140,055 and a projected BPU assessment for the rate year in the amount of $90,500.

Rate Counsel advances the view that petitioner's assessment figure for the test year in the amount of $77,000 is most appropriate. The difference between that figure and the $90,500 projected for the rate year is projected too far into the future to be recognized in this proceeding. Rate Counsel's proposal of a regulatory commission expense of $172,000 reflects a sharing of rate-case expenses other than the public advocate's fee. The Staff agrees with Rate Counsel that a sharing of rate-case expenses in this matter is most appropriate.

In support of its position, the Company advances the view that the sharing of regulatory expenses is inconsistent with the recent enumeration by the Board of Public Utilities on this issue.

In the Board's approval of *In the Matter of the Application of West Keansburg Water Co.*, OAL DKT. NO. PUC 7175-83 (Feb. 29, 1984), *adopted*, Board of Public Utilities (April 12, 1984), the Board noted:

> In the recent past in proceedings involving the State's major utility companies the Board has shared rate case expenses, excluding Rate Counsel fees, equally between the shareholders and the ratepayers. While we will continue to consider this issue on a case by case basis, we are of the opinion that the sharing of rate case expense by a company of the size of petitioner [West Keansburg Water Company] is inappropriate. It is our belief that the sharing of the rate case expenses would have a greater negative effect on the companies such as petitioner [West Keansburg Water Company] as opposed to major utilities. This is so because rate case expenses make up a substantially higher percentage of operating expenses for such companies and the resultant reduction in the earn rate of return would be greater.

After citing the aforenoted language, petitioner urges that Elizabethtown Water Company should not be considered as a major utility company when compared to electric and gas utilities in the State of New Jersey. Petitioner's view in this regard overlooks the fact that Elizabethtown Water Company is one of the largest providers of water services in the State of New Jersey with annual gross income in excess of $50,000,000. I disagree with the Company that Elizabethtown Water Company is not a major utility company for purposes of deciding whether rate-case expenses should or should not be shared between the ratepayers and the shareholders of the company.

Utilizing the theory advanced by the Board of Public Utilities in the above cited case, I **FIND** that Elizabethtown Water Company is a major utility company for purposes of deciding the sharing of rate-case expenses. It would be most appropriate in this instance to allow for the sharing of the rate-case expenses since a substantially lower percentage of operating expenses is reflected in rate case expenses in a company the size of Elizabethtown when compared to smaller companies such as the West Keansburg Water Company. For all of these reasons, I reject petitioner's pro forma regulatory commission expense and reduce it by $45,250 to reflect a sharing of rate-case expenses between the company's shareholders and the consumers.

Rental Expense

Pro forma rental expenses are $215,682. This expense represents an adjustment of $11,907 over annualized test-year expenses of $203,775. Petitioner's proposal includes various increases associated with maintenance costs at its corporate headquarters at One Elizabethtown Plaza, parking lot rentals, storage space rentals and the Fanwood Engineering and Planning Office. Rate Counsel refuses to give recog-

nition to any of these adjustments since they occur after the end of the March 31, 1984 test year. Accordingly, Rate Counsel recommends use of the test-year expense for purposes of determining the appropriate pro forma rental expense.

Board Staff takes the position that the purported proposed increases for parking lot rentals and maintenance expenses at One Elizabethtown Plaza, effective January 1, 1985 are known and measurable changes and should be recognized. The court is in agreement that it is proper to recognize these items since they clearly are known and measurable changes which will occur within one year following the close of the test year. However, the court agrees with Board Staff that the adjustments supplied by petitioner must be normalized in order to compute an appropriate level of rental expenses and accordingly, a total rental expense of $208,000 is appropriate for purposes of this proceeding.

General Cost Increases

Petitioner proposes general cost increases related to operation and maintenance expenses not specifically classified in the amount of $3,300,411. Petitioner's proposal in this regard includes adjustments to the actual test-year figure of $3,229,814. Negative adjustments to these amounts for nonrecurring items such as drought expense amortization, meter inventory and water diversion application fees were proposed by petitioner and uncontested by the parties. Petitioner further adjusted the general cost increases by an amount of four percent for an inflationary factor through June 30, 1985 to arrive at its proposal of $3,300,411.

She noted that in the past three years operation and maintenance expenses have increased 9.78 percent (1980 to 1981); 6.63 percent (1981 to 1982), and 8.5 percent (1983 to March 31, 1984). Ms. Brady indicated that these changes result not only from increases in the consumer price index, but also from growth in territory, increased technology and utilization of more utility plant. Ms. Brady went on to indicate that "since inflation in general has eased," the Company has used a factor of four percent rather than its past experience. Aside from the fact that the Board of Public Utilities has consistently refused to recognize increases associated with general inflationary factors, I find that petitioner has not borne its burden of proof justifying the inclusion of a four percent inflation factor. Ms. Brady, while it may be said that she is an expert in the area of utility accounting, did not

satisfy the court in her testimony regarding a factual basis for the determination of a four percent inflationary increase. Accordingly, for all of these reasons, I reject use of the four percent inflation factor and have disallowed it in the calculation of the expense. The appropriate amount is $3,131,000.

Board Staff calculates pro forma general cost increase expense at $3,135,000. Staff has utilized petitioner's test-year expense adjusted for nonrecurring items. However, consistent with prior Board policy which does not recognize recovery of inflation related adjustments, Board Staff refuses to recognize the four percent inflation factor built into the expense item by petitioner.

Charitable Contributions

It is noteworthy that Rate Counsel has advanced the view that charitable contributions should not be borne by ratepayers. Indeed, I concur with Rate Counsel that charitable contributions and the expense thereof should be borne by the shareholders whose management determines what charities receive the contributions and what amount of the contributions are to be received by each charity. In my view, charitable contributions are not related to the providing of safe and adequate service and are not a reasonable expense item which should be included in a rate case. Similarly, I do not agree with the Company's assertion that the services provided by most charities are essential for the well-being of many of their customers and that it would be extremely detrimental to many if the services were reduced.

While in my view charitable contributions should not be borne by the rate payers, I am not at liberty to overlook a recent Board decision in the Public Service Electric and Gas Company case, in which the Board allowed 75 percent of the charitable contributions to be passed on to ratepayers. Since under the Supreme Court decision in *In the Matter of the Appeal of Certain Sections of the Uniform Administrative Procedural Rules,* 90 *N.J.* 85 (1982), to the effect that agencies make rules, not only by promulgating rules, but by making decisions with respect to the individual cases which come before the agencies, I am proposing that only 75 percent of the charitable contributions be allowed in this case. See also, *Bally Mfg. Corp. v. N.J. Casino Central Comm'n.,* 86 *N.J.* 325, 335-341 (1981), (Hander, J., concurring). Based on the foregoing, I **FIND** that an adjustment of $11,000 must be made to the $43,000 in charitable contributions advanced by the Company as an expense item.

Real Estate and Other Taxes

Petitioner proposes real estate and other taxes of $1,411,816 which represents a $95,720 adjustment to the test-year expense of $1,316,091. Petitioner's proposal is consistent with its concept of rate year ending June 30, 1985, and includes a one-year amortization of revenue taxes associated with the "drop year" previously discussed in the working capital section of this decision.

Rate Counsel, consistent with its position regarding test year, proposes a real estate and other taxes expense of $1,115,000. Rate Counsel proposes adjustment of $50,000 to payroll taxes concurrent with its recommendation of salaries. Counsel further proposes disallowance of the one-year amortization of revenue taxes. Rate Counsel's adjustments are to petitioner's annualized test-year expense.

Staff, in agreement with Rate Counsel in regard to test year, proposes a real estate and other taxes expense of $1,121,000. Staff proposes an adjustment to payroll taxes consistent with its position on salaries and wages, in the amount of $71,264 be made. In accordance with its recommendation in regard to the "drop year" revenue taxes, Staff further recommends an adjustment of $175,561 be made to petitioner's proposal. Staff believes recognition should not be given to petitioner's estimated 1985 increase for real estate taxes and sales tax in the amounts of $37,259 and $6,578 respectively, and therefore recommends disallowance of these adjustments.

I agree with Staff that the appropriate entry is $1,121,000. However, since I am unable to calculate the payroll taxes consistent with my finding on salary, the expense item should be adjusted by the parties to reflect consistent treatment. In the interim, I have utilized Staff's recommendation. Consistent with my previous ruling, the "drop-year" should be adjusted out.

Federal Income Taxes

Petitioner computes Federal income taxes of $5,278,557 for the test year ending March 31, 1984. Petitioner further adjusts this amount by $2,993,386 in computing its Federal income taxes expense at June 30, 1985 of $8,211,943.

Rate Counsel proposes several adjustments to petitioner's computation of this expense. Counsel computes interest expense by using the interest synchronization approach. This approach, which Rate Counsel points out has been consistently used by the Board, consists of

multiplying rate base by the weighted cost of debt included in the capital structure in arriving at an appropriate expense.

Rate Counsel also proposes adjustments to petitioner's calculation of excess tax over book depreciation. Rate Counsel proposes to adjust this amount for inclusion of customer advances in developing a depreciable base of utility plant. Rate Counsel maintains that petitioner is not required by the tax codes to deduct these advances in the determination of a depreciable base.

Rate Counsel flows through tax benefits associated with current and prior capitalized pensions and benefits. Rate Counsel believes the balance of prior capitalized pensions and benefits should be amortized over a three-year period. Counsel advances the opinion that petitioner's Federal income tax expense should reflect these adjustments in order to give ratepayers the benefit of all tax deductions available to the Company.

Staff concurs with Rate Counsel and proposes interest expense be computed by the interest synchronization method. Staff multiplies its rate base of $120,409,000 by the weighted cost of debt, 4.0 percent in arriving at an interest expense of $4,817,000.

This method serves to give a more realistic picture of current interest costs associated with the investment in rate base and therefore Staff recommends its use in arriving at the expense.

In regard to the inclusion of customer advances in computing excess tax over book depreciation, Staff believes the petitioner has presented sufficient evidence to support the calculation. Petitioner argues against such inclusion by citing several court cases which support its position. I agree that petitioner's calculation is appropriate and therefore recommend their position as of March 31, 1984 in the amount of $377,750.

Staff concludes that it is appropriate to flow-through the tax benefits associated with capitalized pensions and overheads. They do not believe, as petitioner maintains, that the timing difference must be normalized. The Board has approved, in the recent Public Service Electric and Gas Company proceeding, that these timing differences should be flowed through currently.

Staff calculates current capitalized pensions and benefits in accordance with its respective recommendations on the components as set forth in Mr. Effron's Schedule to be $230,000.

In light of Petitioner's statements regarding I.R.S. standards on recovery periods, Staff recommends a ten-year amortization period as opposed to Rate Counsel's use of three years. Staff's adjustment

to reflect the flow-through of prior capitalized pensions and benefits is therefore $64,000.

Based on the foregoing, Staff proposes a Federal income tax expense at pro forma present rates of $5,784,000.

I have recalculated Federal tax in accordance with my previous rulings. I concur, on the basis of the Public Service case, that the flow-through is appropriate. Capitalized pensions and benefits should be $230,000 in accordance with Effron's schedule, provided it is not inconsistent with payroll tax and wage expenses cited before. See my Schedule IV.

Accumulated Depreciation and Depreciation

In an attempt to be consistent with allowing known and foreseeable changes in rate base through September 30, 1984, I have also allowed accumulated depreciation for the period March 1984 through September 1984. Depreciation on contributed property has been allowed. I have recognized one-half of test year accumulated depreciation in the amount of $1,470,122 ($2,940,245 divided by 2) and one-half of retirements covering the same period in the amount of $194,434 ($388,867 divided by 2). In my view, this treatment conservatively estimates accumulated depreciation. In the event this treatment and pro forma depreciation expense do not perfectly match and by allowing pro forma depreciation, I am giving the petitioner a slight edge, I, nonetheless, feel that it is appropriate.

In addition, I agree with Rate Counsel and Board Staff that annualization of test-year depreciation is appropriate since the money has not been recovered from ratepayers as of March 31, 1984. Consistent with disallowing the Peapack acquisition adjustment of $12,000, the resulting calculation is $38,732,000 plus $1,470,122 and $194,434 or $40,396,556, accumulated depreciation. Adding accumulated depreciation on contributed property of $70,000 (as noted in petitioner's brief), the resulting computation is $40,466,556.

In accord with my earlier observations, I am adjusting Rate Counsel's figure of $2,875,000 to reflect inclusion of one-half rate-year depreciation (3/31/84 to 9/30/84) in the amount of $158,000. In addition, an adjustment must be made to include depreciation on contributed property ($70,000). Board policy allows inclusion of this item. *Atlantic City Sewerage Company,* 43 *PUR 3rd* 458 (1962) and *Bayshore Sewerage Company,* 96 *PUR 3rd* 504 (1972).

COST OF CAPITAL

One of the most critical issues raised in this proceeding concerns the determination of an appropriate rate of return. The Company asserts that a 15.5 percent rate of return on common equity and an 11.53 percent overall rate of return are "reasonable, conservative rates of return supported by credible evidence in the record" and accordingly, should be adopted as the rates of return in this proceeding. The Public Advocate takes issue with the Company's position and urges that a 13.4 percent return on common equity and a 10.60 percent overall rate of return are appropriate. Board Staff, after an extended analysis of the proper utilization of the DCF model, concludes that a 14.1 percent rate of return on common equity and a 10.88 percent overall rate of return, constitute the most reasonable rates of return for purposes of this proceeding.

Prior to setting forth the substantive positions of the parties on the issue, several observations must perforce be noted. First, we begin with the basic legal axiom that "the rate which a public utility may reasonably charge should be sufficient to encourage good management and furnish a reward for efficiency, to enable the utility, under efficient and economical operation, to maintain and support its credit; and to enable it to raise money necessary for the proper discharge of its public duties." *Bluefield Waterworks and Improvement Co. v. West Virginia Public Service Commission,* 262 *U.S.* 679, (1923); *Petition of Public Service Coordinated Transport,* 5 *N.J.* 196, (1950); *New Jersey Bell Telephone,* 12 *N.J.* 568, (1953).

The above language has been quoted in numerous cases. Its application however, while not a mystery, is never an easy task. For example, experts have utilized numerous methods in attempts to calculate the appropriate rate of return for any given company at any given time. The models employed may be manipulated to arrive at almost any rate of return. This is not a reflection of a desire to manipulate. Rather, it is a reflection of the myriad of factors which must be considered in arriving at a just result. *In the Matter of the Petition of Jersey Central Power and Light Co.,* 85 *N.J.* 520, 531 (1981).

In my view, the most crucial element of the task is arriving at a rate of return which is in the zone between the lowest rate not confiscatory and the highest rate which is fair to the ratepayers who must ultimately bear the burden of providing funds necessary to give the company an opportunity to earn a reasonable rate of return. *Id.*

Secondly, it does not appear that the Company is *currently* ex-

periencing serious difficulty in attracting capital as evidenced by the recent upgrade in its bond rating to AA, and the sale of a large offering of common stock at a premium above book value. The problem facing the Company is maintaining its financial integrity and its ability to actually earn the allowed rate of return. In the last two years, the Company has been successful in these endeavors.

Third, the petitioner makes reference, several times, to its outstanding service to the State and the community. Indeed, there is no doubt that this is an outstanding public utility. The Board has, on many occassions, singled out Elizabethtown Water Company for its outstanding public service. My review of the exhibits supplied by the Company in this regard leads me to the same inescapable conclusion. However, the Company's outstanding service record does not, in my view, entitle it or any other public utility to a premium on its rate of return. Rates, not rates of return, should be sufficient to encourage good management and furnish a reward for efficiency. I disagree with the position advanced by the Company that "[if] efficient management is not rewarded by an allowance in rate of return, then there is no incentive for this utility or any other utility to strive to be the finest." It must be remembered that utilities are in business to serve the public. Rewards for good management are reflected in profits, salaries and fringe benefits. Arguably, good management capitalizes on available resources in order to maximize gain. The ratepayer, of course, bears the financial burden of meeting these expenses. The shareholder is entitled to a "fair" return on his investment, not a premium on his stock interests. As long as the Company is in a position to maintain its financial position through sustained *reasonable* growth, the interests of the shareholder have been satisfied. To attach a premium to rates of return serves to overlook the delicate balancing of interests of the investor *and* the consumer. See, *Jersey Central Power and Light Co., supra,* wherein the court reiterates Board policy of balancing these interests.

In addition, numerous unanswered inquiries surface whenever there is an attempt to reward "efficient" management by an "allowance in rate of return." To determine an appropriate allowance in rate of return for efficient management, is perhaps even more difficult than determining a fair rate of return. First, there is no quantitative analysis available to determine at what point a utility becomes outstanding enough to be entitled to a premium or allowance for good management. Second, there are no standards of measure available to de-

termine what is an appropriate allowance. Indeed, the Company concedes that "it may be difficult to quantify, [but] there should be some attempt at doing so." Third, the definition of "efficient management" is elusive. For example, it can hardly be said, in light of the Company's outstanding service record, that in the years it did not achieve its allowed rate of return that its management was somehow less efficient than it is now. Efficiency cannot be measured by whether the Company has been able to achieve its rate of return since realization of an allowed rate of return is subject to many forces outside management control including: market conditions, interest rates, general economic conditions, rainfall, drought and the regulatory process itself.

That is not to say, and indeed is not intended to say, that good management and investor interests are not proper elements to be considered in arriving at a fair rate of return. However, an allowance or premium in the rate of return, above a reasonable and fair rate of return should not be allowed. I have attempted to reconcile the interest of the investor in receiving a fair rate of return on investment with the interest of the Company in maintaining its financial integrity and the interest of the consumer in paying reasonable rates for utility services provided, at arriving at what is in my judgment, a fair and reasonable rate of return.

The respective positions of the parties, reflected numerically, are set forth below:

Petitioner

Type	Amount	Proportion	Cost	Weighted Cost
Long-term debt	$ 57,000	46.89	7.51	3.52
Short-term debt	6,000	4.94	10.00	.49
Preferred stock	10,055	8.27	15.12	1.25
Common Equity	48,512	39.90	15.50	6.18
TOTAL	$121,567	100%		11.44

Advocate

Type	Amount	Proportion	Cost	Weighted Cost
Long-term debt	$ 58,115	47.74	7.53	3.59
Short-term debt	5,000	4.10	10.00	0.41
Preferred stock	10,055	8.26	15.12	1.25
Common Equity	48,568	39.90	13.4	5.35
TOTAL	$121,738	100%		10.60

Board Staff

Type	Amount	Proportion	Cost	Weighted Cost
Long-term debt	$ 58,115	47.74	7.53	3.59
Short-term debt	5,000	4.11	10.00	.41
Preferred stock	10,055	8.26	15.12	1.25
Common Equity	48,568	39.90	14.1	5.63
TOTAL	$121,738	100%		10.88

In determining the appropriate rate of return, three primary issues must be examined: appropriate capital structure; current earnings performance; appropriate return on equity. L. Sanford Reis and Ralph E. Miller, both recognized experts on rate of return, were presented by petitioner and Rate Counsel, respectively.

Appropriate Capital Structure

Mr. Reis utilized a capital structure which incorporated the debt and equity of the Company and the equity of Mt. Holly Water Company, Elizabethtown's wholly owned subsidiary. The debt of Mt. Holly Water Company was not included in his capital structure analysis. Mr. Miller utilized a consolidated capital structure consisting of the debt and equity of both companies. Board Staff agrees that if the equity of the subsidiary is considered, the debt of the subsidiary must also be included if the capital structure analysis is to be consistent.

Use of a semi-consolidated capital structure, which fails to include the debt of the subsidiary, results in an obvious mismatch between the assets which are generating earnings and the earnings themselves.

In order to properly analyze the capital structure of the Company and to eliminate the mismatch, I have chosen to include both the debt and equity of the Company's subidiary, Mt. Holly Water Company. The resultant capital structure is:

Long-term debt	$ 58,115	47.74
Short-term debt	5,000	4.11
Preferred stock	10,055	8.26
Common Equity	48,568	39.90
TOTAL	$121,738	100%

As a result of the inclusion of the debt and equity of Mt. Holly, petitioner's composite cost rate for its long term debt is raised by 2 basis points.

Recent Earnings Performance

Board Staff raised an interesting question with respect to the Company's recent earnings performance. Mr. Reis related that due to a number of factors, the Company was able to earn in excess of the 14.5 percent return on equity allowed by the Board in the last litigated rate case. Return on equity for 1982 was 15.69 percent and "slightly more than 15.5 percent in 1983, calculated at year's end (September 1983). The calculations were predicated on year-end, unconsolidated data. As noted above, this figure should have been calculated using the consolidated data for both companies.

An additional problem arises with the use of year-end equity calculations. The evidence adduced at the hearing indicated that Elizabethtown issued in excess of $4,000,000 in common equity in November 1983. Utilization of this information within the context of year-end equity analysis results in an increased year-end equity due to the number of shares issued and results in a lower calculated return on equity due to the impact of the issuance of the common stock. The gap between matching investment and income is bound to be more significant and thus, unrealistic, than the use of an average annual equity calculation. Indeed, the Company's calculations regarding average equity return was 16.3 percent (September 1983) and 15.7 percent on a year-end basis. In order to more appropriately reflect equity returns, the average annual yield for common equity and not the year-end yield, should be utilized in this proceeding.

It should also be noted that the Company has managed to exceed

the allowed return on equity in 1982 and 1983. The Company under-earned on equity in the years which preceded 1982 and 1983. The Company also recently succeeded in elevating its bond rating to AA.

Cost of Equity

Both expert witnesses utilized the DCF (Discounted Cash Flow) model for determining an appropriate cost of equity. Mr. Reis and Mr. Miller used the constant-growth, annual DCF model in arriving at their respective estimates regarding cost of equity. Board Staff, after an extensive analysis of the components of the model, arrived at a cost of equity of 14.1 percent.

The formula is:

$$K = \frac{D_1}{P_0} + g$$

where K represents cost; D represents dividend; P represents price; and G represents growth. Cost of capital equals expected yield plus expected growth rate. The model assumes that dividends, earnings and book value grow at the same rate indefinitely.

Mr. Reis calculated the yield component using a six month and a 12 month average yield. He chose not to use current yield because it is subject to manipulation by the Company. Mr. Miller calculated his yield component by dividing the indicated dividend as reported in Standard and Poor's by an average monthly high and low price. He utilized an average of the last three monthly yields (December, January and February) as the yield component in his DCF model. In his view, there is nothing in the DCF model which suggests that more current prices than those he used do not accurately reflect investor expectations. Board Staff asserts in its brief the position that a more current yield than the three months used by Mr. Miller should be used in this case, "and that such is generally appropriate in the DCF model."

I reject the use of the six month and 12 month average yield as utilized by Mr. Reis. In my view, the range in time is too attenuated to accurately reflect investor yield expectations. I do not agree with Board Staff that a yield more current than the three month yield utilized by Mr. Miller is necessary since the most current yield on the stock is often subject to short term manipulation by the Company,

as noted by their expert, Mr. Reis. Short term manipulation of current price is discounted by using a three-month average yield. Accordingly, I **FIND** that the calculation of expected yield by Mr. Miller is the most appropriate and reasonable for this case. Therefore, the most reasonable yield factor for the DCF model is 9.6. Although Board Staff asserts that its yield component is higher than that utilized by the parties because it takes into account the current economical conditions in the marketplace, i.e., higher interest and prime rates, without quanitification, Board Staff's approach cannot be fully merited.

Mr. Miller calculated the yield component using current price and recent dividend increase of sixty-five cents per calendar quarter. Board Staff utilized the indicated dividend in Standard and Poor's most current yield on common equity.

Mr. Reis calculated the DCF growth component by averaging the growth of earnings per share, book value per share, and dividends per share for Elizabethtown Water Company over the last five years (1977/82). Mr. Miller, in calculating the growth rate in his DCF formula, examined the trend in Elizabethtown's earnings, dividends and book value per share since 1973. According to Mr. Miller, growth rates in earnings and dividends far outpaced the growth in book value per share for both the recent five-year period and the ten-year period. He related that both the high rate of earnings growth and the high rate of dividend growth were directly attributable to the excess returns realized by the Company in 1982 and 1983. Mr. Miller noted that dividends could not have increased so rapidly if earnings had been restricted to a level consistent with the authorized rate of return. He concluded that book value growth rates are a reasonable starting point for analysis, but that the much higher earnings and dividend growth rates are not a sound basis for projecting future growth because they were clearly not sustainable. According to Mr. Miller, for the growth rates of 1982 and 1983 to be sustained over the next five to ten years, the Company's 1983 realized rate of return would have to increase to more than 25 percent. In his view, this was clearly an unreasonable expectation.

Mr. Reis, in his testimony conceded that the years 1982 and 1983 have been unusually good years for Elizabethtown. Earnings per share, common dividends per share and book value per share increased substantially more in those years than they had historically and "there isn't a chance of repeating [the performance] of the last two years."

Mr. Miller went on to analyze the Company's growth through earnings retention and noted that the growth through earnings retention is the retention ratio times the realized rate of return. The retention ratio has ranged from a low of .4 percent to a maximum of 7.8 percent since 1973, and is generally correlated with the earned rate of return. The average growth rate through earnings retention was 5.0 percent during the last five years including the two years of exceptionally high earnings. The average growth rate through earnings retention was only 4.1 percent for the past ten years. Since both of these numbers were influenced by the excessively high rates of return earned by the Company in 1982 and 1983, Mr. Miller discounted the results of these two most recent atypical years in his analysis. According to Mr. Miller, a more realistic picture of Elizabethtown's growth through earnings retention would result from the calculated average of growth retention for the nine years, 1973 to 1981. During that time, Elizabethtown achieved an average of 3.6 percent growth through earnings retention. In his view, this period is reasonably comparable to current and prospective financial and money market conditions in the United States economy. The 3.6 percent growth rate forms a lower bound of Mr. Miller's estimated reasonable range of investor growth expectations. Mr. Miller's upper bound of investor growth expectations was 4.2 percent, based upon the average result of the most recent five-year, ten-year and nine year, 1973-1981 periods. Board Staff takes the view that the appropriate growth rate in the DCF equation is measured by long-term sustainable growth. Board Staff would eliminate, as unusually good, the Company's earnings per share, dividends per share, and book value per share in 1982 and 1983. According to Mr. Reis, there "isn't a chance of repeating [the performance] of the last two years." Accordingly, Board Staff takes the position that as a result of the above average performance in 1982 and 1983, that any trend such as that calculated by Mr. Reis which includes those two years, will overstate the likely future growth of the Company and cannot serve as a proxy for long-term sustainable growth.

Board Staff takes issue with Mr. Miller's calculations regarding the growth component of the DCF model. Mr. Miller ultimately uses the reinvested earnings approach. This approach utilizes the assumption that firms grow through reinvesting a portion of their earnings. The growth rate under this theory is derived by multiplying expected earned rate of return by the expected proportion of earnings retained

by the firm and not paid out as dividends. Mr. Miller uses a mix of historical data to estimate the expected earned rate of return (r) and expected retention ratio (b). He calculates growth through retention (b x r) for the periods 1974 through 1983, 1979 through 1983, and 1973 through 1981. These three growth rates range from 3.6 percent to 5.0 percent, and average 4.2 percent. Mr. Miller uses the retention growth rate from the 1973-81 period as a low end of estimated growth rates and the average of the growth rates calculated for each of the three periods as the high-end, giving him a range of 3.6 to 4.2 percent. His final estimate of the cost of equity is 13.4 percent which with the yield of 9.6 percent, implies a growth rate of 3.8 percent. This 3.8 percent is just on the low-end of the mid-range of his projected calculations.

Staff takes the position that historical data must be used carefully in determining the retention growth calculation. Staff noted that there is no good reason to believe that an average of historical earned returns on equity provide any reliable guide to investor expectations about future earned returns. The heavier weight Mr. Miller places on the lower historical rates of return is simply a complex way of assuming that investors expect a return to below average performance by the Company, rather than a continuation of recent above-average performance. Indeed, under Mr. Miller's analysis, investors expect an earned rate of return of 12.7 percent. Board Staff takes the position that it is most reasonable for investors to expect the Company to earn its current allowed rate of return. This expectation reflects a decline in current levels, but does not reflect a return to lower historical levels. In addition, while historical retention ratios and earned returns tend to be correlated, it is the direction of the change in the earned return which affects the retention ratio and not the level of the earned return. Thus, in 1976, for example, (according to Board Staff), there was a 14.5 percent earned return and a 54 percent retention ratio, while in 1982 there was a 17.0 percent earned return and a 43 percent retention ratio. These figures are consistent with the view that historic retention ratios fluctuate around a stable target level in response to changes in earned returns, while earned returns fluctuate less predictably as a result of capital market conditions, weather and other factors. Accordingly, Staff uses a ten-year average retention ratio of 30 percent as a good estimate of the expected long-run retention ratio of the Company. According to Staff, this is consistent with the fact that 30 percent is also the average retention ratio for the group of publicly traded companies listed by Mr. Miller.

The Company also takes issue with Mr. Miller's approach and suggests that he picks and chooses the numbers in such a way as to come out with a deliberately low result. According to petitioner, Mr. Miller chooses to ignore growth in earnings and dividends, two growth factors which investors are likely to utilize in an investment analysis. As a practical matter, the Company suggested the only growth element Mr. Miller considers is average growth through earnings retention. He provides no evidence whatsoever that investors are concerned with earnings retention to the exclusion of earnings growth and dividends growth. Even assuming for purposes of argument that growth retention is an appropriate index for investor expectations, Mr. Miller skews his average by excluding 1982 and 1983 in coming up with a nine-year average. This has the effect of arbitrarily lowering his growth average number to 4.2 percent. The Company proposes that it can be argued that the most recent five-year history is what investors will look to as opposed to ten years and, therefore, even if growth through retention were utilized, the appropriate growth retention percentage is a five-year average of 5 percent as calculated by Mr. Miller. Adding 5 percent to the current dividend yield of 9.9 percent, the resulting rate of return will be 14.9 percent.

The Company then goes on to restate and adjust Mr. Miller's Table 3 using an assumed rate of return of 14.5 percent on average equity, which results in a restatement of the average annual rates of growth. After using the adjusted numbers for 1982 and 1983, the Company notes that the average growth rate for earnings, dividends and book value for five years is 8.11 percent and for ten years the figure is 7.31 percent. Adding the lower of the figures (7.31 percent), to Mr. Miller's dividend yield of 9.6 percent results in what the Company characterizes as a fair rate of return of 16.9 percent which is in line with Mr. Reis' DCF conclusion in the range of 16.2 to 16.69 percent. The Company goes on to state that Mr. Miller ignores recently increased trends in market conditions such as the rise in prime rates and the rise in interest rates on new bond issues.

Board Staff, in essence, rejects the calculations of the expert witness with respect to the growth component. They reject Mr. Reis' analysis because of the inclusion of 1982 data. Board Staff rejects Reis' and Miller's analyses of the growth components asserting that there is no reason to believe that an average of historical earned returns on equity provide any reliable guide to investors' expectations about future earned returns. I disagree. First, it is incredible to believe that investors look only to retention ratios and the most current earnings

when choosing an investment. Second, the assumption that expected earned returns should equal allowed return of 14.5 percent overlooks the historical data that clearly suggest that except for the last two years the company has not earned the allowed rate of return. To assume that investors only utilize current allowed rate of return, is somewhat ludicrous especially in light of Board Staff's observation in its brief that the appropriate growth rate in the DCF formula is long-term sustainable growth. In my view, investors are bound to look to historical data over a reasonable period of time in assessing the expected growth rate in the future given the fluctuating nature of the economical climate. Accordingly, I do not reject the experts' utilization of historical data for the purpose of estimating the potential growth rate.

I agree with Mr. Miller and Board Staff, however, that the mere use of historical data without more is not enough. I also agree that Mr. Reis' utilization of an average of growth in earnings per share, dividends and book value is inappropriate. This approach presupposes that all three elements move in correlation to each other. This observation does not necessarily hold true. For example, in 1982 before the 1983 stock offerings, dividends were up but the stock of the company sold at below book value according to Reis.

In my view, the appropriate method to use in calculating the growth rate is the retention formula (b x r) = g. In the formula, b equals expected earned rate of return and r equals the expected retention ratio. The appropriate growth rate should be measured by resort to historical data over a reasonable period of time.

Ordinarily, I would be persuaded to use the average of earned return over 10 years. However, the Company (through Reis), has demonstrated that earned returns, although they may not again reach recent highs, are on an increase from lower historical values. I do not think that it is realistic to assume that they will return to those lower periods. In addition, while use of the 1982 and 1983 figures should be discounted, they shall not be totally eliminated from consideration. I have considered the testimony to the effect that the recent growth in earnings will not be repeated, as one of the factors in determining the appropriate growth rate. The use of a five-year average of 5.02, as calculated by Mr. Miller shall be utilized. This is true particularly in light of the recent increase in the prime rate, interest rates and bond interest rates. In my view, use of the 5.0 percent average growth rate reflects reasonable investor expectations given the historical data and the myriad of factors which must be considered in determining a fair rate of return.

I agree with Staff that the 10 year average retention ratio of 30 percent is a fairly good, long-term estimate of the expected retention ratio of the Company and is consistent with the average ratio of the companied listed by Mr. Miller. Substituting the numbers into the equation (b x r)=g; 5.0 x 30 percent = 5 percent growth rate.

I pause to note one observation. As is readily seen from an examination of the briefs of the parties, there are always inconsistencies in theory and application whenever one is attempting to estimate a rate of return, given the myriad of factors which must be considered, weighed and analyzed. Depending upon how one performs these tasks, the ultimate rate of return fluctuates accordingly. Oftentimes, factors such as raising interest rates, treasury note and bond activity, as well as stock market fluctuations are difficult to quantify, even for experts that make a livelihood estimating rates of return. In arriving at what I consider to be a *fair* rate of return, I have considered recent rises in the prime rate, return on long term and short term treasury bills, the recent AA bond rating by the company and the fact it has managed to earn in excess of its allowed rate of return. It must be remembered that the calculation of rate of return in utility cases is a complex one and the ultimate determination is merely an *allowed* as opposed to guaranteed rate of return. In my view 14.6 percent is a reasonable return on common equity for this company given the interests of investors *and* consumers. The important question to be addressed is always, what constitutes a fair rate of return given these competing interests. *Central Jersey Power and Light Co., supra.*

As noted in the table below, this yields an overall rate of return of 11.07 percent.

$$K = \frac{D_1}{P_0} + g$$

$$= 9.6 + 5.0$$

14.6

COST OF CAPITAL

Type of Capital	Amount	Proportion	Cost	Weighted
Long-term debt	58,115	47.74	7.53	3.59
Short-term debt	5,000	4.11	1.00	0.41
Preferred stock	10,055	8.26	15.12	1.25
Common equity	48,568	39.90	14.6	5.82
TOTAL	$121,730	100%		11.07%

TARIFF DESIGN

Petitioner proposes that any increase in revenue be allocated to the various classes of customers predicated upon a cost of service study prepared by Mr. Critelli. All of the parties, including intervenors Commonwealth Water Company and Middlesex Water Company, agree with the proposition of utilizing the cost of service study. The cost of service study utilized actual data for the year ending 1982, adjusted to reflect 1979 General Metered Service (GMS) consumption levels. 1979 was used since it was considered to be a "normal" year, i.e. not a post-drought year.

Petitioner, in its reply brief to the briefs of intervenors, Board Staff and the Public Advocate on rate design, requests that this administrative law judge recommend to the Board that the tariffs be approved administratively by Staff without the necessity of a subsequent Board meeting. Commonwealth Water Company advanced the view that no delay in implementing the rates will result because of the five day period rule under *N.J.A.C.* 14:1-6.16(a)5(i). Petitioner notes that the cost of service analysis will require several days to complete and the five day regulation may result in the period expiring between Board meetings. Implementation of a rate increase, if any, would be delayed an additional 7 to 10 days.

I agree with the position that the best way to allocate any rate increase between the various classes of customers is to utilize the cost-of-service study. This has been the preferred practice whenever it is possible to complete such a study. I also agree that the parties in general, and petitioner in particular, have undertaken steps to speedily dispose of the case. Everyone has been most cooperative in that regard. I do not feel at leave to recommend to the Board that the tariff design issue be disposed of administratively, as I view such a recommendation as being an unwarranted intrusion into internal Board matters. Accordingly, I merely pass the suggestion on to the Board, taking no position on its merits and leave it to Board discretion. I do recommend however, that all reasonable steps be taken to implement rates, if at all, on or before the September 3, 1984 suspension period termination date. The Company's current tariffs for GMS reflect a two block consumption rate. The Company and the parties (with the exception of the Public Advocate), concede that the one block GMS tariff design is appropriate. Rate Counsel proposes that rates of Elizabethtown's newly acquired customers (Peapack-Gladstone) remain frozen since the utilization of the one-block tariff

design would result in a reduction in rates for these customers and a raise in rates for existing customers. It is not appropriate, according to Rate Counsel, to raise rates for existing customers as a result of the acquisition of another water system. There is substantial, although sophistical, merit in Rate Counsel position. First, the use of a two-block system fosters discriminatory rate treatment. Second, the use of the one block GMS tariff is in line generally with Board policy and particularly, with conservation efforts. Third, the Board has recently encouraged the acquisition of smaller water companies by larger public utility entities. Fourth, the relatively small size of customers acquired (467) and the spreading of the disparity across the board to all customers would result in a very small increase. Given these observations, I am constrained to disagree with Rate Counsel's position and recommend that the Peapack-Gladstone customers be included in the one block tariff.

Rate Counsel goes on to propose three separate scenarios for tariff design resolution. The first two, which deal with changes in the event of a rate rollback and no increase, need not be examined since I have rejected those alternatives. However, in the event the Board reverses my initial decision, those alternatives are reflected in Rate Counsel's initial brief. Rate Counsel, through the testimony of Mr. Makul, strongly advocated that restrictions be placed on the "Optional Industrial Wholesale" tariff (OIW). Rate Counsel recommends that this provision be restricted to users whose ratio of peak summer monthly usage to average monthly usage exceeds 120 percent. This tariff is presently available to any user whose monthly usage exceeds 1.25 million cubic feet.

The Company has no actual field-measured data of GMS or IOW classes and therefore, no empirical data to verify which customers are responsible for what portion of system peak day and peak hour fluctuations. Assumptions have been utilized to develop cost assignments. Distinct increases for Exxon, Exxon Research, Schering and Princeton during the summer months (1983 data) strongly suggest that these industries are as weather sensitive as GMS and should be billed as such.

The Company agrees that further inquiry is necessary and proposes that a study be completed before the next rate case. Rate Counsel concedes that in the absence of a study, the full analysis of the appropriate rate treatment cannot be made. The difference in the positions of the two parties is that Rate Counsel urges that the companies before-noted, be placed within the GMS category pending

outcome of the study. Petitioner suggested that matters be preserved, status quo, until the study is complete. Board Staff agrees with petitioner.

Rate Counsel's position is well taken. All parties agree that a study is necessary. Whenever possible, however, issues regarding tariff design should be predicated upon concrete empirical data. Given the need and desirability of a study, the observation that a result favorable to inclusion would result in $364,000 in additional revenue, and the uncertainty involved in estimating when another rate case will be brought by the company, I **FIND** that it is in the public interest to undertake the study forthwith. Accordingly, I am recommending that the study be undertaken (started) within 30 days following the final decision of the Board in this case. I am further ordering that the study be completed within six months thereafter (total 7 months). The results of the study should be forwarded to all parties. In the event the Board determines that the study demonstrates the weather sensitivity of the aforementioned companies and that their inclusion within GMS is warranted, an adjustment should be made to reflect the additional revenues associated therewith in the next case. The adjustment should include, but not be limited to, a consideration by the Board (if it so chooses) of whether ratepayers should receive a one-time reduction in billing to reflect the benefit of the additional revenue for the GMS class of customers.

Finally, I note my agreement with Board Staff that any increase applicable to Fire Protection Service be applied to the fire hydrants charge only, in order to at least begin to eliminate the disparity in municipal fire hydrant charges and bring those charges more in line with the Fire Protection Study. In summation:

1. The one block consumption rate for GMS should be accepted by the Board and the charges for Peapack-Gladstone customers should be included in the Common Tariff in accordance with the Order of the Board of Public Utilities dated April 20, 1983, (Dkt. No. BPU 831-49).
2. The inclusion of Exxon, Exxon Research, Schering and Princeton in the GMS class should be postponed until after completion of the study. Said study shall be undertaken within 30 days of the Board's final decision in this case and shall be completed not later than 7 months after the decision of the Board. Petitioner, Board Staff and the Public Advocate shall participate in the study. The results of the study should be forwarded to

the Board for review. In the event the Board determines that these companies should be included in GMS, an appropriate adjustment in rates to all GMS customers should be made.

3. Any increase granted for fire protection services should be limited to fire hydrant charges.
4. The Board's final conclusion on revenues and expenses should form the basic data for application of the cost of service study. All reasonable measures should be undertaken to insure that any rate relief granted will be implemented before the September 3, 1984 suspension termination date.

It is therefore **ORDERED** that petitioner file revised tariffs in accordance with the aforenoted determinations.

This recommended decision may be affirmed, modified or rejected by the **BOARD OF PUBLIC UTILITIES,** which by law is empowered to make a final decision in this matter.

FINAL DECISION BY THE BOARD OF PUBLIC UTILITIES:

After a full review of the above-captioned matters, including petitioner's request for increased rates and the Board Staff's analysis as to whether petitioner's rates during the 1982-84 period produced an unreasonably high level of earnings, the Board **HEREBY AFFIRMS** the initial decision of the administrative law judge (ALJ) presiding in this matter, except as modified herein. The Board notes that, in addition, it will offer comment herein on certain issues on which it is in basic agreement with the ALJ, or where the Commissioners of the Board hold differing views. In addition, the Board will evaluate Staff's analysis of petitioner's earnings during the above stated period with respect to reasonableness and the company's responses thereto.

1. *ACQUISITION ADJUSTMENT*

We accept the analysis of the ALJ with respect to this issue. While the acquisition price over original cost should be recognized with regard to the Washington Valley System since petitioner has demonstrated a specific benefit to the ratepayers of the system, we agree that petitioner has not so demonstrated a tangible benefit with regard to its Peapack and Gladstone Water System. We will continue to recognize the appropriateness of acquisition adjustments where a specific benefit can be shown, such as the acquiring of needed facilities which benefit the entire system. *In re Elizabethtown Water Co.,* BPU Docket

No. 802-76 (June 19, 1980). Reasonable incentives should be given for acquisition of small water companies which are typically undercapitalized and hard-pressed to provide safe, adequate and proper service. Such is the intent of the Small Water Company Takeover Act, *N.J.S.A.* 58:11-59 *et seq.* In addition to the lack of a showing of a specific benefit, we have the additional factor that the system in question was acquired through competitive bidding between utilities which could only serve to enhance the purchase price in relation to original cost.

2. *NET UTILITY PLANT*

The threshold question to determine net utility plant, as well as to quantify numerous other modifications that we believe it necessary to make the analysis of the ALJ, is the appropriate test year. The Company, Public Advocate and Board Staff agreed to a March 31, 1984 test year. In addition the company proposes a base year ending June 30, 1984 and a rate year ending June 30, 1985, the year in which rates will actually be in effect. The ALJ would extend the test year through September 30, 1984. Our conclusion in this regard does not enunciate a change in direction in the policy of this Board. In line with our past policy, the Board will select a test year which is as current as possible under the circumstances but which reflects actual test year data. In addition, we will exercise our discretion to recognize known and measurable changes as the oft-stated policy of the Board from which we do not depart in this case.

The ALJ is imprecise in equating this standard with a "substantial likelihood" or "reasonably anticipated" test. The standard is actual test year data "adjusted for known and measurable changes." *In Re Hackensack Water Co.,* Docket 815-447 (1982); *In Re New Jersey Bell Telephone,* Docket 7711-1156 (1978). The term reasonably anticipated, as cited by petitioner, Reply Brief dated August 6, 1984, with regard to *In Re South Jersey Gas,* Docket 818-754, must be qualified by the clear language of that case which would recognize outside of test year changes possessing "the requisite degree of certainty", i.e., known and measurable. The Board discourages the introduction of "base years" and "rate years", in addition to the introduction of test years in the record; this admonition should not inhibit petitioners from introducing proofs with regard to known and measurable changes outside the test year. If this signal is not recognized, higher procedural control over the process will have to be exercised. We therefore conclude that

the appropriate test year for the purpose of this proceeding should extend through July 31, 1984.

With regard to net utility plant, the Board concludes that it is appropriate to recognize gross utility plant additions as a known change through September 30, 1984. These additions consist almost exclusively of routine construction which re-occurs every quarter on a generally stable and measurable level. To the extent that the ALJ does not recognize routine construction projects through September 30, 1985 and has made certain other minor miscalculations, (Schedule E, *supra*), the position of the ALJ on this issue is hereby modified. The Board has reasonable discretion to recognize additions to rate base which are known and measurable. The particular circumstances of this case, including the availability of actual data on rate base, revenue and expense, and capitalization, through July 31, 1984, as well as our conclusions on the earnings analysis of petitioner (as subsequently addressed herein) which preclude higher rates to be effective until on or about February 1, 1985, approximately six months after the close of our finding of test year, supports our determination of test year and recognition of known and measurable changes. *State vs. New Jersey Bell Tel. Co.,* 30 *N.J.* 16 (1959). We, therefore, find a gross utility plant of $186,233,000, and after appropriate adjustment for accumulated depreciation, a net utility plant of $146,673,000.

3. *CONSTRUCTION WORK IN PROGRESS*

Petitioner proposes that the approximately $1.3 million in the construction work in progress (CWIP) balance as of June 30, 1985 should be included in rate base. We agree with the ALJ that this CWIP inclusion should not be recognized, since the company has not demonstrated that this level of CWIP vitally impacts earnings, cash flow, and its ability to finance construction needed to render safe, adequate and proper service. In addition, the proposed CWIP relates to routine construction projects not in service as of June 30, 1985, which we believe is too remote for consideration, especially in view of our recognition of routine projects through September 30, 1984 as a known change.

4. *WORKING CAPITAL*

We agree with the analysis of the ALJ with respect to the components and recognition of working capital including cash working capital, unamortized taxes, materials and supplies, prepayments, mini-

mum bank balances and deferred charges. We especially concur with the ALJ's analysis with respect to deferred charges. The Board's policy with respect to water companies continues to be that we will not recognize deferred charges in working capital as an undue burden on the ratepayer, who would then be required to pay an amortization of these costs in expenses and also pay a return on these unamortized balances if included in rate base. Therefore, the Board finds a working capital requirement of $4.190 million.

Commissioner Hynes concurs with the above conclusions, except that he concludes that he supports the recognition of a lag with regard to a return on invested capital, namely the lag between the collection of revenues and its payment in interest to investors, which is calculated by Rate Counsel at 80.5 days. In view of the conclusions of the majority, however, in regard to net investment rate base, Commissioner Hynes concurs in the calculation of $125,016,000.

5. *OPERATING REVENUES*

We agree with the ALJ with regard to annualization for customer growth within the test year, but modify his calculation according to our determination of test year. We further agree with the position of Rate Counsel and Staff that Petitioner's proposed adjustment for weather normalization is inappropriate. Petitioner has not demonstrated that test year consumption was abnormally high due to weather abnormality, and that consequently a lower level of revenues should be recognized than that actually produced during the test year and which can be expected during the period rates will be in effect. Petitioner's calculations reflect the higher than normal rainfall and revenues in the Spring of 1983, but ignore the fact that Summer rainfall and revenues in 1982 exceeded those of 1983. Petitioner's method also improperly includes a simple five year average, which is not a reasonable basis from which to calculate normal test year revenues. Thus, petitioner has not demonstrated that the test years were "drier than normal" resulting in abnormally higher revenues that should be adjusted downward. We, therefore, do not accept the analysis and conclusions of the ALJ in this regard, and thus we do not recognize petitioner's proposed adjustment for weather normalization. Therefore, the Board finds pro forma present operating revenues in the amount of $53.666 million.

6. *OPERATING EXPENSES: LABOR, PURCHASED WATER AND POWER*

The Board accepts the conceptual approach of the ALJ with regard to recognition of the February, 1984 wage contract and a portion of the February, 1985 wage contract. The appropriate treatment to reflect our test year conclusion is to recognize six months of the 1985 wage contract. The ALJ miscalculated the 1985 wage contract on the basis of his test year by recognizing six months instead of nine months in regard thereto; our calculation of salary-expense therefore agrees with that of the ALJ, namely, $8.381 million. This recognition is appropriate as known change. For the reasons set forth by the ALJ, we reject the arguments of Rate Counsel with respect to the non-recognition of officers' salaries and other labor expense as being unreasonable. All parties agree that power costs and chemical expense should be calculated based upon the historic numerical relationship of these costs to revenues. Based upon the Board's revenue determination, purchased water is recognized in the amount of $4.054 million and power costs in the amount of $5.072 million.

7. *OTHER OPERATING EXPENSES*

Except as otherwise noted herein, the Board accepts the analysis of the ALJ with regard to all operating and maintenance expenses, and his numerical calculations with respect thereto as reflected on Schedule A attached hereto, except as follows:

a) *Telephone Expense* is adjusted to reflect actual costs through the end of the test year calculated at $282,000
b) *Overhead Capitalization of Wages* is adjusted to reflect the appropriate level of recognition that we have permitted for labor expense resulting in a negative adjustment of $1.054 million. This adjustment is necessary due to a minor miscalculation by the ALJ. Employee pensions and benefits have been correctly calculated by the ALJ with regard to the recognition of labor expense in the amount of $1.760 million;
c) *Rental Expense* has been appropiately adjusted to reflect our test year in the amount of $211,000;
d) *Rate Case Expense:* In line with the Board's policy recently enunciated in the *West Keansburg* case, Docket No. 838-787 (1984), the board believes a sharing of rate case expense for major water companies is appropriate. Since petitioner clearly falls within that category, this adjustment is required as provided for by the ALJ and recommended by Rate Counsel and the Board's Staff. However, the Board has, absent compelling circumstances, provided for a two-year amortiza-

tion of this expense rather than a one-year amortization as recognized by the ALJ. Therefore, an appropriate adjustment is necessary, which results in a recognized expense of $136,000.

e) *Emergency Drought Expense:* We agree with the ALJ in recognition of this expense under the circumstances of this case. Petitioner has agreed to accept a fair share of charges for state water projects which were required on an emergency basis due to the drought. Other water utilities both regulated and non-regulated are subject to these charges. While the charges appear reasonably certain, the timing of the collection requires the establishment of an escrow account with regard to these charges, in consultation with Board Staff.

8. *DEPRECIATION*

Depreciation expense involves both the issue of timing and the conceptual approach to the treatment of depreciation on contributed property. With respect to the timing question, the Board recognizes an adjustment to this account to reflect its finding of gross utility plant and the net investment rate base. The majority of the Board agrees with the position of the ALJ recognizing depreciation on contributed property as proposed by Board Staff, as consistent with our current policy. This adjustment is especially crucial to the smaller water company as a necessary source of cash flow and has been recognized for the small and large water utility alike as a legitimate source of earnings.

Commissioner Hynes *dissents* from the conclusion of the majority and draws a distinction between the requirements of small water companies in this regard, who are often chronically financially unsound, and this large Class A water company, which has been recognized as financially sound by virtue of its AA financial rating. Therefore, the majority accepts the position of the ALJ, while Commissioner Hynes would adopt the position of Rate Counsel proposing a negative adjustment in the amount of $70,000 to depreciation expense.

The full Board concurs that Staff confer with Rate Counsel and representatives of the respective affected utilities in order to study the Board's policy in this regard and come forward with recommendations for Board evaluation as to our future course of action with regard to this issue.

9. *TAXES*

While the Board adopts the position of the ALJ with regard to real estate and other taxes calculated in the amount of $1.166 million;

consistent with our findings regarding pro forma present operating revenue, we find a revenue tax expense of $6.732 million. The Board has recalculated Federal income taxes in view of our other findings in this case resulting in a figure of $5.499 million.

10. *RATE OF RETURN*

The Board accepts the position of the ALJ as recommended by Staff and Rate Counsel with respect to a proper matching of capital structure; therefore, both the equity of petitioner's subsidiary, Mount Holly Water Company, as proposed by Petitioner, and the debt of this subsidiary should be recognized, as recommended by Rate Counsel and Staff.

With regard to rate of return on equity, we are mindful of the classic requirements set down in the *Hope Natural Gas* case, 320 U.S. 281 (1944), which has been followed and adopted by the courts of this state. *In re Public Service,* 5 *N.J.* 196 (1950). The Board is obliged to establish rates sufficient to encourage good management and to enable a utility to maintain and support its credit, and to provide a return to the equity holder commensurate with investments in other enterprises having corresponding risks, such returns to be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and attract capital.

In fulfilling its duty to establish reasonable rates, pursuant to *N.J.S.A.* 48:2-21, especially in regard to our rate of return, the Board is not bound by any single formula or combination of formulae in arriving at a reasonable result. *In re Public Service,* 5 *N.J.* at 217; *In re JCP&L,* 85 *N.J.* 520 (1981). The Board has weighed the evidence and methodologies presented by the expert witnesses presented by both Petitioner and Rate Counsel and concludes that the rate of return analysis and result articulated by Board's Staff is the most reasonable under the circumstances of this case. We believe Staff's approach to the discounted cash flow methodology, which establishes a yield component of 9.77 and a growth component of 4.35 resulting in a return on equity of 14.1 percent, adequately accounts for investor expectations and meets the standards set forth in the *Hope* case. We further take account of the financial indicators, especially that Petitoner is one of only two independent water companies in the nation with a AA bond rating, in measuring a reasonable level of risk and arriving at a reasonable return on equity that the company may seek to earn.

Applying the capital structure which we adopt as of July 31, 1984

herein and the appropriate costs for long-term and short-term debt, preferred stock and common equity results in overall rate of return finding of 10.90 percent.

11. *TARIFF DESIGN*

The Board accepts the position and analysis of the ALJ with respect to tariff design, except as modified herein:

a) *One-Block Tariff: Peapack-Gladstone Common Tariff:* While we agree with the ALJ that a one-block tariff for general metered service is generally appropriate and in line with Board policy to discourage lower charges for higher use, we conclude that it is not appropriate at this time to apply this common tariff to the recently acquired Peapack-Gladstone System. While we have given due recognition to the analysis of the ALJ, we do not feel it is an appropriate signal to apply this common tariff design to Peapack-Gladstone, since there presently exists a disparity of rates between the latter and the rest of the system, and such application would result in a reduction in rates to Peapack customers. The Board therefore concludes that the appropriate course is to freeze the tariffs for this small system and its customers at current levels and to extend the common tariff to this system when such application can be accomplished in a fair and equitable manner to all customers of petitioner.

b) *Transfer of Customers from Wholesale to General Metered Service:* We generally concur with the position of the ALJ which would defer consideration of any transfer of Optional Industrial Wholesale (OIW) customers to general metered service until additional empirical data is established. Therefore, Rate Counsel's position that four large customers, Exxon, Exxon Research, Schering, and Princeton University, are distinctly weather sensitive, and more appropriately belong in the general metered service, should be the subject of study initiated by Petitioner. We do not have sufficient data on system fluctuations and peak hour usage to evaluate this proposal at this time. The study, to be initiated in cooperation with Staff and Rate Counsel, should cover the period October 15, 1984 to October 15, 1985 with recommendations and results to be forwarded to the Board no later than December 1, 1985.

c) *Municipal Fire Protection:* The ALJ has accepted petitioner's position that any rate increase applicable to this tariff be applied to fire hydrant charges only and not to the inch-foot charge. This is a deceptively complex question, since the application of this concept may result in widely varying increases to different municipalities depending upon their characteristics, size and development. There is also great public interest in this question, not only by municipal officials but by the general ratepayers as to the impact of these charges on municipal budgets. Consequently, we request Staff, in consultation with Rate Counsel and interested parties, including water companies, to develop

> the alternatives and the support thereto for consideration by the Board in a public hearing to be set on general notice within a reasonable period of time. Pending such further consideration, the Board defers rendering a conclusion on this issue.

In conclusion, based upon the foregoing and the record in this proceeding, the Board **HEREBY FINDS** a rate base of $125 million a rate of return of 10.9 percent, resulting in an overall income requirement of $13.627 million; the income deficiency is $1.259 million resulting from the deduction of test year utility operating income, as adjusted, in the amount of $12.368 million, from the income requirement. The resultant revenue deficiency to be reflected in higher rates, (according to the terms and conditions which we will specify herein with regard to our treatment of the earnings analysis question), is $2.656 million.

EARNINGS ANALYSIS

At the direction of the Board, Staff has undertaken to monitor the earnings of the various utilities under the Board's jurisdiction with respect to whether or not earnings have been achieved at levels above the statutory standard of just and reasonable rates. *N.J.S.A.* 48:2-21. In this regard, Staff has undertaken a review and analysis of petitioner's achieved rate of return, including return on equity, for the period commencing January 1, 1982 through July 31, 1984, the most recent period for which data is available. This review coincides with the period for which rates have been in effect as a consequence of petitioner's last two previous rate orders, Docket No. 818-735, effective January 1, 1982 and Docket No. 829-696, effective January 1, 1983. During the course of its review, Staff forwarded its position and analysis to petitioner for comment by letter of June 8, 1984 and received comment and response to Staff's earnings analysis by letters of June 27, 1984 and August 28, 1984.

Since questions have been raised as to the Board's authority to review utility earnings for unreasonableness, the Board must state that it believes it has ample jurisdiction and discretion to review earnings achieved by utilities. We believe such a review is not precluded by the admonition of the courts of this state generally against retroactive ratemaking. The leading New Jersey Supreme Court case, *In re Sand Rates,* 66 *N.J.* 12 (1974) limited the Board's discretion to permit utilities to recover past deficiencies or under-earnings in rates. It nowhere can lend support to the proposition that the Board cannot

inquire into whether utilities have, in fact, achieved unreasonable rates of return on equity significantly higher than that authorized by the Board. Indeed, the New Jersey Supreme Court held *In Re Plainfield Water Co.,* 177 *N.J.L.* 18 (1936), that the power of the Board to determine whether utility over-charges have been exacted, is both retrospective and prospective in nature. This regulatory approach has been followed recently by Public Utility Commissions in other jurisdictions, *In re Narragansett Elec. Co.,* Rhode Island P.U.C., 57 *PUR 4th* (1984). There the Commission concluded that any prohibition against retroactive ratemaking does not preclude the Commission from directing refunds to ratepayers with regard to a utility that earned significantly in excess of its allowed rate of return, even if such excessive earnings could not have been anticipated by either the utility or the Commission.[1]

Thus, the Board believes it has not only the authority, but the duty and obligation to review the rates of return achieved by utilities for reasonableness, based upon rates of return authorized by the Board. We further believe that we have the discretion to fashion reasonable methodologies to determine whether, in fact, over-earnings have been achieved, to determine the level of over-earnings that should be accounted for, and to determine the method of refund. The Board is not bound by any particular methodology so long as the methodology it selects is reasonable. *In re Hope Natural Gas,* 320 *U.S.* 591; *In re JCP&L,* 85 *N.J.* 520.

A review of the Staff exhibits supplied to and discussed with Petitioner, as well as Petitioner's responses thereto, leads the Board to the inescapable conclusion that Petitioner achieved a rate of return on average common equity significantly higher than that permitted by the Board during the rate periods in question. According to Staff's calculations, Petitioner in the 1982 rate period achieved excess earnings over the permitted 14.5 percent rate of return on equity of approximately $2 million in revenues. This analysis also supports the conclusion that a level of over-earnings continued through the end of 1983, with a significant downturn in earnings in the first half of 1984. Taking into account the company's submission with respect to

1. In the recent Con Edison case before the New York Commission, Case 28847, August 23, 1984, the Commission approved a stipulation with regard to a similar overearnings question, which took account of potential earning deficiencies, but required a return of net overearnings accrued during the rate period.

earnings through July, 1984, Staff concludes that there has been to date a level of over-earnings of approximately $2.2 million in revenues.

The majority of the Board has taken into consideration the various factors and arguments submitted by Petitioner, including that earnings have deteriorated rapidly in 1984, that the over-earnings resulted from unanticipated events such as the vicissitudes of weather, and the results of drought conditions and the state regulatory response thereto. In addition, the Board has considered the alternate methodologies, and adjustments proposed by Petitioner to that of Staff.

The majority has also taken into consideration and does not hold the company accountable, or at fault, for any lack of forecasting with regard to the earnings in question, nor do we believe penalties in the form of interest or other sanctions are in order. But, the imposition of state curtailments on water usage due to the drought, and the removal thereof, contributed to elastic, unpredictable usage patterns, along with the variable effects of rainfall. The Board believes that the ratepayer must be made whole in compensation for a level of charges which, in fact, have exceeded the levels prescribed by the Board. Taking all these factors before us into consideration, the majority of the Board concludes that the ratepayers should receive recognition for over-earnings by petitioner in the amount of $1.15 million. This is the amount with which the Staff and the Petitioner basically agreed, for purposes of possible settlement, during the conferences held on the Board's investigation into over-earnings. The Board believes that this conclusion does not undermine our responsibility to set reasonable rates for the future, as we have done by virtue of the rate order included herein.

The Board further concludes that the most appropriate methodology to make the ratepayers whole with respect to this level of overrecovery, is to set off this amount against the level of rate increase awarded herein, which is necessary to give petitioner an opportunity to achieve in the future a reasonable rate of return. We will therefore hold the new rates found to be reasonable in this order in abeyance until the difference in revenues between those that would be received under the new rates, as against those received under current rates, equals $1.15 million. It is anticipated that this recovery should be completed on or about February 1, 1985[2]; the date new rates shall

2. Indeed, since new rates shall not become effective until on or about that date, we believe this is an additional reason to extend the test year to July 31, 1984, with known changes primarily for routine construction, through September 30, 1984.

be permitted to go into effect shall be subject to an accounting procedure agreed upon by Petitioner, Board Staff and Rate Counsel, which will determine the exact timing of the implementation of this rate order.

Furthermore, the Board requests Staff, in consultation with Rate Counsel and the affected utilities, to review the applicable standards which should apply to earnings reviews for all segments of the utility industry subject to the Board's jurisdiction.

Commissioner Hynes, while agreeing with the majority of the Board with respect to the methodology or general analysis of this question, *dissents* from the calculation by the majority of the Board as to the amount of over-earnings to be set off against a rate award. He would set the level of over-recovery based upon the numerical calculation of Staff at approximately $2.2 million, although it reflects offsetting underearnings through July 31, 1984. He believes there does not exist counter or mitigating factors or methodologies which justify a lower level of over-recovery set by the majority of the Board.

The reasons for this over-earning are, in his view, twofold. One, the drought restrictions prompted tariff revisions to stabilize water utility earnings. Revenues increased dramatically as the effects of the drought disappeared and higher usage returned. Consequently, the dominant portion of the over-recovery was caused by the Board's quick response to a state emergency. The sacrifices endured by the ratepayers merit a return in full for any over-recovery linked to the consequences of the worst drought in 100 years. Secondly, a portion of the over-recovery is in consequence of a stipulated rate case in January 1983 between the Petitioner, Rate Counsel and Staff. The review system failed to discover significant over-earnings in the 1982 calendar year. He joins with the majority to call for a single earnings test to prevent such lapses in the future. Yet he believes since the procedure failed, the ratepayers should not pay for this oversight.

The full Board concurs that since the recovery shall be achieved on a prospective basis, there should not be any need to restate 1982 or 1983 earnings. The Board recognizes that Petitioner, according to the State Administrative Procedure Act, is entitled to apply for a hearing with respect to the Board's over-earnings conclusion and to test the facts which support such conclusion and make a record in support of whatever position they believe is appropriate. While Petitioner engaged in many productive conferences and interchanges with Board Staff during the course of this earnings review, petitioner, in

the absence of a signed stipulation, is free to take, without prejudice, whatever legal and factual position they believe is appropriate.

Therefore, the rate increase permitted herein, will not be permitted to take effect until on or about February 1, 1985, but in no event until verification of the amount of refund has been resolved and tariffs filed in conformance with this order have been accepted, by further order of this Board. New rates pursuant to this order may not go into effect on February 1, 1985 absent further Board order.

SCHEDULE I

ELIZABETHTOWN WATER CO.

REVENUE REQUIREMENT
(000's OMITTED)

Rate Base	$121,129
Rate of Return	11.07%
Income Requirement	13,409
Utility Operating Income	11,874
Income Deficiency	1,535
Conversion Factor	x 2.11
Revenue Deficiency	$ 3,240

SCHEDULE II

ELIZABETHTOWN WATER CO.

RATE BASE
(000's OMITTED)

Gross Utility Plant	$182,976
Accumulated Depreciation	40,467
Net Utility Plant	142,509
Construction Work in Progress	0
Working Capital:	
Cash Working Capital	2,211
Unamortized Taxes	0
Materials and Supplies	1,247
Prepayments	222
Minimum Bank Balances	509
Deferred Charges	0
Total Working Capital	4,571
Sub-Total:	$146,698
Deductions:	
Customer Advances for Const.	12,424
Contribution in Aid of Const.	7,441
Unamortized Investment Tax Credit	587
Deferred Taxes—ADR & ACRS	4,983
Other Deferred Taxes	0
Customer Deposits	134
Total Deductions	25,569
Net Investment Rate Base	$121,129

SCHEDULE III

ELIZABETHTOWN WATER CO.

PRO FORMA PRESENT INCOME
(000's OMITTED)

Operating Revenues	$52,558
Operating Expenses:	
Labor	8,381
Purchased Water	4,054
Power	4,967
Chemicals	1,077
Tank Painting	45
Main Cleaning & Lining	200
Emergency Drought Project	135
Commercial	448
Telephone	269
Uncollectibles	156
Overhead Capitalization	(1,019)
Interest on Customer Deposits	12
Insurance	542
Outside Services	259
Employee Pensions & Benefits	1,760
Regulatory Expense	172
Rents	208
General Cost Inreases	3,135
Total Operating & Maintenance Expenses	24,801
Depreciation	3,103
Revenue Taxes	6,601
Real Estate & Other Taxes	1,121
Federal Income Tax	5,058
Total	40,684
Utility Operating Income	$11,874
Interest Expense	(4,845)
Net Utility Operating Income	$7,029

SCHEDULE IV

ELIZABETHTOWN WATER CO.

FEDERAL INCOME TAXES
(000's OMITTED)

Revenues:	$52,558
Expenses:	
Operation & Maintenance	24,801
Depreciation	3,103
Revenue Taxes	6,601
Other Taxes	1,121
Total Expenses	$35,626
Pre-Tax Operating Income	$16,932
Interest Expense	4,845
Excess Tax Over Book Dep.	378
Capitalized Pensions & Benefits	230
Flow-Through of Prior Cap. P & B	64
Total Tax Reconciling Items	$5,517
Taxable Income	$11,415
Tax on First $100,000	26
Tax on Balance at 46%	5,192
ITC Amortization	(134)
F.I.T. Expense	$5,058

SCHEDULE A: TEST YEAR JULY 31, 1984

ELIZABETHTOWN WATER COMPANY

REVENUE REQUIREMENT
(000's OMITTED)

Rate Base	$125,016
Rate of Return	10.90%
Income Requirement	$ 13,627
Utility Operating Income	$ 12,368
Income Deficiency	$ 1,259
Conversion Factor	2.11
Revenue Deficiency	$ 2,656

ELIZABETHTOWN WATER COMPANY

RATE BASE AT JULY 31, 1984 TEST YEAR
(000's OMITTED)

Gross Utility Plant	$186,233
Accumulated Depreciation	39,560
Net Utility Plant	$146,673
CWIP	$ 0
Working Capital	
Cash Working Capital	$ 2,211
Unamortized Taxes	$ 0
Materials & Supplies	$ 1,248
Prepayment	$ 222
Minimum Bank Balances	$ 509
Deferred Charges	$ 0
Total Working Capital	$ 4,190
Subtotal:	$150,863

Deductions	
Customer Advances for Construction	$ 13,745
Contributions in Aid of Construction	$ 7,456
Unamortized Investment Credit	$ 581
Deferred Taxes	$ 3,925
Other Deferred Taxes	$ 0
Customer Deposits	$ 140
Total Deductions	$ 25,847
Net Investment Rate Base	$125,016

ELIZABETHTOWN WATER COMPANY

PRO-FORMA PRESENT INCOME AT JULY 31, 1984
(000's OMITTED)

Operating Revenues	$53,666
Operating Expenses:	
Labor	$ 8,381
Purchased Water	$ 4,054
Power	$ 5,072
Chemicals	$ 1,100
Tank Painting	$ 45
Main Cleaning & Lining	$ 200
Emergency Drought Service	$ 135
Commercial	$ 450
Telephone	$ 282
Uncollectibles	$ 156
Overhead Capitalization	$(1,054)
Interest on Customer Deposits	$ 13
Insurance	$ 542
Outside Services	$ 259
Employee Pensions & Benefits	$ 1,760
Regulatory Commission Expenses	$ 136
Rents	$ 211
General Cost Increases	$ 3,135

Total Operating & Maintenance Expenses	$24,877
Depreciation	$ 3,074
Revenue Taxes	$ 6,732
Real Estate & Other Taxes	$ 1,166
Federal Income Tax	$ 5,449
Total Operating Expenses	$41,298
Utility Operating Income	$12,368

ELIZABETHTOWN WATER COMPANY

CAPITAL STRUCTURE AT JULY 31, 1984
(000's OMITTED)

LT Debt	$ 58,115	47.41%	7.53	3.57%
ST Debt	5,000	4.08	10.00	.41
Preferred	10,046	8.20	15.12	1.24
Common	49,408	40.31	14.10	5.68
	$122,568	100.00%		10.90%

You must check the New Jersey Citation Tracker in the companion looseleaf volume to determine the history of this case in the New Jersey courts.

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State of New Jersey

BOARD OF PUBLIC UTILITIES
1100 RAYMOND BLVD.
NEWARK, NEW JERSEY 07102

AGENDA DATE: 12/18/85

IN THE MATTER OF THE PETITION OF SOUTH JERSEY GAS COMPANY FOR APPROVAL OF INCREASED BASE TARIFF RATES AND CHARGES FOR GAS SERVICE AND FOR AUTHORITY TO CHANGE THE RATES FOR DEPRECIATION CURRENTLY BEING USED AND MAKE OTHER TARIFF REVISIONS PHASE II	)	DECISION AND ORDER BPU DOCKET NO. 843-184 OAL DOCKET NO. PUC 2694-84
IN THE MATTER OF THE PETITION OF SOUTH JERSEY GAS COMPANY NOT TO CHANGE THE LEVEL OF ITS RAW MATERIALS ADJUSTMENT CLAUSE	)	BPU DOCKET NO. GR8508858

(APPEARANCE LIST ATTACHED)

BY THE BOARD:

On February 27, 1985, the Board issued its Decision and Order in this docket, granting South Jersey an increase in base rates designed to produce $2.991 million in additional annual revenues. The Board also determined that a Phase II proceeding was necessary to allow the parties an opportunity to supplement the record on seven issues, which appear below:

1. Post Test Year Additions - Major Construction Projects

   A. McKee City Operating Facility
   B. McKee City LNG Facility
   C. Expansion of Folsom General Office

2. Other Property on Customer Premises

3. Acquisition Adjustment

4. Cash Working Capital - Gross Receipts and Franchise Tax

5. 1985 Payroll Wage Increase
   A. 1985 General Wage Increase
   B. Employee Additions

6. Non-Recurring Expense

7. Transportation Service (TSG)

With respect to the Phase II proceeding to be conducted at the Office of Administrative Law, the Board expressed its expectation that a complete record be available for its review and consideration on or about November 1, 1985.

Motions for reconsideration and clarification of the Decision and Order were filed by Rate Counsel, Owens-Corning Fiberglas Corporation and the Industrial Customer Group. On May 10, 1985, the Board issued its Decision on Reconsideration. In addition to resolving the various issues raised by the parties in their respective motions, the Board adopted a procedural framework for the conduct of Phase II and directed its Staff to include the procedural framework in the transmittal of the matter to the OAL to serve as the basis for litigation of the Phase II issues. The matter was transmitted to the OAL for hearings by letter from Board Secretary Peretz dated May 10, 1985.

After a prehearing conference on July 3, 1985, Administrative Law Judge Walter Sullivan issued a Prehearing Order on July 11, 1985. Rate Counsel filed a motion for interlocutory review with the Board, requesting that the Board overturn that portion of the Prehearing Order prohibiting Rate Counsel from introducing testimony on the issue of South Jersey's overall financial condition. By letter dated August 20, 1985, the Board affirmed Judge Sullivan's Order as consonant with the intention of the Board on the issue of overearnings as expressed in its Decision on Reconsideration.

On August 1, 1985, Owens-Corning moved before Judge Sullivan to strike testimony submitted by South Jersey pertaining to the transportation issue as beyond the scope of the Board's Phase I Order. After a denial of its motion, Owens-Corning filed a motion for interlocutory review with the Board on August 7, 1985, seeking review of the ALJ's denial. By letter of September 5, 1985, the Board withdrew the issue of transportation from Phase II.

Eight days of evidentiary hearings were conducted during Phase II. Also, after notice in compliance with N.J.A.C. 14:1-6.16, a public statement hearing was held in Atlantic City on July 23, 1985.

On November 6, 1985, Judge Sullivan filed his Initial Decision with the Board. Similar to his Initial Decision in Phase I, no schedules quantifying the level of rate relief recommended by the ALJ were attached to the Initial Decision. Exceptions to the Initial Decision and Replies to Exceptions were filed by all parties.

After a review of the entire record in this matter, the Board HEREBY AFFIRMS the Initial Decision pursuant to N.J.S.A. 52:14B-10(c), except as hereinafter modified:

1. Post Test Year Additions

By establishing the Phase II proceeding, the Board sought a supplementation of the record with regard to three specific major construction projects: McKee City operating facility, McKee City LNG vaporizer and the Folsom office building. Each of these projects was under construction or consideration at the time of the Board's Decision and Order in Phase I; two of the projects are currently in-service, while the third is scheduled to be placed in-service in early 1986.

Throughout the proceeding, Rate Counsel vigorously opposed rate base recognition of these projects. The basis for their opposition was that the projects fell too far beyond the test year requested by South Jersey, creating a substantial mismatch between investment, revenues and expenses. The ALJ

concluded, recognizing the Board's " . . . capacity to mold test year concepts . . . ", that the fact that the projects were not known and measurable at the end of the test year or completed before the time of the Board's Decision and Order in Phase I did not preclude their inclusion in rate base. The Board concurs.

However, the Board does not agree with his conclusion limiting rate base inclusion of these projects to the amounts originally requested by South Jersey in Phase I. After a discussion of an ALJ's power to permit an amendment to a petition, where he concluded he was not authorized to do so by the Board, Judge Sullivan determined that South Jersey's attempt to expand the record to include actual costs for these projects was contrary to the Board's intention in creating Phase II. This construction of the Board's intent was erroneous. In ordering a supplementation of the record for these projects, the Board intended that more recent information be placed into the record pertaining not only to their completion date, but also, to the actual costs for construction. As the Company aptly stated, to do otherwise would render the Phase II proceeding a meaningless and futile exercise.

Therefore, the Board determines that the actual costs for the projects as of November 1, 1985 be included in rate base. Those amounts are set forth below:

A. McKee City Operating Facility - $1 ,132,406

This facility has been completed and is currently used by South Jersey in providing service. It provides security for the Company's LNG plants, allows for the relocation to McKee City of those Company personnel responsible for this function and provides a central location for the Company's gas allocation office and transmission and corrosion control departments.

B. McKee City LNG Facility - $1,501,395

The addition to this facility has also been completed and is currently in service. Its completion expands the vaporization capability of the facility enabling the Company to better meet the firm demand of its customers during winter peak periods.

C. Folsom Office Building - $3,696,527

Expansion of the facility will provide an additional 20,000 sq. feet for use by the Company, alleviating overcrowding and enabling the Company to meet its growth needs through 1995.

The values of the Folsom addition, LNG vaporizer and McKee City operating facility were derived from the data attached to the Company's letter of December 12, 1985. While the Board finds that this data comports with the cost information submitted by the Company in the Phase II hearings, it has not been tested by the parties. The Board, therefore, directs the Company to provide a certification, from an official familiar with these costs, that it represents actual amounts incurred by the Company as of November 1, 1985.

An issue related to rate base recognition of the Folsom office building involves the allocation between the Company and its non-utility affiliates of

the use of the facility and the necessary adjustment to other income of the Company to reflect the allocation of the facility. The ALJ found that this issue should be addressed in Phase II in response to a proposal made by Rate Counsel. Notwithstanding the Board's prior ruling that the issue be deferred until completion of the management audit currently being performed, the Board believes that, since the parties have presented testimony and have briefed the issue, the issue can be decided at this time. The Board accepts the recommendation of the ALJ, with the exception of the value of the new furnishings. Since the Board has included the actual costs incurred for the new furnishings as of November 1, 1985 in rate base, these costs should also be recognized in the allocation of the facility.

2. Acquisition Adjustment

The Company sought full rate base recognition of the premium - $2,948,400 - that it paid to the New Jersey Natural Gas Company for the purchase of the Cape May Division. Further, the Company proposed above-the-line treatment for the annual amortization of the premium over a period of nineteen years. Rate Counsel and Staff opposed the proposal on the ground that the Company failed to show any benefits accruing to its customers as a result of the acquisition.

The Board's policy on this issue was clearly set forth in a 1984 matter involving an acquisition of a water system by the Elizabethtown Water Company (Docket No. 8312-1072, Decision and Order 9/24/84). There the Board indicated it would recognize an acquisition adjustment only where it was proven that a specific and tangible benefit inurred to ratepayers from the acquisition.

In his Initial Decision, Judge Sullivan properly recognized the Board's policy in this area and correctly rejected the Company's position that the Board should look to both utilities and their ratepayers in determining if any benefits were created by the transaction. However, the Board disagrees with the ALJ's recommendation that $182,315 be included in rate base due to benefits resulting from the acquisition. It is elementary that the Company bears the burden of proof with regard to any benefits from its acquisition of the Cape May territory. The Board is not persuaded by the Company's testimony that any benefits resulted from the transaction; therefore, the Board rejects the ALJ's recommendation based upon its conclusion that the Company failed to carry its burden of proof as to whether any specific and tangible benefits resulted from its acquisition from New Jersey Natural.

3. 1985 Payroll Adjustments

While the ALJ correctly permitted recognition of the 5.5% wage increase incurred by the Company as of November 1, 1985 pursuant to its labor contract, the Board rejects his recommendation that the Company was precluded by the Board's Phase I Order from providing updated information regarding employee additions and merit increases. The Phase I Order specifically listed employee additions as part of this issue to be supplemented in Phase II. Consistent with its decision with respect to post test year additions, the Board intended that Phase II serve as a vehicle for considering the most recent information available on each issue. Therefore, the Board adopts the Company's position and recognizes a payroll adjustment of $818,500.

4. Non-Recurring Expenses

The ALJ found that expenses incurred by South Jersey associated with its intervention in Docket No. 8312-1093, New Jersey Resources Corp. v. NUI Corp., were non-recurring in nature and recommended non-recognition of the amount - $45,277 - as an expense. Staff took the position that, although the Company had moved to intervene prior to the Board's invitation, the Company's participation in the proceeding was sought by the Board and should be recognized.

The Board accepts Staff's position, including its recommendation of a two-year amortization of the expense. The Board's invitation to the Company to intervene was indicative of its desire for the Company's participation. That fact should be controlling, not the timing of the Company's motion to intervene, in determining whether the expense should be given rate recognition. However, the Board stresses that its decision in this regard is based upon the particular circumstances of this matter and is not to be viewed as precedential.

5. Rate Case Expenses

The Board also accepts the position of Staff on this issue. Although South Jersey's calculation reflected a two-year amortization of its estimated rate case expenses consistent with the methodology approved by the Board in its Phase I Order, the Board believes that Staff's position constitutes a more reasonable estimation of rate case expenses incurred by the Company in Phase II, based upon the level of rate case expenses allowed in Phase I.

6. Proof of Revenues

During the proceeding, a concern was raised by Rate Counsel and Staff that the billing determinants used by South Jersey may cause it to derive more revenues than permitted by the Board in Phase II. In calculating its proposed rates in Phase II, the Company employed the same number of customers and usage recognized by the Board in Phase I.

The billing determinants used by the Company were based upon a fully allocated cost of service study performed for use in this rate case. The Board is convinced that these billing determinants represent a proper balance between revenues, expenses and investment and, therefore, accepts the methodology proposed by South Jersey.

In accepting the Company's methodology, the Board places the Company on notice that, if the use of its methodology results in the Company overearning, it will bear the risk of the consequences associated with an overrecovery of revenues. Staff is directed to closely monitor this situation and report any evidence of overearnings to the Board, at which time, the Board will take any actions consistent with the law necessary to correct the situation.

7. Residential Customer Service Charge

South Jersey proposed an increase in the residential customer service charge for Tri-Division customers from $5.50 to $6.40. Rate Counsel and Staff recommended that any increase in this charge be limited to $6.00.

The Board accepts the position of Rate Counsel and Staff, and authorizes an increase in the customer service charge to $6.00 for residential customers in the Tri-Division. This increase is designed to gradually bring the Tri-Division into parity with Cape May Division.

8. Federal Income Tax Normalization

In its Phase I Order, the Board accepted the Company's proposed FIT normalization adjustment when it affirmed the ALJ's Initial Decision in Phase I. However, the Board, in response to a motion for reconsideration from Rate Counsel, directed the parties to rebrief the issue during Phase II; the Board indicated it would reconsider this issue at the time of its decision on Phase II.

Prior to the Board's Order in Phase I, the Board has flowed-through the tax benefits derived by South Jersey from the use of accelerated depreciation on pre-1976 property. This treatment for South Jersey is consistent with the Board's policy on this issue. The Company proposed that the tax benefit on this property be normalized in order to comply with the provisions of the Economic Recovery Tax Act of 1981 respecting accelerated depreciation.

Rate Counsel and Staff opposed the Company's proposal on the grounds that a rejection by the Board of the Company's proposal will not result in financial harm to the Company. Instead, the Company will be able to recover in future rate cases its actual tax expense; that expense will reflect an appropriate level of depreciation associated with pre-1976 property. Rate Counsel also pointed out that the Company proposal was similar to a tax proposal rejected by the Idaho Public Utilities Commission in 1984,/1 where the Idaho Commission found no justification for burdening current ratepayers with more deferred taxes. Also, Rate Counsel cited a decision of the Pennsylvania Supreme Court/2 holding that normalization of utility state taxes violated the "actual taxes paid" doctrine and offered no offsetting advantages to ratepayers. Further, Rate Counsel noted that the Appellate Division in New Jersey has held that ratepayers should support through rates only the actual taxes paid by a utility in the course of its operations./3

After review of the parties' positions on this issue, the Board is persuaded that the position espoused by Rate Counsel and Staff is correct. The Company has not shown any negative implications from a rejection of its proposal. This fact is buttressed by the position/4 of the Financial Accounting Standards Board issued in December, 1982 that recognized flow-through accounting with respect to this property as an acceptable option. Accordingly, the Board reverses its decision in Phase I and orders that the Company flow-through the tax benefits on pre-1976 property derived through the use of accelerated depreciation.

/1 In Re Utah Power and Light Company, 63 PUR 4th 13 (1984).

/2 Barash v. Pennsylvania Public Utility Commission, 491 A2nd 94 (1985).

/3 In re Lambertville Water Company, 153 NJ Super 24 (1977).

/4 Statement of Financial Accounting Standards No. 71: Accounting for the Effects of Certain Types of Regulations, December, 1982.

While the Phase II proceeding was being conducted at the OAL, South Jersey filed a petition with the Board pertaining to the level of its Raw Materials Adjustment Clause (RMA) for the 1985-86 RMA year. In its petition, the Company sought Board approval for a continuation of the existing level of the RMA through the end of the 1985-86 period. Although South Jersey anticipated a slight rise in gas costs over the course of the new RMA year based upon projections from its principal supplier-Transcontinental Gas Pipeline Corporation (Transco), the Company requested no change in the clause factor primarily because it believed that deregulation of the gas industry would cause a drop in gas prices that Transco would have to meet to remain competitive.

After exchanging discovery and conducting a number of conferences, the parties were able to reach a Stipulation providing for a reduction in the RMA of $2.6 million. The revised RMA factor reflected in the Stipulation was calculated based upon an effective date of November 1, 1985. Provision was made, however, for compression of the factor to coincide with the actual date of implementation; by doing so, the parties insured that rates will reflect the entire amount of the reduction during the RMA year.

South Jersey filed a motion with the Board on December 12, 1985, seeking approval from the Board, by way of an order, of revised tariff sheets in the RMA matter. The revised tariff sheets reflected a reallocation of gas cost components in the Company's base rates in addition to the modifications necessary to implement the RMA Stipulation. In support of its motion, the Company cited the Board's Decision and Order in Phase I of this matter, wherein the Board ordered that the reallocation be implemented in South Jersey's next RMA proceeding. Responses to the Company's motion were submitted by Rate Counsel, Owens-Corning and the Industrial Customer Group.

The reallocation issue arose during the litigation of South Jersey's previous base rate case (Docket No. 831-107). The industrial intervenors proposed a reallocation of $12.4 million in gas costs on a cost-of-service basis. In Docket No. 818-754, the Board had offset a base rate increase of $13.9 million with a $12.4 million credit to the Company's RMA. The RMA credit was effectuated on a commodity basis while the base rate increase was allocated on a cost of service basis; the result was a mismatch of gas cost components that placed a disproportionate share of the increase on the industrial class. In response to the industrial intervenors proposal, the parties stipulated to a reallocation of $4.5 million on a cost of service basis, effective in the Company's next RMA case. In order to effectuate the reallocation, certain base cost of gas adjustments for the residential class-reduction of $.0138 per therm - and large volume service class - increase of $.0088 per therm - were made to offset the impact of the reallocation. The parties further agreed to terminate the cost of gas adjustments in the Company's next base rate proceeding and that the reverals of the cost of gas differentials would not be deemed a rate increase for any purpose.

In Phase I of this docket, South Jersey sought authorization, pursuant to the above agreement, to equalize the cost of gas among customer classes by reversing the above per therm adjustments to the base cost of gas. In its Phase I Decision and Order, the Board clearly stated that the reallocation should be implemented in the Company's 1985-86 RMA proceeding. The Board's position in support of the reallocation has been unambiguously set forth in two prior Orders. Rate Counsel seeks a further deferral of this issue until the Company's next base rate filing. Deferral of the reallocation would require an extension of rates premised upon multiple base costs of gas for an indefinite period of time; also, it would undermine the agreement of the parties set forth in the aforementioned Stipulation in Docket No. 831-107. Recognizing these factors and given the Board's direction in the Phase I Order, the Board believes that the reallocation should be effectuated at this time and therefore, grants South Jersey's motion.

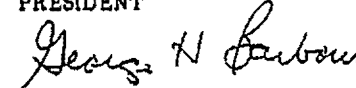
Based upon the above, the Board HEREBY DETERMINES that South Jersey is entitled to an increase in base rates that will produce $1,644,800 in additional annual revenues, as set forth on the attached schedules. Also, the Board HEREBY CONCLUDES that the RMA Stipulation submitted by the parties provides for a reasonable resolution of the Company's filing and therefore, HEREBY ACCEPTS and INCORPORATES said Stipulation as though set forth more fully herein.

After a number of telephone conferences, the parties were able to reach agreement as to tariff design. South Jersey filed revised base rate and RMA tariff sheets with the Board on December 26, 1985, reflecting the agreement of the parties. All parties having reviewed and approved the revised tariff pages pursuant to N.J.A.C. 14:1-6.16(a), the Board HEREBY ACCEPTS the revised tariff sheets as consonant with its decision in these matters, effective for service rendered on and after the date of this Decision and Order.

DATED: December 30, 1985

BOARD OF PUBLIC UTILITIES
BY:

BARBARA A. CURRAN
PRESIDENT



GEORGE H. BARBOUR
COMMISSIONER

ROBERT N. GUIDO
COMMISSIONER

ATTEST:

BLOSSOM A. PERETZ
SECRETARY

BPU Docket No. 843-184
OAL Docket No. PUC 2694-84

BPU Docket No. GR8508858

Schedule A

SOUTH JERSEY GAS COMPANY
PHASE II - DOCKET NO. 843-184
REVENUE REQUIREMENT

RATE BASE	$147,866,000
RATE OF RETURN	x 12.89%
OPERATING INCOME REQUIREMENT	$ 19,059,927
TEST YEAR OPERATING INCOME	16,916,700
OPERATING INCOME DEFICIENCY	$ 2,143,227
REVENUE FACTOR	x 2.163
REVENUE REQUIREMENT - DOCKET NO. 843-184	$ 4,635,800
LESS: PHASE I RATE RELIEF	2,991,000
PHASE II REVENUE REQUIREMENT	$ 1,644,800

Schedule B

SOUTH JERSEY GAS COMPANY
PHASE II - DOCKET NO. 843-184
RATE BASE

Utility Plant in Service	$217,285,300
Construction Work in Progress (CWIP)	920,100
Premium to New Jersey Natural	-0-
Accumulated Depreciation	(57,935,600)
Net Utility Plant	$160,269,800
Materials and Supplies	946,000
Merchandise - Repair Parts	243,400
Cash Working Capital	(10,201,000)
Gas Inventory:	
Natural Gas Stored	10,337,000
LNG Stored	1,711,000
Propane	251,000
Customer Deposits	(4,138,000)
Customer Advances	(261,000)
Deferred F.I.T.	(10,661,200)
Pre-1970 I.T.C.	(631,000)
TOTAL RATE BASE	$147,866,000

Schedule C

SOUTH JERSEY GAS COMPANY

PHASE II - DOCKET NO. 843-184
TEST YEAR OPERATING INCOME

TOTAL OPERATING REVENUES	$218,917,100
TOTAL COST OF GAS	$137,923,600
OPERATING EXPENSES:	
Operation and Maintenance	$ 23,124,400
Depreciation	5,497,200
Amortization of Premium	-0-
Taxes other than Income:	
General Taxes	1,215,300
Revenue Taxes	29,923,100
Federal Income Taxes	2,452,100
Investment Tax Credit	1,978,000
TOTAL OPERATING EXPENSES	$ 64,190,100
NET OPERATING INCOME	$ 16,803,400
AFUDC	113,300
NET OPERATING INCOME	$ 16,916,700

A P P E A R A N C E   L I S T

In the Matter of the Petition of South Jersey Gas Company for Approval of Increased Base Tariff Rates and Charges for Gas Service and for Authority to Change the Rates for Depreciation Currently Being Used and Make Other Tariff Revisions - Phase II

BPU Docket No. 843-184
OAL Docket No. PUC 2694-84

In the Matter of the Petition of South Jersey Gas Company Not to Change the Level of its Raw Materials Adjustment Clause

BPU Docket No. GR 8508858

Ira G. Megdal, Esq.
Davis, Reberkenny & Abramowitz
499 Cooper Landing Road
P.O. Box 5459
Cherry Hill, New Jersey 08002

Keith R. McCrea, Esq.
Philip O'Neill, Esq.
Squire, Sanders & Dempsey
1201 Pennsylvania Ave., N.W.
Washington, D. C. 20004

R. Brian Corcoran, Esq.
Connole & O'Connell
900 - 17th Street, N.W. - 4th Fl.
Washington, D. C. 20006

DEPARTMENT OF THE PUBLIC ADVOCATE

Division of Rate Counsel
744 Broad Street - 30th Fl.
Newark, New Jersey 07102

By: Helene Wallenstein, Esq.
Nusha Wyner, Esq.
Menasha J. Tausner, Esq.

BOARD OF PUBLIC UTILITIES

1100 Raymond Boulevard
Newark, New Jersey 07102

By: Vaughn Donovan, Chief, Bureau of Rates & Tariffs, Division of Gas
Joseph O'Hara, Chief, Bureau of Revenue Requirements, Division of G
Michael Kammer, Accountant II, Division of Gas
Alice Bator, Rate Analyst III, Division of Gas
Craig, Kehrle, Accountant III, Division of Gas