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

[handwritten initials] 2/27/19

February 25, 2019

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**
OAL Docket No.: PUC 16279-2018S
BPU Docket No.: WR17090985

Dear Judge Gertsman:

Please accept this letter brief in lieu of a more formal brief as the Reply of the Division of Rate Counsel ("Rate Counsel") 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. Rate Counsel's Reply does not address all issues in the parties' initial briefs, but is limited to a few select, significant points.

CMS/M. Kammer
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

A. BPU Policy on Acquisition Adjustments is Clear, in That Such Adjustments are Only Appropriately Included in Rates Where a Utility Has Proven Net Benefits to Existing Customers, or The Acquired System is a Small, Troubled Utility.

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, 62 P.U.R. 4th 613 (N.J.B.P.U. 1984) ("Elizabethtown Acquisition Order")[1]. In that matter, the Board held that acquisition adjustments should be awarded only in two limited circumstances. First, an acquisition adjustment may be allowed if a utility has proven net benefits to existing ratepayers as a result of the acquisition. Elizabethtown Acquisition Order at 614. The second situation where an acquisition adjustment may be permitted involves the acquisition of a small, troubled system. Id. Several other Board orders note this same policy on acquisition adjustments. See, e.g., I/M/O Long Beach Water System, BPU Docket No. 8310-855, Order dated 7/5/84 (splitting a proposed acquisition adjustment 50/50 between ratepayers and shareholders, due to the Board's determination of "a well-established customer benefit"); 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 (denying a proposed acquisition adjustment, as the Board found no benefits inured to existing ratepayers as a result of the transaction).

In its initial brief, the Company asserts that a utility's status as troubled is irrelevant to the consideration of whether an acquisition adjustment should be allowed in rates. Company Initial Brief at 33. The Company claims that "[w]hether a system is troubled is not part of the consideration in deciding whether to allow an acquisition adjustment under *Howell*[2] or any other

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[1] Rate Counsel's Initial Brief included an incorrect citation to the Public Utilities Reports for this case. The proper citation is noted above.
[2] I/M/O N.J. American Water Co., 193 P.U.R. 4th 30 (1999) ("Howell Order").

BPU Precedent." Company Initial Brief at 33. This assertion is simply not true. The Board has repeatedly limited acquisition adjustments in rates to two narrow circumstances, one of which is where a utility demonstrates that it acquired a small, troubled utility. Indeed, the Staff of the Board of Public Utilities ("Board Staff"), in its initial brief, noted the same case law on acquisition adjustments as did Rate Counsel. Board Staff Initial Brief at 14-16. Board Staff rejected the proposed acquisition adjustments for Shorelands and Haddonfield because neither was shown to be a "troubled" utility, nor did the Company prove net benefits to existing ratepayers. Id. at 17-19. As noted below, the Howell Order affirmed this long-standing precedent.

B. The Howell Order Affirms the Board's Long-Standing Policy on Acquisition Adjustments, and Supports The Positions of Rate Counsel, Board Staff & Middlesex Water that the Requested Acquisition Adjustments Should be Denied.

In our Initial Brief, Rate Counsel demonstrated that the Company failed to meet its burden to prove that it should receive acquisition adjustments for Shorelands or Haddonfield under the long-standing policy set forth in the Elizabethtown Acquisition Order. The Company, for its part, argues in its Initial Brief that both the Elizabethtown and Howell Orders support their position. As explained below, the Company misconstrues the Howell Order, which in fact supports denial of both requested acquisition adjustments.

First, the Howell Order does not "encourage" utility consolidation, as the Company claims in its initial brief. Company Initial Brief at 24. Instead, as in Elizabethtown and South Jersey Gas, the Board in Howell noted that while it understood the goal of consolidating small water systems, it also recognized "the need to carefully examine the manner in which regionalization is accomplished, the costs of achieving regionalization, and the benefits resulting from consolidation and regionalization." Howell Order, 193 P.U.R. 4^{th} at 43. While the Board recognized consolidation may be worthwhile, the primary concern of the Board in Howell was weighing the costs and benefits of the transaction. Indeed, the Howell Order further held that "[t]he Board, on an ongoing basis, will seek to ensure a proper balance between the benefits resulting from consolidation and regionalization, and the associated costs to achieve that goal." Id. The Board's holding in Howell was a continuation of its policy on acquisition adjustments set forth fifteen years earlier in Elizabethtown and South Jersey Gas, where the Board required utilities to prove either (a) net benefits to existing ratepayers or (b) that the acquired system was a small troubled system, in order to receive an acquisition adjustment. The Board has always been focused on the costs to ratepayers of any acquisition.

As always, the Board's consideration of the Howell acquisition and several smaller acquisitions was fact-specific. In Howell, the Board allowed several small acquisition adjustments for small systems based on its finding that the Company had proven these systems would benefit from increased reliability in the provision of safe, adequate and proper service, from economies of scale, and based on the minimal impact on rates. Id. at 43. This holding is consistent with Elizabethtown's allowance of acquisition adjustments for small troubled systems.

The Board allowed one-half of the acquisition adjustment for New Jersey American's acquisition of the Howell system based on those particular set of facts. , The facts in Howell, however, were very different from the current acquisitions of Shorelands and Haddonfield. In Howell, the Board found that no party offered a challenge to the Company's \$27 million valuation of the system or to the Company's proposed value of avoided costs of \$12.5 million. Id. at 45. This stands in stark contrast to Rate Counsel's position through witness Howard Woods in the present matter. In terms of Shorelands, Mr. Woods demonstrated the flaws in the

Company's analysis of avoided and deferred costs. Mr. Woods shows that the Company's analysis contained unrealistic assumptions. As explained in Rate Counsel's Initial Brief, one example of a flawed assumption in the Company's analysis relates to its Navy Tank. *RC-1* at 32-35. 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. The Company has never proven that an assumed service life of 107 years is a realistic assumption, nor has the Company ever committed to keeping the Navy Tank in service for such a long period of time.

Mr. Woods' testimony illustrated 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 or merely delayed in time, Mr. Woods demonstrated that the Company's claim of net benefits from the Shorelands acquisition does not stand scrutiny.

Mr. Woods' testimony stands in contrast to the facts of the Howell case, for which the Company received one-half of the acquisition adjustment in part because there were no challenges to Company's analysis of avoided costs. Howell Order at 45, 46. Even without such challenges, the Board in Howell still found that "the degree to which these benefits [under Elizabethtown] accrue to all ratepayers is not easily measured on the record provided by the Company." Id. at 45. While the Board noted benefits to existing ratepayers as a result of greater security of the water supply, the Board still found that "[t]he record does not provide the Board with specific information or analysis on this issue" of the degree to which ratepayers benefit. Id. at 46.

The lesson to be learned from the Howell Order is that the Board has a very high bar for awarding acquisition adjustments. Indeed, in Howell there were no challenges to the analyses submitted by the Company, and yet the Board still felt that the Company had not fully proven its position. In this case, given the Company's burden of proof, Mr. Woods' extensive challenges to the Company's net benefit analysis, and the strict standards for acquisition adjustments utilized by the Board in Howell and other cases, the proposed acquisition adjustments should be denied.[3]

Similarly, Mr. Woods' testimony demonstrated that the Company failed to meet its burden of proving net benefits to existing ratepayers from the Haddonfield acquisition. As Mr. Woods testified, almost all of the benefits of the Haddonfield acquisition asserted by the Company benefited only Haddonfield ratepayers, not existing customers. *RC-1* at 23. Furthermore, the Company did not prove the one benefit that it claimed inured to existing ratepayers, namely, the Haddonfield water allocation permit. While the Company claimed this permit would be useful in addressing water quality requirements associated with perfluorinated

[3] It is worth noting that the Board in Howell also considered the reasonableness of the purchase price in its determination of whether to award an acquisition adjustment. Howell Order at 44. In Howell, the Company valued the system at $27 million, and paid a purchase price of $35 million. In Shorelands, all parties valued the system at approximately $24.5 million. The Company paid approximately $51.5 million for the system, more than double its book value, representing a premium of $26.7 million. If Your Honor or the Board were to apply the criteria of reasonableness of purchase price, as was done in Howell, then the Company has surely failed to prove how paying more than double for the system could be considered a reasonable decision.

compounds ("PFCs"), the Company was unable to quantify the overall benefit of this permit. 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, and has failed to do so.

C. Despite the Company's Claim to the Contrary, Shorelands Customers Will Be Subsidized By Existing Ratepayers if the Acquisition Adjustment is Permitted.

Finally, in its initial brief, the Company claims that the Shorelands acquisition "provides an additional net benefit to legacy customers because the revenue from Shorelands' customers exceeds Shorelands' cost of service." Company Initial Brief at 18. Therefore, the Company asserts, the Company should be allowed to recover the acquisition adjustment in rates.

The Company's argument is extremely misleading. The Company's statement is true only if the proposed acquisition adjustment is excluded from rates. In its Petition, the Company presented the stand-alone revenue requirement for Shorelands in Mr. DeStefano's Rebuttal P-13, Exhibit DMD-RT-4. With the $26.7 million acquisition premium *included* in rate base, the revenue requirement exceeded the Shorelands operating income by $1,817,538. Id. In other words, the revenue received from Shorelands' rates did not cover the Shorelands revenue requirement with the acquisition premium included. While the Company's Petition proposed to increase Shorelands' rates by approximately $2 million to cover this shortfall, the stipulation of settlement ultimately resulted in a revenue increase for Shorelands of approximately $1.3 million. (Stipulation of Settlement, Schedule C, Page 9). In other words, under present rates, the Shorelands system will be subsidized by other Company ratepayers if the acquisition adjustment is permitted. Simply stated, if the Company receives the acquisition adjustment it seeks, then its justification for the adjustment – that revenue from Shorelands covers its cost of service - will no longer be true. Accordingly, the Company's argument for an acquisition adjustment for Shorelands fails.[4]

Conclusion

For all of the reasons stated above, and as set forth in Rate Counsel's Initial Brief, the Company's request for acquisition adjustments for the Shorelands and Haddonfield systems should be denied.

Respectfully submitted,
STEFANIE A. BRAND
DIRECTOR, DIVISION OF RATE COUNSEL

By: ______________________
Christine M. Juaréz, Esq.
Assistant Deputy Rate Counsel

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

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[4] The same argument applies to Haddonfield. As can be seen in Mr. DeStefano's Rebuttal Testimony, if the Haddonfield acquisition adjustment is permitted, Haddonfield customers will be subsidized by other ratepayers under the Company's current rates. Without the acquisition adjustment, Haddonfield's revenues exceed its cost of service, but only for the water utility. Since being acquired in 2015, Haddonfield sewer has received and continues to receive a major subsidy from other ratepayers of approximately $3 million annually. (P-13, Exhibit DMD-RT-4).

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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