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

July 7, 2020

VIA ELECTRONIC DELIVERY
Aida Camacho-Welch, Secretary
State of New Jersey, Board of Public Utilities
44 South Clinton Avenue, 9th Floor
P.O. Box 350
Trenton, New Jersey 08625-0350

Re: I/M/O the Joint Petition for Approval of SUEZ Water New Jersey, Inc. for Approval of a Pilot Program to Facilitate the Replacement of Lead Service Lines and a Related Cost Recovery Mechanism
BPU Docket No. WO19030381
OAL Docket No. PUC 07138-2019S

Dear Secretary Camacho:

Please accept for filing the original of a letter brief in electronic format on reply exceptions from the Division of Rate Counsel ("Rate Counsel") in the above referenced matter. Kindly stamp the extra copy as "filed" and return it in the enclosed self-addressed, stamped envelope. Thank you very much for your attention to this matter.

PRELIMINARY STATEMENT

This case poses a simple question: Can a utility earn a return on investment in property it does not own? Absent specific statutory authority, the simple answer is no. The Administrative Law Judge's ("ALJ") Initial Decision granting Rate Counsel's Motion to Dismiss Suez's ("Suez"

or the "Company") Petition in this matter, addresses a fundamental tenet of utility regulation – that public utilities can only charge ratepayers in rates for investments in utility property that is used and useful in the public service. Used and useful investments must be owned by and have been dedicated to the public service by the public utility. The customer-owned portions of the service lines Suez seeks approval to replace in its Petition, earning a full return of and on its investment in the process, meet none of these requirements. The ALJ properly recognized this fact and dismissed Suez's Petition. The Board should affirm that decision.

Suez asserts that this case is about solving the public health crisis surrounding lead in New Jersey's water pipes. It is not. Rather, this is about how Suez can profit off of that crisis. Suez seeks to have its ratepayers pay for all but $1,000 of the cost of replacing privately owned service lines, with the Company then earning its full rate of return on the investment paid for by ratepayers. Suez attempts to camouflage this scheme by calling its return "carrying costs" on a "regulatory asset." These carrying costs, however, are not at the rate of interest, but at the Company's full weighted average cost of capital (WACC). Significantly, Suez has rejected any proposal that will lower the profit it would make on its customer's property. While Suez argues that Rate Counsel persists in saying "no" to any solution, the reality is that the only thing Rate Counsel has opposed is the Company's brazen attempt to take advantage of the problem in order to increase dividends for its shareholders.

It is extremely important that the Board keep in mind the inequities of what Suez is asking to do and the broad impact for ratepayers as a whole. The requirement that utility returns are limited to used and useful utility-owned property did not arise out of happenstance. As discussed in this brief and those filed by Rate Counsel below, it was a careful balancing of the interest of utilities to be fairly paid for their services with the interest of consumers to not be

charged confiscatory rates. Its basis in fundamental fairness is evident here, where ratepayers, many of whom are struggling to pay their bills particularly during the current economic crisis, are being asked to pay to enhance the value of private property owned by others. With no limits on who may participate in Suez's program, those customers may be subsidizing others with much greater means. Moreover, the implications of the Board abandoning precedent and allowing utilities to profit off of private property are substantial. If the Board were to abandon the law as requested by Suez, the implications for struggling ratepayers will no doubt increase, disrupting the long-standing balance struck by the courts.

The ALJ saw through this poorly disguised scheme and granted Rate Counsel's motion. While Suez argues that it's proposal does not run afoul of the "used and useful" requirement because it is creating a "regulatory asset" and not "rate basing" the customer-owned lead service lines, its arguments are form over substance. Suez will invest in property it does not own that is not used and useful in the public service and then, as it would with utility property that <u>is</u> used in the public service, have ratepayers pay a full return of and on that property. The argument that the property would not be in "rate base" is nothing more than smoke and mirrors and an attempt to distract the Board from the real impact of its decision. While we are all concerned about lead in drinking water, we must also be wary of those attempting to capitalize on the issue as a way to enhance their profits and consider the consequences if long-standing ratepayer protections could be evaded simply by calling the accounting mechanism to be employed by a different name.

Nothing argued by Suez in its exceptions changes the material relevant facts that were agreed to and are undisputed by the parties. Nor has the governing body of law changed. Suez cannot recover costs associated with replacing customer-owned lines from ratepayers, whether that recovery is in rate base or given another name to evade more than one hundred years of

precedent. The ALJ's decision is fully supported by undisputed facts and well-established law. The Board should adopt the Initial Decision in full.

ARGUMENT

a. The Legal Arguments Advanced in the Company's Exceptions Misconstrue the Initial Decision and Case Law and Should Be Rejected.

The relevant facts here are undisputed, and the body of case law used to decide Rate Counsel's Motion ("Motion") is clear. Despite this, the Company's exceptions advance an incorrect interpretation of the relevant case law that should be rejected. This Board should not be fooled by Suez's effort to evade binding precedent that has existed for more than one hundred years by calling what it is doing something else. The ALJ saw through this ruse and the Board should as well. The Company argues that because it did not request rate base treatment in its Petition, the Initial Decision erred in applying the used and useful principle. ID at 7. The Company cites to a single case in support of this unorthodox, extremely narrow interpretation of the used and useful principle. Suez unsuccessfully advanced this same argument in briefs on the Motion before the ALJ. It was rejected there just as it should be rejected here.

Suez's assertion that it does not seek rate base treatment is akin to a game of three card monte. While not calling its recovery rate base treatment, the Company nonetheless seeks the equivalent of rate base treatment. The so called "carrying costs" are to be at the Company's full rate of return, not the cost of debt or some other lower rate.[1] It is ironic indeed that Suez spends so much of its brief complaining that Rate Counsel only says no when the Company refuses to even consider any solution that does not include the Company earning its full return on investment in

[1] Carrying costs tend to be at the Treasury rate plus some slight adder. See eg I/M/O the Verified Petition of JCP&L Co. for Review and Approval of Increases in and other adjustments to its Rates and Charges for Electrical Service, and for Approval of Other Tariff Revisions in connection therewith, and for Approval of an Accelerated Reliability Enhancement Program ("2012 Base Rate Filing"), Docket No. ER12111052 (March 18, 2015), p. 74.

other people's property. While other solutions and sources of funds could be found to assist homeowners who cannot afford to replace their lines, Suez only seeks the "solution" that will enhance its profits to the detriment of its other customers.

Moreover, Suez's attempt to distinguish its proposal from extensive contrary legal precedent is unavailing. Both the Courts and the Board have long required investments to be both owned by the utility and used and useful in the public service in order to be recoverable in rates. As Rate Counsel's Motion noted, some of the earliest cases on the used and useful principle discussed when property becomes "clothed with a public interest." Munn v. Illinois, 94 U.S. 113, 125-26 (1877). A public utility is required to submit to government regulation because it "devotes [its] property to a use in which the public has an interest." Id. Because of this public interest, the utility must "submit to be controlled by the public for the common good." Id. In return, the utility is entitled to just compensation for the use of its property under the Fifth and Fourteenth Amendments. St. Joseph Stock Yards Co. v. U.S., 298 U.S. 38, 51 (1936).

While a utility is entitled to compensation for its property devoted to the public use, the captive ratepaying public can likewise only be asked to pay a rate based on the value of utility property that is used and useful in the public service. Duquesne Light Co. v. Barasch, 488 U.S. 299, 307 (1989). In other words, "[w]hat the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it…than the services rendered by it are reasonably worth." Smyth v. Ames, 169 U.S. 466, 547 (1898), rev'd on other grounds, Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 605 (1944)..

None of these early cases use the term "rate base." They simply prohibit a utility from earning a "return" on anything other than utility property that is used and useful in the public

service. The same is true of later New Jersey state cases. Our State Supreme Court held that "[a] rate based upon an excessive valuation or upon property not used or useful in the rendition of the service subject to such regulation obviously would lay upon the individual user a burden greater than the reasonable worth of the accommodation thus supplied." Atl. City Sewerage Co. v. Bd. of Pub. Util. Comm'rs, 128 N.J.L. 359, 365-66 (1942). New Jersey has long recognized that utilities can only recover a return on investment in utility assets, noting that "investors may expect a utility to earn a reasonable rate of return on its assets." In re Valley Rd. Sewerage Co., 154 N.J. 224, 240 (1998).

The Board has long followed the law prohibiting utilities from earning a return on non-utility property that is not used and useful in the provision of service. Perhaps the most important and most recent of these Board orders – and indeed, a case discussed by the ALJ in his Initial Decision – is the 2017 Order for Rockland Electric Company, I/M/O Petition of Rockland Electric Co. For Approval of an Advanced Metering Program; and For Other Relief, BPU Docket No. ER16060524, Order dated 8/23/17 ("RECO AMI Order"). In this matter, the Board barred any and all form of rate recovery for customer-owned property that is not used and useful in the public service. Rockland Electric Company requested pre-approval to install advanced meters throughout its entire service territory. As part of its installation plan, Rockland proposed to perform work on the customer side of the electric meter in order to facilitate installation of the new meters. Similar to customer-owned lead service lines, because the property was located on the customer's side of the meter, the property was customer-owned. Rockland proposed to capitalize such costs in rate base, where, similar to Suez's Petition, Rockland would earn a return of and a return on customer-owned property.

The Board found Rockland's proposal to be contrary to New Jersey law. Even though the Board believed such work was necessary for the safe installation of AMI, the Board agreed with Rate Counsel that the Company's proposal "violates settled New Jersey case law." Rockland AMI Order at 22. The Board specifically found that:

> [w]ith respect to the cost of such work, the Board HEREBY FINDS that RECO's proposal is contrary to settled New Jersey case law. Accordingly, the Board HEREBY DENIES RECO's request to capitalize such costs. Costs related to this work shall not be recovered from the Company's ratepayers.
> Id.

There are at least two important takeaways here. First, this matter involved work performed by the utility on customer-owned property. These facts are analogous to the present Suez matter. Also, the Board did not simply prohibit rate base treatment for these costs, it prohibited all forms of rate recovery – rate base, expensing, creating a regulatory asset, etc. The Company's brief argues that non-utility property is recoverable in rates as long as it is not in rate base. The Board's decision in the RECO AMI Order puts this argument to rest. Such costs are not recoverable in any form, and the Board correctly said so in the RECO AMI Order.

In his Initial Decision, the ALJ also correctly applied the undisputed facts of this case to the case law and Board orders set forth above. The ALJ specifically held that in order to be included in rates, assets must (a) be owned by a utility, and (b) be used and useful in the public service. The ALJ held:

> The long-settled case law is clear that rate recovery is limited to fair value of the property owned by the utility and used and useful in the public service. In re N.J. Power & Light Co., 9 N.J. 498 at 209.[2] It is not in dispute that the customer-owned LSL in the pilot program are not an asset of the Company nor will they be in the future. Further, the LSL, as they are owned by the customers, are not dedicated to the public service.
>
> Initial Decision at 12.

[2] Rate Counsel believes this citation should be to page 509.

It is undisputed that Suez's Petition proposes replacement of lead service lines that are not, and never will be, owned or controlled by Suez.[3] Furthermore, as the ALJ concluded, these privately-owned lines will never be dedicated to the public service. Ratepayers can only be asked to compensate a utility for the value of its property that is used and useful in the public service. See, e.g., Duquesne Light Co. v. Barasch, 488 U.S. 299, 307 (1989). Because privately-owned lead service lines are not utility assets and are not dedicated to the public service, the ALJ properly found that ratepayers cannot be required to pay their costs in rates.

b. The Board Orders Cited in the Company's Brief are Inapposite and Should Be Disregarded.

The Company's brief offers another distraction in the form of various Board Orders that purport to show that the Company should be permitted to do what it seeks, namely, earn a return on investment in customer-owned property. First, the Company offers a convoluted interpretation of the 2017 RECO AMI Order that it claims supports its position. This is simply not true. As discussed above, a plain reading of that order details the Board's position that rate recovery for customer-owned property is not allowed in any form.

The Company goes on to discuss the Regional Greenhouse Gas Initiative ("RGGI") statute, N.J.S.A. 48:3-98.1. The Company claims this is "proof positive" that Rate Counsel's analysis is incorrect. Not so. In that statute, the Legislature provided that renewable energy and energy efficiency investments and rate recovery on the customer side of the meter are explicitly permitted. There is no such statute applicable to Suez's proposal. While it is unclear how the courts would have dealt with this provision in N.J.S.A. 48:3-98.1 had it been challenged, the lack of explicit statutory authority is a critical distinction. Accordingly, this argument should be rejected.

[3] Statement of Material Facts not in Dispute, para. 16, 25.

Furthermore, Suez cites to the cost recovery authorized by the Board in the 1980's pertaining to abandoned floating nuclear power plants. This situation is entirely inapposite to what Suez proposes here, as that matter involved expenditures on utility property (albeit never used and useful), not customer-owned property, and the Board authorized recovery of actual costs with no rate of return. I/M/O Petition of Pub. Serv. Elec. & Gas Co. for Approval of an Increase in Elec. & Gas Rate & for Changes in the Tariffs for Elect. & Gas Servs., P.U.C. N.J. No. 7 Elec., & P.U.C. N.J. No. 6 Gas, Pursuant to R.S. 48:2-21, BPU Docket No. 794-310, Initial Decision dated (2/9/80).

Suez also attempts to draw an analogy between its proposal and recovery of storm costs associated with Superstorm Sandy by Jersey Central Power & Light Company ("JCP&L"). According to Suez, this matter offers an example where a utility was permitted to amortize certain costs along with a rate of return.[4] Yet this analogy also fails. The JCP&L matter involved costs associated with repairing and/or replacing utility property that was damaged as a result of Superstorm Sandy.[5] Rate Counsel and Suez are already in agreement that ratepayers are responsible for the prudently-incurred costs associated with replacing utility-owned lead service lines. The crux of the dispute between Rate Counsel and Suez is whether ratepayers can be made to pay for replacing privately-owned lead service lines, including allowing Suez to earn a return on these costs. Because the JCP&L Order involved replacement of utility property, it is not instructive on the issues that are disputed between the parties in this case.

[4] The Board explicitly rejected the Company's request to earn its weighted average cost of capital and instead, the rate of return granted to JCP&L was the rate for seven-year constant maturity Treasury securities plus sixty basis points, not the full authorized rate of return sought by Suez. 2012 Base Rate Filing, p. 74.

[5] While Suez offers the conjecture that JCP&L included costs related to cleanup of non-utility property, it offers no support at all for this claim.

Perhaps most instructive of all is the fact that Suez fails to point to a single case or Board order where a New Jersey utility was permitted to do what it proposes, namely to collect costs plus earn its fully authorized rate of return for investing in non-utility property. As the ALJ properly recognized, this is because such a scenario is contrary to more than one hundred years of State and Federal case law. The ALJ properly granted Rate Counsel's Motion to Dismiss Suez's Petition. The Board must also follow precedent and should adopt the Initial Decision in full.

CONCLUSION

For all of the reasons stated above, the Board should reject the Company's exceptions, and adopt the Initial Decision dismissing Suez's Petition as a matter of law.

Respectfully submitted,

STEFANIE A. BRAND
DIRECTOR, RATE COUNSEL

By: ***Christine M. Juarez***_____
Christine M. Juarez
Assistant Deputy Rate Counsel