

February 13, 2018

VIA HAND DELIVERY

Ira G. Megdal

Direct Phone 856-910-5007

Direct Fax 877-259-7984

imegdal@cozen.com

Paul Flanagan, Executive Director
New Jersey Board of Public Utilities
44 South Clinton Ave.
3rd Floor, Suite 314
PO Box 350
Trenton, NJ 08625-0350

**Re: In the Matter of the New Jersey Board of Public Utilities' Consideration of the Tax
Cuts and Jobs Act of 2017
BPU Docket No. AX18010001**

**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, Change in Depreciation Rates and Other Tariff Provisions
BPU Docket No. WR17090985
OAL Docket No. PUC 14251-2017 S**

Dear Mr. Flanagan:

Please accept this letter memorandum (this "Memorandum") in support of the motion of New Jersey-American Water Company, Inc. ("NJAWC" or "Movant") for an Order of the Board of Public Utilities ("Board" or "BPU") consolidating NJAWC's currently pending base rate case with the Board's generic proceeding concerning the Tax Cuts and Jobs Act of 2017 (the "Act"), to the extent that this generic proceeding pertains to NJAWC, and granting relief from the requirement that NJAWC file tariffs to be effective April 1, 2018. In support thereof, Movant states as follows:

I. Preliminary Statement.

NJAWC has a base rate case pending before the Office of Administrative Law, *I/M/O Petition of New Jersey-American Water Company, Inc.*, OAL Docket No. PUC14251-17, BPU Docket No. WR17090985. That case was filed September 14, 2017. A prehearing conference was held in that matter on November 2, 2017 and a Prehearing Order dated December 18, 2017 emanated from that prehearing conference. Discovery is ongoing; settlement meetings are scheduled for February and March 2018; and NJAWC will file its final updated schedules in that case on April 16, 2018, with discovery thereon continuing through April 30, 2018.

NJAWC anticipates a potential settlement in this case appearing on the Board's Agenda as early as its June 20, 2018 Open Public Meetings Act meeting.

On January 31, 2018 the BPU issued an order (the “Order”) in Docket No. AX18010001 (the “Tax Act Proceeding”). On February 8, 2018 NJAWC filed updated testimony, exhibits and schedules in its base rate case giving effect to the Act.

II. The Effect of the Order.

Pursuant to the terms of the Order, NJAWC is required to file new tariffs by March 2, 2018 to be effective April 1, 2018. The new tariffs are designed to reflect the effect of a reduced tax expense resulting from the decrease in the corporate tax rate arising from the Act. In NJAWC’s case this would mean that on April 1, 2018 a substantial rate reduction would take place.

In view of the fact that NJAWC anticipates a rate increase to be implemented as early as July 1, 2018 at the Board’s June Board Meeting, the rate decrease of April 1 would be shortly followed by a rate increase. This “yo-yo” effect would be confusing to customers, would impede the ability of customers to properly budget and could result in substantial confusion.

As a result, NJAWC requests that the Board grant relief from the requirement that NJAWC make tariffs effective April 1, 2018. Instead, NJAWC asks that the Board direct that NJAWC, and the parties to its base rate case take into consideration the impact of the tax rate reduction and other impacts from the Act in resolving NJAWC’s rate case.

Moreover, proposals in NJAWC’s rate case will further smooth the impacts of the Act on customers and achieve long-term regulatory benefit, and intergenerational equity.

Consolidating NJAWC’s base rate case with the Tax Act Proceeding will enable the full consideration of factors that should be considered according to New Jersey case law, when rates are set. These concepts are appropriate when setting rates reflecting reduced current and deferred tax expense. In NJAWC’s base rate case the BPU will be able to give full consideration to all relevant factors and to properly allocate benefits and costs, liquidate balance sheet accounts, and provide for fair and equitable intergenerational tax benefit allocations. Moreover, it can do so in a timely manner.

III. The Board Has the Opportunity to Consider Tax Act Issues in NJAWC’s Pending Rate Case.

In the case of NJAWC, the Board has the ability to implement tax rate changes in the NJAWC rate case, while avoiding substantial and unnecessary delay. The Board recognized the benefit of proceeding this way in its consideration of the Tax Reform Act of 1986 (“TRA-86”). There, in its Order in Docket No. AX86121392 dated January 6, 1987, the Board stated at page 2:

We believe an immediate rate change without first establishing the dollar impact of the tax changes and comment from the affected utilities is not in the public interest and could be violative of due process. However, to countenance an inordinate delay in recognizing the reduced tax would be unfair to ratepayers. This known and measurable change in rates should be reflected in rates in a timely fashion. Additionally, a company should not enjoy windfall profits from any delay. Use of the proposed deferred accounting, would prove no incentive to delay. Therefore, considering the options available, a deferred

accounting approach is the Board's best alternative. At the same time, the Board recognizes that deferred accounting is a departure from the accepted test year ratemaking philosophy, however, the unique circumstances of this tax change merits such an approach.

Item 2 deals with the timing of the rate change. Generally, we believe that two options are available, they are: (1) a mini or interim rate case to reflect the ongoing net effect of the TRA-86*, or (2) a deferred accounting approach in conjunction with the ongoing effects of the new tax law reflected at the time of the next rate change. Alternatively, if no rate change is anticipated to become effective during 1987, a rate adjustment would be made no later than the end of the first quarter of 1987.

*The mini rate case would also reflect the resolution of the deferred account.

We believe that option two (2) is the best approach because it yields rate stability and at the same time recognizes that the ratepayers are entitled to receive the full benefit of the reduced revenue requirement. *In order to foster stability in the rate level, the tax changes can be incorporated in each utility's next rate change along with the deferred amounts.* (Emphasis added).

In recognizing in the TRA-86 order that tax rate changes can best be established in the context of a rate proceeding, and that doing so would promote rate stability the Board acted consistently with New Jersey law. In *In re Proposed Increase Central R.R.*, 125 N.J. Super. 48 (App. Div. 1973), the Court found that the Board had established rates without making the appropriate findings. The Court there stated: "For although the Board concluded that the 'proposed increase rates . . . are just and reasonable,' the conclusion is founded upon considerations other than a fair rate of return calculated by relating projected income (including that reasonably anticipated from the proposed increase) to the carrier's rate base." (At p. 51). In reversing the Board, the Appellate Division concluded as follows:

"We conclude, therefore, that the action of the Board in approving and accepting the proposed increased rates on industrial sand was without legal basis or authority, and for this reason must be set aside. In so concluding we are not unmindful or nor unsympathetic to the difficulties and problems confronting many rail carriers, including The Central Railroad of New Jersey. Notwithstanding, such predicament does not and cannot justify the fixing or approval of freight or other rates without regard to the standards, long extant, by which the competing interests of the railroad and the public are served." (Citations omitted, at pp. 52-53).

This decision was affirmed by the Supreme Court of New Jersey, which ruled that an examination of the appropriate ratemaking standards would be lawfully required for the setting of rates. *In re Industrial Sand Rates*, 66 N.J. 12 (1974) (at p. 19). *See, also, In re Revision of Rates by Redi-Flo Corporation*, 76 N.J. 21 (1978).

These cases make it clear that utility rates are best set or adjusted within the context of a full rate proceeding. In such a proceeding, the Board can make findings related to the appropriate test year, rate base, test year operating income, and appropriate rate of return. By consolidating NJAWC's base rate case with proceedings under the Order, the Board would more closely adhere to the legal precepts discussed in this section, and followed by the Board relative to TRA-86.

IV. NJAWC Has Made Proposals in its Rate Case which Will Smooth out Rates and Benefit Customers in the Near Term and Foreseeable Future.

On February 8, 2018 NJAWC filed the "Tax Act Supplemental Direct Testimony of John S. Tomac Regarding Tax Law Changes" (the "Tomac Testimony"). Submitted with this letter memorandum is a Certification by John S. Tomac, Senior Director of Rates & Regulation for NJAWC. Mr. Tomac certifies as to the truth of the statements contained in this Memorandum. Succinctly stated, NJAWC has already begun the process of addressing the Tax Act in its rate case with the prospect of a conclusion by July 1, 2018. In pertinent part, Mr. Tomac's testimony states as follows:

8.Q. In light of this pending base rate case proceeding, is it appropriate to issue a rate reduction effective April 1, 2018 as a result of the TCJA, as provided in the Board's recent order in Docket No. AX18010001.

A. No, for several reasons. First, implementing a rate reduction effective April 1, 2018, of the deferral of the tax expense reduction for the period January 1, 2018 to March 31, 2018, as described in the Board's TCJA Order, while the Company's anticipated rate increase in its pending rate case is expected to occur two months later, in or about July 2018, will create confusion about pricing and cause issues with customer budgeting. In addition to the instant filing, the Company has recently provided its 9+3 Update. Settlement negotiations are scheduled to occur in late February and early March, and it is anticipated that a settlement in the rate case will be achieved in time for the Board to issue an order in this proceeding at its June agenda meeting, with rates effective July 1, 2018. Additionally, as I explain in my testimony, implementing a rate reduction before the conclusion of the Company's rate case will also impact the Company's filed pro forma revenues, making the "yo-yo effect" of a rate decrease that is promptly followed by a rate increase even more pronounced. NJAWC believes clearer, more accurate pricing signals would result if the effects of the TCJA were resolved within its open rate case because there will be clear messaging about the pricing of the Company's water service.

Second, by addressing the impact of the TCJA in the context of the Company's rate case, the Board would be able to make its determination on this issue by applying its well-established ratemaking concepts that rates must be set through a determination of just and reasonable rates, based upon findings of

rate base, prospective operating income, and fair rate of return. The Board would have the information that is included in a test year that coincides more closely with the passage of the TCJA (the twelve months ending March 31, 2018), rather than the historical outcome of the Company's last base rate case proceeding, which was concluded in September 2015. Consolidating the effect of the Tax Act with the pending base rate case's consideration is also more efficient with regard to resource allocation of staff and consultants for the BPU, Rate Counsel, and the Company.

Finally, as described in my testimony below, the Company is proposing to utilize straight tax expense savings resulting from the enactment of the TCJA to offset future ratepayer obligations that would otherwise would be paid over future periods. As noted herein, the net impact of the straight tax savings and expense offsets would result in a reduction to the Company's 9&3 Updated revenue requirement totaling \$18.25 million, a decrease of 13.4% in proposed revenue increase. These proposals, along with the Company's request for deferral accounting for the TCJA's effect on its ADIT balances, merit consideration within the context of its pending rate case proceeding.

* * *

16.Q. Please explain the “yo-yo effect” that would occur if the Company implemented a rate reduction effective April 1, 2018, followed by a rate increase resulting from the conclusion of the Company's pending base rate case.

A. Per the BPU Order in Docket No. AX18010001, companies are required to implement tariff rates effective April 1, 2018 that reflect the lowered income tax rate being in effect as of January 1, 2018. As mentioned above, this amounts to an annual revenue requirement decrease of approximately \$42.6 million for base rates and DSIC. With revenues in base rates of \$634,919,006 and DSIC revenues of \$32,570,922 for New Jersey American Water, plus \$10,911,534 for the former Shorelands Water Company, this amounts to a rate decrease of approximately 6.3%. Per the procedural schedule set in the Company's current base rate proceeding, it is expected that the rate case may be concluded as soon as July 2018 if a settlement is reached between the parties. Applying a rate decrease on April 1, 2018 of 6.3% only to increase rates again on July 1, 2018 a few months later will cause customer confusion and a likely increase in customer calls to the BPU and the Company to explain the fluctuations. *The rate volatility will also create issues in customers' budgeting for their water bills as we enter the summer*

*months, where customer usage tends to increase materially.
(Emphasis Added)*

* * *

17.Q. Does NJAWC believe that its customers should realize the benefits created by the TCJA?

A. Yes. As a general matter, both the current and deferred effects resulting from reduction in the federal corporate tax rate from 35 percent to 21 percent will reduce NJAWC's federal tax expense. Given that federal tax expense is part of NJAWC's current rates, NJAWC believes that its customers should realize the benefits of the reduced tax rate. This can most readily be done by adjusting the revenue requirement in the current case, and providing a levelizing effect on customer rates. The Act gives us a unique opportunity to benefit customers by reducing rates, while eliminating future obligations and implementing a smoothing of rate impacts.

Further, given that major federal tax overhauls seem to occur only every 30 years or so, it is inappropriate to give the benefits from this legislation only to today's customers. NJAWC proposes to apply these benefits to reduce costs to customers into the future. For example, by using these benefits to accelerate and pay for a cost of removal asset with the tax benefits, rather than over 32 years, the Company is benefitting future customers. This brings about generational equity.

* * *

24.Q. If the proposals in your testimony were adopted, what would be the result?

A. If the Company's proposals regarding the application of the tax expense savings in this rate case and the request for deferral accounting are approved, then the full quantifiable benefits of the 2017 TCJA would be provided to customers, in the form of a reduction to the overall revenue requirement requested in this case by NJAWC and in the further benefits to customers in the Company's next base rate case, as a result of deferral accounting. Thus, NJAWC's customers would reap the full benefits of the TCJA and enjoy more affordable water service.

V. Relief Requested.

NJAWC requests that the Board issue an Order accomplishing the following things:

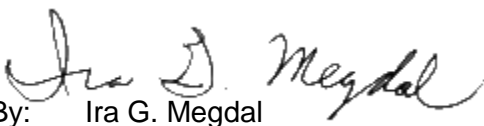
- Consolidate NJAWC's base rate case with the BPU's generic tax proceeding, to the extent this generic tax proceeding pertains to NJAWC.
- Grant relief from the requirement that NJAWC must file by March 2, 2018, reduced rates to be effective April 1, 2018.

VI. Conclusion.

NJAWC has a pending rate case, which is reasonably anticipated to be resolved and implemented as of July 1, 2018. This rate case affords the Board the opportunity to address the implications of the Tax Act on NJAWC in this rate case, while avoiding significant disruptions to customer bills. Moreover, it affords the Board and the parties to the base rate case the opportunity to explore the implications of the Tax Act in a ratemaking proceeding, during which the books and records of NJAWC are open to the parties. It also affords the opportunity for substantive analysis and application of Tax Act benefits to current and future customers in a manner that is equitable to all.

Respectfully,

COZEN O'CONNOR, PC


By: Ira G. Megdal

IGM:kn

cc: See Attached List (via email)