

August 9, 2007

Via Hand Delivery

Honorable Kristi Izzo, Secretary
Board of Public Utilities
Two Gateway Center
Newark, New Jersey 07102

IN THE MATTER OF THE PETITION OF AQUA NEW JERSEY, INC.
FOR AUTHORITY (1) TO MAKE, EXECUTE AND DELIVER TO U.S.
BANK, NATIONAL ASSOCIATION, AS TRUSTEE, A
SUPPLEMENTAL INDENTURE TO AN ORIGINAL INDENTURE AS
OF OCTOBER 1, 1957, AND (2) TO ISSUE UP TO \$4,000,000
PRINCIPAL AMOUNT OF FIRST MORTGAGE BONDS
BPU Docket No. WF07030196

Dear Secretary Izzo:

Please accept for filing an original and ten copies of these comments filed on behalf of the Department of the Public Advocate, Division of Rate Counsel (“Rate Counsel”) regarding the above-referenced matter. Enclosed is one additional copy. Please date stamp the copy as “filed” and return it to the courier. Thank you for your consideration and attention to this matter.

Background

On March 21, 2007, Aqua New Jersey, Inc. (“Aqua NJ” or “Company”) filed a Petition with the State of New Jersey, Board of Public Utilities (“BPU” or “Board”), requesting its approval for authority 1) to make, execute and deliver to U.S. Bank, National Association, as Trustee, Supplemental Indenture “Q” to an original indenture dated as of October 1, 1957 (“Original Indenture”, and together with the Supplemental “Q” Indenture, the “Indenture”); 2) to issue, by private placement, up to \$4,000,000 principal amount of First Mortgage Bonds Series T (“2007 Bonds”); and 3) to take the actions necessary to accomplish the aforementioned transactions.¹ On June 28, 2007, the Company’s Board of Directors passed a resolution authorizing the issuance of the 2007 Bonds and approving other actions related thereto.² The Company will use the proceeds of the issuance to redeem its First Mortgage Bonds Series H (“Existing Debt”), and to finance expenses incurred in the issuance and sale of the 2007 Bonds.³

Aqua NJ, formerly Consumers New Jersey Water Company (“CNJ”), is a wholly owned subsidiary of Aqua America, Inc. (“Aqua America”). Aqua America is the holding company for water and wastewater utilities that, together with the Company, serve approximately 2.8 million residents in 13 states, including New Jersey.⁴ Aqua NJ provides potable water and wastewater services to 150,000 residents in 18 New Jersey municipalities in Warren, Hunterdon, Mercer, Burlington, Monmouth, Ocean, Camden,

¹ Petition, para. 2.

² Response to RCR-11.

³ Id.

⁴ Id.

Gloucester, and Sussex Counties. The Company also provides operations and management contract services to other water and wastewater operators.⁵

Analysis

The Company has already solicited bids for the 2007 Bonds and determined it will issue and sell the 2007 Bonds to Mutual of Omaha (“MO”), subject to terms and conditions to be set forth in the Indenture, and to the terms and conditions of a bond purchase agreement to be entered into between the Company and MO.⁶ The 2007 Bonds will be issuable in fully registered form in the single amount of \$3,800,000, will be dated as set forth in Supplemental Indenture “Q” (but no earlier than September 1, 2007), will bear interest from their dated date at an annual rate of 5.8%⁷ (which interest will be payable semi-annually), will have a term of 30 years, and will be subject to other terms and conditions as set forth in the Indenture.⁸ Bids were solicited by The Royal Bank of Scotland as the placement agent.⁹

The Existing Debt that the Company proposes to redeem using the net proceeds of the proposed issuance was issued on October 24, 1990 in the principal amount of \$4,000,000 at an interest rate of 9.73% and a maturity date of September 15, 2020, with annual sinking fund payments of \$200,000 commencing September 15, 2006.¹⁰ The Existing Debt has a current balance of \$3,800,000, has an annual interest expense of \$369,740, and is currently

⁵ Id.

⁶ Response to RCR-11.

⁷ Note: The Company estimated an interest rate of 6.00% in its Petition for the 2007 Bonds.

⁸ Response to RCR-11.

⁹ Response to OCE-1.

¹⁰ Petition, para. 3.

subject to redemption at 104.662%, which would require a redemption premium of \$177,156.¹¹

In its Petition, the Company estimated annual interest expense of \$228,000 on the 2007 Bonds, based on an estimated coupon rate of 6.00%.^{12 13} The actual interest expense will be somewhat less, since the 2007 Bonds will carry interest at a rate of 5.8%.

Following are the short-term debt balances for Aqua NJ and Aqua America at:¹⁴

	<u>Aqua NJ</u>	<u>Aqua America</u>
December 31, 2006	\$6,500,000	\$119,150,000
December 31, 2005	\$9,500,000	\$138,505,000
December 31, 2004	\$100,000	\$74,810,000

Aqua NJ's targeted capital structure is 50% debt and 50% equity.¹⁵ Following are the capital structures for Aqua NJ and Aqua America at March 31, 2007:¹⁶

	<u>Aqua NJ</u>	<u>%</u>	<u>Aqua America</u>	<u>%</u>
Debt	\$50,368,000	54	\$1,202,435,000	56.4
Equity	<u>\$43,043,000</u>	<u>46</u>	<u>\$928,164,000</u>	<u>43.6</u>
	\$93,411,000	100	\$2,130,599,000	100

Following is the Company's actual and pro forma capitalization at December 31, 2006 giving effect to the issuance of 2007 Bonds:¹⁷

¹¹ Id.

¹² Id., para. 3.

¹³ Note: The June 27, 2007 Board of Directors' resolution provided in response to RCR-11 states the 2007 Bonds will actually "bear interest at a rate of 5.8% per annum."

¹⁴ Response to RCR-7.

¹⁵ Response to RCR-1.

¹⁶ Response to RCR-2.

¹⁷ Petition, Exh. F.

	Actual at Dec. 31, 2006		Adjusted Amounts	Adjusted at June 30, 2007	
	Amount	%		Amount	%
Common Shareholders' Investment:					
Common Stock	\$ 3,603,125	3.89%	\$ -	\$ 3,603,125	3.73%
Amounts > Par Value	24,632,107	26.59%	-	24,632,107	25.47%
Reinvested Earnings	16,987,329	18.34%	1,120,000	18,107,329	18.72%
	45,222,561	48.82%	1,120,000	46,342,561	47.92%
First Mortgage Bonds:					
Series "H", 9.73% due 2020 (a)	3,800,000	4.10%	(3,800,000)	-	0.00%
Series "K", 8.14% due 2025	7,500,000	8.10%		7,500,000	7.76%
Series "L", Loan A, 5.00% due 2020 (b)	415,000	0.45%		415,000	0.43%
Series "L", Loan B, 5.00% due 2020 (b)	1,130,000	1.22%		1,130,000	1.17%
Series "L", Loan C, 0.00% due 2020 (b)	325,476	0.35%	(5,908)	319,568	0.33%
Series "L", Loan D, 0.00% due 2020 (b)	870,094	0.94%	(15,804)	854,290	0.88%
Series "M", 5.87% due 2012	6,000,000	6.48%		6,000,000	6.20%
Series "N", 5.10% due 2032	5,330,000	5.75%		5,330,000	5.51%
Series "O", 5.00% due 2032	1,670,000	1.80%		1,670,000	1.73%
Series "P", 4.44% due 2024 (c)	1,250,000	1.35%		1,250,000	1.29%
Series "Q", 0.00% due 2024 (d)	1,089,955	1.18%	(16,041)	1,073,914	1.11%
Series "R", 5.14% due 2019	5,000,000	5.40%		5,000,000	5.17%
Series "S", 6.23% due 2036	6,000,000	6.48%		6,000,000	6.20%
Berkeley Acquisition 0.00%	525,170	0.57%		525,170	0.54%
Series "T", 6.00% due 2037	-	0.00%	3,800,000	3,800,000	3.93%
	40,905,695	44.16%	(37,753)	40,867,942	42.26%
Short-Term Debt	6,500,000	7.02%	3,000,000	9,500,000	9.82%
Total Capitalization	\$ 92,628,256	100.00%	\$4,082,247	\$ 96,710,503	100.00%

Notes:

- The Petition at para. 5e, indicates a total principal amount of \$4,000,000 for Series "H" bonds at Dec. 31, 2006.
- The Petition at para. 5e, indicates a total principal amount of \$3,056,000 for Series "L", whereas Exh. F indicates a total principal amount of \$2,740,570 for Series "L" bonds at Dec. 31, 2006.
- The Petition at para. 5e, indicates a total principal amount of \$1,300,000 for Series "P" bonds at Dec. 31, 2006.
- The Petition at para. 5e, indicates a total principal amount of \$1,135,000 for Series "Q" bonds at Dec. 31, 2006.

Following is the Company's interest coverage at the twelve months ended

December 31, 2006:¹⁸

	Actual	Adjustments*	Pro Forma
Gross Operating Revenues	\$ 23,354,044	(C)	\$ 23,354,044

¹⁸ Petition, Exh. B.

Non-Operating Revenues (A)	524,528		524,528
	<u>\$ 23,878,572</u>	\$ -	<u>\$ 23,878,572</u>
Operating Expenses:			
Operations Expense	9,224,244		9,224,244
Maintenance Expense (B)	1,167,702		1,167,702
Depreciation	4,017,585		4,017,585
Taxes Other Than Income	3,239,321		3,239,321
	<u>\$ 17,648,852</u>	\$ -	<u>\$ 17,648,852</u>
Net Earnings Available for Interest Coverage	<u>\$ 6,229,720</u>	<u>\$ -</u>	<u>\$ 6,229,720</u>
Interest on Secured Debt	<u>\$ 2,107,279</u>	<u>\$ 202,301</u>	<u>\$ 2,309,580</u>
Interest Coverage	<u>2.96</u>	x	<u>2.70</u> x

* Adjustments are in accordance with para. 1 of Subdivision (B) of Section 2.3 of the Original Indenture, as amended.

Notes:

(A) For the purpose of the interest coverage calculation, net Non-Operating Revenues shall not exceed fifteen percent (15%) of Net Earnings.

(B) In the event that the actual expenditures for ordinary maintenance and repairs shall have been less than five percent (5%) of Gross Operating Revenues, then for the purpose of this calculation five percent (5%) must be used.

The incremental interest expense of \$202,301 shown above is based on expected interest savings of \$141,740 for the 2007 Bonds relative to the debt being replaced, plus interest of \$344,041 relating to Series D debt that was issued in December 2006 in the amount of \$6,000,000 at an interest rate of 6.23%.

Following are the Company's capital expenditures for the past five years.¹⁹

2002	\$9,709,000
2003	\$6,733,000
2004	\$8,500,000
2005	\$12,011,000
2006	\$14,293,000

¹⁹ Response to RCR-3.

Following are the Company's anticipated capital expenditures for the next five years.^{20 21}

2007	\$10,268,000
2008	\$12,298,000
2009	\$ 9,790,000
2010	\$ 7,198,000
2011	\$ 5,178,000

Aqua NJ proposes to offer the 2007 Bonds through a private placement, stating that the Board has approved similar private placement transactions proposed by the Company in the past.²² The Company states that private placement is the appropriate offering vehicle for the subject financing owing to i) the relatively small size of the proposed issue; ii) the Company's stock is privately held, not publicly traded, so it neither files SEC reports nor is subject to the same scrutiny by security analysts following public companies; and iii) a private placement would be substantially less expensive than a public offering.²³ Following is the Company's estimated cost savings for private placement versus a public offering:²⁴

	Public Offering	Private Placement	Savings
Legal Fees	\$50,000	\$20,000	\$30,000
Bond Purchaser's Counsel	40,000	18,000	22,000
Regulatory Counsel	20,000	10,000	10,000 *
Underwriter's Fee	100,000	0	100,000
Placement Agent's Fee	0	50,000	(50,000)

²⁰ Response to RCR-4.

²¹ Note: The Company states these projections are subject to change based on "numerous factors, including system demands, changing regulations and technological advances." Response to RCR-4.

²² Petition, para. 4.

²³ Id.

²⁴ Id., Exh. J.

Bond Rating Fee	7,500	0	7,500
Accounting Letter	10,000	0	10,000
Redemption Premium	177,156	177,156	0
Printing	10,000	1,000	9,000
Miscellaneous	10,000	5,000	5,000
	<u>\$424,656</u>	<u>\$281,156</u>	<u>\$143,500 *</u>

* Exh. J. to the Company's Petition shows no dollar savings for Regulatory Counsel, and computes overall savings of \$133,500, or \$10,000 less than what this actual calculation shows.

The Company estimates total net present value savings of \$2,360,712.22 resulting from the proposed transaction, as shown below:²⁵

<u>Date</u>	<u>9.73% Prior Debt Service</u>	<u>Interest Portion</u>	<u>6.00%* Refinancing Interest Portion</u>	<u>Difference/ Savings on Interest Portion</u>	<u>Difference/ Savings on Total Debt Service</u>
9/15/2007	384,8700	184,870	114,000	70,870	270,870
3/15/2008	175,140	175,140	114,000	61,140	61,140
9/15/2008	375,140	175,140	114,000	61,140	261,140
3/15/2009	165,410	165,410	114,000	51,410	51,410
9/15/2009	365,410	165,410	114,000	51,410	251,410
3/15/2010	155,680	155,680	114,000	41,680	41,680
9/15/2010	355,680	155,680	114,000	41,680	241,680
3/15/2011	145,950	145,950	114,000	31,950	31,950
9/15/2011	345,950	145,950	114,000	31,950	231,950
3/15/2012	136,220	136,220	114,000	22,220	22,220
9/15/2012	336,220	136,220	114,000	22,220	222,220
3/15/2013	126,490	126,490	114,000	12,490	12,490
9/15/2013	326,490	126,490	114,000	12,490	212,490
3/15/2014	116,760	116,760	114,000	2,760	2,760
9/15/2014	316,760	116,760	114,000	2,760	202,760
3/15/2015	107,030	107,030	114,000	(6,970)	(6,970)

²⁵ Id.

9/15/2015	307,030	107,030	114,000	(6,970)	193,030
3/15/2016	97,300	97,300	114,000	(16,700)	(16,700)
9/15/2016	297,300	97,300	114,000	(16,700)	183,300
3/15/2017	87,570	87,570	114,000	(26,430)	(26,430)
9/15/2017	287,570	87,570	114,000	(26,430)	173,570
3/15/2018	77,840	77,840	114,000	(36,160)	(36,160)
9/15/2018	277,840	77,840	114,000	(36,160)	163,840
3/15/2019	68,110	68,110	114,000	(45,890)	(45,890)
9/15/2019	268,110	68,110	114,000	(45,890)	154,110
3/15/2020	58,380	58,380	114,000	(55,620)	(55,620)
9/15/2020	1,258,380	58,380	114,000	(55,620)	1,144,380
	<u>7,020,630</u>	<u>3,220,630</u>	<u>3,078,000</u>	<u>142,630</u>	<u>3,942,630</u>

Present Value of savings from cash flow	\$253,005	<u>\$2,641,868</u>
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Present Value of savings from cash flow	\$2,641,868
Less: Redemption Premium	(177,156)
Less: Issuance Costs	(104,000)
Net Present Value Savings	<u><u>\$2,360,712</u></u>

* The June 27, 2007 Board of Directors' resolution provided in response to RCR-11 states the 2007 Bonds will actually "bear interest at a rate of 5.8% per annum."

The Company anticipates making its next debt approval request to the Board in the fourth quarter of 2007.²⁶

Recommendation

Rate Counsel has reviewed the Petition and is not opposed to its approval. The Company supplies water to homes and businesses in 18 municipalities located in eight New Jersey counties and can bring the necessary resources to bear in properly and adequately serving its customers. Also, as a subsidiary of Aqua America, the Company has access to additional managerial, technical, and financial resources furthering its ability to serve its customers in a safe and proper manner.

²⁶ Response to RCR-5.

Moreover, the 2007 Bonds will replace existing debt, so there will not be any negative impacts to the Company's capital structure. The 2007 Bonds will also result in interest savings, which will be reflected in the Company's capital costs when it files its next base rate case.

Approval of the Petition should not include authorization to include in rate base any specific assets that may be acquired as a result of this Petition. The determination of any assets to be included in rate base and the ratemaking impact of serving customers, therefore, should be addressed in a future base rate proceeding. Accordingly, Rate Counsel recommends that any Board Order approving the Company's Petition contain the following language:

1. This Board's approval is limited to the offering of 2007 Bonds in the amount of \$4,000,000 for sale on a long-term basis, at an interest rate of no more than 6.0%, through Private Placement.
2. This Order shall not be construed as directly or indirectly fixing, for any purposes whatsoever, any value of any tangible or intangible assets now owned or hereafter to be owned by the Company.
3. This Order shall not affect nor in any way limit the exercise of the authority of the Board, or of the State of New Jersey, in any future petition or in any proceedings with respect to rates, franchises, services, financing (including the method of sale of securities), accounting, capitalization, depreciation, or in any other matters affecting the Company.
4. No franchise or right is proposed to be capitalized, directly or indirectly, as a result of, or in connection with the sale of the securities referred to herein.
5. The authority granted in this Order shall become null and void and of no effect with respect to any portion thereof that is not exercised by December 31, 2007.

These provisions will satisfy the concerns of Rate Counsel that BPU approval is limited to the transactions as herein described, and does not indicate authorization to

include any specific assets or amounts in rate base, or indicate authorization for any other ratemaking treatment.

Respectfully Submitted,

RONALD K. CHEN
PUBLIC ADVOCATE OF NEW JERSEY

Kimberly K. Holmes, Esq.
Acting Director, Rate Counsel

By: _____
Christine M. Juarez
Assistant Deputy Public Advocate