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STEFANIE A. BRAND
Director

January 31, 2011

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 United Water New Jersey for
Authority to Issue and Sell up to \$75 Million Dollars Principal
Amount Taxable Bonds
BPU Docket No. WF10120914**

Dear Secretary Izzo:

Please accept for filing an original and ten copies of these comments filed on behalf of the New Jersey 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 December 6, 2010, United Water New Jersey (“United” or the “Company”) submitted a petition to the Board of Public Utilities (“BPU” or “Board”) seeking authority to issue up to \$75,000,000 in long-term debt. The net proceeds from the sale and delivery of the Bonds will be applied to the redemption of \$40 million of the Company’s tax-exempt First Mortgage bonds; \$26 million worth of short-term debt; and \$9 million of preferred stock. The Petition claimed that these proposed redemptions will allow the Company to lower its overall cost of capital as well as reduce interest rate risk while providing quality service.

Specifically, United seeks authority to (a) issue and deliver, by private placement with a placement agent, up to \$75 million in aggregate principal amount of promissory notes to support the issuance and sale of up to \$75 million principal amount of taxable bonds, in one or more series (“the Bonds”) with a final maturity of each not to exceed thirty years from date of issue; (b) to secure the Bonds by the Company’s promissory notes; (c) to amortize the costs associated with the \$75 million principle amount of the taxable Bonds; (d) to amortize any of the unamortized costs associated with the existing \$40 million of tax-exempt First Mortgage bonds over the life of the Bonds; and (e) to amortize the premium to be paid and any unamortized costs on the preferred stock over the life of the new debt. Petition, para. 3.

The Company intends to issue and deliver the bonds through private placement using Bank of America as the placement agent. Petition, Exhibit I. Bank of America appears to be the largest placement agent in the country, having placed almost fifty percent more dollar volume than their closest competitor. *Id.* Bank of America’s

placement fee is .5% of the principal amount of the bonds issued. *Id.* The Company provided information that a .5% fee is standard for deals of this size.

In a competitive private placement, the Company selects a placement agent to market and solicit bids from at least ten or fifteen potential investors. Response to Rate Counsel verbal discovery request 1/28/11. The placement agent then makes a recommendation to the Company for choosing the most cost-effective bid. *Id.* The Company believes that a private placement will secure the lowest possible interest rate and best terms for the sale of the bonds, because numerous investors are competing for the opportunity to purchase the bonds. *Id.*

The Company considered other alternatives for issuing the bonds. In addition to a competitive private placement, the Company considered doing a negotiated sale. With a negotiated sale, the Company would have selected its underwriter in advance, been given a bid from that underwriter on a pre-determined pricing day, and then would have decided whether or not to accept that bid. The disadvantage of the negotiated sale is that, unlike a private placement, the Company would not have access to a large number of investors. Response to Rate Counsel verbal discovery request 1/28/11.

The Company also asserts that private placement of the bonds is more cost-effective than the alternative of tax-exempt financing. *Id.* The Company has represented to Rate Counsel that the interest rates on tax-exempt financings are actually higher than interest rates on comparable non-tax-exempt financings. According to the Company, this is mainly due to the fact that beginning in 2011, tax-exempt bonds are now subject to the Alternative Minimum Tax.

Rate Counsel Recommendation

Rate Counsel does not object to the Board's approval of the Company's petition. The Company represents that it will be able to place the proposed \$75 million debt issue at a cost rate between 100 and 150 basis points over Treasuries, depending on the duration. Response to Staff Request 1. This translates into interest rates on the refinanced bonds between 4.5% and 5.0%. *Id.* The \$40 million in bonds proposed to be refinanced have an interest rate of 5.85%. Assuming an interest rate of 5.0% on the new bonds, the lower interest rate will result in an interest expense savings of \$340,000 per year, with a net present value savings of \$3.1 million over the life of the bonds. Response to Staff Request 2. This interest expense savings only applies to the \$40 million of refinanced bonds. There will be additional expense savings resulting from the redemption of \$9 million of preferred stock, which currently carries a cost rate of 6.97%. Petition, para. 4(b).

The proposed debt issue would also increase the Company's long term debt ratio and reduce the Company's equity ratio in its capital structure, resulting in a lower overall rate of return. Specifically, the Company's rate of return would be reduced from 8.05% to 7.89%. RCR-9. The proposed issuance would also result in a small increase in the Company's current net income. RCR-8. These are all benefits that the Company will receive if it is able to refinance the bonds at a cost rate of 5.0% or lower.

Rate Counsel is satisfied that private placement of the bonds with Bank of America serving as the placement agent is an acceptable option for placing the bonds. Rate Counsel notes that approval of this petition would not result in approval of any underlying asset, rate base addition, or capital expenditure. These issues should be

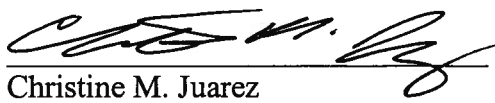
examined in United's next base rate proceeding. Rate Counsel recommends the inclusion of the following language in the Board Order:

1. The Board's approval is limited to the issuance of bonds in the amount of \$75 million for sale on a long-term basis, at an interest rate of no more than 5.0%.
2. The Board's approval of the petition does not constitute pre-approval of any cost recovery from retail customers or rate setting authority.
3. 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.
4. 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.
5. The authority granted in this Order shall become null and void if not exercised by June 30, 2011.

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,

STEFANIE A. BRAND
Director, Division of Rate Counsel

By: 
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Assistant Deputy Rate Counsel

**I/M/O Petition of United Water
New Jersey Inc. for Authority to
Issue and Sell up to \$75 Million
Dollars Principal Amount Taxable
Bonds**

BPU Docket No. WF10120914

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****Receives all correspondence except
discovery.***