



STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102
www.bpu.state.nj.us

)	<u>WATER</u>
IN THE MATTER OF THE PETITION OF)	
AQUA, NEW JERSEY, INC., FOR APPROVAL)	ORDER MODIFYING IN PART
OF AN INCREASE IN RATES FOR WATER)	AND ADOPTING IN PART INITIAL
SERVICE AND OTHER TARIFF CHANGES)	DECISION AND ADOPTING
AND;)	STIPULATION OF SETTLEMENT
IN THE MATTER OF THE PETITION OF)	
AQUA, NEW JERSEY, INC., FOR APPROVAL)	BPU DOCKET NO. WR05121022
OF DEFERRED ACCOUNTING TREATMENT FOR))	OAL DOCKET NO. PUC 3338-06
CERTAIN COSTS RELATED TO WATER QUALITY))	
TREATMENT FOR RADIO NUCLIDES)	BPU DOCKET NO. WR06120897

(SERVICE LIST ATTACHED)

BY THE BOARD:

On December 8, 2005, Aqua New Jersey, Inc. (f/k/a Consumers New Jersey Water Company) (Aqua or Company), a public utility corporation of the State of New Jersey subject to the jurisdiction of the Board of Public Utilities (Board) filed a petition with the Board pursuant to N.J.S.A. 48:2-21 and N.J.A.C. 14:1-5.11 and 5.12 which requested an increase in rates and charges for water service. The Company proposed an increase in rates for the purpose of producing additional revenues of approximately \$4,162,884 or approximately 18.73% above the annual level of revenues for the pro forma test year ending April 30, 2006.

On December 29, 2006, the Company filed a petition with the Board (WR06120897) requesting permission for deferred accounting treatment for certain costs related to the treatment of affected wells in the Southern and Central Divisions for radium levels in excess of the maximum contaminant level (MCL) allowed by State and Federal environmental regulations.

The Company is engaged in the business of collecting, treating and distributing water for retail service to more than 44,000 customers. The Company is also engaged in the wastewater collection, treatment and transmission business and currently provides service to more than 4,000 customers. The rates for wastewater service are not the subject of this petition. The Company's customers are located in several municipalities in Warren, Hunterdon, Mercer, Burlington, Monmouth, Camden, Ocean, Sussex and Gloucester counties. The Company recently acquired the assets of the Berkeley Water Company (Berkeley) under Docket No. WM04121767 and dated October 18, 2005 (subsequently modified on November 14, 2005).

For the Company's residential customer service, the proposed increase would result in an increase in rates from the current annual charge of \$342.60 to \$418.96, a difference of \$76.36 per year (from \$85.65 to \$104.74 per quarter).

BACKGROUND/PROCEDURAL HISTORY

The matter was transmitted to the Office of Administrative Law as a contested case pursuant to N.J.S.A. 52:14B-1 et seq. and N.J.S.A. 52:14F-1 et seq. On December 21, 2005, the Board issued an Initial Suspension Order suspending the proposed rates to May 9, 2006. On April 27, 2006, the Board issued a second Suspension Order suspending the proposed rates to September 9, 2006.

The matter was assigned to Administrative Law Judge (ALJ) Barry Frank. On April 7, 2006, Judge Frank held a telephone pre-hearing conference in which counsel for the Company and the statutory parties to the case, the Department of the Public Advocate, Division of Rate Counsel (DPA or Rate Counsel) and Board Staff (Staff) participated. A pre-hearing order was issued on April 11, 2006 setting forth, among other things, the issues to be litigated and the schedule going forward.

Two public hearings were conducted on May 25, 2006 in Bayville, New Jersey and Hamilton, New Jersey. One member of the public appeared at the Hamilton public hearing and the comments centered on the magnitude of the rate increase requested by the Company. Discovery proceeded in the normal course. Evidentiary hearings were held on July 12 and July 13, 2006 before Judge Frank in Newark, New Jersey.

The DPA recommended an overall increase in rates in the amount of \$476,501 or 2.17%. Through briefs, Board Staff recommended an overall increase in rates in the amount of \$1,152,924 or 5.25%. Initial Briefs were filed by all the parties on August 14, 2006. Reply Briefs were filed by all the parties on August 30, 2006. By letter dated September 7, 2006, the Company filed a Supplemental Brief to this proceeding. Board Staff filed a Supplemental Brief to this proceeding on September 19, 2006.

On November 29, 2006, ALJ Frank issued his Initial Decision in the matter. Based upon ALJ's Frank's recommendations, the overall increase in revenues would amount to \$2,806,501 or 12.60% above current rate revenues.

On December 21, 2006, the Board issued an Order of Extension extending the effective date for the ALJ's Initial Decision to February 26, 2007.

Exceptions to the Initial Decision were filed on December 12, 2006, by the Company, the DPA and Board Staff. Replies to the Exceptions were filed on December 19, 2006, by the Company, the DPA and Board Staff.

Subsequent to the filing of the Initial Decision the Parties, the DPA, Company and Board Staff (Signatory Parties) engaged in settlement negotiations. The Parties reached a Settlement on all issues and entered into a Stipulation of Settlement (Stipulation or Settlement) that result in an overall increase of \$2,500,000 representing an 11.22% above current revenues of \$22,276,658.

STIPULATION

As more fully set forth in the attached Stipulation¹, the Stipulation provides that:

1. The Company's total rate base as of October 31, 2006, is agreed to be \$78,000,000. (Settlement Paragraph 1).
2. The Signatory Parties agree that for the purposes of this proceeding only to utilize an overall rate of return of 8.14%, which would result in an overall additional revenue requirement of \$2,500,000. For the purposes of this proceeding only, this overall rate of return is calculated using the Company's current capital structure with long term debt calculated at a rate of 6.236% and equity calculated at a rate of 10.0%. (Settlement Paragraph 2).
3. The Signatory Parties stipulate that a revenue increase for the Company of \$2,500,000 or approximately 11.22% over present rate revenues of \$22,295,658 is an appropriate result of this matter. The Company anticipates this increase being effective on January 17, 2007. The Signatory Parties agree that this revenue requirement should represent a level of revenues necessary to ensure that the Company will continue to provide safe, adequate, and proper water service to its customers. (Settlement Paragraph 3).
4. The Signatory Parties agree that the attached tariff pages (included as Exhibit A), implementing the terms of this Stipulation, should be adopted by the Board in their entirety. The Signatory Parties agree that the consumption rates of the general metered service customers in all the Company's divisions will be made uniform in the Company's next base rate proceeding. Attached as Exhibit B is a Proof of Revenues for the Company. (Settlement Paragraph 4).
5. The Signatory Parties acknowledge that in a separately docketed matter (BPU Docket No. WR06120897) the Company has sought deferred accounting treatment for certain costs related to the treatment of affected wells in its Southern and Central Divisions for radium levels in excess of the maximum contaminant level ("MCL") allowed by state and federal environmental regulations. The Signatory Parties agree that the Company should be permitted to use deferred accounting to track its necessary expenditures. The prudence of these expenditures will be examined in the Company's next base rate proceeding. Further, as part of this Stipulation of Settlement, the Signatory Parties respectfully request that the Board approve the Company's request in the deferred accounting proceeding at the same time the Board considers this matter. The cumulative rate recovery of the \$105,000 of annualized 2006 expenses included in the rates resulting from this case shall be used as an offset to the total amount included in the deferral account so that customers only pay once for those expenses. (Settlement Paragraph 5).
6. The Signatory Parties recommend that the Board approve the proposed net acquisition adjustment (based upon the results of the original cost study related to the acquisition of the Berkeley Water Company's assets) in the amount of \$ 25,607 (to be amortized over 15 years). (Settlement Paragraph 6).

¹ Cited paragraphs referenced are in the settlement documents. This is only a summary, the full settlement document controls, subject to the Board's findings and conclusions contained herein.

7. The Company agrees it will not file a base rate proceeding prior to the start of the fourth quarter of calendar year, 2007. (Settlement Paragraph 7).

DISCUSSIONS AND FINDINGS

The Board, having reviewed ALJ Frank's Initial Decision and the Stipulation of Settlement among the Signatory Parties to this proceeding, FINDS that the Signatory Parties have voluntarily agreed to the Stipulation, that the Stipulation fully disposes of all issues in this proceeding, and is consistent with the law. To the extent that the terms of the Initial Decision are inconsistent with the terms and conditions set forth herein, the Board HEREBY MODIFIES AND REJECTS the ALJ's Initial Decision and ADOPTS the Stipulation attached hereto, as its own, incorporating by reference the terms and conditions as if fully set forth at length herein, subject to the following:

- a. The Company's total rate base as of October 31, 2006, is \$78,000,000.
- b. The overall rate of return of 8.14% shall result in an overall additional revenue requirement of \$2,500,000. The overall rate of return shall include a long term debt rate of 6.236% and equity calculated at a rate of 10.0%.
- c. The revenue requirement increase shall be \$2,500,000 or approximately 11.22% over present rate revenues of \$22,295,658 and represents a level of revenues necessary to ensure that the Company will continue to provide safe, adequate, and proper water service to its customers.
- d. The attached tariff pages implementing the terms of this Stipulation, are hereby adopted by the Board in their entirety. The move to uniform rates with respect to the Company's consumption charges of the general metered service customers in all the Company's divisions will be determined in the Company's next base rate proceeding. The revenue requirement shall be allocated pursuant to the attached proof of revenues (Exhibit B).
- e. The Company shall be permitted to use deferred accounting to track its necessary expenditures related to certain costs to the treatment of affected wells in its Southern and Central Divisions for radium levels in excess of the maximum contaminant levels allowed by state and federal environmental regulations. The prudence of these costs shall be examined in the Company's next base rate proceeding. The cumulative rate recovery of the \$105,000 of annualized 2006 costs included in the rates resulting from this rate case filing shall be used to offset the total amount included in the deferred account so that if the deferred costs are found to be prudent and allowed in rates, customers only pay once for those expenses.
- f. The acquisition adjustment charge is a result of the difference between the purchase price of the assets acquired and the original cost of the assets sold which can result in either a positive acquisition adjustment or a negative acquisition adjustment. The net acquisition adjustment related to the acquisition of the Berkeley Water Company's assets shall be in the amount of \$ 25,607 and shall be amortized over a 15 year period.
- g. The Company shall not file a base rate proceeding prior to start of the fourth quarter of calendar year, 2007.

As a result of the Board's decision in this matter, a residential water customer (using 80,000 gallons of water per year) will experience an increase from \$342.60 per year (\$85.65 per quarter) to \$382.40 per year (\$95.60 per quarter), an increase of \$39.80 annually. This represents an annual increase of 11.61%.

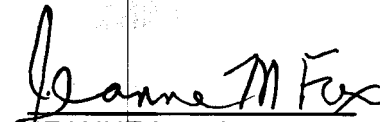
Based upon the foregoing, the Board HEREBY APPROVES an overall increase in revenues in the amount of \$2,500,000 representing an 11.22% increase over current revenues.

The Board HEREBY ORDERS the Company to submit a complete revised tariff conforming to the terms and conditions of the Stipulation and this Order within (10) days from the date of this Order.

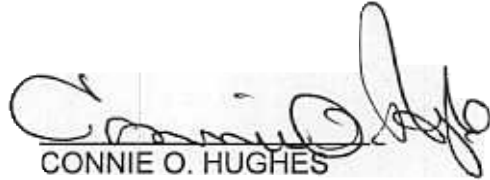
DATED:

1/17/07

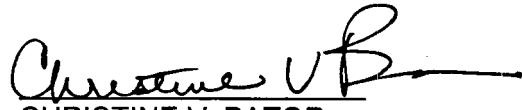
BOARD OF PUBLIC UTILITIES
BY:


JEANNE M. FOX
PRESIDENT


FREDERICK F. BUTLER
COMMISSIONER


CONNIE O. HUGHES
COMMISSIONER

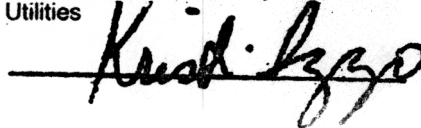

JOSEPH L. FIORDALISO
COMMISSIONER


CHRISTINE V. BATOR
COMMISSIONER

ATTEST:


KRISTI IZZO
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities



I/M/O THE PETITION OF AQUA NEW JERSEY, INC. FOR APPROVAL OF AN
INCREASE IN RATES FOR WATER SERVICE AND OTHER TARIFF CHANGES

BPU DOCKET NO. WR05121022

OAL DOCKET NO. PUC 3338-06

AND

I/M/O THE PETITION OF AQUA, NEW JERSEY, INC., FOR APPROVAL OF
DEFERRED ACCOUNTING TREATMENT FOR CERTAIN COSTS RELATED
TO WATER QUALITY TREATMENT FOR RADIO NUCLIDES

BPU DOCKET NO. WR06120897

Stephen B. Genzer, Esq.
Saul Ewing, LLP
One Riverfront Plaza, 5th Floor
Newark, NJ 07102

Colleen Foley, Esq.
Saul Ewing, LLP
One Riverfront Plaza, 5th Floor
Newark, NJ 07102

Paul Flanagan, Esq.
Department of the Public Advocate
Division of Rate Counsel
P.O. Box 46005
31 Clinton Street, 11th Floor
Newark, NJ 07101

Susan McClure, Esq.
Department of the Public Advocate
Division of Rate Counsel
P.O. Box 46005
31 Clinton Street, 11th Floor
Newark, NJ 07101

Christine Juarez, Esq.
Department of the Public Advocate
Division of Rate Counsel
P.O. Box 46005
31 Clinton Street, 11th Floor
Newark, NJ 07101

Suzana Loncar, SDAG
Department of Law and Public Safety
Division of Law
124 Halsey Street, 5th floor
Newark, NJ 07101

Anne Marie Shatto, DAG
Department of Law and Public Safety
Division of Law
124 Halsey Street, 5th floor
Newark, NJ 07101

Paul R. Adezio, Esquire, Director
Hamilton Township Department of Law
2090 Greenwood Avenue
P.O. Box 00150
Hamilton, NJ 08650-0150

**STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES**

**IN THE MATTER OF THE PETITION
OF AQUA NEW JERSEY, INC. FOR
APPROVAL OF AN INCREASE IN
RATES FOR WATER SERVICE AND
OTHER TARIFF CHANGES**

**:
:
:
:
:
:
:**

**BPU DOCKET NO. WR05121022
OAL DKT. NO. PUCRS 3338-06

STIPULATION OF SETTLEMENT**

APPEARANCES:

Stephen B. Genzer, Esq., and Colleen A. Foley, Esq. Saul Ewing LLP, on behalf of Aqua New Jersey, Inc., Petitioner

Anne Marie Shatto, Esq., Deputy Attorney General, on behalf of the Staff of the Board of Public Utilities

Christine M. Juarez, Esq. Assistant Deputy Public Advocate, and Susan E. McClure, Esq., Assistant Deputy Public Advocate, on behalf of the Department of the Public Advocate, Division of Rate Counsel

Paul Adezio, Esq., on behalf of Participant, Hamilton Township

TO THE HONORABLE BOARD OF PUBLIC UTILITIES:

The Parties in this proceeding are as follows: Aqua New Jersey, Inc. (the "Company" or "Petitioner"), the Department of the Public Advocate, Division of Rate Counsel ("Rate Counsel"), the Staff of the Board of Public Utilities ("Board" or "Staff"), and Participant, Hamilton Township. As a result of an analysis of Petitioner's pre-filed testimony and exhibits, extensive discovery, evidentiary hearings, an Initial Decision issued November 29, 2006, negotiations, and two public hearings held on May 25, 2006, the Company, Board Staff and Rate

Counsel (collectively, the "Signatory Parties") have come to an agreement on the issues in dispute in this matter. The Signatory Parties hereto agree and stipulate as follows:

The procedural history of this matter is as follows:

On December 8, 2005, Petitioner, a public utility corporation of the State of New Jersey, pursuant to N.J.S.A. 48:2-21 and N.J.A.C. 14:1-5.12 and 14:9-7.1 *et seq.*, filed a petition to increase rates for water service and to make other tariff changes. Specifically, the Company requested a rate increase of \$4,162,884 or approximately 18.73% above the adjusted annual level of revenues for the test year ending April 30, 2006. During the pendency of this proceeding, the Company's request was revised to reflect a rate increase of \$4,061,730 or approximately 18.40% above adjusted test year revenues.

On December 21, 2005, the Board entered an Order suspending until May 9, 2006 the implementation of changes Aqua sought to make to its tariffs. On February 8, 2006, the Board transmitted the matter to the Office of Administrative Law ("OAL"), and Administrative Law Judge ("ALJ") Barry N. Frank was assigned to hear the case. A Pre-Hearing Conference was convened by ALJ Frank on April 7, 2006, and a Pre-Hearing Order was issued on April 11,

On April 27, 2006, the Board issued a second order suspending the implementation of proposed rates until September 9, 2006. On May 25, 2006, ALJ Frank issued an order suspending implementation of the proposed rate increase until further order. ALJ Frank issued his Initial Decision on November 29, 2006. On December 21, 2006, the Board entered an Order which has the effect of extending the time for it to act on the Initial Decision until February 26, 2007.

Extensive discovery was conducted by the Parties with the Company providing responses to hundreds of data requests. After proper notice, two public hearings were held in the

service territory on May 25, 2006: one in the afternoon in Berkeley Township; and one in the evening in Hamilton, New Jersey. A member of the public appeared whose comments were heard by the Signatory Parties and the ALJ. The public comments generally concerned the magnitude of the increase requested by the Company.

Evidentiary hearings were held on July 12 and 13, 2006, at the OAL in Newark, New Jersey. During the course of those hearings, the Company presented the following witnesses: Sharon Schulman, Edward Rapciewicz, William Packer, Jack Schreyer, and Pauline Ahern. By agreement of the Parties, the testimony of the Company's witness Richard Russo was incorporated into the record without cross examination. Rate Counsel presented the testimonies of David Parcell and Robert Henkes. By agreement of the Parties, the testimony of Rate Counsel's witness Brian Kalcic was incorporated into the record without cross examination as well. The Staff of the Board did not present any witnesses.

The Signatory Parties filed Initial Briefs on August 14, 2006 and Reply Briefs on August 30, 2006. ALJ Frank issued his Initial Decision on November 29, 2006. The Signatory Parties filed Exceptions to the Initial Decision on December 12, 2006. Replies to Exceptions were filed by the Company and Rate Counsel on December 19, 2006, with Staff filing its Reply on December 20, 2006.

Settlement discussions were held, and the agreements reached during those discussions have resulted in the following stipulation by the Signatory Parties:

1. For purposes of this proceeding only, the Company's total rate base as of October 31, 2006, is agreed to be \$78,000,000.
2. The Signatory Parties agree that for the purposes of this proceeding only, they agree to utilize an overall rate of return of 8.14%, which would result in an overall additional

revenue requirement of \$2,500,000. For the purposes of this proceeding only, this overall rate of return is calculated using the Company's current capital structure with long term debt calculated at rate of 6.236% and equity calculated at rate of 0.0%.

3. The Signatory Parties stipulate that revenue increase for the Company of \$2,500,000 or approximately .22% over present rate revenues of \$22,295,658, is an appropriate result of this matter. The Company anticipates this increase being effective on January 17, 2007. The Signatory Parties agree that this revenue requirement should represent level of revenues necessary to ensure that the Company will continue to provide safe, adequate, and proper water service to its customers.

4. The Signatory Parties agree that the attached tariff pages included as Exhibit A), implementing the terms of this Stipulation, should be adopted by the Board in their entirety. Attached as Exhibit B is Proof of Revenues for the Company. The Signatory Parties agree that the consumption rates of the general metered service customers in all the Company's divisions will be made uniform in the Company's next base rate proceeding.

5. The Signatory Parties acknowledge that in separately docketed matter (BPU Docket No. WR06 20897) the Company has sought deferred accounting treatment for certain costs related to the treatment of affected wells in its Southern and Central Divisions for radium levels in excess of the maximum contaminant level ("MCL") allowed by state and federal environmental regulations. The Signatory Parties agree that the Company should be permitted to deferred accounting to track its necessary expenditures. The prudence of these expenditures will be examined in the Company's next base rate proceeding. Further, as part of this Stipulation of Settlement, the Signatory Parties respectfully request that the Board approve the Company's request in the deferred accounting proceeding at the same time the Board considers this matter.

Any of the \$105,000 of annualized 2006 expenses included in the rates resulting from this case shall be used as an offset to the total amount included in the deferral account so that customers only pay once for those expenses.

6. The Signatory Parties recommend that the Board approve the proposed net acquisition adjustment (based upon the results of the original cost study related to the acquisition of the Berkeley Water Company's assets) in the amount of \$ 25,607 (to be amortized over 15 years).

7. The Company agrees it will not file a base rate proceeding prior to the start of the fourth quarter of calendar year, 2007.


8. This Stipulation is the product of extensive negotiations by the Signatory Parties, and it is an express condition of the settlement embodied by this Stipulation that it be presented to the Board in its entirety without modification or condition. It is also the intent of the Signatory Parties to this Stipulation that this settlement, once accepted and approved by the Board, shall govern all issues specified and agreed to herein. The Signatory Parties to this Stipulation specifically agree that if adopted in its entirety by the Board, no appeal shall be taken by them from the order adopting same as to those issues upon which the Signatory Parties have stipulated herein. The Signatory Parties agree that the within Stipulation reflects mutual balancing of various issues and positions and is intended to be accepted and approved in its entirety. Each term is vital to this Stipulation as a whole, since the Signatory Parties hereto expressly and jointly state that they would not have signed this Stipulation had any terms been modified in any way. In the event any particular aspect of this Stipulation is not accepted and approved by the Board, then any Signatory Party hereto materially affected thereby shall not be bound to proceed under this Stipulation. The Signatory Parties further agree that the purpose of

bound to proceed under this Stipulation. The Signatory Parties further agree that the purpose of this Stipulation is to reach fair and reasonable rates, with any compromises being made in the spirit of reaching an agreement. None of the Signatory Parties shall be prohibited from or prejudiced in arguing a different policy or position before the Board in any other proceeding, as such agreements pertain only to this matter and to no other matter.

9. This Stipulation may be executed in as many counterparts as there are Signatory Parties of this Stipulation, each of which counterparts shall be an original, but all of which shall constitute one and the same instrument.

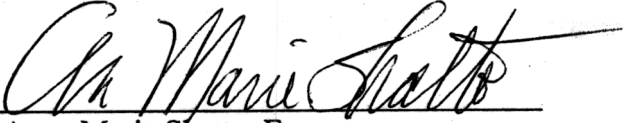
AQUA NEW JERSEY, INC.

1/12/07
Date

By: 
Saul Ewing LLP
Stephen B. Genzer, Esq.
Attorney for Petitioners

STUART RABNER, ESQ.
ATTORNEY GENERAL OF NEW JERSEY

1/12/07
Date

By: 
Anne Marie Shatto, Esq.
Deputy Attorney General

RONALD K. CHEN
PUBLIC ADVOCATE OF NEW JERSEY
DEPARTMENT OF THE PUBLIC ADVOCATE
SEEMA M. SINGH, ESQ.
DIRECTOR, RATE COUNSEL

1/12/07
Date


By: 
Christine M. Juarez, Esq.
Assistant Deputy Public Advocate

Exhibit B

TOTAL QUARTERLY
TOTAL ANNUAL

PUBLIC FIRE INCH FEET:
P-BURG
HAMILTON
B-WOOD

PRIVATE FIRE HYDRANTS:
P-BURG
HAMILTON
B-WOOD
EASTERN

EASTERN PRIVATE FIRE
3" OR ☐
4" ☐
6" ☐
8" ☐
10" ☐
12" ☐
TOTAL PRIVATE FIRE

TOTAL FIXED SERVICE CHARGE	\$	5,576,907
TOTAL CONSUMPTION CHARGE		15,938,276
TOTAL PUBLIC FIRE		1,836,906
TOTAL PRIVATE FIRE		1,030,816
OTHER		412,752

TOTAL REVENUE REQUIREMENT	\$	24,795,658
LESS: FIRE REVENUE, FIXED, & OTHER	\$	(8,857,381)
LESS: BERKELEY COMMODITY		

Present Consumption Revenue	Required % Change
\$14,267,296	11.71%

CNJ
BESLOW
KPA
DAC/AG

SHATTO
SLUTZKY
BELLO
QUIRLO

W05



RECEIVED
CASE MANAGEMENT

2006 NOV 28 PM 4: 2

BOARD OF PUBLIC UTILITIES
NEWARK, N.J.

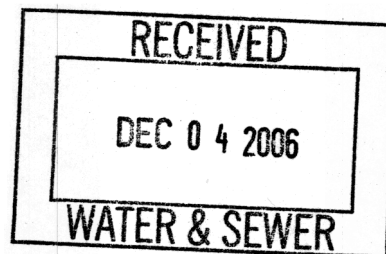
State of New Jersey
OFFICE OF ADMINISTRATIVE LAW

INITIAL DECISION

OAL DKT. NO. PUC 3338-06

AGENCY DKT. NO. WR05121022

IN THE MATTER OF THE PETITION
OF AQUA NEW JERSEY, INC., FOR
APPROVAL OF AN INCREASE IN
RATES FOR WATER SERVICE AND
OTHER TARIFF CHANGES



Stephen B. Genzer, Esq., and Colleen A. Foley, Esq., for petitioner
(Saul Ewing LLP, attorneys)

Susan E. McClure, Esq. and Christine M. Juarez, Esq., for Division of the
Ratepayer Advocate (Seema H. Singh, Director)

Anne Marie Shatto, Deputy Attorney General, for Staff of Board of Public
Utilities (Stuart Rabner, Attorney General of New Jersey, attorney)

Record Closed: September 28, 2006

Decided: November 28, 2006

BEFORE **BARRY N. FRANK, ALJ :**

STATEMENT OF THE CASE

Petitioner filed its petition with the Board of Public Utilities (BPU) December 8, 2005, seeking an increase in per annum revenues of approximately \$4,262,884 or approximately 18.73% using a test year ending April 30, 2006. The Petitioner also proposed several other accounting and cost recovery measures for consideration,

primarily regarding assets it has recently acquired, located in the eastern division, but also regarding a senior citizens program, private fire control tariffs, and smart growth compliance.

PROCEDURAL HISTORY

On December 8, 2005, petitioner Aqua New Jersey, Inc. (hereinafter "Aqua" or "Company") filed a petition to increase rates for water service and to make other tariff changes. Pet. Initial Brief at 3. On December 21, 2005, the Board entered an Order suspending until May 9, 2006 the implementation of changes Aqua sought to make to its tariffs. Id. On April 27, 2006, the Board issued a second order suspending the implementation of proposed rates until September 9, 2006. Id.

On March 14, 2006, the Board transmitted the matter to the Office of Administrative Law ("OAL") for hearing, and the undersigned was assigned to hear the case. Id. A telephone prehearing conference was conducted April 7, 2006, and a Pre-Hearing Order was issued on April 11, 2006, in which the following issues were identified:

"Whether the Petitioner's proposals are reasonable and calculated so as to allow it to continue providing safe, adequate and proper service to its customers." I/M/O the Petition of Aqua New Jersey, Inc. For Approval of an Increase in Rates for Water Service and Other Tariff Changes, Prehearing Order, OAL Docket No. PUC 03338-06.

Two public hearings were conducted on May 25, 2006. The first public hearing was held in the afternoon at the Municipal Building, Berkeley Township, New Jersey, and the second, that evening, at the Hamilton Township Library, Hamilton, New Jersey. Pet. Initial Brief at 4. Only one member of the public at the two meetings spoke in opposition to the proposed rate increase.

Evidentiary hearings were conducted July 12 and 13, 2006 in Newark, New Jersey. Staff Initial Brief at 1. During the course of these hearings, the Company

presented five witnesses: Pauline M. Ahern, CRRA, Vice president, AUS Consultants-Utility Services; Sharon Schulman, President and CEO of the Company; William C. Packer, Jr., Regional Director of Accounting for the Company; Jack Schreyer, Manager of Rates for Aqua America, Inc. and its subsidiaries; and Edward A. Rapsiewicz, Vice President of Operations for the Company. Id. at 1-2. Rate Counsel presented two witnesses: David Parcell, Executive Vice President and Senior Economist of Technical Associates, Inc. and Robert J. Henkes, Principal and Founder of Henkes Consulting. Id. By agreement of the parties, the testimony of Rate Counsel's witness Brian Kalcic was incorporated into the record without cross-examination as well. Pet. Initial Brief at 4. The Staff of the Board did not present any witnesses. Id.

FINDINGS OF FACT

Aqua New Jersey is a utility that provides water service to more than 44,000 customers in the State of New Jersey. Rate Counsel Initial Brief at 1. Aqua New Jersey is a subsidiary of Aqua America. Id. The Company's water customers are located in various municipalities in Warren, Hunterdon, Mercer, Burlington, Monmouth, Camden, Ocean, Sussex and Gloucester Counties. Id. Aqua also provides wastewater service to approximately 4,000 customers in New Jersey, however, rates for wastewater service are not the subject of this current petition. Id.

ISSUES

1. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s capital Structure for purposes of this rate base proceeding?
2. Whether short-term debt, should be included in Aqua New Jersey, Inc.'s capital structure.
3. What is the appropriate rate of return on equity?
4. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s utility plant in service?

5. Whether Aqua New Jersey, Inc. is entitled to recover transaction costs for the acquisition of Berkeley Water Company.
6. Whether Aqua New Jersey, Inc. is entitled to an unamortized acquisition adjustment from the acquisition of Berkeley Water Company.
7. Whether Aqua New Jersey, Inc. is entitled to recover unamortized deferred rate case expenses.
8. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s reserve for depreciation?
9. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s balance of customer advances?
10. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s balance of accumulated deferred income taxes?
11. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s reserve balances (including pension and FAS 106 reserves, as well as tank maintenance reserves)?
12. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s balance of customer deposits?
13. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s balance of metered sales revenues?
14. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s balance of public and private fire revenues?
15. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s balance of power and chemical expenses?

- 16 What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s balance of interest on customer deposits?

What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s balance of depreciation expense?

18. What is the appropriate date to be used for determining Aqua New Jersey, Inc.'s balance of non-income taxes (including GRAFT and property and labor related tax expenses)?

- 19 What percentage of antenna revenues Aqua New Jersey, Inc. is entitled to reflect in its operating income?

Whether Aqua New Jersey, Inc. is entitled to reflect in its operating income any O&M contract revenue.

21. What amount of Labor Expenses is Aqua New Jersey, Inc. entitled to include in its operating income?

What amount of Health, Life, LTD, Pension and OPEB Expenses is Aqua New Jersey, Inc. entitled to include in its operating income?

- 23 What amount of Insurance Expenses is Aqua New Jersey, Inc. entitled to include in its operating income?

What amount of Lease Expenses is Aqua New Jersey, Inc. entitled to include in its operating income?

- 25 What amount of rate case expense is Aqua New Jersey, Inc. entitled to recover?

- 26 What amount of other O&M expenses is Aqua New Jersey, Inc. entitled to recover?

27. What amount of Interest Expense is Aqua New Jersey, Inc. entitled to include in its operating income?
28. What is the proper Income Tax rate to be used by Aqua New Jersey, Inc.?
29. What is the appropriate rate structure that should be used by Aqua New Jersey, Inc. in this rate base proceeding?
30. Whether Aqua New Jersey, Inc.'s proposed Low Income Assistance Program should be implemented.
31. Whether this proceeding should be delayed pending the resolution of the Berkeley Water Company consent issue.

DISCUSSION, FINDINGS AND CONCLUSION

Appropriate Capital Structure


Rate Counsel and Staff propose that the appropriate capital structure of Aqua New Jersey, Inc. for purposes of this rate base case is that structure which is in place on April 30, 2006, including long-term debt, short-term debt and equity. See Rate Counsel Initial Brief at 3; Staff Initial Brief at 5-6; Staff Reply Brief at 4. Rate Counsel also proposes that the appropriate rate of return on Equity should be 9.5%. See Rate Counsel Initial Brief at 7. Rate Counsel came to these conclusions because April 30, 2006 constitutes the end of the actual test year, and thus reflects the most substantial, credible evidence on the record, rather than mere speculation and estimation about what the structure will be in the future. Id. at 4-5. Rate Counsel also uses short-term debt in its structure due to the fact that on April 30, 2006, Aqua's actual capital structure does include short-term debt, and that the Company consistently uses this form of financing. Id. at 5-6. Additionally, Rate Counsel relies on Witness Parcell's calculations, using three approaches, to estimate that the appropriate rate of return on equity would be approximately 9.5%. Id. at 7.

Aqua New Jersey, on the other hand, proposes that the appropriate capital structure is that calculated to be in place on October 31, 2006, including *only* long-term debt and equity. See Pet. Initial Brief at 35-36. Aqua also proposes that the appropriate rate of return on Equity should be 11.5% (Id. at 35), which includes a .25% premium to recognize the Company's favorable policy of acquiring smaller troubled water companies throughout New Jersey. Ahern Direct Test. 2:26-3:3. The Company believes that October 31, 2006 is a better date to use for determining capital structure because, as the proposed rate changes would not go into effect until late 2006, October 31, 2006 would represent a more appropriate date for matching what customers are paying to actual rate base that is in effect. Pet. Initial Brief at 36. Additionally, Aqua argues that short-term debt is not appropriate for inclusion, as the Company uses short-term debt solely as a bridge to acquiring long-term debt financing, and that the rate base which will be in service by October 31 will not be funded at all by short-term debt. Ahern Rebuttal Testimony at 2:22-3:19. Lastly, in order to determine an appropriate rate of return on equity, Aqua relies on Witness Ahern's use of four approaches for determining the cost of equity. That estimation is also given a .25% premium in order to reward the company for implementing risky acquisitions which benefit the State in the long run. Ahern Direct Testimony 2:26-3:3.

The parties agree that the end of the test year is April 30, 2006, and that this test-year data may be adjusted only for "known and measurable" changes, which the Board has defined as "prudent and major in nature and consequence." In re Elizabethtown Water Co., BPU Docket No. WR8504330 (1985). Although the standard is fixed, the application of the standard has historically been flexible. Although Aqua Witness Rapciewicz described the proposed changes as "regular, ongoing, commitments by the Company," he also stated that the investments are necessary to provide safe, adequate and proper service to its customers. Rapciewicz, Hearing Transcript 1 (July 12, 2006), at 52-53. The Board has previously allowed such changes in similar investments when the facilities were essential to providing safe, adequate and proper service. See I/M/O the Petition of Gordon's Corner Water Company for Approval of an Increase in Rates for Water Service and Other Tariff Changes, BPU Docket No. WR00050304 (2001). As Aqua has been forthright about the progress and

costs of the projects with which they've engaged, and as October 31, 2006 will pass by the time this decision is entered, and as allowing these changes represents good policy in giving incentive to the Company to undertake and/or accelerate its new or replacement investments, **I FIND** that October 31, 2006 is the appropriate date for determining Aqua New Jersey's capital structure, for purposes of this rate case.

In a prior Board order, which adopted an OAL decision, it was held that "short-term debt should not be included in the capital structure unless there is clear and convincing evidence to prove that a portion of the jurisdictional rate base was actually financed by the short-term debt." I/M/O the Petition of Middlesex Water for Approval of an Increase in its Rates for Water Service and Other Tariff Changes, BPU Docket No. WR00060362 (2001). As the only evidence shown was that Aqua uses short-term debt to finance some daily operations of the Company, but not to finance any of the rate base, **I FIND** that short-term debt is not to be included in determining Aqua New Jersey, Inc.'s capital structure for purposes of this rate case.

Determining the cost of equity for Aqua New Jersey, Inc. is not a fixed science. Staff Initial Brief, at 6-7. Not only is the cost rate of equity not fixed when issued (unlike stocks or bonds), but a company such as Aqua is not publicly traded. Id. Both of these factors make it necessary to estimate the Company's cost of equity, based on comparisons to similar companies that are publicly traded. Id. Between Witness Parcell and Witness Ahern, seven different calculations were performed in order to attempt to determine an appropriate cost of equity. Id. at 7. Due to the fact that two distinguished economists, using roughly the same tests and methodologies, result in estimations of 9.5% and 11.5%, respectively, an equitable result would be to split the difference, resulting in a rate of return of 10.5%. **I FIND** that the appropriate cost rate of equity for Aqua New Jersey is 10.5%. 

Appropriate Rate Base

Timing

Rate Counsel proposes that the appropriate utility plant in service should be determined as of April 30, 2006. Rate Counsel Initial Brief at 22. They argue that the investments taking place after the April 30, 2006 test-year end are not major in nature or characteristic, but rather merely routine. Id. They also argue that the Company chose to file the rate base case when it did, and for that reason must live with that decision – knowing that post-April 30, 2006 investments would not be included in rate base. Rate Counsel Reply Brief at 3.

Aqua New Jersey proposes that the appropriate utility plant in service should be determined as of October 31, 2006, in order to match rate base with the actual costs and investments in place at the time the service is rendered to customers. Pet. Initial Brief at 10. Additionally, the allowance of utility plant in service on October 31, 2006 will serve as an incentive to investors by allowing an appropriate rate of return on more than \$6 million in investments. Id. at 11.

As discussed above, I find that the changes to the test year *are* appropriate as they are essential to providing safe, adequate and proper service to its customers. It is also appropriate to match the Company's utility plant in service and rate base with its capital structure that is in effect, and which was determined earlier to be October 31, 2006. Allowing a return on these investments is good policy in order to incentivize the Company to improve water service for all customers. **I FIND** that October 31, 2006 is the appropriate date for determining the Company's utility plant in service.

Accordingly, because the appropriate date of determining utility plant in service is October 31, 2006, **I FIND** that the appropriate date in determining the following figures¹ and balancing is also October 31, 2006:

- Aqua New Jersey, Inc.'s appropriate reserve for depreciation (See Pet. Initial Brief at 17; Staff Initial Brief at 20; Rate Counsel Initial Brief at 27).

¹ The parties only disagreed on these figures based on the different cut-off points for recognizing and/or calculating these items. There was no disagreement as to calculations or that the figures should or should not be recognized. Pet. Initial Brief at 3.

- Aqua New Jersey, Inc.'s appropriate balance of customer advances (See Pet. Initial Brief at 17; Staff Initial Brief at 21; Rate Counsel Initial Brief at 27).
- Aqua New Jersey, Inc.'s appropriate balance of accumulated deferred income taxes (See Pet. Initial Brief at 17; Staff Initial Brief at 21; Rate Counsel Initial Brief at 28).
- Aqua New Jersey, Inc.'s appropriate reserve balances (including pension & FAS 106 reserves, as well as tank maintenance reserves (See Pet. Initial Brief at 18; Staff Initial Brief at 23; Rate Counsel Initial Brief at 29).
- Aqua New Jersey, Inc.'s appropriate balance of customer deposits (See Pet. Initial Brief at 18; Staff Initial Brief at 23; Rate Counsel Initial Brief at 29).

Acquisition of Berkeley Water Company

Aqua and Rate Counsel agree that Aqua is entitled to an unamortized acquisition adjustment for the acquisition of Berkeley Water Company. Pet. Reply Brief at 21. Aqua argues that it has been Board practice of allowing such an adjustment, and that doing so is in the public interest, giving utility companies an appropriate and reasonable incentive to acquiring troubled water systems. Pet. Initial Brief at 15.

Staff recommends that Aqua is not entitled to an adjustment because the Company was not urged by the Board to acquire the assets of Berkeley, but rather did so as an independent business decision, and that the acquisition did not have any positive benefits to the Company's customers located outside the Berkeley service territory. Staff Initial Brief at 18-19.

Staff concedes that the Board did find this transaction in the public interest and indicated that Aqua *may*, but is not guaranteed to recover some or all of the transaction costs. Staff Reply Brief at 11. Staff failed to point to any evidence that Aqua was not compelled to acquire the assets, nor that it had any positive benefit to Aqua customers. Petit. Reply Brief at 21. Aqua showed however, that the Board and its Staff did hold

that the transaction was expected to benefit the customers of Aqua. Id. at 22-23. I **FIND** that Aqua is entitled to an unamortized acquisition adjustment for the acquisition of Berkeley Water Company.

Unamortized Deferred Rate Case Expenses

Rate Counsel and Staff agree that Board policy has consistently been to exclude amortized deferred rate cases expense from rate base. See Staff Initial Brief at 19-20, citing I/M/O Environmental Disposal Corp., Docket No. WR99040249 (2000); I/M/O Elizabethtown Water Company, Docket No. 8312-1072 (1984). Rate Counsel Witness Henkes testified that to his understanding, the BPU has never previously allowed this inclusion for such unamortized cost balances. Henkes Direct Testimony at 14:1-5.

Aqua argues that this unamortized deferred rate case expense should be included in the Company's calculation of rate base because it represents an expenditure that was for the direct benefit of the Company's customers, and that the exclusion of which would constitute an unequitable forfeiture. Pet. Initial Brief at 16.

Board policy has been unwavering in holding that unamortized deferred rate case expenses should not be included in rate base. Staff Initial Brief at 19-20. I **FIND** that this case contains no exception to Board policy, and that unamortized deferred rate case expenses will not be included in Aqua's rate base.

Operating Income

Timing

Again the parties argue about the appropriate date for determining certain items included in determining Aqua New Jersey Inc.'s operating income. Parties agree, however, that these items, for matching purposes, should be calculated on the same date as utility plant in service is calculated. Because, as discussed above, it has been determined that October 31, 2006 is the appropriate date for determining utility plant in

service, I **FIND** that the appropriate date for calculating the following figures and balances is also October 31, 2006:


- Aqua New Jersey, Inc.'s appropriate balance of metered sales revenues (See Pet. Initial Brief at 18-19; Staff Initial Brief at 24-25; Rate Counsel Initial Brief at 30-31).
- Aqua New Jersey, Inc.'s appropriate balance of public and private fire revenues (See Petit. Initial Brief, at 18-19; Staff Initial Brief, at 25-27; Rate Counsel Initial Brief, at 31).
- Aqua New Jersey, Inc.'s appropriate balance of power and chemical expenses (See Pet. Initial Brief at 24-25; Staff Initial Brief at 34-36; Rate Counsel Initial Brief at 36-37).
- Aqua New Jersey, Inc.'s appropriate balance of interest on customer deposits (See Pet. Initial Brief at 31; Staff Initial Brief at 51-52; Rate Counsel Initial Brief at 40).
- Aqua New Jersey, Inc.'s appropriate balance of depreciation expense (See Pet. Initial Brief at 32; Rate Counsel Initial Brief at 42).
- Aqua New Jersey, Inc.'s appropriate balance of non-income taxes (including GRAFT and property and labor related tax expenses) (See Pet. Initial Brief at 32-33; Rate Counsel Initial Brief at 42).

Antenna revenues

Rate Counsel and Staff propose that 100% of the Company's revenues from leasing the space atop water towers should be reflected entirely as benefits to the customers. Staff Initial Brief at 29. They argue that customers have shouldered all of the costs to construct and maintain the water towers, and that, as no risk was involved in the antenna endeavors, the Company and its investors hopes to benefit without incurring risk or cost. Rate Counsel Initial Brief at 33. Staff points to a prior Board decision which held that "the Company should not be permitted to use its regulated utility property to engage in unregulated activities without providing appropriate compensation to its ratepayers." Staff Initial Brief at 29-30, citing I/M/O the Petition of

Gordon's Corner Water Company for Approval of an Increase in Rates for Water Service and Other Tariff Changes, BPU Docket No. WR00050304 (2001).

Aqua proposes that revenue from antenna leases should be shared 50/50 between customers and Company investors. Pet. Initial Brief at 20. It argues that giving investors this return will encourage the Company to seek out additional sources of revenue and maximize benefits both to customer and shareholder. Id.

As is consistent with prior Board policy, as well as the principle that the customers who incurred the costs should also receive the benefits, **I FIND** that it is appropriate for 100% of the antenna revenues to be reflected for the benefit of Aqua's ratepayers for rate-making purposes. 

O&M Contract Revenue

Rate Counsel and Staff propose that any O&M Contract Revenue that Aqua has received should be included as part of the Company's operating income. Staff Initial Brief at 30, 32. Rate Counsel argues that because these contract operations are performed by employees on Aqua's regulated payroll, customers are funding these employees and should enjoy the benefits of this expenditure. Rate Counsel Reply Brief at 6-7. They also point out that had Aqua used a non-regulated subsidiary for these contracts, this revenue would not be includable as part of Aqua's operating income. Id.

Aqua proposes that O&M Contract Revenue should *not* be calculated as part of the Company's operating income because this revenue arises from unregulated business arrangements, of which no burden is placed on the customers. Pet. Initial Brief at 20-21.

As Rate Counsel has shown that some of the burden of these contracts *is* placed on the customers, **I FIND** that it is equitable to include \$101,352 of O&M Contract Revenue, as calculated by Rate Counsel, in Aqua's total operating income.

Labor Expenses

Aqua proposes that the Company's labor expenses include an "incentive compensation" plan that awards employees for meeting certain goals. Pet. Initial Brief at 23-24. It argues that Board policy has not been entirely consistent with incentive compensation plans, as the Board in I/M/O the Verified Petition of Jersey Central Power & Light Company for Review and Approval of an Increase in and Adjustments to its Unbundled Rates and Charges, BPU Docket Nos. ER02080506, ER02080507, EO02070417 and ER02030173, Final Order (2004) allowed the inclusion of some incentive plans that were specifically negotiated between the union and management. Pet. Reply Brief at 34. Aqua also proposes that a 1.5% wage increase factor be applied in order to reflect wage increases which will be implemented in April 2007. Pet. Initial Brief at 22. Aqua argues that this wage increase factor is *not* a general inflation factor, which the Board consistently disallows, but rather a realistic estimate of the wage increases that the Company knows will take place. Pet. Reply Brief at 34.

Rate Counsel and Staff agree that neither the wage increase factor nor the incentive compensation plan should be included in the Company's operating income, due to consistent Board policies which refuse to include such figures. Staff Initial Brief at 33. In regards to the wage increase factor, Witness Henkes testified that a general inflation factor has never been allowed for ratemaking purposes and that even if the figure is not a general inflation factor, it still represents an expense increase projection falling 11 months beyond the end of the test year – a type of projection which the Board consistently refuses to allow. Henkes, Hearing Transcript 2 (July 13, 2006) at 120. In regards to the incentive compensation program, Rate Counsel and Staff pointed to several Board decisions which refused to include these payments in operating income calculations. Staff Initial Brief at 33, citing I/M/O Jersey Central Power and Light Company, Docket No. ER91121820J, dated June 15, 1993; and I/M/O Middlesex Water Company, Docket No. WR00060362, dated June 6, 2001 ("...ratepayers should not be paying additional costs to reward a select group of Company employees for performing the job they were arguably hired to perform in the first place").

FIND that neither the 1.5% wage increase factor nor the incentive compensation payment should be allowed in calculating Aqua's operating income, due to prevailing Board policies and procedures which Rate Counsel and Staff pointed out.

Health, Life, LTD, Pension and OPEB Expenses

Aqua proposes to include the projected cost of health, life, LTD, pension and OPEB as of April 30, 2007. Pet. Reply Brief at 37. The Company urges that this projection is accurate and that it is undisputed that costs of insurance and pension programs have been continually rising for several years. Id.

Rate Counsel and Staff argue that these expenses should be calculated as of the end of the test year, April 30, 2006, and that the projection of expenses to 2007 would be too speculative in nature and should not be allowed. Staff Initial Brief at 37.

In accordance with the matching principle, it is more appropriate to use the amount of expenses that will be in effect with the new rate. As Witness Schreyer has testified, and which neither Rate Counsel nor Staff dispute, the projected increases in costs were reasonable, and therefore **I FIND** that the projections as to April 30, 2007 should be included.

Insurance

Aqua proposes that the insurance expense to be included for operating income should be that in effect on April 30, 2006 plus 5% for increased premiums. Pet. Initial Brief at 25. The Company argues that this 5% increase is *not* speculative in nature, but rather based on information from the Company's insurance broker. Pet. Reply Brief at 37.

Rate Counsel and Staff argue that the 5% increase is inflationary in nature, which would be contrary to Board policy that rejects inflationary adjustments. Staff

Initial Brief at 38. They propose that the appropriate expense should be that in effect on April 30, 2006. Id.

I **FIND** that the 5% increase is not inflationary in nature, but rather based on information received from the Company's insurance broker, and thus it is appropriate.

Lease Expenses

Aqua and Rate Counsel agree that the appropriate figure for lease expenses should be \$161,327, which represents the Company's actual expenditures pursuant to the various lease agreements it has entered. Pet. Initial Brief at 27.

Staff argues that lease expenses should be reduced to account for the fact that Company's well #11 was not completed, nor in service on April 30, 2006. Staff Initial Brief at 43.

I **FIND** that \$161,327 is the appropriate figure for lease expenses based on the lease agreements already in place.

Rate Case Expenses

Aqua proposes that it is entitled to recover 100% of the reasonable costs of the current proceeding, arguing that public policy encourages settlement, and that if a company is unable to recover the costs of a proceeding, it becomes more difficult for a company to recoup costs, as a proceeding is the only way to do so. Pet. Reply Brief at 39-40.

Rate Counsel and Staff agree that the rate case expenses should be shared 50/50 between shareholders and ratepayers, due to the fact that the primary motivation in filing a rate case is to add shareholder value, and thus, some of the expenses should be born by the shareholders. Rate Counsel Initial Brief at 40. Staff also presented

several Board actions in which the Board ordered a 50/50 sharing of rate case expenses. Staff Initial Brief at 51.

As previously discussed, the Board is under no duty or obligation to settle a rate case.² Simply because the Company dislikes the fact or reason why this case did not quickly settle does not require the Board to go away from its general practice of splitting rate case expenses. A rate case arises for the benefit of a company's shareholders, who should then be required to shoulder some of the burden. Rate Counsel Initial Brief at 40. I FIND that the rate case expenses should be split 50/50 between shareholders and customers, with \$48,750 being applied to Aqua's operating income.

Amortization-Acquisition

As discussed earlier³, Aqua is entitled to recover an unamortized acquisition adjustment for the acquisition of Berkeley Water Company. The parties are not in dispute about the amount of this adjustment.

Other O&M Expenses

Aqua and Rate Counsel agree on the figure of \$266,278 for other operating and maintenance expenses. Pet. Reply Brief at 40. Staff, however, disallows \$60,000 of relocation expenses because such relocation had no significant benefit to the shareholders. Staff Initial Brief at 54-55.

I FIND that \$266,278 is the appropriate figure for other operating and maintenance expenses, as agreed to by Rate Counsel and Aqua. Relocation is a common practice and expense in corporate America and should be included as public policy dictates that the expense of acquiring quality employees and management is good for customers and benefits them in the long run. Pet. Reply Brief at 40.

² See Letter to Counsel from Judge Barry N. Frank, dated September 25, 2006.

³ Supra, page 7, "Acquisition of Berkeley Water Company."

Interest Expenses

Rate Counsel proposes that interest expenses should be calculated as of April 30, 2006 and should include interest on short-term debt. Pet. Initial Brief at 33. Aqua argues that October 31, 2006 is the appropriate date and that calculating the interest on short-term debt is not appropriate when short-term debt is not included in the Company's capital structure. Id.

As noted above,⁴ October 31, 2006 is the more appropriate figure for calculating operating income. Furthermore, it has been noted that short-term debt should not be included in the Company's capital structure.⁵ Based on these previous findings, I FIND that Aqua's calculation of interest expense at \$2,392,023, which is based on an October 31, 2006 balance, excluding short-term debt, is appropriate.

Income Taxes

The parties agree that the Internal Revenue Code provides that the first \$10 million of taxable income is taxed at a rate of 34%. Rate Counsel Initial Brief at 43. Rate Counsel argues that Aqua, as a stand-alone company, would have less than \$10 million in taxable income, and should thus be subject to a tax rate of 34%. Rate Counsel Reply Brief at 12. Rate Counsel continues that by participating in a consolidated filing, Aqua reaps the benefits of losses incurred by the Parent, and thus is subject to a tax rate of much less than 34%. Id.

Aqua, however, argues that it participates in a consolidated income tax filing of its parent company, Philadelphia Suburban Company (PSC), which due to consolidated PSC operations, has taxable income in excess of \$10 million, "thereby triggering a 35% income tax rate for all companies that participate in the consolidated tax filing." Rate Counsel Initial Brief at 43.

⁴ Supra, page 5, "Appropriate Capital Structure."

⁵ Id.

Staff did not brief this issue, but uses a 35% income tax rate in its calculations. Pet. Reply Brief at 41.

As Rate Counsel itself pointed out, "...the consolidated PSC operations have taxable income in excess of \$10 million, thereby triggering a 35% income tax rate for all companies that participate in the consolidated tax filing." Rate Counsel Initial Brief at 43. As Aqua is a company that participates in the consolidated tax filing, the law is clearly stated and, therefore, **I FIND** that a 35% income tax rate is appropriate.

This 35% tax rate also effects the appropriate revenue conversion factor to be used in calculating Aqua's operating income. Rate Counsel Initial Brief at 44. Since Aqua's figure of 35% is appropriate, so is their revenue conversion factor of 1.79138.

Appropriate Rate Structure

The Company is proposing to implement the rate increase from this proceeding solely for General Metered Service customers, and not from public and private fire protection rates. Pet. Initial Brief at 42. The Company proposed this structure in order to address one of the financial pressures faced by many New Jersey municipal governments and fire districts. Id. Aqua also argues that by increasing the rates to municipal governments and fire districts, the taxpayers will end up footing the bill regardless, as the taxpayers depend on the services provided by these entities. Schulman Rebuttal Testimony at 11.

The Rate Counsel and Staff, on the other hand, wish to impose the rate increase across-the-board to all of Aqua's customers, not just the General Metered Service Customers, in order to minimize any increases in rates to any individual customer. Pet. Reply Brief at 42. Staff also believes that an across-the-board increase is more appropriate, as the Company has failed to provide a class cost of service survey. Staff Initial Brief at 56.

Had Aqua performed a class cost of service survey, they might be better able to argue who should shoulder what portions of the rate increase. Accordingly, without such a study, I **FIND** that it is more equitable to impose an across-the-board rate increase and consolidation, as Witness Kalcic recommended.

Low Income Assistance Program

Aqua is proposing to implement a new program to make water services more affordable for low-income seniors and disabled individuals. Staff Initial Brief at 57-58. This program would allow 6,000 gallons of water to be provided quarterly to eligible customers. Id. While Rate Counsel and Staff are not opposed to such a program, they do agree that there are too many unanswered questions concerning the program, and that rather than allocating funds to experiment on the project, a working group should be formed, in which both Rate Counsel and Staff expressed willingness to participate. Id. at 58-59. Aqua agrees that a working group would be welcome, but believes, based on previous Rate Counsel and Staff inaction that the effort will not come to fruition until monies are actually allocated for its implementation. Pet. Initial Brief at 42.

As Staff pointed out, "the Company admitted that its proposal was offered in an effort to begin a dialogue on low-income issues with interested parties." Staff Initial Brief at 58. I, therefore, **RECOMMEND** that rather than allocating funds to an unknown, the parties continue this dialogue in the form of a working group being implemented for the purpose of creating a feasible program with limited unanswered questions.

Delay of Proceeding Pending the Resolution of the Berkeley Water Company (BWC) Consent Issue

In November 2005, the Board issued an Order of Clarification conditionally allowing Aqua to continue serving the customers of BWC, but to act expeditiously to obtain the requisite municipal consent required to properly provide water. Staff Initial Brief at 59. Staff argues that no documentation has been provided by Aqua regarding any effort in resolving the issue, and that prior to adjudication, the Company should be

required to provide the Board and its Staff with copies of any correspondence dealing with the resolution of this matter. Id. at 61.

Aqua argues that attempts have been made to contact the Berkeley Township Municipal Utilities Authority (BTMUA), but as of yet, BTMUA has been uncooperative and any communication has only taken place via telephone – thus explaining the lack of documentation. Pet. Reply Brief at 43. Aqua points out that neither the Board, nor Aqua may force the BTMUA to resolve this issue, and that the threat of ceasing water service – as Staff proposes – would be “both irresponsible and inappropriate.” Id.

The BTMUA situation is a difficult one, which a court-appointed receiver described as being one that will not be consummated expeditiously. Id. at 43-44. The only party who can expedite this process is BTMUA itself, over whom neither Aqua nor the Board have authority. Id. I FIND that it would be inequitable to refuse the Company a reasonable rate of return on its investment based on a circumstance beyond their control. This proceeding will not be delayed pending the resolution of the BTMUA matter.

SUMMARY OF FINDINGS

I FIND that October 31, 2006 is the appropriate date for determining Aqua New Jersey's capital structure, for purposes of this rate case.

I FIND that short-term debt is not to be included in determining Aqua New Jersey, Inc.'s capital structure for purposes of this rate case.

FIND that the appropriate cost rate of equity for Aqua New Jersey is 10.5%.

I FIND that October 31, 2006 is the appropriate date for determining the Company's utility plant in service.

I **FIND** that the appropriate date in determining the following figures and balancing is also October 31, 2006:

- Aqua New Jersey, Inc.'s appropriate reserve for depreciation
- Aqua New Jersey, Inc.'s appropriate balance of customer advances
- Aqua New Jersey, Inc.'s appropriate balance of accumulated deferred income taxes
- Aqua New Jersey, Inc.'s appropriate reserve balances (including pension & FAS 106 reserves, as well as tank maintenance reserves
- Aqua New Jersey, Inc.'s appropriate balance of customer deposits

I **FIND** that Aqua is entitled to an unamortized acquisition adjustment for the acquisition of Berkeley Water Company

I **FIND** that unamortized deferred rate case expenses will not be included in Aqua's rate base.

I **FIND** that the appropriate date for calculating the following figures and balances is also October 31, 2006:

- Aqua New Jersey, Inc.'s appropriate balance of metered sales revenues
- Aqua New Jersey, Inc.'s appropriate balance of public and private fire revenues
- Aqua New Jersey, Inc.'s appropriate balance of power and chemical expenses
- Aqua New Jersey, Inc.'s appropriate balance of interest on customer deposits
- Aqua New Jersey, Inc.'s appropriate balance of depreciation expense

- Aqua New Jersey, Inc.'s appropriate balance of non-income taxes (including GRAFT and property and labor related tax expenses)

I FIND that it is appropriate for 100% of the antenna revenues to be reflected for the benefit of Aqua's ratepayers for rate-making purposes.

I FIND that it is equitable to include \$101,352 of O&M Contract Revenue, as calculated by Rate Counsel, in Aqua's total operating income.

I FIND that neither the 1.5% wage increase factor nor the incentive compensation payment should be allowed in calculating Aqua's operating income.

I FIND that the projections in Health, Life, LTD, Pension and OPEB expenses as to April 30, 2007 should be included.

I FIND that the 5% increase in insurance expenses is appropriate.

I FIND that \$161,327 is the appropriate figure for lease expenses based on the lease agreements in place.

I FIND that the rate case expenses should be split 50/50 between shareholders and customers.

I FIND that \$266,278 is the appropriate figure for other operating and maintenance expenses, as agreed to by Rate Counsel and Aqua.

I FIND that Aqua's calculation of interest expense at \$2,392,023, which is based on an October 31, 2006 balance, excluding short-term debt, is appropriate.

I FIND that a 35% income tax rate is appropriate.

CONCLUDE that the appropriate rate structure is to impose an across-the-board rate increase and consolidation, as Witness Kalcic recommended. **I**

RECOMMEND that Petitioner receive an increase in per annum revenues of approximately \$2,806,501 or approximately 12.60% using a test year ending April 30, 2006. I also **RECOMMEND** that the Petitioner's proposed senior citizens program contains too many unanswered questions, and that money should not at this time be allocated to implement the program. In regards to these issues and the related accounting and cost recovery measures for consideration, a summary of my results is attached.

I **RECOMMEND** that rather than allocating funds to an unknown, the parties continue a dialogue regarding the low-income assistance program, and form a working group for the purpose of creating a feasible program with limited unanswered questions.

I **CONCLUDE** that this proceeding should not be delayed pending the resolution of the BTMUA matter.

ORDER

Accordingly, it is **ORDERED** that:

- 1 The rates proposed by Petitioner are **DENIED**.
2. Petitioner may file for the Board's consideration revised tariff sheets consistent with the rate design and findings set forth herein, to become effective on a date to be determined by the Board.

hereby **FILE** my initial decision with the **BOARD OF PUBLIC UTILITIES** for consideration.


This recommended decision may be adopted, modified or rejected by the **BOARD OF PUBLIC UTILITIES**, which by law is authorized to make a final decision in this matter. If the Board of Public Utilities does not adopt, modify or reject this decision within forty-five (45) days and unless such time limit is otherwise extended, this

recommended decision shall become a final decision in accordance with N.J.S.A.
52:14B-10.

Within thirteen (13) days from the date on which this recommended decision was mailed to the parties, any party may file written exceptions with the **SECRETARY OF THE BOARD OF PUBLIC UTILITIES, 2 Gateway Center, Newark, NJ 07102**, marked "Attention: Exceptions." A copy of any exceptions must be sent to the judge and to the other parties.

November 28, 2006

DATE _____


BARRY N. FRANK, ALJ

BARRY N. FRANK, ALJ

E-mail Receipt of Initial Decision Confirmed by the Board of Public Utilities on:

1-28-06

DATE _____

Mailed to Parties:

DATE _____

jb

OFFICE OF ADMINISTRATIVE LAW

APPENDIX

Witnesses

For Petitioner:

Pauline M. Ahern, CRRA, Vice president, AUS Consultants-Utility Services

Sharon Schulman, President and CEO

William C. Packer, Jr., Regional Director of Accounting

Jack Schreyer, Manager of Rates for Aqua America, Inc.

Edward A. Rapsiewicz, Vice President of Operations for the Company.

For Ratepayer Advocate:

David Parcell, Executive Vice President and Senior Economist of Technical Associates, Inc.

Robert J. Henkes, Principal and Founder of Henkes Consulting

Brian Kalcic

For Staff of the Board:

None

List of Exhibits

For Petitioner and Respondent: See attachment following Summary of Exhibits I to V

Summary of Exhibits I to VExhibit I: Income Statement in Comparison

	Company	Rate Counsel	BPU Staff	OAL
OPERATING REVENUES				
Metered Sales	\$19,332,054	\$19,041,642	\$19,041,642	\$19,332,054
Public Fire	\$1,639,844	\$1,627,227	\$1,627,227	\$1,639,844
Private Fire	\$912,008	\$897,393	\$897,393	\$912,008
Miscellaneous	\$35,000	\$35,000	\$35,000	\$35,000
Golf Course	\$26,000	\$26,000	\$26,000	\$26,000
Sales for Resale	\$7,500	\$7,500	\$7,500	\$7,500
Antennae Revenues	\$109,548	\$222,900	\$222,900	\$222,900
O&M Contract Revenue	\$0	\$101,352	\$101,352	\$101,352
TOTAL OP. REVENUES	\$22,061,954	\$21,959,014	\$21,959,014	\$22,276,658
O&M EXPENSES				
Labor	\$3,115,380	\$2,961,759	\$2,961,759	\$2,961,759
Power	\$1,056,792	\$931,604	\$1,056,792	\$1,056,792
Chemicals	\$401,181	\$360,358	\$401,181	\$401,181
Health/Life/LTD/Pension	\$978,551	\$882,920	\$882,920	\$978,551
Insurance	\$261,363	\$240,682	\$240,682	\$261,363
Misc. Employee Benefits	\$64,528	\$64,528	\$64,528	\$64,528
Outside Services	\$508,870	\$508,870	\$508,870	\$508,870
Management Fees	\$724,281	\$724,281	\$724,281	\$724,281
Leases	\$161,327	\$161,327	\$58,542	\$161,327
Transportation	\$263,748	\$263,748	\$263,748	\$263,748
Sludge Removal	\$21,499	\$21,499	\$21,499	\$21,499
Supplies	\$196,741	\$196,741	\$196,741	\$196,741
Purchased Water	117,214	\$117,214	\$117,214	\$117,214
Bad Debt Expense	\$42,817	\$41,885	\$43,128	\$43,128
Tank Painting	\$200,000	\$200,000	\$200,000	\$200,000
Audit Fees	\$128,069	\$128,069	\$128,069	\$128,069
Lab Expense	\$231,158	\$231,158	\$231,158	\$231,158
Legal Expense	\$57,579	\$57,579	\$57,579	\$57,579
Rate Case Expense	\$97,500	\$48,750	\$48,750	\$48,750
Interest – Cust. Deposits	\$2,435	\$4,836	\$4,836	\$2,435
Acquisition Adjust	\$11,472	\$11,472	(\$43,521)	\$11,472
Other	\$266,278	\$266,278	\$206,278	\$266,278
TOTAL O&M EXPENSES	\$8,908,783	\$8,425,558	\$8,375,034	\$8,706,723
Depreciation Expense	\$3,737,681	\$3,479,938	\$3,479,938	\$3,737,681
Income Taxes	\$1,251,302	\$1,411,856	\$1,482,953	\$1,700,966
Non-Income Taxes	\$3,578,230	\$3,527,042	\$3,533,398	\$3,578,230
TOTAL OP. EXPENSES	\$17,475,996	\$16,844,394	\$16,871,323	\$17,723,600
UTILITY OPERATING INCOME	\$4,585,958	\$5,114,620	\$5,087,691	\$4,553,058
TOTAL OP. EXPENSES (pre-tax)	\$16,224,694	\$15,432,538	\$15,388,370	\$16,022,634
Net Revenues before Income Tax	\$5,837,260	\$6,526,476	\$6,570,644	\$6,254,024
Income Tax	\$1,251,302	\$1,411,856	\$1,482,953	\$1,329,305
After-Tax Operating Income	\$4,585,958	\$5,114,620	\$5,087,691	\$4,924,719

Exhibit II: Rate Base in Comparison

<u>Rate Base</u>	Aqua, NJ	Staff	Rate Counsel	OAL
Utility Plant in Service	\$147,728,590	\$139,919,821	\$139,919,821	\$147,728,590
Working Capital	----	----	----	----
Materials and Supplies	\$1,244,144	\$1,244,144	\$1,244,144	\$1,244,144
Prepayments	\$241,693	\$241,693	\$241,693	\$241,693
Unamortized Acq. Adj.	\$81,085	(\$743,822)	\$81,085	\$81,085
Unamort. Mgmt. Audit.	----	----	----	----
Unamort. Rate Case Expense	\$94,762	\$0	\$0	\$0
Subtotal	\$149,390,274	\$140,661,836	\$141,486,743	\$149,295,512
Reserve for Depreciaton	\$31,989,224	\$30,091,725	\$30,091,725	\$31,989,224
Customer Advances	\$9,679,179	\$10,442,924	\$10,442,924	\$9,679,179
Contrib. Property	\$16,079,818	\$16,079,818	\$16,079,818	\$16,079,818
Deferred F.I.T.	\$11,901,347	\$11,498,747	\$11,498,747	\$11,901,347
Pension & FAS 106 Reserves	\$1,295,217	\$1,102,443	\$1,102,443	\$1,295,217
Tank Maintenance Reserve	\$433,506	\$333,506	\$333,506	\$433,506
Customer Deposits	\$82,820	\$164,492	\$164,492	\$82,820
Subtotal	\$71,461,111	\$69,713,655	\$69,713,655	\$71,461,111
Rate Base	\$77,929,163	\$70,948,181	\$71,773,088	\$77,834,401

Exhibit III: OAL Cost of Capital Calculation

As of October 31, 2006

	<u>Ratio%</u>	<u>Cost Rate</u>	<u>Weighted Cost Rate</u>
Long-Term Debt	49.30%	6.128%	3.02
Short-Term Debt	0%	0	
Equity	50.70%	10.5%	5.32
	100%		8.34%

Exhibit IV: OAL Federal Income Tax Calculation

Net Revenues before FIT	\$6,254,024	
Less: Pro Forma Interest	<u>\$2,392,023</u>	
Income Before FIT	\$3,862,001	
Add: Flow-Back Depreciation	<u>\$17,500</u>	(From Sch. RJH-14)
Taxable Income	\$3,879,501	
FIT Rate	<u>35%</u>	
Income Tax Prior to ITC Amort.	\$1,357,825	
ITC Amortization	<u>(28,520)</u>	(From Sch. RJH-14)
Net Pro Forma Income Taxes	\$1,329,305	

Exhibit V: Aqua New Jersey Rate Adjustment

	Company	Staff	Rate Counsel	OAL
Rate Base	\$77,929,163	\$70,948,181	\$71,773,088	\$77,834,401
Cost of Capital	<u>8.85%</u>	<u>8.09%</u>	<u>7.45%</u>	<u>8.34%</u>
Required Return	\$6,896,732	5,741,191	5,346,690	6,491,389
Utility Operating Income	<u>\$4,585,958</u>	<u>5,087,691</u>	<u>5,114,620</u>	<u>4,924,719</u>
Operating Income Deficiency	2,310,773	653,500	232,070	1,566,670
Revenue Multiplier	<u>1.79138</u>	<u>1.76423</u>	<u>1.76423</u>	<u>1.79138</u>
Revenue Requirement Increase	<u>\$4,139,473</u>	<u>\$1,152,924</u>	<u>\$409,425</u>	<u>\$2,806,501</u>
 Present Revenues	 \$22,061,954	 \$21,959,014	 \$21,959,014	 \$22,276,658
Proposed Revenues	\$26,201,427	\$23,111,938	\$22,368,439	\$25,083,159
Percentage Increase	18.76%	5.25%	1.86%	12.60%