



Agenda Date: 4/3/09

Agenda Item: 5A

STATE OF NEW JERSEY

Board of Public Utilities

Two Gateway Center

Newark, NJ 07102

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WATER

IN THE MATTER OF THE JOINT PETITION OF
THE CITY OF TRENTON, NEW JERSEY AND NEW
JERSEY-AMERICAN WATER COMPANY, INC. FOR)
AUTHORIZATION OF THE PURCHASE AND SALE OF
THE ASSETS OF THE OUTSIDE WATER UTILITY
SYSTEM ("OWUS") OF THE CITY OF TRENTON, NEW
JERSEY AND FOR OTHER RELIEF

ORDER ADOPTING
INITIAL DECISION

DOCKET NO. WM08010063

(SERVICE LIST ATTACHED)

BY THE BOARD:

PROCEDURAL HISTORY:

On January 25, 2008, New Jersey American Water Company, Inc. ("NJAW" or the "Company"), a public utility subject to the jurisdiction of the New Jersey Board of Public Utilities ("Board" or "BPU"), and the City of Trenton ("Trenton" or the "City")(collectively, the "Joint Petitioners") filed a petition with the Board pursuant to N.J.S.A. 40:62-3.1, N.J.S.A. 48:2-21(a) and 48:2-14, and N.J.A.C. 14:1-5.1.1.¹ The petition sought approval of the following: (1) the proposed sale and transfer of the City's water system assets located outside the City (the "Outside Water Utility System" or "OWUS") and within Ewing, Hamilton, Lawrence and Hopewell Townships (each a "Township" and collectively the "OWUS Townships") from the City to NJAW (the "Transfer"), (2) use of the NJAW rates of depreciation for ratemaking purposes for the appropriate components of OWUS, (3) the change to a monthly billing cycle for OWUS customers and the requisite tariff revisions regarding the same, pursuant to N.J.A.C. 14:1-5.11, (4) the transfer to NJAW of the City's existing Board approved municipal consents which allow the City to provide water service to each of the OWUS Townships, (5) the City's request to discontinue providing service to each of the OWUS Townships, (6) NJAW's request that the franchises to serve Ewing, Hamilton, and Lawrence Townships be of perpetual duration, (7) the determination that the Water Supply Agreement ("WSA") between the City and NJAW is reasonable and prudent; and that NJAW may recover all costs incurred under and pursuant to the WSA through its traditional, Board-

¹ This petition was originally assigned BPU Docket No. WE08010063. After discussion among the various Board divisions assigned to this matter, the docket number was changed to WM08010063. All documents bearing the WE number are deemed filed in the revised WM docket.

approved cost recovery mechanism (*i.e.* its Purchased Water Adjustment Clause or "PWAC"); and that NJAW may defer all WSA-related costs until NJAW's next PWAC proceeding; (8) granting the Joint Petitioners' motion to consolidate the petition with NJAW's then pending rate case petition (BPU Docket No. WR08010020), pursuant to N.J.A.C. 1:1-17.1, *et seq.*, and (9) other actions necessary to obtain the relief requested in the petition.

The petition also sought approval to include a purchase price of \$100,000,000 in NJAW's rate base as agreed to by the City and NJAW in an Agreement of Sale dated December 21, 2007. As proposed, the City would retain water system assets located within the City (the "Inside Water Utility System" or "IWUS").

The petition was transferred to the Office of Administrative Law ("OAL") for hearing as a contested case, and a Notice of filing was issued by the OAL on February 11, 2008. The matter was assigned to Administrative Law Judge Mumtaz Bari-Brown who convened a pre-hearing conference on April 2, 2008, and issued a pre-hearing Order dated April 21, 2008. This pre-hearing Order was later amended on May 20, 2008 and September 4, 2008.

Motions for Leave to Intervene were filed by: Rutgers, The State University of New Jersey; Johanna Foods, Inc.; Princeton University; ConocoPhillips Company; Cogen Technologies Linden Venture, L.P. ("OIW Customer Coalition"); Middlesex Township; Hamilton Township; Lawrence Township; Hopewell Township; Ewing Township and Aqua New Jersey, Inc. Pursuant to the April 21, 2008 pre-hearing Order, the motions to intervene filed by Cogen Technologies Linden Venture, L.P., Princeton University, Aqua New Jersey, Inc., and Middlesex were granted. The remaining motions to intervene from ConocoPhillips Company, Ewing, Hopewell and Lawrence Townships, and Johanna Foods, Inc. were granted by Amended Pre-hearing Order dated May 20, 2008. The motions to intervene filed by Hamilton Township and Rutgers were granted by Amended Pre-hearing Order dated September 4, 2008 (each an "Intervenor" and collectively "Intervenors").

After publication of notice in newspapers of general circulation, on July 23, 2008, a public hearing was held in this matter in Hamilton Township. ALJ Patricia M. Kerins presided over the public hearing at the request of ALJ Bari-Brown. Presentations were made by counsel for NJAW and the City outlining what each sees as the benefits of the Transfer to residents of the OWUS Townships and to the residents of the City. Rate Counsel explained its role in the review of the matter, and invited public participation as part of the evaluation process in conjunction with Rate Counsel's experts. Officials from Hopewell, Hamilton and Lawrence voiced concerns about the proposed purchase price and possible rate increases under NJAW ownership, the need for infrastructure improvements and the cost of those improvements which would be borne by ratepayers. Statements were also made by residents of Hamilton, Hopewell, Lawrence, Trenton Wellington Manor Development, Pennington and Forked River, all echoing concerns about the possible costs and rate increases.

Discovery was propounded upon and by the Joint Petitioners, the Department of the Public Advocate, Division of Rate Counsel ("Rate Counsel"), Board Staff and the Intervenors; and responses were received. Initial and rebuttal testimony was filed by Joint Petitioners. Testimony was filed by Rate Counsel and the Intervenors. Three separate valuation studies for the OWUS assets were submitted by Rate Counsel, the City and NJAW showing a value of the assets to be purchased (without recognition of any contributed property) ranging from \$94,700,000 to \$124,286,000. Prior to the evidentiary hearings, the Company, Trenton, Board Staff, Rate Counsel and the Intervenors participated in settlement discussions and conferences. The attached stipulation ("Stipulation") is the result of those discussions and conferences. By letter dated February 18, 2009 to ALJ Bari-Brown, Hamilton Township withdrew from the

proceedings, recognizing that by doing so it was giving up all rights to participate in the matter, and indicating that it did not object to the matter continuing without its involvement. By Initial Decision dated February 19, 2009, ALJ Bari-Brown noted that Hamilton had withdrawn its request to intervene, and that based on her review of the record, the Stipulation was a voluntary agreement of the parties, there were no objections to the settlement agreement, and the agreement satisfies the requirements of N.J.A.C. 1:1-19.1. No exceptions to the Initial Decision were filed with the Board.

However, on February 25, 2009, a group of Trenton residents filed a petition seeking to force a revote and possible referendum on the proposed sale. By operation of law, the effective date of the ordinance authorizing Trenton to consummate the transaction, City of Trenton Ordinance 09-02, was suspended until actions relating to the challenge were determined. On March 4, 2009, Trenton filed a lawsuit in the Superior Court, Law Division seeking a declaration that N.J.S.A. 40:62-3.1 which governs the sale of the OWUS assets preempts the general initiative and referendum provisions of the Faulkner Act so that the referendum petition is a nullity. In re Petition for Referendum on City of Trenton Ordinance 09-02, Docket No. MER-L-48-09 (Sup. Court, Law Division) (the "Referendum Petition"). The lawsuit also sought to enjoin the city clerk from taking any action on the referendum petition. On March 17, 2009, the Honorable Linda R. Feinberg, A.J.S.C., issued a decision finding that, as advocated by Trenton and NJAW, N.J.S.A. 40:62-3.1 preempts the general referendum provisions applying to municipal transfers, and substitutes the proceedings before the Board for the usual municipal review process. Judge Feinberg issued an order declaring the referendum petition null and void, and directed the City clerk to take no further action on it. The time for appeal of the decision on the Referendum Petition has not yet run.

THE PROPOSED STIPULATION:

As stated above, NJAW, Trenton, Rate Counsel and the Intervenors reached agreement on the major issues raised in connection with the Transfer. Below are some of the key provisions of the Stipulation.²

The purchase price for the OWUS assets will be \$75 million. The purchase price does not reflect the repayment of any amount for contributed property which will also transfer at closing. The \$75 million purchase price will be included in Utility Plant in Service (representing an amount net of contributed property) on the Company's books and records for financial accounting purposes upon closing, and will be included in the Company's rate base in its next rate base proceeding and in the base rate proceedings thereafter. The net rate base addition from the Transfer will not exceed \$75 million, an amount that the parties agree is reasonable and prudent.

The City, through its authorized representatives, will provide NJAW with advisory and consulting services after closing relating to the transition of ownership of the OWUS and separation of the OWUS from the IWUS, and continuing the services to NJAW thereafter, all based on the City's specialized knowledge and expertise related to its ownership and operation of the OWUS over many years and the inter-relationship of the OWUS and the IWUS. The services are to be provided in accordance with the Agreement of Sale. NJAW will, at closing, pay the City a one time lump sum payment of \$5 million as the total payment to be made by NJAW in consideration for the City's provision of the services. NJAW will not receive any rate-making recognition for this \$5 million payment.

² Although described in this Order at some length, should there be any conflict between this summary and the Stipulation, the terms of the Stipulation control, subject to the findings and conclusions in this Order.

The City and NJAW will enter into an amendment to the water supply agreement ("WSA") executed by the City and NJAW on December 21, 2007 that will provide for an initial 20 year term. For each year during years 1-3 following the closing, NJAW will agree to buy 14 million gallons of water per day. For the remainder of the contract term, NJAW will purchase and the City will provide all of the water supply requirements of the OWUS system. In the event of an emergency condition or other issue which prevents the City from meeting the contracted quantity and/or quality commitments under the WSA, NJAW retains the right to obtain water for the OWUS system from other sources. The initial rate under the amended WSA shall be less than the current rate.

The parties agree that NJAW shall defer for rate-making purposes a portion of the costs it incurs under the WSA with the accumulated deferral amount to be recovered from customers through rates approved in NJAW's next base rate case, amortized for rate-making purposes over 10 years. NJAW will recover all deferred amounts as provided in paragraph 21 of the Stipulation with interest at the specified carrying cost rate in base rates approved in NJAW's next base rate case.

General Metered Service ("GMS") rates for the customers in each OWUS Township will be brought to NJAW's SA-1 rates over time (over the next three NJAW base rate cases) starting with an initial 30% increase over the rates charged by the City to residential customers prior to October 1, 2008.

NJAW will file at least one cost of service study in its next base rate case, as described in paragraph 32 of the Stipulation.

NJAW will bear all of the costs to physically separate the OWUS assets from the IWUS assets, including the costs for the installation of master meters and pipe closures.

The parties to the Stipulation agree to the following findings pursuant to N.J.S.A. 48:2-51.1:

The proposed Transfer will not adversely affect competition.

Customers within the OWUS will receive an immediate rate reduction from rates currently paid to Trenton.

Existing NJAW customers will not see any immediate rate increase, and purchase water costs under the WSA will be recovered in base rates beginning in NJAW's next rate case.

As a result of the approval of the Transfer, NJAW will add additional employees to serve the OWUS.

Over the long run, the addition of the approximately 40,000 OWUS customers to the NJAW system will contribute to the recovery of fixed costs to the benefit of all NJAW customers.

The parties also agree that there are positive benefits resulting from the Transfer including that the change in ownership of the OWUS will allow NJAW to enhance existing emergency interconnections to address regional and local water supply needs; private capital will be invested in the infrastructure of the OWUS; NJAW will add a local operating location within the OWUS service area creating additional local employment opportunities, and the State will

receive additional gross receipts and franchise taxes from NJAW that it would not otherwise receive if the OWUS assets remained with the City.

Additional issues concerning rates to OWUS customers, the handling of certain rate design issues, treatment of other costs related to the system separation, the level of lost and unaccounted for water, transfer of water assets serving private communities, and certain stipulated wheeling matters related to wholesale transactions have been agreed to by the parties, and are also described in the attached Stipulation.

As previously stated, in an Initial Decision dated February 19, 2009, ALJ Bari-Brown approved the Stipulation finding that the parties had voluntarily agreed to the Stipulation, and that the Stipulation satisfies N.J.A.C. 17:27-19.1, meaning that the agreement fully disposes of all issues in controversy and is consistent with the law. A copy of the Initial Decision is appended to this Order. No exceptions were received.

DISCUSSION AND FINDINGS:

The Board has reviewed the record in this proceeding, including the comments made at the public hearing, the Initial Decision and the Stipulation. Based on that review, as discussed more fully below, the Board HEREBY ADOPTS the Initial Decision which approved the Stipulation, subject to the findings and conclusions in this Order.

In evaluating the Stipulation and the underlying Transfer, the Board has considered the requirements of both N.J.S.A. 40:62-3.1 and of N.J.S.A. 48:2-51.1. The Joint Petitioners contend that only the first section applies. That section provides that a municipality may transfer a municipal water utility system if that system serves less than 5% of the municipality, if the transfer is authorized by ordinance and the terms of the sale and the ordinance authorizing the sale are approved by the Board. The Board has been provided with a copy of City Ordinance 09-02, approved on February 5, 2009, which authorizes the Transfer, based on a determination by the City that the Transfer is advisable in the interests of public health and safety of the City and the OWUS Townships. N.J.S.A. 40:62-3.1 guides the Board in reviewing the proposed transaction from the perspective of the seller. However, as recognized by the Joint Petitioners, the Transfer results in a change in ownership of the OWUS system, which once separated from the rest of the City water system, can be viewed as a separate public utility as defined under N.J.S.A. 48:2-13.

N.J.S.A. 48:2-51.1 provides that "[n]o person shall acquire or seek to acquire control of a public utility directly or indirectly...without requesting and receiving the written approval of the Board of Public Utilities. Any agreement reached, or any other action taken, in violation of this act shall be void." Furthermore, the statute sets forth the explicit elements that the Board must consider prior to the granting of any approval.

In considering a request for approval of an acquisition of control, the board shall evaluate the impact of the acquisition on competition, on the rates of ratepayers affected by the acquisition of control, on employees of the affected public utility or utilities, and on the provision of safe and adequate utility service at just and reasonable rates.

[N.J.S.A.: 48:2-51.1]

Under the Board's current regulatory framework, the review of the acquisition of a public utility is subject to what has been termed the "positive benefits" standard. Under N.J.A.C.: 17:27-5.14(c),

“[t]he Board shall not approve a merger, consolidation, acquisition and/or *change in control* unless it is satisfied that positive benefits will flow to customers and the State of New Jersey and, at a minimum, that there are no adverse impacts on any of the criteria delineated in N.J.S.A. 48:2-51.1.” (Emphasis added.) It is within this framework that the Board must evaluate the proposed Stipulation in this matter and the underlying Transfer.

As stated previously, the parties to the Stipulation have agreed to the following:

The proposed acquisition will not adversely affect competition because there is no traditional competition within the water utility industry.

Customers within the OWUS will receive an immediate rate decrease. Existing NJAW customers will not see any immediate rate increase as a result of the acquisition. Purchased water costs under the Water Supply Agreement, which will initially be lower under the amended WSA, will be recovered in base rates beginning with NJAW's next base rate case. Over the long run, the approximately 40,000 additional OWUS customers will contribute to the recovery of fixed costs – thus benefiting all NJAW customers.

There will be no adverse impact on employees of NJAW. As a result of the proposed acquisition, the management of NJAW will not change. Nor will there be changes to any day-to-day operations of NJAW as a result of the proposed acquisition. No workforce reductions are anticipated. In fact, the parties to the Stipulation claim that NJAW will add additional employees to serve the OWUS. The proposed acquisition will not affect existing collective bargaining agreements currently entered into by NJAW.

The proposed acquisition will not have an adverse impact on the continued provision of safe, adequate and proper service at just and reasonable rates in fulfillment of their obligations under New Jersey law. As a result of the proposed acquisition, NJAW will continue to adhere to its tariffs and to honor its customer and regulatory obligations. All service company agreements approved by the Board will remain in effect.

Based upon review of the record including the comments at the public hearing, the Initial Decision and the Stipulation, the Board HEREBY ADOPTS the proposed findings as its own and therefore, HEREBY FINDS that the proposed acquisition is unlikely to have any negative impact upon the provision of safe, adequate and proper service at just and reasonable rates.

Also as previously stated, the parties to the Stipulation have agreed that approval of the transaction will produce the following positive benefits:

NJAW will add additional employees to serve the OWUS. Furthermore, NJAW will establish a new local operating location within the OWUS service area, creating additional local employment opportunities.

Change in ownership of the OWUS system will allow NJAW to enhance existing emergency interconnections to address regional and local water supply needs during emergency events. In addition, the financial resources and backing of NJAW and its affiliates will be a benefit to the existing OWUS customers in the ongoing maintenance and renewal of infrastructure and continued compliance with the Safe Drinking Water Act, 42 U.S.C. §300, et seq. The customers of OWUS will benefit from becoming part of the largest regulated water utility in the United States. The customers of OWUS will receive the benefits of water industry standard best practices in areas such as planning,

research, environmental compliance, water quality, finance, risk management, operations and service delivery and management.

The State of New Jersey will receive additional gross receipts and franchise taxes from NJAW that it would not otherwise receive if the acquisition were not to be completed.

Private capital will be invested in infrastructure in the OWUS.

Based upon the Board's review of the record, including the comments at the public hearing, the Initial Decision and the Stipulation, the Board HEREBY FINDS that the proposed acquisition will provide positive benefits.

Accordingly, the Board HEREBY FINDS that the standards for approval of a transfer of control, under N.J.S.A. 48:2-51.1 and N.J.A.C. 14: 1-5.14 have been satisfied such that approval of the transfer of control of the OWUS is appropriate under the circumstances, is in accordance with laws and regulations, and is in the public interest.

As such, the Board HEREBY ADOPTS the Initial Decision adopting the Stipulation and HEREBY INCORPORATES each and every term of the Stipulation into this Order as though those terms were set out in full herein, subject to the following:

Effective as of the date of the closing of the Transfer, the City is HEREBY AUTHORIZED to discontinue service to the OWUS Townships. The Board expressly states that its decision in this matter to permit the City to discontinue utility service under N.J.S.A. 48:2-24 is based upon the representation that there will be a continuity of service to those customers previously served by the City, who will now be serviced by NJAW.

The permission to discontinue utility service herein granted is subject to the following conditions:

1. NJAW shall notify the Board, in writing, of the closing date within twenty (20) days of closing.
2. Upon entry of this Order, the City is to provide notice to its OWUS customers advising them of its discontinuance of service and that water service to the former City customers will now be provided by NJAW.

Effective as of the date of the closing of the Transfer and subject to the provision of notice by the City, NJAW is HEREBY AUTHORIZED to provide service to the OWUS Townships pursuant to the existing municipal consents previously approved by the Board which are HEREBY TRANSFERRED to NJAW.

Furthermore, the Board HEREBY ORDERS that Joint Petitioners shall notify the Board of the closing of the proposed transaction within ten (10) days of consummation of the Transfer and shall file with the Board final journal entries within 60 days of the closing.

Within ten (10) days of the date of the closing, NJAW shall file final revised tariff sheets including a description of its expanded service territory and applicable rate schedules.

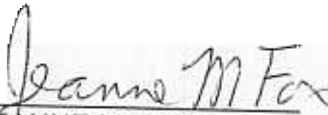
This Order shall be effective upon issuance. However, it shall be automatically stayed if a timely appeal is taken to a court of competent jurisdiction pursuant to Rule 2:4-1 of the New Jersey Court Rules, from the Order of Mercer County Superior Court, Law Division, in In Re Petition for Referendum on City of Trenton Ordinance 09-02, Docket No.MER-L-548-09, issued

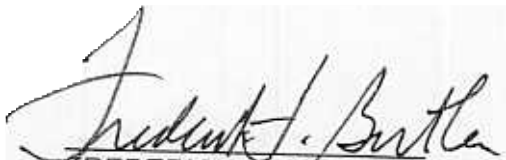
on March 16, 2009. In the event of a timely appeal, the stay shall remain in effect until the appeal is finally resolved. If no timely appeal is filed, this Order shall remain in full force and effect.

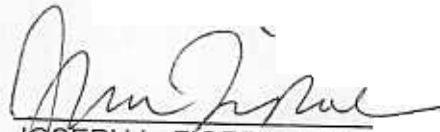
Finally, the Board ORDERS that the approval of this Stipulation and associated proposed Transfer shall expire on December 31, 2009, unless the proposed acquisition has been consummated or unless an extension or modification has been ordered by this Board.

DATED: 4/3/09

BOARD OF PUBLIC UTILITIES
BY:


JEANNE M. FOX
PRESIDENT

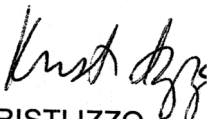

FREDERICK F. BUTLER
COMMISSIONER


JOSEPH L. FIORDALISO
COMMISSIONER


NICHOLAS ASSELTA
COMMISSIONER


ELIZABETH RANDALL
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

