



Agenda Date: 2/27/19
Agenda Item: 1A

STATE OF NEW JERSEY
Board of Public Utilities
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www.nj.gov/bpu/

AUDITS

IN THE MATTER OF THE AUDIT OF THE AFFILIATED)	ORDER OF
TRANSACTIONS BETWEEN AQUA NEW JERSEY)	IMPLEMENTATION
WATER COMPANY AND AQUA AMERICA AND)	
AFFILIATES AND A COMPREHENSIVE)	
MANAGEMENT AUDIT OF AQUA NEW JERSEY)	
WATER COMPANY PURSUANT TO N.J.A.C. 14:3-12.1-)	
14:3-12.4)	DOCKET NO. WA16121156

Parties of Record:

John Hilderbrand, President, Aqua New Jersey Water Company
Stefanie A. Brand, Esq., Director, New Jersey Division of Rate Counsel

BY THE BOARD:

On June 18, 2018, Sage Management Consultants, LLC ("Sage") submitted its audit report ("Final Report") to the New Jersey Board of Public Utilities ("Board" or "BPU") rendered in the audit of Aqua New Jersey Water Company ("Aqua NJ" or "Company"). The Final Report contained 66 recommendations. At the Board's August 29, 2018 agenda meeting, the Board accepted the Final Report for filing purposes only and authorized the release of the Final Report to the public for comment. On September 28, 2018, Aqua NJ and the New Jersey Division of Rate Counsel ("Rate Counsel") submitted comments.

By this Order, the Board considers the recommendations in the Final Report and the comments submitted to the Board regarding recommendations to be implemented by Aqua NJ.

BACKGROUND AND PROCEDURAL HISTORY

At its agenda meeting of January 25, 2017, the Board authorized staff of the Audits Division ("Staff") to initiate an audit of affiliated transactions between Aqua NJ, its holding company, Aqua America and affiliates, and a comprehensive management audit of Aqua NJ. The Board also authorized Staff to send a request for proposals ("RFP") to the seven pre-approved management consulting firms under State Term Contract T2482.

Aqua NJ provides water and wastewater service to more than 174,000 residents in 29 municipalities across New Jersey. Its service territory is divided into several divisions. The assignment included a comprehensive management audit of all major and functional areas of Aqua NJ's operations and the effect of the Company's association with its parent Company, Aqua America, and affiliates. The scope of work in the RFP for the audit included an examination of Executive Management and Corporate Governance, Organizational Structure, Human Resources, Strategic Planning, Systems Operations, Customer Service, External Relations, Support Services, Finance, Cash Management, Accounting and Property Records, Affiliate Cost Allocation and Relationships and Company Contractor Performance.

In accordance with the RFP, Silver Point Consulting, Sage, Overland Consulting, Schumaker and Company and Saleeby Consulting submitted bid proposals to the Board's Audits Division on or before March 10, 2017. The sixth firm, NorthStar Consulting Group, advised Staff in writing that they would not bid on this project. The seventh firm, Liberty Consulting Group, did not submit a bid. The bid proposals were subsequently forwarded to an evaluation committee for review and analysis. The evaluation committee consisted of staff members from the Division of Audits (3), the Division of Water (2), and Counsel's Office (1).

At its May 31, 2017 agenda meeting, the Board approved the evaluation committee's recommendation of Sage to perform the audit at a not-to-exceed cost of \$399,700. The Board further authorized former President Mroz to execute a consulting agreement with Sage.

Prior to the publication of the Final Report by Sage in the audit of the affiliated transactions between Aqua NJ, its holding company, Aqua America and affiliates, and a comprehensive management audit of Aqua NJ, draft versions were provided for review by Staff (including the Divisions of Audits and Water). A draft version was also provided to Aqua NJ for its review and comment on factual discrepancies only, and the need for any redactions in the Final Report to protect information claimed to be confidential or business sensitive.

On June 18, 2018, Sage submitted the Final Report with the 66 recommendations. At the Board's August 29, 2018 agenda meeting, Staff recommended that the Board accept the Final Report for filing purposes only and authorize the release of the report to the public for comment. These actions were adopted by the Board.

On September 28, 2018, Aqua NJ filed its comments on the recommendations included in the Final Report. The Company responded to the specific recommendations made by Sage and provided further commentary on various statements made within the Final Report. The Company concurred with 44 of the recommendations, and agreed to take action to implement those accepted recommendations. The Company disagreed with four of the recommendations, and accepted 18 in concept with clarifications and/or minor exceptions.

By letter dated September 28, 2018, Rate Counsel filed its comments on the recommendations included in the Final Report. While not specifically indicated in its letter, Rate Counsel's comments addressed audit recommendations Chapter II Section II-F, #2, Chapter III Section H #1, Chapter IV Section F #1 and Section I #1 and #7, and Chapter VII #2, #3 and #6.

Below is a detailed discussion of the comments filed by the Company and Rate Counsel as they relate to specific recommendations made by Sage. Additionally, the position of Staff is stated with respect to each of the audit recommendations that the Company did not agree to implement.

Chapter II: Executive Management

Chapter II Section B - Aqua America Board of Directors

Recommendation II-B, #1: Aqua America should consider recruiting directors with water and wastewater utility experience.

The Company accepts this recommendation and has considered recruiting directors with water and wastewater utility experience.

Rate Counsel did not take a position on this recommendation.

Staff agrees with the recommendation by Sage.

Recommendation II-B, #2: Aqua America should consider recruiting directors with experience with enterprises employing a growth-by-multiple-small-acquisitions strategy.

The Company accepts consideration of this recommendation.

Aqua America will continue to evaluate director candidates based upon qualifications and experience that are aligned with Aqua America's corporate strategy, including its growth initiative.

Rate Counsel did not take a position on this recommendation.

Staff agrees with the recommendation by Sage.

Recommendation II-B, #3: Consider reassigning the responsibilities for risk evaluation and mitigation oversight to the Board Audit Committee.

The Company has considered this suggestion and respectfully rejects the recommendation.

While the Company agrees with the observation that "[t]he evaluation of potential acquisitions and divestitures is specialized and this function requires frequent, active participation by Board members,"¹ it does not agree with the corresponding recommendation. The Company argues that risk evaluation and mitigation oversight more appropriately belongs in the Risk Mitigation and Investment Policy Committee ("Committee") where it can be evaluated separately from financial risk and controls which are the main focus of responsibility of the Audit Committee. Given the Audit Committee's narrow focus, the Company argues that it would be inappropriate to expand its risk purview into operational and enterprise risk management functions. The Company believes that this function more appropriately resides in its own Committee that directly reports to the full Board of Directors rather than included as another additional responsibility for the Audit Committee. However, if the burden of investment oversight begins to consume too much of the Committee's resources, the Company conceded that it may consider the reallocation of investment risk oversight into the Audit Committee.

Rate Counsel did not take a position on this specific recommendation.

¹ Final Report at page 35.

Staff disagrees with the recommendation by SAGE and agrees with the Company's position.

Recommendation II-B, #4: Have the Governance Committee require a formal executive succession plan from Aqua America and review it at least semi-annually.

The Company partially accepts this recommendation, except the stipulated review frequency. Aqua America is currently implementing a succession planning process, focusing on the Company's leadership. Once completed, C-level plans will be presented to the Board, and specifically to the Corporate Governance Committee to be reviewed on an annual basis. This frequency is explicitly stated in the Corporate Governance Committee's charter, which has repeatedly been deemed appropriate and approved annually.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the Company's position.

Chapter II Section C - Corporate Governance

Recommendation II-C, #1: Keep and circulate minutes for the management committee meetings and the Aqua NJ Opportunities Meeting.

The Company accepts this recommendation.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation II-C, #2: Consider placing Customer Operations and Information Technology higher in the organization structure.

The Company accepts this recommendation. Presently, the Vice President of Customer Operations and the Chief Information Officer report to the Chief Administrative Officer, who reports to the Chief Financial Officer. In April 2018, it was announced that the current Chief Financial Officer will retire in October, and at that time the Chief Administrative Officer will report directly to the Chief Executive Officer. This will elevate the Chief Administrative Officer and her direct reports to the second and third levels in the organization, respectively.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation II-C, #3: Develop a services contracting function in the Supply Chain organization.

The Company partially accepts this recommendation. Aqua NJ will consider the possibility of developing a services contracting function in the Supply Chain organization. While such a function could be valuable to the Company and its subsidiaries, the costs of implementing a new program or function must be carefully weighed against the potential benefits, and the budgetary constraints must be considered.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the Company's position in that the Company should always perform its due diligence and review costs however, pursuing centralized rules and practices generally where appropriate tend to lead to efficiencies, better operations and lower costs by ensuring that there are centralized rules for the contracting function which should be developed, implemented, and overseen with standardized contracting contracts, contractor management and contract administrative policies, procedures and systems. This will help allow the Company's functional and local involvement in services contracting to be maintained while achieving applicable consistency and possibly reduce risk throughout the Company. Staff recommends that within three months of this order, Aqua report back to Staff on the status of their cost analysis and status of implementation and position.

Chapter II Section D - Strategic Planning Process And Plans

Recommendation II-D, #1: Develop a strategic planning process that informs the subordinate functional plans.

The Company accepts this recommendation and has initiated this process.

Rate Counsel did not take a position on this specific recommendation.

Staff accepts the recommendation by Sage.

Chapter II Section E – Corporate Performance Management

Recommendation II-E, #1: Upgrade the Aqua NJ Scorecard.

Specifically, Sage recommends that the Company update the performance metrics, add employee safety metrics, report more benchmarks and utilize them in setting targets, have targets for all metrics, have accurate actual measurements for all metrics and include the State Engineer in the Scorecard.

The Company accepts this recommendation and has already made several changes to the monthly Scorecard. The Company removed "Inactive Sewer Only Accounts," and "Inactive Water Accounts," added "Waste Water Chemicals as cost per Kilogallon," "Priority 2 Appointments Met," and "Completion of Required Safety Training."

The Company agrees that the State Engineer should be listed on the scorecard, and will add the respective employee beginning in 2019 (changes to the scorecard are completed on an annual basis). Aqua NJ also agrees to consider additional meter reporting metrics. A new National Metrology Manager was hired in 2018, and she will review the existing metrics and evaluate improvement options. While the scorecard may not be the appropriate place for comprehensive meter reporting, the metrics will be tracked and managed in an appropriate manner.

Rate Counsel did not take a position on this specific recommendation.

Staff accepts the recommendation by Sage.

Recommendation II-E, #2: Consider developing a separate corporate performance management program and reweight the Aqua America incentive compensation program to less financial performance measures and more operational performance measures relevant to Aqua NJ.

The Company partially accepts this recommendation. While the Company does not agree that a separate corporate performance management program is necessary, it has reweighted the Aqua America incentive compensation program for 2018.

As a result with this change, the weight allocated towards financial goals was reduced from 60% to 50% and the Customer Satisfaction metric was given a 10% weight. In addition, the Company will continue to weight safety at 15%, compliance at 15%, and individual goals at 10%.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the Company's 10% reduction in the weight given to financial goals and the 10% weight added for customer satisfaction. This provides a more even distribution of weighing between financial measures and other operational performance type measures in the compensation calculation. Although Staff believes that this is a step in the right direction, Staff recommends that in the next audit of Aqua NJ that this issue be examined further to determine whether other operational performance metrics such as reliability of service leakage performance and other performance benchmarking metrics should be incorporated into the formula for compensation especially as the Company develops a comprehensive benchmarking program as indicated below in the recommendation in Section II-E, #3.

Recommendation II-E, #3: Develop a comprehensive benchmarking program.

The Company accepts this recommendation and is in the process of developing a benchmarking program.

Rate Counsel did not take a position on this recommendation.

Staff agrees with the recommendation by Sage.

Chapter II Section F – Legal Department

Recommendation II-F, #1: Consider reassigning the regulatory counsels to the General Counsel's office.

The Company accepts this recommendation and is open to considering the reassignment of the regulatory counsels.

The Company states, the regulatory counsels have traditionally been included in the Rates Department, in order to be aligned with rate case personnel, accountants, and financial analysts in order to assist in the filing of rate cases and other regulatory filings. Furthermore, they believe this approach has proven successful in the past, as close coordination and a particular skill set is needed for these responsibilities. Aqua NJ appreciates this suggestion and will consider this organizational move.

Staff agrees with the recommendation by Sage. As the Company considers the reassignment, Aqua NJ shall ensure that the skill set is not lost in the transition.

Recommendation II-F, #2: Increase the scope of the attorney assigned to Aqua NJ to cover all legal and risk related matters.

The Company accepts this recommendation, and will continue the developmental trajectory of the Assistant General Counsel assigned to Aqua NJ.

Rate Counsel agrees with this recommendation, and supports a directive from the Board to increase the assignment and visibility of inside legal counsel to the operations of Aqua NJ, and regulatory filings with the BPU. In order to be most effective, this assigned counsel should have utility regulatory experience.

Staff supports Sage's recommendation as written and the additional suggestions by Rate Counsel so that the particular regulatory skill set of these attorneys is not lost but rather enhanced with direct regulatory responsibility so that inside legal counsel has increased assignments and visibility with the BPU.

Chapter II Section G - Enterprise Risk Management ("ERM")

Recommendation II-G, #1: Hire or develop an ERM professional to direct the program.

The Company partially accepts this recommendation. The Company's current plan is to develop a current Assistant General Counsel to manage the ERM program. The formal ERM program is a new initiative at Aqua America, with 2017 marking the first year it was operational. As the program matures, the Company will consider additional employee needs.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the Company's position.

Recommendation II-G, #2: Reconcile the ERM developed risks and the risks disclosed in the SEC Form 10-K.

The Company partially accepts this recommendation. Aqua is open to considering the reconciliation of the ERM developed risks and the risks disclosed in the SEC Form 10-K. The risks listed in the 10-K are evaluated for accuracy and comprehensiveness every year during the 10-K editing process.

However, the ERM dashboard and the 10-K are directed at different audiences and have different requirements for what risks are listed. The 10-K is aimed at investors and is intended to provide a discussion of the "most significant factors that make the offering speculative or risky,"² whereas the ERM dashboard is an internal tool used to manage operational risk holistically. An operational risk could present a concern to management for qualitative reasons and be included on the ERM dashboard, however that same risk could be immaterial from an investor's perspective and thus not deemed appropriate for the 10-K filing.

Rate Counsel did not take a position on this specific recommendation.

² 17 C.F.R. § 229.503(c).

Staff agrees with the Company's position and within six months shall provide staff with its analysis to reconcile the ERM developed risks and the risks disclosed in the SEC Form 10-K.

Chapter III: System Operations

Chapter III Section A - Overview

Recommendation III-A, #1: Aqua NJ should install Supervisory Control And Data Acquisition ("SCADA") monitoring systems on its wastewater facilities that do not have them.

Aqua accepts this recommendation and plans to install SCADA monitoring systems on its wastewater facilities that require them over a period of time and with sensitivity to rate impacts and prudent investment. This installation was an existing plan at the time of the audit and simply needs to be allowed to proceed to its planned conclusion.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation and further recommends that within three months of this implementation order, Aqua NJ provide Staff with a status of the installation and any analyses performed by the Company with respect to their comments above.

Chapter III Section C – Aqua Services Regulated Operations

Recommendation III-C, #1: Consider realigning the reporting arrangement for the two

Aqua NJ Engineering Technicians to report directly to the State Engineer instead of the Operations Director.

The Company accepts this recommendation and will consider changing the reporting relationship for the two Aqua NJ Engineering Technicians. Currently, one of the two engineering technicians already reports to the State Engineer. The existing reporting relationships are functioning effectively, and communication between the Director of Operations, the State Engineer, and the two Technicians is clear and efficient.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation and further expects that the Company should continue to function effectively, with clear and efficient communication continuing between the Director of Operations, the State Engineer, and the two technicians.

Chapter III Section D – Performance

Recommendation III-D, #1: Further upgrade the Aqua NJ Scorecard by entering actual performance data for all metrics that are included on the Scorecard and assigning targets for all metrics being tracked.

The Company accepts this recommendation and has added actual and target data for all applicable metrics on the NJ scorecard. The Company changes to the Scorecard, are reflected in its response to Section II-E, Recommendation #1 under Chapter II: Executive Management.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation.

Recommendation III-D, #2: Aqua NJ should ensure that its Safety performance is completely and accurately registered on the Scorecard.

The Company partially accepts this recommendation. Safety is a top priority at Aqua America, and is consistently tracked by the Safety Department separately from the Aqua NJ Scorecard. In 2018, "Completion of Required Safety Training" was added to the scorecard and tracked as a whole, and within each division.

While this recommendation is certainly understandable, safety reporting is done at the state level. The metrics that are on the scorecard are reported as a whole for senior management, but broken down to the division level for each area manager. This is in contrast to the safety metrics, which are tracked on a state-wide level.

Safety metrics are tracked via Qlik and are a key part of the Corporate and State Short-Term Incentive ("STI") program. The metrics in Qlik are constantly available to employees who have access, and are periodically updated on the Company's intranet for those employees who do not have access. Redistribution is not truly necessary; however, Aqua can consider adding a reproduction of these metrics as a safety addendum to the scorecard. The scorecard and the safety metrics are reviewed together at the financial opportunities meetings.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation and understands that there are state and division level safety metrics but believes the safety and performance metrics for Aqua NJ be included on the scorecard even if shown on a state-wide level and division wide basis. This will allow Aqua NJ to focus on potential issues for a particular operation and allow the Board to see a more specific breakdown for Aqua NJ.

Chapter III Section E - Practices and Processes

Recommendation III-E, #1: Aqua NJ should consider home dispatch for operators and field service workers ("FSWs").

With existing Global Positioning System technology, the superintendents and foremen have the ability to monitor the locations of Aqua NJ workers' vehicles. To achieve greater efficiencies, Sage recommends that workers be dispatched from their homes to the site for their first work assignments and likewise return home from their last assignment for the day and only return to the division Headquarters if it becomes necessary during the day.

The Company accepts this recommendation and is willing to consider home dispatch for operators and FSWs. Presently, most Aqua NJ workers live within close proximity to their division office, so the potential "windshield time" saved by dispatching straight from home would be minimal. While efficiency should remain a focus, such a change should be balanced with the negative effects of home dispatch. Clear communication, team synergy, and employee morale are important factors that could be negatively affected if employees reduce their visits to the division office.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation and appreciates the comments submitted by the Company. Staff recommends that within three months but no later than six months, the Company advise Staff of the results of its consideration and review. Although Aqua states in its comments that the "windshield time" savings will be minimal since Aqua NJ workers live within close proximity to their division office, the Aqua System resulting from many acquisitions tends to be very spread-out and far from the division office according to recommendation III-H #1. This leads Staff to question the claim of minimal savings since as the system grows employees may at some point be further away from the division office and live in different areas that are throughout the growing system. This should be taken into consideration in the Company review.

Recommendation III-E, #2: Consider adding the capability to access the Aqua NJ Geographic Information System ("GIS") to the FSW tablet devices.

The Company accepts this recommendation and has already added the GIS access capability to the FSWs' tablets. Training on this new capability was conducted in February 2018.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation and with the Company providing tablets with GIS systems to their workers. Staff believes that this technology will provide better communication with the headquarters about the progress of their daily assignments resulting in overall efficiencies and perhaps greater assignments being completed in a normal day.

Recommendation III-E, #3: Perform a cost-benefit analysis to determine the cost effectiveness of moving meters from inside customer premises to outside meter pits.

The Company accepts this recommendation and will perform the specified analysis.

Rate Counsel did not take a position on this specific recommendation.

Moving meters to an outside location may improve accessibility and may prevent damage to the premises from potential leaks, however, the cost of moving meters may be prohibitively expensive and therefore, Staff agrees that a cost benefit analysis is necessary to determine cost effectiveness. Staff recommends that the cost benefit analysis be filed with the Board within six months of this order.

Recommendation III-E, #4: Formalize the contractor performance evaluation process and record the results for reference during future contract bid evaluations.

The Company accepts this recommendation and is in the process of formalizing and recording the contractor evaluation process.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage. Documentation will provide supporting detail as to whether contractor performance warrants others from utilizing the contractor again within Aqua NJ and elsewhere with Aqua America.

Chapter III Section F – System Planning, Facilities, and Land Management

Section III-F, #1: Aqua NJ should develop a facilities management plan and a land/real estate management plan to optimize the value of its facilities and real estate holdings.

The Company accepts this recommendation, will incorporate management of facilities into its asset management plan, and will continually review its real estate holdings.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage, which if implemented could lead to cost efficiencies that should flow to Ratepayers.

Chapter III Section G – Capital Program

Recommendation III-G, #1: Aqua NJ should standardize the methodology for tracking and recording main leaks to enhance the input of information for main replacement prioritization.

The Company accepts this recommendation. Main leaks are currently tracked and recorded in Maintenance Connection, on a master map, and for purposes of Distribution System Improvement Charge filings, however there is a variance of detail that exists between the divisions. A standard form will be created to collect consistent detail for input to Maintenance Connection.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage and the comments provided by the Company.

Chapter III Section H – System Acquisitions

Recommendation III-H, #1: Aqua Services should consider inclusion of an accessibility factor in its due diligence evaluation checklist for the maintenance and operation of candidate acquisitions.

Sage finds that acquisitions between 2012 and 2017 may have been acceptable from a financial and accounting perspective, but not from a practical standpoint. According to SAGE, Aqua NJ acquisitions totaled 787 water system connections and 638 wastewater system connections, representing an average addition of 131 water connections and 213 wastewater connections per system acquired. Sage finds that the acquired systems are inconveniently and inefficiently located from the Division office, one as far as 53 miles. SAGE points out this causes operations and maintenance activities at those locations to be inefficient due to difficult accessibility and excessive windshield time for employees. Although New Jersey public policy and laws encourage the purchasing of small systems by larger systems that have more scale and expertise, Aqua NJ should incorporate efficiency of operations when considering the acquisition of remote, smaller systems.

The Company accepts this recommendation and currently considers accessibility in its due diligence for acquisitions. Accessibility is only one factor in a portfolio of considerations, some of which may be critical to public health. All of Aqua NJ's acquisitions are reviewed by the NJ

BPU, and the breadth of pros and cons for each unique situation is evaluated at that time. Approval of the acquisition is inclusive of all factors, including accessibility.

Rate Counsel agrees with this recommendation. Rate Counsel refers to the Final Report whereby it notes that many of Aqua NJ's recent acquisitions have been impractical from an operations standpoint, being "inconveniently and inefficiently located," citing the Final Report at 114. They also note that the acquisitions are located an average of 37 miles from a Division office, with one as far as 53 miles away. Rate Counsel shares the Audit Report's concern, since such remotely located systems are costly in terms of travel and time spent by Aqua personnel, putting upward pressure on rates in the process. Rate Counsel urges the Board to adopt this recommendation.

Rate Counsel further states that it is concerned to see that the "impact on customer rates" of an acquisition is not included in the list of criteria used for evaluating water and wastewater system acquisitions. Rate Counsel argues that if an acquisition target cannot be self-supporting, Aqua should approach such an acquisition with skepticism. Rate Counsel urges the Board to direct Aqua to consider the impact on rates in its evaluation of potential acquisitions.

Staff disagrees with Sage's recommendation noting that there are acquisitions that are encouraged by the Board and the DEP that result in non-adjacent service territories for the acquiring company.

Chapter III Section I – Procurement, Materials Management, and Transportation

Recommendation III-I, #1: Aqua Services should review and strengthen its engineering and construction contracting process to include more checks and balances to avert any potential malfeasance.

The Company accepts this recommendation and will consider including enhancements to the engineering and construction contracting process as part of ongoing process improvement efforts.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation and requests that the Board direct Aqua NJ to advise Staff of the additional checks and balances that it proposes to implement prior to deployment of them, but no later than six months from the effective date of this Order.

Chapter IV: Customer Services

Chapter IV Section B - Metering and Meter Reading

Recommendation IV-B, #1: Remove or replace irrelevant or inadequate metrics from Aqua NJ monthly performance reporting and add more relevant metrics.

The Company accepts this recommendation and has removed the "Inactive Sewer Only Accounts" and the "Inactive Water Accounts" metrics on the 2018 Scorecard.

The metric "Total Meters Replaced" remains on the scorecard because it is a weighted metric that is awarded points based on meeting or exceeding the target. Tracking the meters replaced

vs. the target meters replaced is considered to be a useful metric for ensuring that the meter replacement program is on track and meeting regulatory requirements.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation and supports the suggestions by Sage that Aqua NJ include such metrics as percent of meters tested on schedule, percent of meter test failures, and theft of service discovered. Measuring meter test failures has a direct correlation with the number of meters to replace and their targets. If a meter is used and useful perhaps it should not be on their meter replacement track.

Chapter IV Section C – Billing and Payments

Recommendation IV-C, #1: Move forward with the development of moving Zipcheck enrollment online.

The Company accepts this recommendation. Evaluation of vendors for this project began in 2018, and this project will likely move forward in 2019, if not cost-prohibitive.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation and the comments submitted by Aqua NJ.

Chapter IV Section D – Credit and Collections

Recommendation IV-D, #1: Implement additional Aqua Customer Operations (“ACO”) Credit and Collection metrics for better performance management.

The Company partially accepts this recommendation and will review and discuss including some or all of the metrics suggested for implementation, pending sufficient staffing.

Any implementation of additional credit and collections metrics must be evaluated in a cost-benefit analysis. As referenced in the audit report, Aqua NJ has generally performed better than its targets for Percent Accounts Receivable (“AR”) > 90 Days to Total AR and Percent Bad Debt to Total Revenue.³ This low level of bad debt lends itself to a low incremental value of additional tracking for NJ specifically. As such, any potential benefit must be carefully considered in light of associated costs, and in the context of a holistic program that can support multiple states, as is the approach of a service company model.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage, but also agrees with the Company's position to perform a cost benefit analysis and recommends that the Board require Aqua NJ to share the results with Staff and to work with Staff as to which additional metrics should be implemented and provide the most valuable information for the Board and Aqua NJ for rate making purposes and to improve operations.

³ Final Audit Report at page 136.

Chapter IV Section E – Call Center Operations

Recommendation IV-E, #1: Analyze the decline in annual average Quality Assurance Customer Service Representative (“CSR”) Call Evaluation scores and the below-target performance for the call centers and implement corrective actions.

The Company accepts this recommendation. The Company states that analyzing a decline in any performance metric is an ongoing process focused on continuous improvement. Specifically, and in the short-term, the Quality Assurance program is being reviewed in 2018. Aqua NJ has partnered with the firm Corporate Execute Board, Inc. to assist with this process and to guide Aqua NJ through implementation of best-practice changes.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage and recommends that the Board direct the Company to provide the Board and Staff with the results of the Quality Assurance Program review and any reports from CEB.

Recommendation IV-E, #2: Correct the problems of the Quality Assurance CSR Call Evaluation Program.

According to Sage, the Company should re-establish the monthly ten assessments per Customer Service Representative which was the historic assessment level and increase the current minimum acceptable score of 92% and evaluate the Quality Assurance Call Evaluation Program for additional improvements and work towards improving some deficiencies in a combination of hiring, training, coaching, supervision, and Quality Assurance Staff.

The Company accepts this recommendation and is in the process of reviewing the Quality Assurance program.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation IV-E, #3: Improve call center productivity and utilization in conjunction with customer service quality.

Sage states that the measures associated with customer service quality metrics to improve productivity should be achieved without decreasing customer service quality.

The Company partially accepts this recommendation. Aqua NJ agrees that call center productivity and utilization in conjunction with customer service quality can be improved, and affirms that such improvement is a continuous process and focus of the Company. Aqua NJ agrees to consider enhancement of and addition to existing metrics.

Specifically, this recommendation suggests measuring and including the Average Handle Time (“AHT”) metric. While Aqua NJ agrees with monitoring and managing AHT metrics, the Company asserts that attaching any sort of performance target or goal to reduce the metric could degrade customer service quality by placing too much emphasis on productivity. Additionally, it is recommended to implement unit costs to quantify the cost of AHT components. As discussed in Section IV-I, Recommendation 5, Aqua NJ will utilize unit cost analysis in

certain scenarios, however this particular circumstance is not one that is deemed useful at this time.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage, but also recommends that the Company be encouraged to improve efficiencies and measure customer satisfaction. The two go hand in hand, but one results in cost efficiencies and the other in happy customers. This is why Sage recommended that the Company continue with existing protocols, but also add new quality metrics in conjunction with the AHT and cost metrics including First Call Resolution metrics. Staff believes that this recommendation tries to combine cost efficiencies and quality assurances in these metrics and measurements, therefore Staff supports the recommendation. Staff recommends that the Company share and discuss with Staff the results of its examination of how it could improve its call center performance and customer service quality in more detail.

Recommendation IV-E, #4: Implement First Call Resolution as a key performance objective and metric.

The Company accepts this recommendation. Aqua NJ agrees with the intent of this recommendation and First Call Resolution is a metric that is currently being evaluated for implementation.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation IV-E, #5: Explore the ability to include Aqua NJ as a stand-alone participant in the J.D. Power Annual Customer Satisfaction Surveys.

The Company accepts this recommendation.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation IV-E, #6: Implement the J.D. Power recommendations for improved CSR training.

The Company partially accepts this recommendation. Since receiving the results of the J.D. Power assessment, Aqua NJ has been evaluating the recommendations and deciding on how to respond. The Company will continue to evaluate and take steps towards implementing those that align with cost concerns and provide sufficient benefit to justify the initiatives. The Company cannot commit to implementing all seven recommendations within a specific and narrow timeframe due to cost concerns; however progress has been made and will continue.

One of the operational gaps specifically referenced in the J.D. Power assessment and in the audit report was a need for better workforce management to "make it clear when training is needed" and "eliminate the desire to "rush" staff out to the floor."⁴ In 2018, Aqua NJ worked with International Customer Management Institute ("ICMI") to evaluate workforce management tools

⁴ DR CS-060.

and structure. Currently, the Company is implementing recommendations from said evaluation to improve the workforce management function so that staffing needs can be better managed, which will help alleviate this concern.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage and while the Company has expressed some concerns in its position, Staff recommends that the Company provide a report to Staff and the Board on the status of each of J.D. Power's recommendations with implementation dates within 2019 and for those recommendations that Aqua NJ will not implement, a full and complete explanation of the decision within four months from the date of this order.

Recommendation IV-E, #7: Implement the 2015 Customer Satisfaction Study recommendations for improved customer experience.

The Company partially accepts this recommendation. Aqua NJ conceptually agrees with implementing recommendations from a Customer Satisfaction Study; however, the recommendations from the 2015 study are dated and do not reflect new improvements or issues that have developed since the last study was conducted. Per the response to Section IV-E, Recommendation 8 (below), the Company plans to perform an updated customer experience study, and will consider implementation of specific suggestions that are derived from more recent customer experiences.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the Company's position.

Recommendation IV-E, #8: Perform periodic customer satisfaction transactional studies and other annual studies and surveys.

The Company accepts this recommendation and is actively evaluating potential vendors to assist with this initiative. Once a vendor is chosen, the proposal will be presented to the Senior Leadership Team for approval.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation IV-E, #9: Develop a credible plan for improving and maintaining or replacing the CIS.

The Company accepts this recommendation.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Chapter IV Section F – Complaints

Recommendation IV-F, #1: Analyze the root causes for the increased BPU complaints and implement improvements that will more closely address customer problems.

The Company accepts this recommendation and will continue to examine the root causes of all BPU complaints and take action to address customer issues as part of the Company's continuous improvement efforts.

Rate Counsel supports this recommendation, and comments that the Final Report found that complaints filed with the BPU increased 47% between 2013 and 2017 citing the Final Report at page 151. Rate Counsel believes Aqua NJ should prioritize an investigation into the root causes of this increase in customer complaints. Rate Counsel further agrees with the Audit Report's recommendation that the Company should categorize complaints on a more granular level in order to identify the root cause of the complaints

Staff agrees with the recommendation by Sage and supports the comments filed by Rate Counsel. Moreover the increase in complaints may have a direct correlation with the quality controls in place at the customer service centers and thus tracking and improving First Call Resolution of complaints at Aqua NJ may reduce the number of BPU complaints received.

Recommendation IV-F, #2: Develop a consistent approach for more accurately categorizing and tracking complaint types.

The Company accepts this recommendation and agrees with its intent. Accurately categorizing complaints is a key component of identifying root causes and implementing process solutions that could decrease the number of complaints.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage and the comments by the Company.

Chapter IV Section G – Revenue Protection

Recommendation IV-G, #1: Develop and track theft-of-service metrics.

The Company accepts this recommendation. Aqua NJ is concerned about revenue protection, and regularly exercises diligence in detecting lost, stolen or unbilled water from its distribution system. Aqua NJ's Customer Service Operation has formalized processes in place to detect unauthorized usage, and to limit exposure to theft and to maintain a bad debt /revenue ratio of less than 0.5%. Aqua NJ's field personnel are trained in what to look for, so as to spot any signs of trouble expeditiously and report the same for further investigation. Aqua NJ currently monitors the number of critical Zero Consumption SOs, and the number per 10,000 accounts. Theft of service is tracked and discovered within this metric.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Chapter IV Section H – Communications and Conservation

Recommendation IV-H, #1: Implement the Customer Experience Website Project to improve the customer experience.

The Company accepts this recommendation.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage and the comments by the Company.

Chapter IV Section I – Performance Management

Recommendation IV-I, #1: Establish a comprehensive set of Aqua Customer Operations (“ACO”) performance metrics.

Sage provided a comprehensive set of ACO performance metrics and further recommended that they be tracked by state, so that they can be reported for Aqua NJ. Sage recommended that ACO assess its current state of performance metrics, decide which ones are necessary for measuring performance and eliminate ones that are not, and add new metrics that will enable ACO to improve the recommended metrics.

The Company accepts this recommendation. The Company states that ACO is currently assessing its current state of performance metrics, will decide which ones are necessary for measuring performance, will eliminate ones that are not, and will add new metrics that will enable ACO to improve. This process organically began when the current Vice President of ACO was hired in 2017.

Rate Counsel states that it appears that Aqua NJ does not properly track relevant customer service metrics. It commented that the Final Report lists a number of customer service metrics that Aqua NJ should adopt, and track by state, such as average call answering time, percentage of calls answered within 60 seconds, first call resolution, etc. Further, Aqua NJ also fails to track other relevant ACO metrics such as revenue protection metrics. Rate Counsel is concerned to learn that Aqua NJ has not been properly tracking these industry standard customer service metrics. Rate Counsel strenuously recommends that the Board adopt this recommendation and require Aqua NJ to begin tracking customer service metrics.

Staff supports Sage’s recommendation as written and further recommends that if Aqua NJ deviates from the Sage’s recommended metrics, Aqua NJ be directed to apprise Staff of its assessment regarding which metrics they plan to add and which ones it plans to eliminate with supporting reasons for the decision

Recommendation #2: Implement an ACO Monthly Performance Report as a basis for ACO performance management meetings that focuses on corrective actions and performance improvements.

The Company accepts this recommendation. Development of an ACO monthly performance report is already in process, with Key Performance Indicator development for each group well underway.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation IV-I, #3: Develop and expand the capability for performance analytic skills within ACO to support performance analysis and management.

SAGE commends ACO's plan to hire an additional staff resource, but also suggests that the analytic skill of existing staff be evaluated so ACO has employees who can provide additional needed analytic support, and then provide analytics and performance management training.

The Company accepts this recommendation. The Company states that currently, ACO is evaluating the skill set of the existing complement, and reviewing the time and resources that are both available and needed for departmental goals. Pending budgetary approval, hiring additional resources to lighten the analyst's current workload is the preferred method to allow increased focus on analytics.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation IV-I, #4: Restructure Aqua NJ State Opportunities meetings to focus on performance management, improvement, and follow-up actions.

The Company accepts this recommendation and is willing to consider some revisions to the Aqua NJ State Opportunity Meeting structure. According to the Company, the current agenda topics are decided by management in the Service Company, and generally follow the same structure for each of the states. Aqua NJ will add a performance management section to the agenda moving forward, and will attach the monthly scorecard to the agenda for review and discussion.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation IV-I, #5: Implement improved cost performance management with unit costs.

The Company partially accepts this recommendation. While ACO is considering using unit costs in some scenarios (e.g., cost per call), this type of cost performance measure is not useful in all cases, and the department prefers to utilize alternative types of metrics (as evidenced by the Company's response to several other recommendations). ACO will explore the potential of unit cost analysis, but only implement such measures when deemed appropriate.

Rate Counsel did not take a position on this specific recommendation.

Staff supports Sage's recommendation as written. While Sage is recommending that the Company include unit cost metrics as a way for measuring efficiencies and potential unit cost reductions and associated organizational budget category reductions, Sage is also suggesting that it be paired with internal intra-organizational corporate service metrics and external customer service quality metrics. This will simply allow Aqua NJ to better understand the costs

behind customer service, satisfaction and experience and perhaps place Aqua NJ in a better position to preserve quality of service but may lead to meeting those goals in innovative ways that are more cost efficient. It is good practice to understand the costs behind good performance which could lead to efficiencies without negatively impacting service performance and quality.

Recommendation IV-I, #6: Make benchmarking a new objective and take advantage of existing national benchmarking resources.

The Company partially accepts this recommendation, and agrees with its intent. ACO will consider including customer service in its benchmarking efforts; however, there is a lack of data to benchmark against. The Company states that American Water Works Association has included customer service in its benchmarking publication, however this is one of the only data sources for customer service metrics in the water utility industry, and there are relatively few metrics measured.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with Sage's recommendation, but also recognizes the concerns expressed by the Company. As an additional resource for benchmarking SAGE recommends that Aqua NJ investigate other utility industry benchmarks that may also apply to the water industry. In consideration that some of Aqua NJ's Board members have direct experience in the energy industry, Aqua NJ can use their experience as a resource to uncover similar benchmarking that is common to both industries.

Recommendation IV-I, #7: Improve ACO contract management and vendor performance and renegotiate or rebid existing contracts including considering alternative vendors.

The Company accepts this recommendation, and is in the process of evaluating the current portfolio of ACO contracts and vendors. If the evaluation deems that a rebid or renegotiation would produce cost savings or other benefits, those options will be pursued.

Incremental and prudent changes to vendor and contract management will be considered and implemented, however a single, large overhaul initiative - as implied by the scale of this recommendation - is unlikely.

Rate Counsel agrees with this recommendation, and believes that Aqua NJ has an obligation to continuously monitor its contracts with outside vendors to ensure that it is securing the lowest available cost and most favorable contract terms on behalf of its ratepayers who are paying the costs of these contracts. Indeed, Rate Counsel is troubled to learn that "ACO has routinely allowed contract auto-renewals and allowed contract terms to expire without a performance review, for as few as three years to as much as 14 years, with no policies, procedures, or performance criteria for planned contract renewal, renegotiation, cancellation, or rebidding for the services." Rate Counsel believes at a minimum, Aqua NJ should develop processes "for either a cost-effective re-negotiated contract extension or a competitive bidding process."

Staff supports Sage's recommendation as written and the comments provided by Rate Counsel. Staff supports a competitive bidding process, one that looks at cost in concert with quality of service, ability to provide the scope of service, and the level of experience. It is imperative for a utility to conduct and document performance review of the work provided by vendors and contractors and to compare to developed performance criteria and processes. This together

with securing the lowest cost, while not impacting quality of service, should be the basis for extending contracts, and for approving bid proposals at the most beneficial contract.

Recommendation IV-I, #8: Implement an ACO business process improvement strategy with appropriate process documentation and management tools.

The Company partially accepts this recommendation. Business process improvement is a continuous effort within ACO. Unfortunately, the department doesn't have budgetary flexibility to hire a business process engineer at this time. Therefore any initiative must utilize the existing complement of staff.

The department is currently evaluating knowledge management systems focused on process documentation. The existing program, Align, is more of a compliance database and used for SOX purposes. The need for workflow documentation and management has been recognized and solutions are being explored. Implementation is dependent on cost factors and senior management approval.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the Company's position.

Chapter V: Human Resources

Chapter V Section A - Overview⁵

Recommendation V-C, #1: Aqua Services leadership should perform an objective review of the circumstances involved with the staffing turbulence in the Human Resources Department, identify the root cause(s) for it, and solve the problems.

The Company accepts this recommendation. The Company states that with the ascent of the interim Chief Human Resources Officer ("CHRO") changes were implemented in the Human Resources Department and the turnover rate decreased drastically. Since the change in leadership, only one employee has left the department.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation V-C, #2: Human Resources should design and implement a thoughtful, comprehensive training and development program.

The Company accepts this recommendation. The Company states that an expansion of the training and development program is included in the strategic roadmap of the department. The Company further states it is focusing its efforts on implementing two human resource systems Workday and Kronos which will be used by employees for time and attendance, benefits, and performance management as well as core human resources data. Once in place, the Human Resources Department can redirect its focus on training and other initiatives.

⁵ Chapter 5 has only three sections A-Overview, B-Findings and C-Recommendations.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation V-C, #3: The Human Resources Department should enhance the Employee Performance Evaluation process to include development of collaborative employee performance improvement plans developed by each employee and the evaluating supervisor.

The Company partially accepts this recommendation. Aqua NJ agrees that the employee performance evaluation process needs to be enhanced, and has taken steps in the recent past to work towards improvement. The employee self-evaluation and the mid-year review are components of the evaluation program that were established in 2017, which began to shift Aqua NJ's philosophy regarding evaluations.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage with further enhancement.

Recommendation V-C, #4: Humans Resources should conduct a thorough and objective upgrade of its policy, procedure, and process documentation to address the obvious deficiencies that exist and to ensure the continuity of its human resources management capabilities as well as to sustain service levels.

The Company accepts this recommendation. Aqua agrees that an upgrade of HR policy, procedure, and process documentation will be beneficial and believes that the progression of the WorkLife project and the start of the new CHRO's tenure organically facilitate this suggestion.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation V-C, #5: Restructure the Aqua Services organization to enhance efficiencies by eliminating unnecessary echelons and increasing spans of management control.

Sage's recommendation is premised on the finding that a structure with many management levels is likely to be characterized by slower decision-making, slower response, and less than optimum efficiency. It is experience that a broader, flatter structure with fewer management levels is likely to have timelier decision-making, better responsiveness and greater overall efficiency. According to Sage, larger organizations with complex operations have more management levels than small organizations less complex operations such as like Aqua NJ. This is also evident from the considerable undesirable lower levels of spans of control per manager.

The Company rejects this recommendation. Aqua NJ recognizes the importance of maintaining appropriate spans of control and agrees with the concept of reviewing the structure of Aqua Services. Organizational structure is currently reviewed and necessary changes are implemented on an annual basis.

At this time, Aqua NJ believes that the current structure of Aqua Services is appropriate. The seemingly narrow spans of control are a function of the lean operating environment of the Company. As the Company has grown, the Aqua Services headcount has remained stable in an effort to keep operations and maintenance costs low. Instead of hiring additional employees, existing employees were given additional responsibilities and more senior titles. This decreased the overall bandwidth for management, thus requiring low subordinate volume.

Aqua NJ will continue to review the appropriateness of the existing spans of control in the Aqua Services, and will adjust as necessary on an ongoing annual basis.

Rate Counsel did not take a position on this specific recommendation.

Staff disagrees with the recommendation by SAGE and agrees with the Company's position.

Recommendation V-C, #6: The Executive Compensation Committee should consider making compensation comparisons with other water and wastewater enterprises when benchmarking the competitiveness of Aqua America Named Executive Officers ("NEO") compensation.

The Company partially accepts this recommendation and does review data from water/wastewater enterprises when benchmarking the competitiveness of Aqua America NEO compensation.

The Compensation Committee retains the services of a compensation consulting firm to perform benchmarking analysis of the Company's NEO salaries. This analysis is completed in two parts. First the consultant looks at a group of water/wastewater companies. In this group, American Water is the largest company and Aqua America is the second largest. However after Aqua NJ, the remaining companies' size and revenues decrease dramatically – the size of most of the companies in this group is not comparable to Aqua NJ. As such, the second part of the analysis is conducted with data from the larger investor-owned utility market, whose data is adjusted by the consultant to account for differences in revenue and commodity costs. Due to the relatively limited number of investor-owned water utility companies of the Company's size, the Compensation Committee believes that this method of using the broader utility market data provides reasonable and reliable data for determining competitive compensation levels. While data from other water utilities is considered in the first part of the analysis, the formal benchmarking analysis will continue to use a broader and more comparable data set.

The Company notes that including public operations in the initial group of water utilities would increase the volume of companies, but would inappropriately compare a public or municipal company to a large, private enterprise. The managerial, financial, and regulatory requirements of a large, national, investor-owned utility are significantly different and more varied and complex than those of a geographically focused, smaller, public system. As such, the skill set needed in executive leadership of a national, investor-owned company will come at a higher cost than that required in a local, public role. Comparing the two costs is not equitable.

Rate Counsel did not take a position on this specific recommendation.

Staff sees merit in the recommendation of Sage. Ratepayers are paying for these large compensations and not investors. Although the Company appears to have taken some steps in determining the proper executive compensation by trying to review some water and wastewater utilities; however, Sage noticed that the database listing of companies with which the

compensation is determined is heavily weighted by significantly more complex gas and electric companies than Aqua America. Thus, their operations are not as simple to operate as that of a Water and Wastewater Company. According to Sage, these large companies operate large fleets of nuclear and and/or fossil power plants, have extensive renewable resource investments, and operate multi-state electric and gas transmission facilities as well as multi-state distribution operations. Sage states that these complexities clearly exceed the complexities of Aqua America's water and wastewater operations. Moreover, Sage questions Aqua America's correlation between compensation and company revenues stating that the Compensation Committee and its consultant have concluded that the Company's revenues under represent the complexity and scope of the Company's business even with the adjustments for the fact that water cost of goods compared to revenue is significantly lower than the cost of goods relative to energy revenues. Staff recommends that the Board direct the Company to take more of a proactive review of its compensation calculation and comparisons incorporating more companies with similar complexities of operations as that of Aqua America and similar water cost of good and revenue ratios. Thus, the Company should consider replacing a reasonable portion of these energy companies with water companies that are closer in the complexities of operations, size, revenue and cost of goods to Aqua NJ.

Recommendation V-C, #7: To achieve actual cash incentive awards to NEOs that are aligned with the targets set by the Executive Compensation Committee, the Committee should establish performance objectives that are more challenging for NEOs.

Sage states that the cash incentive awarded for 2016 indicated that it surpassed the bonus target percentages and so more challenging performance objectives are necessary for NEOs.

The Company partially accepts this recommendation. The Company's intent is instead of simply changing the performance objectives of the NEOs, the entire cash incentive program was revised. Per the 2017 Proxy Statement:

During 2017, the Compensation Committee, Pay Governance, and management determined that it was appropriate to revise the design of the annual cash incentive portion of the total direct compensation paid to the named executive officers to place more emphasis on financial, safety, and compliance performance metrics and to reduce the weight allocated to individual goals. The Compensation Committee believes that these changes will focus the named executive officers' efforts on business metrics that are core to the Company's mission and reward the named executive officers' performance in achieving those metrics.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with Sage's recommendation, but also recognizes that the Company is trying to make changes that may be more in line with the overall performance goals and mission of the company. Staff recommends that the changes made be reviewed in the next audit to see if they have met the intent of Sage's recommendations.

Chapter VI: Finance and Accounting

Chapter VI Section C – Recommendations

Recommendation VI, #1: Information Technology should evaluate the Customer Information System (“CIS”) to determine if it should be replaced.

The CIS is reaching the end of its life. The Company has acknowledged that it will need in the near future to determine whether the CIS should be repaired or replaced. This recommendation corresponds with the Customer Service recommendation number 9 where Sage recommends that the Company develop a credible plan for improving and maintaining or replacing the CIS.

The Company accepts this recommendation.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with Sage’s recommendation.

Recommendation VI, #2: The Records Management function should be centralized and managed by a records management function.

The Company partially accepts this recommendation and will consider a centralized records management function for policies and procedures on the Company’s intranet. Any addition to the Service Company (and subsequently to all of the subsidiaries’ budgets) must be considered with sensitivity to rate impacts and prudent human capital investment.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the Company’s position. Staff recommends that the Company, keep staff regularly informed about their analysis with regard to the rate impact and efforts to meet the recommendation and its beneficial intent under different cost scenarios.

Chapter VII: Affiliate Relationships and Transactions

Rate Counsel raised a general concern with respect to Sage’s findings that Aqua Services and ACO expenses charged to Aqua NJ have been increasing at a faster rate than other Aqua NJ expenses stating that the compounded increase of 9.4% annually with total charges increasing 7.1% annually, clearly exceed inflation. This, in combination with over 90% of Aqua Service’s charges to Aqua NJ being allocated and not directly charged has further heightened Rate Counsel’s Concerns. Given these concerns, Rate Counsel recommends that the Board order Aqua NJ to investigate and report back to the Board and Rate Counsel as to the root cause for these increases with a plan for mitigation showing how Aqua NJ intends to contain these costs moving forward.

Staff agrees with Rate Counsel’s recommendation that the Company report back to the Board and Rate Counsel as to the root cause for these increases to determine whether such increases are within reason.

Chapter VII Section C – Recommendations

Recommendation VII, #1: Improve the transparency of the Accounting Units and the applicable departments, functions, and cost centers by name, and document the allocation methodologies in the Corporate Charges Allocations Manual.

The Company partially accepts this recommendation. Aqua NJ understands and agrees with the need for transparency surrounding the Accounting Units, applicable departments, functions, cost centers, and the associated allocation methodologies. For the purpose of allowing management to easily determine that correct charges have been billed to the state, a combination of the existing monthly Service Company bill and a recently added supplemental monthly report that shows a breakdown of accounting units and allocation amount is sufficient.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with Sage's recommendation. Allocation Manuals should be explicitly clear. Along with the detailed allocation methodologies, the service accounting units should clearly identify the departments, functions, and costs centers by name charging the accounting units and a description of the type of services for which costs were accumulated in the accounting units. This is necessary for transparency especially as Aqua America has grown over the years and may continue to acquire additional regulated and possibly create unregulated entities. Consistent with Sage's findings this transparency will allow Aqua NJ to better understand the costs allocated to them and to compare the basis for its cost allocations with services rendered to them. In addition this will also be valuable information to regulators so that they have a better sense of the specific types of services rendered and how they are being allocated to Aqua NJ. Staff recommends that within three months from the date of this Order that the Company provide to Staff the progress it is making to implement this recommendation.

Recommendation VII, #2: Re-evaluate current allocation methodologies.

The Company accepts this recommendation and states that they currently review all allocation methodologies on an annual basis as part of the budgeting process.

The Company further states that testing and evaluation of intercompany allocations is performed by independent outside consultants and regulators in almost every rate case proceeding throughout the Aqua America footprint.

Rate Counsel commented that the current allocation methodologies determine the percentage of costs that get allocated to different entities, including Aqua NJ. Rate Counsel noted that the current percentage are rounded numbers such as 100%, 70%, etc., which the auditors concluded are "most likely based on rough estimates and are arbitrary." Rate Counsel agrees with the auditors' recommendation for Aqua NJ to complete time studies and gather empirical data on which to base allocation percentages. Rate Counsel recommends that the Board should order Aqua NJ to report this information to Board Staff and Rate Counsel during the Company's next base rate case. Staff supports Sages recommendation as written.

Staff agrees with Sage's recommendation and the comments and recommendations by Rate Counsel. Staff also recommends that the Company be directed to report back to the Staff on its implementation status within three months of the effective date of this Order.

Recommendation VII, #3: More affiliate cost from Aqua Services assigned to Aqua NJ should be directly charged rather than allocated.

The Company partially accepts this recommendation. While Aqua NJ understands the rationale for this recommendation, it would like to note that it is in the nature of a service company for a majority of the charges to be indirectly allocated since a majority of the tasks benefit multiple affiliates. Nevertheless, as part of the annual budgeting process, the Company will review the direct and indirect charges to Aqua NJ and recommend any necessary changes to the allocation methodologies.

Rate Counsel agrees with this recommendation. Rate Counsel states that from 2012 through 2016, only seven percent of charges from Aqua Services to Aqua NJ were directly charged. According to the auditors, "[t]his is considerably less than is usual for affiliate charges between utility service companies and utility operating companies." RC Comments Page 7 According to the Audit Report, thirty to forty percent of charges should typically be directly charged. Rate Counsel recommends that the Board order Aqua NJ to implement direct billing where feasible. Direct billing more accurately reflects the actual costs of the services being incurred on behalf of New Jersey ratepayers. Rate Counsel supports a directive by the Board requiring the Company to increase its percentage of direct charges.

Staff recognizes that each holding company structure as well as each holding company's policies and service agreements are uniquely different and should be evaluated independently and on their own merits. It is Staff's position as it has been in the past with other regulated entities that service company costs should directly allocate costs as much as possible and where feasible. Clearly identifying the services for the accounting units may assist in this effort. Thus, services and their costs that are more clearly described and tracked make it easier to be directly allocated. The percentage of directly allocated cost is unique to each holding company structure but in the case of Aqua America is significantly low at approximately 7 percent. Staff agrees with Sage's recommendation and further recommends that the Company be directed to provide annual reports on direct and indirect charges per function and service and to show that the Company is taking reasonable steps to increase direct billing.

Recommendation VII, #4: Affiliate relationship and transaction training should be formalized and increased.

The Company accepts this recommendation and will create a formal training presentation on affiliate relationships and transactions.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with the recommendation by Sage.

Recommendation VII, #5: Have an expert third party examine Aqua NJ's payments to Aqua America for income taxes to determine if they are equitable.

The Company rejects this recommendation. The Company is willing to explain the difference in effective income tax rate between Aqua America and Aqua NJ, but does not agree that an expert third party assessment is warranted.

Aqua America accrues and pays federal income taxes in compliance with federal tax law and allocates federal income tax to each subsidiary per the Tax Allocation Agreement. This

agreement has been filed with the BPU in each of the Company's prior rate cases for the past 20 plus years. Aqua NJ will be pleased to fully address the federal income tax allocation methodology at the appropriate time in the Company's next base rate case, as required by the NJ BPU.

The Company explains that the reduction in Aqua America's effective income tax is due to Aqua Pennsylvania flow-through accounting from Pennsylvania tax repair, which the Company claims has no impact to Aqua NJ, and as such did not have any effect on Aqua NJ's effective income tax rate. The decrease in the effective tax rate for Aqua America was noted in several of the Company's recent annual reports and 10-Q filings under the *Income Taxes* section. Per the most recent 10-Q filed on 8/3/18, "In accordance with a 2012 settlement agreement with the Pennsylvania Public Utility Commission, Aqua Pennsylvania expenses, for tax purposes, qualifying utility asset improvement costs, which results in a substantial reduction in income tax expense and greater net income and cash flows."

All tax liabilities are determined in accordance with Generally Accepted Accounting Principles ("GAAP") Financial statements prepared according to GAAP are audited by an independent auditor on an annual basis, and submitted to the Securities and Exchange Commission ("SEC") on a 10-K filing. Additionally, GAAP financial statements are reviewed by independent auditors on interim quarters and filed with the SEC as a 10-Q filing.

Given the documented tax allocation agreement, applicable tax laws, GAAP requirements, independent audits for SEC filings, the explanation listed above, and Aqua NJ's willingness to further address the issue within Aqua NJ's next base rate case, the Company strongly disagrees that an expert third party is necessary to examine Aqua NJ's payments to Aqua America for income taxes, and believes that such a requirement would incur significant and unnecessary costs.

Rate Counsel did not take a position on this specific recommendation.

Staff agrees with Sage's recommendation and also recommends that this matter be reviewed in the Company's next base rate as suggested by Aqua NJ.

Recommendation VII, #6: Report Aqua Resources' HomeServe product sales as Aqua NJ affiliate transactions.

Specifically, Sage recommends that Aqua Resources revenues from HomeServe product sales should be shared with Aqua NJ and reported as an affiliate transaction. SAGE also states that all costs incurred by ACO in support of the HomeServe product should be charged to Aqua Resources as an affiliate transaction and any cost incurred by Aqua NJ in facilitating the HomeServe product sale to its customers should be charged to Aqua Resources and reported as an affiliate transaction.

The Company rejects this recommendation. The suggestion presented is a ratemaking issue that can be decided in Aqua New Jersey's next base rate case, when due process regarding ratemaking concerns is afforded to both the Company and the BPU.

Rate Counsel agrees with this recommendation and states Aqua Resources, which is an unregulated affiliate of Aqua NJ, sells service line warranties to Aqua NJ ratepayers. Rate Counsel also states that it appears that Aqua NJ is not recording these sales as affiliate transactions. In addition, Rate Counsel agrees that any costs incurred by Aqua NJ in the sales

of these warranties should be charged to Aqua Resources, and the Board should direct Aqua NJ accordingly.

Staff finds that Sage raises an issue that merits further review to determine the relationship whether direct or tangential between HomeServe, Aqua Resources, and Aqua NJ and any impact it may place on Aqua NJ and its Ratepayers. If such services are deemed competitive, Aqua NJ has the burden of proof to show there is a full separation, with any competitive entity affiliated or non-affiliated with Aqua NJ. Staff needs assurances that the relationship with the competitive entity is not placing it at a competitive advantage over other purveyors of the same or similar services. It is also unclear as to the amount and types of costs incurred as a result of any relationship or endorsement of the competitive entity. Staff agrees that this has some possible rate implications in addition to basic competitive issues. Only after there is full and complete examination of the issue with full cooperation of the Company will Staff have a better understanding of whether there are any issues that need to be addressed. Staff recommends that the Board commence a separate proceeding or direct the Division of Water to review this matter in the current pending base rate case.

DISCUSSION AND FINDINGS

As noted above, there are 66 recommendations in Sage's Final Report for improvement in the management and operations of Aqua NJ. The Company objects to recommendations II-B-3, V-C-5, VII-5 and VII-6. As also noted above, with respect to two of the recommendations, II-B-3, V-C-5, Staff agrees with the Company and does not recommend implementation by the Company at this time. With respect to recommendation VII-5, Staff recommends that it be reviewed in the current base rate case. Regarding recommendation VII-6, Staff believes that more information is necessary for Staff to make a proper recommendation to the Board with respect to the relationship between the Company, its affiliates and HomeServe. Staff recommends that the Board direct the Division of Water to review this matter in the current pending base rate case. With respect to recommendation III-H-1, Staff does not recommend implementation by the Company on the basis that it is inconsistent with current Board policy. Staff recommends implementation of the remaining 61 recommendations and modifications recommended by Staff.

After review of the Final Report, the comments filed by the Company and Rate Counsel, and Staff's recommendations, the Board agrees with Staff's recommendations. Therefore, upon careful review of the Final Report recommendations and the comments received, the Board **HEREBY ORDERS** the Company to implement the 61 recommendations in the Final Report, as modified above. With respect to the recommendation VII-5, the Board **DIRECTS** that it be reviewed in the current base rate case. Regarding recommendation VII-6, the Board agrees with Staff that more information is necessary to fully understand the relationship between the Company, its affiliates and HomeServe. Accordingly, the Board **HEREBY DIRECTS** the Division of Water to review in the current base rate case the relationship between Aqua NJ, its affiliates and HomeServe.

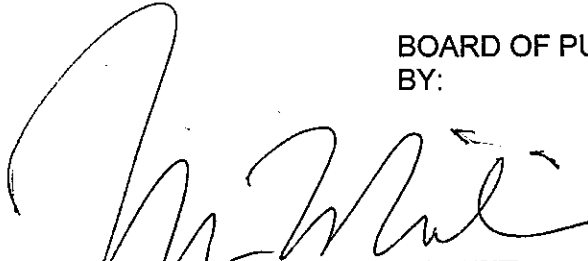
Specifically, the Board **HEREBY DIRECTS** Aqua NJ, with the assistance of the Division of Audits, to formulate detailed implementation plans for the 61 recommendations as modified above, within 60 days from the date of this Order. Aqua NJ shall implement all recommendations as soon as possible but not later than one year from the date of this Order unless otherwise directed in this Order above.

Furthermore, the Board **HEREBY DIRECTS** Aqua NJ to file quarterly reports with the Division of Audits, by the fifteenth day of the month following the conclusion of each calendar quarter, regarding the status of all recommendations. The Division of Audits shall monitor, evaluate, and modify, as necessary, the implementation of the recommendations. The recommendations of the Final Report shall not be dispositive of issues raised in any other proceedings before this Board.


This Order shall be effective on March 9, 2019.

DATED: 2/27/19

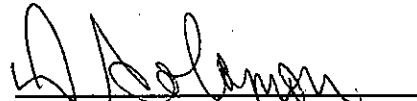
BOARD OF PUBLIC UTILITIES
BY:



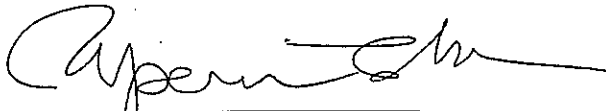
JOSEPH L. FIORDALISO
PRESIDENT



MARY-ANNA HOLDEN
COMMISSIONER




DIANNE SOLOMON
COMMISSIONER



UPENDRA J. CHIVUKULA
COMMISSIONER



ROBERT M. GORDON
COMMISSIONER

ATTEST: 
AIDA CAMACHO-WELCH
SECRETARY

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

IN THE MATTER OF THE AUDIT OF THE AFFILIATED TRANSACTIONS BETWEEN AQUA
NEW JERSEY WATER COMPANY AND AQUA AMERICA AND AFFILIATES AND A
COMPREHENSIVE MANAGEMENT AUDIT OF AQUA NEW JERSEY WATER COMPANY
PURSUANT TO N.J.A.C. 14:3-12.1-14:3-12.4

DOCKET NO. WA16121156

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