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October 6, 2017

VIA ELECTRONIC DELIVERY
Irene Kim Asbury, Secretary
State of New Jersey, Board of Public Utilities
44 South Clinton Avenue, 3rd Floor, Suite 314
CN Box 350
Trenton, New Jersey 08625-0350

Re: Infrastructure Investment and Recovery
Proposed Amendment: N.J.A.C. 14:3-2A
BPU Docket No.: AX17050469

Dear Secretary Asbury:

Please accept the Division of Rate Counsel's ("Rate Counsel") comments regarding the above referenced matter. Thank you for your consideration and attention to this matter.

Proposed New Rules: N.J.A.C. 14:3-2A

Infrastructure Investment and Recovery

Summary

Comments: In the summary section as well as in Section 14:3-2A.1 of the proposed regulation, the Board sets forth its underlying reason for proposing the Infrastructure Investment Program ("IIP") as creating "a financial incentive for utilities to accelerate the level of investment needed to promote the timely rehabilitation and replacement of certain non-revenue producing components that enhance reliability, resiliency, and/or safety." Rate Counsel disagrees that IIP is necessary to "allow a utility to construct, install, or remediate utility plant and facilities related to reliability, resiliency, and/or safety to provide safe and adequate service." In other words, the infrastructure investment program is not necessary in order for the utilities to meet the bedrock

principle in utility ratemaking of ensuring "safe and reliable service at just and reasonable rates" and their regulatory service obligations pursuant to N.J.S.A. 48: 3-1 et seq.[1]

In the past, the Board has approved utility infrastructure programs pursuant to its existing statutory and regulatory authority but only when emergent circumstances warranted such measures. Prior programs addressed significant and identified issues such as safety or public emergencies. For example, following several major storms in New Jersey, including Hurricane Irene in 2011 and Superstorm Sandy in 2012, and millions of dollars spent to restore service from these events, the Board issued an order inviting the State's utilities to file proposals to upgrade and protect infrastructure from future major storm events. I/M/O the Board's Establishment of a Generic Proceeding to Review Costs, Benefits and Reliability Impacts of Major Storm Event Mitigation Efforts, BPU Docket No. AX13030197, Board Order, (March 20, 2013). The Board did so because of its determination that hardening of utility infrastructure was a significant policy issue that needed to be addressed immediately and proactively. The Board's Order was issued following an extraordinary series of storms that affected large portions of the State's utility infrastructure, left ratepayers without power or natural gas for days or weeks and caused unprecedented levels of damage. The Order sought to preserve the utilities' ability to maintain safe, adequate and proper service during major storms, something that is a basic obligation of a utility.

Similarly, BPU approvals of main replacement programs for gas utilities are aimed at addressing safety concerns that were the subject of a "call for action" by the federal government after a gas main explosion in California and elsewhere. They are designed to address a specific safety problem surrounding cast iron and unprotected steel mains that required immediate action. I/M/O the Petition of NJNG for Approval of its SAFE Program, BPU Docket No. GO12030255, Order (October 23, 2012).

The economic stimulus programs instituted by Governor Jon Corzine in 2008 were also based on a specific concern that needed to be addressed via swift action. I/M/O Public Service Electric & Gas Company for Approval of a Capital Economic Stimulus infrastructure Investment Program and an Associated Cost Recovery Mechanism Pursuant to N.J.S.A. 48:2-21 and 48:21.1, BPU Docket Nos. ER09010049 and GR09010050, Decision and Order Approving Stipulation, (April 28, 2009) and I/M/O the Petition of Atlantic City Electric Company for Approval of Certain Energy Infrastructure Investments and Approval of Cost Recovery for Such Projects and Related Tariff Modifications Associated Therewith Pursuant to N.J.S.A. 48:2-21 and 48:21.1, BPU Docket No. ER09010049 and GR09010054, Decision and Order Approving Stipulation, (April 28, 2009). In those cases, the Board acknowledged that it was departing from normal ratemaking procedures but felt that "[t]hese difficult economic times require creative responses that respect the law but adapt to extraordinary circumstances." PSE&G Order at 8.

[1] N.J.S.A. 48:2-21 and 48:2-23.

The Board was careful to state, however, that its approval "in no way sets a new framework for future actions; instead it reflects the realities of today's economic situation." Id. at 11.

These lines of cases demonstrate that where emergency or extraordinary circumstances require immediate action, the Board's existing powers are sufficient to address them. Rate Counsel's position was echoed by Commissioner Joseph Fiordaliso at the June 30, 2017 agenda meeting when the Board voted on the publication of the proposed regulation in the New Jersey Register. Although Commissioner Fiordaliso voted to publish the proposed regulation for additional comments, he was less than convinced of the need for such regulation, stating, "I question what we're fixing. But because I think the process has worked pretty darn well up to this point." June 30, 2017 BPU Agenda transcripts 6:17-9. If extraordinary circumstances do not exist, incentives to build should be through the traditional ratemaking mechanisms that prevent goldplating and unreasonable rate increases. The Board has the ability to respond to emergent conditions on a case by case basis, ensuring that any necessary infrastructure mechanism is not overused and that its statutory mandate to ensure that the rates charged to ratepayers to pay for such programs remain just and reasonable.

Now, the Board is moving to make these programs permanent and divorcing them from any emergent circumstances that might justify departing from the normal ratemaking process. The Board is taking this step without any record that supports the need to do so. Before the proposed regulations were published for comments the Board convened only one meeting with interested parties on May 4, 2017 and one round of comments on May 12, 2017. At the untranscribed "stakeholder" meeting on May 4th, no discussions between the parties or Board Staff took place. Several parties including Rate Counsel, AARP and NJ LEUC vehemently argued against the procedural process and the clear haste towards adoption of the proposed regulation.[2] Before taking this extraordinary step of adopting the IIP regulation, the Board should take the time to investigate the need for such a program and whether the proposed Straw Proposal is appropriately tailored to meet any such need.

Ensuring reliability is an integral part of managing any utility distribution system. The regulatory compact provides that in exchange for being granted a monopoly franchise area, a utility will provide safe and reliable utility service at reasonable rates. The obligation to provide safe and reliable service is a cornerstone of the utility's obligations. Thus, the concept of undertaking reliability improvements, when required, is not new or novel. Rather, this is a fundamental obligation of any utility, and should be paid for in the normal course through rates. It should be clear that this fundamental change not only changes how utilities will be paid for their core business responsibilities, but also the burden placed upon them to demonstrate that their actions were prudent. These IIP regulations shift the burden to those challenging the provision to demonstrate that the proposed projects are imprudent and do not meet the standards

[2] See, May 4th Comments filed by AARP page 5 and NJLEUC page 2-3 in the proceeding below.

of the regulation. This is a significant change in how utilities recover their investments and removes the burden of prudency placed upon the utilities currently.

Social Impact

The proposed new rules will have a positive social impact because an IIP is a regulatory tool that would complement the existing regulatory framework in New Jersey. Furthermore, it would improve service reliability and resiliency through planned replacements and reduce service interruptions, emergency replacements, and attached emergency costs, which can run multiple times over the level of planned costs. The proposed new rules may help to ensure that the people of New Jersey will receive safe, adequate, and proper utility service at reasonable rates.

The Board's mandate is to require that utilities provide safe, adequate and proper service at reasonable rates. This social impact statement provides that the extraordinary departure from standard ratemaking principles "may help to ensure that the people of New Jersey will receive safe, adequate, and proper utility service at reasonable rates." (emphasis added). The choice of the word "may" is significant. Had the Board gone through a proper stakeholder proceeding and taken the time to properly vet these rules, it might have made a more definitive statement. Until such time as the Board is convinced that these proposed rules will help to ensure that the people of New Jersey will receive safe, adequate, and proper utility service at reasonable rates, these rules should be rejected.

Economic Impact

The proposed new rules will have an economic impact. The purpose of an IIP is to provide a rate recovery mechanism that encourages and supports necessary accelerated rehabilitation and replacement of critical utility infrastructure. As provided for in the rules, this investment would occur in a systematic and sustained way to advance the accelerated rehabilitation and replacement of utility distribution infrastructure needed for continued safe, reliable, and resilient service and sustained economic growth in the State of New Jersey. The accelerated recovery component will allow a utility to petition the Board for expenditure recovery prior to the utility's next base rate case. Thus, ratepayers may see rate increases phased in incrementally during the course of an approved IIP.

Comments: The economic impact of the proposed rules asserts that the program is a means to "advance the accelerated rehabilitation and replacement of utility distribution infrastructure" needed to run the utility and aid in the growth of the State's economy. However as discussed above, there is a significant question whether such a program is needed to achieve that goal. In addition, the economic impact analysis is one sided. The statement only discusses the positive effect of the improved infrastructure to the overall "economic growth in New Jersey" but fails to

address the negative pressure on economic growth that arises from higher utility rates. In other words, the summary does not present a net economic impact analysis, but instead simply presents benefits of the program without considering any of the costs. A real economic impact analysis should take into account both the costs and the benefits of a project. In this context, there are benefits associated with the initial construction and ongoing operations and maintenance, but also there are costs associated with the rate increases that will be needed to pay for the program. Rate increases reduce household disposable income and increase costs to business and industries. This rate increase has a negative impact on the regional economy since it takes income and increases costs for several classes of market participants without any corresponding direct economic offset (or transfer). A reduction in household income, or an increase in business costs, reduces the amount of money spent on goods and services, which in turn, leads to "ripple effects" (or multiplier effects) in a regional economy.

Although the original Straw proposal distributed by Board Staff for comments specifically capped the annual rate increases at 2% that ratepayers may see in any given year, this version takes away that 2 percent minimum ratepayer protection without explanation. See page 2 paragraph 12, BPU Staff Straw attached here to as Attachment A, paragraph 9, page 3. In Rate Counsel's initial comments submitted in May 2017, we noted that the Straw Proposal, if adopted, could result in annual rate increases of up to 2% per year for at least five years for one utility without any demonstration of exigent circumstances or comprehensive review in a rate case. Under the proposed regulation the electric, gas and water utilities can all increase their rates under the IIP, pancaking the rate increases, taking a larger percentage of disposable income. The lack of a cap for rate increases in this draft only serves to exacerbate the problem even further. Without a cap on the allowed spending, there is potential for goldplating without the offsetting benefits.

If the same improvements are made under the traditional ratemaking mechanism, all things being equal, the same capital project would be built with less cost to ratepayers. That is because the utilities would not be paid via a more favorable cost-recovery mechanism for the same project. Given that there is no record to establish that an alternative recovery mechanism is even necessary in order to undertake the infrastructure investments needed to provide safe and reliable utility service, the level of investment contemplated by this proposed regulation should be recovered pursuant to the base rate case methodology that has traditionally been used by the Company to recover its cost of service. Instead of addressing Rate Counsel's well-reasoned concerns, the Board eliminated the cap altogether.

Many large businesses and industries have left New Jersey to move to another state because operating a business here is unaffordable. Opportunity New Jersey, an organization comprised of the New Jersey Business and Industry Association, the New Jersey Chamber of

Commerce and other interested parties, held an "Affordability Summit" in the State recently to promote the need for the State's business groups to pool their experience and expertise in an effort to reduce the cost of living and working in New Jersey.[3] High utility rates contribute to the exodus of people and businesses out of the State leaving fewer ratepayers to pay for utility capital improvements.[4] With people and businesses leaving the State, the utilities will have fewer ratepayers to spread the cost of any improvements approved under IIP, increasing the rates even further. Balancing affordable rates with improved reliability through increased capital spending is a continuous challenge for utility regulatory bodies that should not be taken lightly. One of the overarching goals of the State's 2011 Energy Master Plan is to:

1. **Drive down the cost of energy for all customers** – New Jersey's energy prices are among the highest in the nation. For New Jersey's economy to grow energy costs must be comparable to costs throughout the region; ideally these costs should be much closer to U.S. averages.

See, New Jersey State 2011 Energy Master Plan page 1.
http://www.nj.gov/emp/docs/pdf/2011_Final_Energy_Master_Plan.pdf

The Division of Rate Counsel believes that the case by case approach to infrastructure filings that exists today is a better solution to balance the need for reasonable rate increases with the need for addressing aging infrastructure. As these infrastructure investments go on line, there is an unquestionable burden placed on households and businesses that will have to pay higher utility rates. This will ultimately have a dampening effect on the economy that may offset or exceed the positive economic impact in New Jersey.

Federal Standards Statement

No Federal standards analysis is required because the proposed new rules are not being proposed in order to implement, comply with, or participate in any program established under Federal law or under a State law that incorporates or refers to Federal law, standards, or requirements.

Comments: Rate Counsel has no comment on this Federal Standards Statement.

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[3] MyCentralJersey.com Article "Summit focuses on how to make NJ affordable again" http://www.mycentraljersey.com/story/money/business/2017/09/02/summit-focuses-how-make-nj-affordable-again/613869001/

[4] Electric prices in New Jersey have consistently been in the top ten highest prices compared to other states See U.S. Energy Information Administration Table of Average Price of Electricity to Ultimate Customers by End-use Sector https://www.eia.gov/electricity/monthly/epm_table_grapher.php?t=epmt_5_6_a.

Jobs Impact

> *The proposed new rules may have an impact on the generation of jobs in New Jersey. Rutgers University reports that for every $ 1 million of utility infrastructure project spending, a total of 7.9 full-year jobs are created in New Jersey, assuming key materials are manufactured in New Jersey. A total of 6.5 full-year jobs per $ 1 million in utility infra- structure project spending are created if key materials are manufactured outside of New Jersey, according to the report.*

Comments: The Job Impact analysis is inextricably linked to the Economic Impact. Losses of jobs will have a dampening effect on New Jersey's economy all things being equal. Many of Rate Counsel's comments made in the Economic Impact section of these comments apply to Job Impact as well. As with the Board's Economic Impact analysis, the Job Impact section also touts the potential positive benefits of job creation without the corresponding negative impact the IIP may have on job numbers. Relying on an unspecified Rutgers University report for its job creation analysis, the Board claims that for every $1 million of utility infrastructure project spending, between 6.5 to 7.9 full-year jobs will be created in New Jersey. Without stating the name and date of the Rutgers report relied upon, or identifying who prepared it, the Board nonetheless relies on it for the Job Impact analysis.

The Office of Administrative Law Rules for Agency Rulemaking requires that agencies proposing regulations must ensure that the draft maintains certain minimum information so that the proposed regulation is:

> sufficiently complete and informative as to permit the public to understand accurately and plainly the legal authority, purposes and expected consequences of the adoption, readoption or amendment of the rule or regulation.
>
> N.J.A.C. 1:30-2.1 (a) (emphasis added).

Because the Board did not provide any means to identify the Rutgers report relied upon, the public is unable to assess the accuracy of the statement made in that report. The Rutgers document was not provided in proceedings below and appears for the first time in the proposed regulations published in the Register.

Although it is true that the statements for a proposed rule are not part of the rule it is nevertheless an "intrinsic part of the proposal and adoption as published in the Register." As such, these statements may be used in interpreting the rule. N.J.A.C. 1:30-2.5. The public reviewing the proposed regulation should be afforded clarity on whether this proposed regulation will ultimately have a positive or negative job outcome.

In a recent unpublished opinion of the Appellate Division, the Court overturned the Board's decision in I/M/O the Board's Review of the Applicability & Calculation of a Consolidated Tax Adjustment, Docket No. A-1153-14T (September 18, 2017) ("CTA Appellate Decision") (attached as Attachment B) on due process grounds. Applying the APA which governs rule adoption, the Court reiterated the need for a full analysis of evidence used to support the Board's decision to propose a new regulation:

> We do not consider these APA requirements to be insubstantial. They require more of the Board than merely making information available on a website and requesting comment. Compliance with the requirements provides the stakeholders with the Board's analysis and assessment of the economic impact of a proposed rule and the Board's response to a stakeholder's data, comments and arguments before a rule is adopted. Moreover, compliance provides the stakeholders with the opportunity to present evidence and address the Board's economic impact assessment and response to the stakeholder's data, comments and argument. In other words, the statutory requirements guarantee that Rate Counsel and the stakeholders are fully informed of the Board's position concerning a rule's economic impact and the Board's response to the submitted data, comments and arguments, thus permitting Rate Counsel and the stakeholders an opportunity to present further evidence and argument. When the requirements are ignored, the Board gathers information and comment, but Rate Counsel and the stakeholders are deprived of the right granted by the APA to consider and contest the Board's assessment of economic impact and responses to the submissions prior to the adoption of a rule.
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> (CTA Appellate Decision at pp. 25-26) (emphasis added).

Thus, the Appellate Division clearly stated, an interested party should be afforded a chance to review the analysis used by the regulatory agency to support the proposed regulation and have an opportunity to dispute it, if necessary. The parties to this proceeding were not provided this opportunity. It is clearly insufficient for the Board to simply say "Rutgers University reports" without more details.

Moreover, a net job and economic impact study that considers both positive and negative potential impacts must be considered before any final regulations are adopted. The negative job impact resulting from increases in rates are not quantified in the proposed regulation. A more vigorous proceeding below would have addressed some of these deficiencies. At this juncture the public has no data to assess the net impact of these potential positive and negative effects. As discussed more fully in the Economic Impact section above, there is potential overall negative

impact to both New Jersey's economy and jobs due to the IIP especially since the draft regulation does not cap the project costs or the amount of the rate increases. The job impact analysis does not account for the lost jobs to the State due to the higher, accelerated utility rates imposed by the IIP. Therefore the Board should not adopt the proposed regulation at this time without a comprehensive analysis of the economic and job impacts.

Agriculture Industry Impact

The Board does not expect any agriculture industry impact from the proposed new rules.

Comments: Rate Counsel has no comment on this Agriculture Industry Impact Statement.

Regulatory Flexibility Statement

The proposed new rules will not impose any recordkeeping, reporting, or other compliance requirements on small businesses. A small business, as defined in the New Jersey Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq., is a business that has fewer than 100 full-time employees. With regard to utilities that qualify as small businesses under the Act, this new subchapter establishes a voluntary program and, as such, will not impose any requirements on any utility that chooses not to participate in the program.

Comments: Rate Counsel has no comment on this Regulatory Flexibility Statement.

Housing Affordability Impact Analysis

The proposed new rules will have no impact on the affordability of housing in New Jersey and will not evoke a change in the average costs associated with housing because the scope of the proposed new rules is limited to the implementation of an IIP.

Comments: The IIP regulations will result in higher utility rates. This will increase rents for some renters in New Jersey and will increase housing costs for all residents of New Jersey. A blanket statement that increased utility rates will not change average costs associated with housing is simply incomplete and makes a reasoned response impossible.

This is especially troubling given the requirement that there be a housing affordability impact analysis. N.J.S.A. 52:14b-4.1b. There is no analysis of any kind in this statement. Nor can the Board rely upon the exception to N.J.S.A. 52:14b-4.1b(a), which provides that the subsection will apply if the impact is minimal, as the agency must still provide an indication of the basis for its finding. The lack of analysis or any basis whatsoever for the Board's statements makes it insufficient to satisfy the statutory requirement for proposed rules. See I/M/O the Board's Review of the Applicability and Calculation of a Consolidated Tax Adjustment, supra. at 25-26.

Smart Growth Development Impact Analysis

The proposed new rules will not have any significant impact on smart growth in Planning Areas 1 or 2, or within designated centers, under the State Development and Redevelopment Plan because the scope of the proposed new rules is limited to the implementation of an IIP.

Comments: Rate Counsel has no comment on this Smart Growth Development Impact Analysis.

SUBCHAPTER 2A. INFRASTRUCTURE INVESTMENT AND RECOVERY

14:3-2A.1 Infrastructure Investment Program--purpose, scope, and general provisions

(a) This subchapter establishes a regulatory mechanism concerning an Infrastructure Investment Program, which will allow a utility to accelerate its investment in the construction, installation, and rehabilitation of certain non-revenue producing utility plant and facilities that enhance safety, reliability, and/or resiliency. Through an Infrastructure Investment Program approved by the Board, a utility may obtain accelerated recovery of qualifying investments, subject to the terms of this subchapter, and any other conditions set by the Board in approving an individual utility's Infrastructure Investment Program.

(b) The purpose of an Infrastructure Investment Program is to provide a rate recovery mechanism that encourages and supports necessary accelerated construction, installation, and rehabilitation of certain utility plants and equipment. As set forth in this subchapter, such investment would occur in a systematic and sustained way to advance construction, installation, and rehabilitation of utility infrastructure needed for continued system safety, reliability, and resiliency, and sustained economic growth in the State of New Jersey.

(c) The Board shall require frequent and detailed reporting of expenditures during all phases of an Infrastructure Investment Program, as set forth in this subchapter, in order to ensure prudent investment and compliance with this sub-chapter.

Comments: As stated above in the summary section, there is no reason for the Board to implement these rules in order to ensure safe, adequate and reliable service at reasonable rates. The Board currently does so and can continue to do so without these proposed regulations.

14:3-2A.2 Project eligibility

(a) The projects within an Infrastructure Investment Program shall be:

1. Related to safety, reliability, and/or resiliency;

2. *Non-revenue producing;*

3. *Specifically identified by the utility within its petition in support of an Infrastructure Investment Program; and*

4. *Approved by the Board for inclusion in an Infrastructure Investment Program, in response to the utility's petition.*

Comments: The definition of "resiliency" is unclear. That term needs to be defined in order to ensure that the favorable cost recovery mechanism allowed by this regulation is not overused. In the last four years, three of the New Jersey's EDCs have filed storm hardening petitions. Examples of projects proposed by EDCs in those filings include: distribution automation, selective undergrounding, feeder circuit hardening, substation mitigation, and circuit reconfiguration, etc. If the intent here is to use the procedures established in these regulations for storm-related resiliency, the regulations should be revised to say so. If "resiliency" is intended to encompass other types of measures, that should be stated as well.

Within the specifics of individual resiliency filings, Rate Counsel has found that some program elements have clear resiliency benefits while others have questionable resiliency benefits. The EDCs should be required to demonstrate that there is a sufficient business case for multi-year infrastructure programs to justify spending and ultimately recovery from ratepayers. Furthermore, the proposed programs must have a clear nexus to improved resiliency. For natural gas companies, it is questionable whether resiliency projects should be included under an accelerated infrastructure program as they are not primarily safety projects. Those projects are instead ones that the gas companies have undertaken to ensure an adequate supply of gas during a range of extreme events, not at improving safety. Non-safety related resiliency projects should be handled in the normal course.

A comprehensive list and description of each project should be provided as part of the infrastructure program filing. The utility should identify objectives for each project implemented under the program. Details of the utility's filing should include but not be limited to: clearly-defined individual investments, the purpose of each investment, and quantification of benefits associated with the proposed investments. The utility must identify the benefits of the proposed investments and must quantify those benefits for all investments on an annual basis. The utility should also explain how projects will be prioritized and identify how each project will meet its purported goals (e.g. reliability; resiliency; modernization; enhancement; etc.). Rate Counsel recommends that information similar to that required in the New Jersey Distribution System Improvement Charge ("DSIC") Foundational Filing be required, including: 1) a description of the condition or type of infrastructure that will be replaced, 2) a description of the enhanced/reinforced, or renewed project; 3) the duration and location of the project; 4) the project's in-service date; and 5) project identification numbers so the projects can be easily tracked in the review process.[5]

[5] N.J.A.C. §14.9-10.4(2).

If a utility seeks to substitute projects once a program is approved, it should be required to submit its request to the Board for approval, copying Rate Counsel. This is similar to the requirement imposed in the DSIC regulations.[6] Also as required in the DSIC regulations, if Rate Counsel or Board staff objects to any project included by a utility in its Initial filing or request for substitution, the utilities should be required to delete the project or seek specific Board approval overturning the objection.[7]

Finally, Rate Counsel agrees that revenue producing projects and blanket programs should not be eligible. This is consistent with the DSIC and current infrastructure programs.

(b) Projects within an Infrastructure Investment Program may include:

1. The replacement of gas utilization pressure cast iron mains with elevated pressure mains and associated services;

2. The replacement of mains and services that are identified as high risk in a gas utility's Distribution Integrity Management Plan;

3. The installation of gas excess flow valves where existing gas service line replacements require them, excluding excess flow valves installed upon customer request pursuant to 49 CFR 192.383;

Comments: The draft rules provide that programs could include the replacement of Utilization Pressure cast iron pipes with elevated pressure mains. Rate Counsel agrees that cast iron pipes should be targeted for replacement and cast iron mains should be targeted for replacement in all pressure systems of gas utilities, not just in Utilization Pressure systems. In fact, higher-pressure cast iron can carry higher safety risks. PHMSA recommends all cast iron be considered for replacement.[8] The implementation of a cast iron replacement program may become obsolete as the gas utilities in New Jersey have been implementing accelerated replacement programs for a number of years to replace the majority of their cast iron pipelines. New Jersey Natural Gas has already replaced all of its cast iron pipelines. South Jersey Gas anticipates that it will have replaced all of its cast iron pipeline by the conclusion of its current AIRP II program. Thus, the additional recovery mechanism provided by these rules is not needed for cast iron main replacement as those initiatives are already well underway.

The word "unprotected" was omitted from the draft rules as it stated: "5...The projects within the program...may include...(b) Replacement of Gas bare steel and coated steel mains

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[6] N.J.A.C. 14:9-10.4(b)(5).
[7] N.J.A.C. 14:9-10.5(b).
[8] The Pipeline and Hazardous Materials Safety Administration ("PHMSA") issued a Call to Action to State Regulators in 2009 with the goal of accelerating the rehabilitation, repair, and replacement of high risk pipeline infrastructure. This effort came on the heels of several high profile pipeline accidents, including two gas distribution line explosions in Pennsylvania that resulted in multiple deaths. See:
49 C.F.R. 192.1007 *et seq.*, the required elements of an integrity management plan.

and services." Coated and electrically protected steel pipes are considered state of the art and should not be replaced. Thus the draft should have read: "...coated but unprotected steel mains and services." New Jersey has not permitted the replacement of protected coated steel in any settlements since it is not one of the materials recommended for replacement by PHMSA. The Board should not include protected coated steel if this program is adopted.

Additionally, the draft rules specify that Excess Flow Values ("EFVs") should be installed "where existing service line replacements require them." It is recommended that this provision should also include that EFVs should be installed "where existing regulations require them." EFV's are "necessary" for all replaced services. However, they are not approved or available for many types of customers such as multi-unit housing, commercial, or industrial customers and these draft regulations should make this clear.

4. Electric distribution automation investments, including, but not limited to, supervisory control and data acquisition equipment, cybersecurity investments, relays, reclosers, voltage and reactive power control, communications networks, and distribution management system integration;

Comments: The proposed regulations provide that eligible projects may include "[e]lectric distribution automation investments," and cites further examples of what falls within that category of investment. However, the proposed regulations fail to tie the example to the criteria set forth in 14:3-2A.2(a), namely 14:3-2A.2(a)(1). The proposed regulations should specify that the primary purpose of the project should be increasing or improving the "safety, reliability, and/or resiliency" of the electric distribution service, not just "related" to that purpose. Otherwise, routine projects with only a tangential relationship to safety, reliability and resiliency could be eligible for the IIP. Furthermore, the utility should provide substantial support in the form of studies and analyses which demonstrate that its proposed projects will increase or improve the "safety, reliability, and/or resiliency" of electric distribution service. At the very least, the cited examples should be prefaced by references to other subsections which require documentation and support for the utility's claims.

5. The installation of break-predictive water sensors and wastewater sensors to curtail combined sewer overflows; and

Comments: In our comments on proposed N.J.A.C. 14:3-2A.4(d), Rate Counsel recommends that the proposed rule be modified to exclude water and sewer utilities from participating in the Infrastructure Investment Program. Water utilities already have access to an accelerated investment and rate recovery regulation with the DSIC, which was implemented following a comprehensive stakeholder process and recently re-adopted. The Board has also convened a new stakeholder process to begin discussions on a possible sewer DSIC. Accordingly, N.J.A.C. 14:3-2A.2(b)(5) should be stricken from the proposed rule.

6. *Other projects deemed appropriate by the Board.*

Comments: This proposed language creates a broad and inadequately defined category of "other" projects that could be included in a utility's infrastructure program. The proposed language does not contain any criteria or standards that would limit this category. An essential purpose of rulemaking is defining standards for the exercise of an agency's discretion. 613 Corp. v. State, Div. of State Lottery, 210 N.J. Super. 485, 500-01 (App. Div. 1986) (holding that rulemaking is required to establish standards for denying licenses to sell lottery tickets notwithstanding Division of State Lottery's sixteen-year practice of considering applications on an ad hoc basis); See, See Metromedia v. Dir., Div. of Taxation, 97 N.J. 313, 333-34 (1984).

If a "catchall" category is to be included in the adopted rules, it should include specific criteria and standards, which the utilities should be required to demonstrate in any petition that proposes to include a project in the "other" category. At a minimum, the rule should require a showing that the project will provide clear, demonstrable ratepayer benefits that could not be accomplished through the traditional ratemaking process.

(c) *A utility shall maintain its capital expenditures on projects similar to those proposed within the utility's Infrastructure Investment Program. These capital expenditures shall amount to at least 10 percent of any approved Infrastructure Investment Program. These capital expenditures shall be made in the normal course of business and recovered in a base rate proceeding, and shall not be subject to the recovery mechanism set forth in N.J.A.C. 14:3-2A.6.*

Comments: The meaning of this provision is unclear. First, it is not clear whether the 10% applies to each individual project (as would appear based on the remainder of the sentence which refers to "similar" projects), project categories, (e.g., main replacement, EVFs, electric distribution automation), or to the entire IIP (which is suggested by the second sentence). The Board should clarify what the 10% applies to.

Further, there is no explanation as to why the Board would find it appropriate that as much as 90% of utility infrastructure investment should be allowed accelerated recovery through a surcharge imposed on ratepayers. As noted in proposed N.J.A.C. 14:3-2A.1, the purpose of the proposed rule is to allow utilities "to accelerate their investment," incremental to an annual baseline spend[9]. N.J.A.C. 14:3-2A.3 This would seem to imply that the investment made under the IIP should augment -not replace- the utility's current investment. The 10% rule however suggests that the purpose of the IIP is not to encourage the utility to spend an additional amount over the base spend, but rather to replace its normal capital spending almost entirely with the IIP. If this is intended to set the bar for annual baseline spending by the utilities on infrastructure,

[9] Base rate recovery and base rate spending refer to amounts spent pursuant to, and recovered through, the traditional base rate case process.

then the bar has been set too low. Any infrastructure surcharge should be ancillary and incremental to base rate recovery, not the primary mechanism for recovery. Accordingly, the Board should revise this requirement to ensure that at least 50% of a utility's spending on projects similar to those proposed for recovery through the IIP surcharge are made in the normal course of business and recovered through base rates. This would ensure that the utility will not neglect its base rate spending in favor of more generous infrastructure program spending. It also ensures that the traditional rate case process will continue to be the primary recovery mechanism for capital expenditures required by the utility.

14:3-2A.3 Annual baseline spending levels

(a) A utility seeking to establish an Infrastructure Investment Program shall, within its petition, propose annual baseline spending levels to be maintained by the utility throughout the length of the proposed Infrastructure Investment Program. These expenditures shall be recovered by the utility in the normal course within the utility's next base rate case.

(b) In proposing annual baseline spending levels, the utility shall provide appropriate data to justify the proposed annual baseline spending levels, which may include historical capital expenditure budgets, projected capital expenditure budgets, depreciation expenses, and/or any other data relevant to the utility's proposed baseline spending level.

(c) Upon approving a utility's proposed Infrastructure Investment Program, the Board shall establish, within its order approving the Program, annual baseline spending levels for each year of the Infrastructure Investment Program. In establishing the annual baseline spending levels, the Board shall set forth, within its order approving the Infrastructure Investment Program, the factors used to establish the annual baseline spending levels. The Board, in its discretion, may consider a utility's historical capital expenditure budgets, projected capital expenditure budgets, depreciation expenses, or any other data deemed relevant by the Board in establishing the annual baseline spending levels.

(d) Only expenditures that are in excess of the annual baseline spending levels established by the Board and that meet the other requirements of this subchapter shall be eligible for accelerated recovery pursuant to N.J.A.C. 14:3-2A.6.

Comments: The draft rules require that "only expenditures that are in excess of annual baseline spending levels established by the Board" will be eligible for accelerated recovery. In its initial comments on the straw proposal, Rate Counsel agreed that any infrastructure program must be incremental to the Utility's average capital expenditures over the prior five years. However, the draft rules do not establish how this baseline spending will be determined nor do they specify over what historical time period this spending would be evaluated.

Rate Counsel recommends that "base spend" be measured by examining historical capital expenditures, excluding previous capital expenditures from specific infrastructure programs approved by the Board and "special" projects. Amounts allowed in previous accelerated infrastructure programs and/or "special" projects approved by the Board were determined to be incremental to the utilities' normal or base spending.[10] The use of the utility's base spending as a reference point is consistent with the definition of an eligible project under the terms of the DSIC implemented by water utilities.[11] Specifically, those terms define an eligible project as a distribution system project and projected costs that are in excess of the utility's base spending.[12] The infrastructure programs that are the subject of the instant proceeding should require a demonstration that the costs of the program are not already being recovered through the utility's current base rates.[13] Furthermore, the terms of any infrastructure program should also take into consideration that base spending should increase over time as the types of replacements made under accelerated replacement programs would decline as utilities' replacement programs slow down and move toward completion.

Moreover, the draft rules should require that utilities show, through financial analysis, the potential financial harm that would result if capital cost recovery is not allowed through a tracker mechanism as opposed to traditional rate base rate recovery. A utility with poor financial ratings has to pay more for debt, which increases the costs to ratepayers. The requirement will also help ensure that the accelerated cost recovery of these infrastructure investment programs does not become excessive or overly burdensome to ratepayers by showing that the program's accelerated cost recovery is necessary for the utility to continue to provide adequate service to its customers at reasonable rates.

Finally, the draft rules should require that a utility, as part of its filing, provide information demonstrating that the infrastructure program will improve safety, reliability, resiliency, operations and management beyond normal base spending/replacements. The utility is requesting accelerated cost recovery for projects at an accelerated cost to ratepayers; therefore, the utility must be able to demonstrate that the program will meet its purported goals. For example, if a utility claims that the infrastructure program will improve reliability, the utility should be able to provide data and details on the level of improvement to reliability such as a reduction in leak rates, outages, and associated cost savings that would result from the program(s).

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[10] In the Matter of the Petition of Public Service Electric and Gas Company for Approval of the Energy Strong Program, Docket Nos.: EO13020155 and GO13020156, Order Approving Stipulation and Settlement, (May 21, 2014) at pg. 3.

[11] N.J.A.C. §14:9-10.2 and §14:9-10.3.

[12] N.J.A.C. §14:9-10.2 and §14:9-10.3, DSIC eligible project, (3).

[13] N.J.A.C. §14:9-10.2.

14:3-2A.4 Infrastructure Investment Program length and limitations

(a) A utility may petition the Board for approval of an Infrastructure Investment Program extending for a period of five years or less.

Comments: Rate Counsel does not oppose programs of five years or less, however, the utility should be required to file a base rate case within three years of approval of the program. See Comments to proposed N.J.A.C. 14:3-2A.6(f) below.

(b) The Board may limit the size of a particular Infrastructure Investment Program due to its anticipated impact on rates, or for any other reasons in the Board's discretion.

Comments: This provision is overly vague. Rather than set a fixed limit on the total impact an IIP can have on customer rates, the Board has issued a regulation that basically says that the Board will determine this on a utility by utility, case by case basis. This is very different from the Board's DSIC regulations where the Board set out a specific limit on the allowed revenue increase per year through the DSIC. The point of formally issuing regulations is to provide a set of rules for all parties to know beforehand and to follow. Program review is more fair and greatly simplified if the Board promulgates specific rules for the utilities to adhere to in making their IIP proposals. If the Board can, in its discretion, modify the size of programs "for any [ ] reason" it defeats the purpose of uniform regulations applied equally to all parties. The Board, at a minimum, should place a measurable limit on the size of the utility proposed IIP based on the increase in revenues, on the impact on customer rates or on some other common element.

(c) A utility that offers more than one regulated service may file separate petitions to establish separate Infrastructure Investment Programs for each regulated service offered by the utility. Under these circumstances, each Infrastructure Investment Program approved by the Board shall be subject to its own respective spending cap.

Comments: This section would seem to be written to address the State's only electric and gas utility, PSE&G. Rather than leaving to the discretion of the utility whether to file electric and gas together or separately, Rate Counsel submits that the Board should require the utility to file separately which would facilitate review of the filings.

(d) A water utility shall not simultaneously maintain an Infrastructure Investment Program and utilize the Board's Distribution System Improvement Charge (DSIC), set forth in N.J.A.C. 14:9-10. Before filing a petition in support of a proposed Infrastructure Investment Program under this subchapter, a water utility shall first close out any existing DSIC program.

Comments: This proposed provision provides that a water utility cannot maintain both a DSIC and an Infrastructure Investment Program. Rate Counsel recommends that these proposed rules

be modified to exclude water and sewer utilities from participation in the Infrastructure Investment Program. Water utilities already have a Board regulation, the DSIC, that permits accelerated recovery of capital investment. Furthermore, the Board is convening a stakeholder process in October 2017 to consider the possibility of a regulation for a sewer DSIC. An additional infrastructure investment regulation – especially one like the Infrastructure Investment Program with weaker ratepayer protections than the DSIC – is not only unnecessary, but would be a step backwards for the State's water consumers.

The DSIC regulations were approved by the Board following a comprehensive stakeholder process that included input from the water utilities, Board Staff, and Rate Counsel. The result is a regulation that allows accelerated capital investment and cost recovery for a limited category of non-revenue producing, aging infrastructure, while also containing numerous provisions to protect the ratepayers who are footing the bills. The Board just recently re-adopted the DSIC regulations, again with input from stakeholders on necessary improvements.

The water utilities should continue to fund their accelerated capital investment exclusively through the DSIC. If the Board permits the water utilities to participate in the Infrastructure Investment Program, it will be effectively replacing its DSIC regulations and the hard work that Board Staff and stakeholders put in to create them. Compared to the proposed rule, the DSIC regulations offer more extensive ratepayer protections, and provide for much greater scrutiny by Board Staff and Rate Counsel. For all of these reasons, the water utilities are likely to abandon the DSIC if permitted to utilize the proposed rule. The follow chart illustrates the differences in the two programs:

DSIC Requirements	**Infrastructure Investment Program Requirements**
DSIC Cap – Set at 5% of a utility's total annual revenues.	No cap.
Base Spending is specifically defined as the annual depreciation expense of certain utility plant accounts.	Base spending appears to be negotiable and seemingly up to the discretion of the utility, based on what the utility chooses to submit to the Board.
Eligible Investments are limited to five very specific categories of plant	Project categories are general.
A rate case must be filed every three years.	A rate case must be filed every five years.
Requires an initial rate case to begin using a DSIC.	Initial rate case not required.
If a utility does not file a rate case within three years, the charges collected in DSIC must be refunded to customers.	Does not specify any remedy if a utility fails to file a rate case within five years.
Cost of Debt must be updated if it is lower than	No such provision.

the cost of debt approved in utility's last base rate case	
Semi-Annual Filing Requirements – before rates can be implemented, company must file a DSIC filing to be reviewed by Staff and Rate Counsel. Discovery is conducted. If Staff and Rate Counsel identify a project of concern, the Company must remove it from DSIC clause and collect it through the normal course.	Rate implementation appears to be automatic. Semi-annual filings appear to be for informational purposes only. No provision for review by Rate Counsel and Board Staff, or remedy if Rate Counsel and/or Board Staff identify areas of concern.
Earnings Test – utility is allowed to earn up to its authorized ROE. If authorized ROE is exceeded, DSIC collection stops and utility must receive Board approval to resume the DSIC.	Utility is allowed to exceed its authorized ROE by 50 basis points. No Board approval is required to resume collecting after over-earning.
Billing – utility is required to separately list the DSIC charge on customers' bills, leading to greater transparency for customers.	No such requirement – rate increase may be hidden in overall rate.

Even a cursory review of this chart shows that the IIP removes many of the ratepayer protections included in the DSIC. It is reasonable to expect that, if allowed, the water utilities will abandon the DSIC program in favor of the proposed Infrastructure Investment Program. The DSIC rule arose from a multi-year process involving a litigated case, the initiation of a stakeholder process, and numerous stakeholder meetings. It was re-adopted only two months ago, again with further stakeholder input. The Board is now convening a similar stakeholder process to begin discussion of a sewer DSIC. The DSIC regulations attempt to balance the interests of all stakeholders. The water utilities should not now be allowed to abandon the DSIC regulations in favor of the proposed rule, which fails to protect ratepayers in the same way the DSIC does, and will likely lead to higher rate increases than the DSIC. The proposed rule should be amended to exclude the State's water and sewer utilities from the IIP and allow them to continue to invest in infrastructure utilizing the DSIC regulations.

> *(e) Allowance for Funds Used During Construction (AFUDC) shall be permitted under an Infrastructure Investment Program, but a utility shall not utilize AFUDC once Infrastructure Investment Program facilities are placed in service.*

Comments: Rate Counsel agrees that AFUDC accrual would be allowed while plant is under construction. The regulation should make clear that AFUDC should be calculated in accordance with the utility's standard accounting rules and procedures. This means that once construction is complete and the project is in-service, AFUDC must cease and the utility must begin at that time to reflect depreciation expense. This is the same treatment that would be used for plant

expenditures recovered in base distribution rates. Moreover, not all Construction Work in Progress ("CWIP") is eligible for AFUDC accrual.

Further, the regulation should state that the AFUDC rate should reflect the same equity cost rate as the return on equity used in the infrastructure cost recovery mechanism calculation, and should include short-term debt, in the same manner as normally used by the utility. For example, all New Jersey electric utilities should use the "FERC formula" for directly assigning actual short-term debt to CWIP for AFUDC purposes.

(f) Year-to-year variations in an Infrastructure Investment Program's approved annual budget of up to 10 percent shall be permitted, provided that the total Program budget is not exceeded. Variations in excess of 10 percent shall require Board approval.

Comments: It appears from this subsection that when an IIP has more than one project included in the IIP, that individual projects can vary by more than 10% as long as the total program budget is not exceeded. Allowing significant variations in the individual project budgets must be measured against the limits set out in proposed section N.J.A.C. 14:3-2A.2 (c). This sub-section should be modified to limit annual budget variations to 10% for individual projects and for the IIP annual budget as a whole. In addition, the regulation should make clear that when the total program budget has been reached, the program ends.

14:3-2A.5 Infrastructure Investment Program minimum filing and reporting requirements

(a) All Infrastructure Investment Programs shall be voluntary, in that a utility shall not be required by the Board to establish an Infrastructure Investment Program.

Comments: Rate Counsel agrees that no utility should be forced to participate in the IIP.

(b) A utility requesting approval of an Infrastructure Investment Program shall include within its petition:

Comments: New Jersey's recent experience with large-scale infrastructure projects provides valuable guidance on how to structure clause-type infrastructure programs. The proposed regulations should incorporate lessons learned from these programs. Generally, more up-front information facilitates a more thorough and efficient approval process and, just as important, informs the ongoing monitoring of the programs and related true-ups, if any. The up-front information should include clearly defined projects, supporting engineering and cost analyses, performance benchmarks, timetables for construction together with the associated cost estimates for each stage of construction, provisions for oversight, as well as multi-year rate impact projections. Further, the up-front information should include detailed actual and projected utility

financial information to assess the effect of the proposed infrastructure program on the respective utility's financial health. (See I/M/O PSE&G Energy Strong, BPU Dkt. Nos. EO13020155 and GO13020165, Order dated 5/21/14, Stipulation Attachment A [MFRs]). This information should be updated in quarterly reports to the Board and Rate Counsel.

> *1. Projected annual capital expenditure budgets for a five-year period, identified by major categories of expenditures;*

Comments: In addition to high-level budget totals, this information should be provided in sufficient detail to compare projected base level capital expenditure budgets to the projected budgets for the proposed IIP projects, down to the level of Uniform System of Accounts ("USA") entries used to record the project expenditures. This level of detail would aid in monitoring IIP spending to ensure that the IIP spending is incremental and not already included in base rates. Further, the projected capital expenditure budgets should be supported by detailed information about how the budgets were developed.

> *2. Actual annual capital expenditures for the previous five years, identified by major categories of expenditures;*

Comments: Much like the recommended requirements for projected budgets, in addition to high-level budget totals, this information should be provided in sufficient detail to compare actual historic base level capital expenditure budgets to the projected budgets for the proposed IIP projects, down to the level of which USA accounts will be used to record IIP project expenditures. The actual budgets should be further broken-down into regular capital expenditures and those funded under clause-type mechanisms. This level of detail would aid in monitoring IIP spending to ensure that the IIP spending is incremental and not already included in base rates or other clauses.

> *3. An engineering evaluation and report identifying the specific projects to be included in the proposed Infrastructure Investment Program, with descriptions of project objectives, detailed cost estimates, in service dates, and any applicable cost-benefit analysis for each project;*

Comments: The filing should include clearly defined project descriptions, with supporting engineering and cost analyses, post-construction performance benchmarks and metrics, timetables for construction together with the associated cost estimates for each stage of construction, as well as provisions for IIP project oversight and post-construction Measurement & Verification testing. Construction benchmarks and specific performance targets are needed to monitor efficiency in construction and operation. A fully documented cost/benefit analysis is also of critical importance. It should include supporting analysis and data for each major component or sub-program within the proposed IIP. The Board should make clear that only those components or sub-programs that provide benefits greater than costs should be included in

the program. For example, even if the entire program as a whole may be cost beneficial, there may be individual elements that are not. In that circumstance, only those program elements that bring benefits greater than the program costs should be approved, in order to maximize customer benefit and the public interest. This level of detail would aid in ensuring that IIP projects are well-planned, forming the least costly alternative to achieve specific results.

4. An Infrastructure Investment Program budget setting forth annual budget expenditures;

Comments: The projected budgets for the proposed IIP projects should be provided in detail, down to the level of which USA accounts will be used to record the IIP project expenditures, on a project-by-project basis. Further, the projected capital expenditure budgets should be supported by detailed information about how the budgets were developed, including a break-out of any contingency amounts.

5. A proposal addressing when the utility intends to file its next base rate case, consistent with N.J.A.C. 14:3-2A.6(f);

Comments: The IIP filing should include a definitive date for the respective utility's next base rate case filing, consistent with the requirements set forth in proposed N.J.A.C. 14:3-2A.6(f). As noted in the comments to proposed N.J.A.C. 14:3-2A.6(f), the rate case should be within three years of the beginning of the program.

6. Proposed annual baseline spending levels, consistent with N.J.A.C. 14:3-2A.3(a) and (b);

Comments: As stated above in relation to projected capital expenditures, this information should be provided in sufficient detail to compare proposed base level capital expenditure budgets to the projected budgets for the proposed IIP projects, down to the level of which USA accounts will be used to record the IIP project expenditures. The bases for these projections should also be supported by information supplied with the filing. This allows for proper analysis of the filing to assure it complies with the baseline spending requirements set forth by these proposed rules.

7. The maximum dollar amount, in aggregate, the utility seeks to recover through the Infrastructure Investment Program; and

Comments: In addition to first-year costs, the filing should contain projected total cost estimates for each year through the period encompassing the estimated financial (depreciable) lives of the proposed IIP projects.

8. *The estimated rate impact of the proposed Infrastructure Investment Program on customers.*

Comments: In addition to first-year bill impacts by rate class, the filing should contain projected bill impacts through the estimated financial (depreciable) lives of the proposed IIP projects.

(c) In considering a utility's petition in support of an Infrastructure Investment Program, the Board may require that the utility:

1. Provide any supplemental information, beyond the information required under N.J.A.C. 14:3-2A.5(b), that the Board deems necessary to evaluate the utility's petition in support of an Infrastructure Investment Program;

Comments: Rate Counsel agrees that after considering comments and testimony filed by interested parties, including Rate Counsel, the Board should have the ability to require supplemental information needed to evaluate the utility's filing.

2. Retain an independent Infrastructure Investment Program monitor, as a condition of approval of the utility's petition, to review and provide quarterly or semi-annual reports to the Board and to the Division of Rate Counsel, where the monitor shall be paid by the utility. If the Board requires an independent Infrastructure Investment Program monitor, the monitor's reports shall address:

i. The effectiveness of Infrastructure Investment Program investments in meeting project objectives;

ii. The cost-effectiveness and efficiency of investments;

iii. The appropriateness of cost assignments; and

iv. Any other information required by the Board.

Comments: This section of the proposed regulation states that as a condition of approval of the program, the Board may require the utility to retain an independent Infrastructure Investment Program monitor ("Independent Monitor") paid for by the utility. Rate Counsel believes that this section requires further clarification and amendments. As drafted, the proposed regulation does not require that an Independent Monitor be retained but instead "may" be retained at the discretion of the Board presumably on a case by case basis. In addition, the proposed regulation does not specify what event or circumstances will trigger a need for an Independent Monitor. Rate Counsel believes that all projects under IIP would benefit from an Independent Monitor. It is also essential that any such monitor retained by the utility maintain its independence from the utility it oversees. In this respect, the Independent Monitors should operate at the direction of

Staff, not the utilities paying for their services. This level distance between the utility and the monitor is necessary to maintain the Monitor's independence.

When the Independent Monitor will be retained is also unclear. In addition to reviewing the effectiveness of the program in reaching its goals after Board approval, the Independent Monitor could also help assess the reasonableness of specific projects prior to Board approval. For example, the Independent Monitor could help the BPU Staff to evaluate project alternatives and needs assessments performed by the utilities to justify specific projects. In either case, the Independent Monitor should have a high level auditing role in order to be effective.

In addition to the need for an Independent Monitor, it is unclear what happens if the IIP is not meeting expectations. The proposed regulation is silent on what actions can be taken if the IIP projects fail to meet specific project objectives or if the cost effectiveness target is not met. The Board should be able to suspend or even terminate an IIP if certain benchmarks are not met.

> *(d) Before the Board approves an Infrastructure Investment Program, the Board shall conduct a public hearing. Notice of the public hearing shall contain the maximum dollar amount the utility seeks to recover through its Infrastructure Investment Program and the utility's estimated rate impact.*

Comments: The above language properly requires a public hearing on any proposed Infrastructure Investment Program. However, it does not address the need to afford the utility's ratepayers an opportunity for discovery and potentially evidentiary hearings on any infrastructure proposal. The infrastructure proposals contemplated under the proposed rules implicate the statutory and constitutional rights of utility ratepayers, and thus, if contested, must be handled as "contested cases" under the New Jersey Administrative Procedure Act ("APA"). N.J.S.A. 52:14B-2(b), -9 & -10.

Under the proposed new rule, utilities could seek Board approval to undertake millions of dollars in capital expenditures, and to begin recovering for those expenditures on an expedited basis, through a special rate recovery mechanism and outside of a base rate case. Although the potential impact on ratepayers is difficult to estimate, it is clear that approval of an Infrastructure Investment Program would authorize repeated rate increases over a period of years. For this reason, such programs may not be approved without providing the affected ratepayers with an opportunity for evidentiary hearing.

The requirement for a hearing is founded upon constitutional principles. As explained by the New Jersey Supreme Court:

> ... if the rate for the service supplied be unreasonably low it is confiscatory of the utility's right of property, and if unjustly and unreasonably high ... it cannot be permitted to inflict extortionate and arbitrary charges upon the public.

In re Industrial Sand Rates, 66 N.J. 12, 23-24 (1974).

The utility bears the burden of proving that the rate increase it seeks is just and reasonable. N.J.S.A. 48:2-21. Further, utility customers have a statutory right to rates and other terms of service that are not "unjustly discriminatory or unduly preferential," and a right to a hearing before rates are increased. N.J.S.A. 48:3-1, N.J.S.A. 48:2-21. Thus, utility rate increases affect the statutory and constitutional rights of ratepayers, and ratepayers accordingly are entitled to due process when the Board considers a proposed rate increase.

The APA specifies the procedures an administrative agency must follow when a party is entitled to a hearing. The APA defines a "contested case" as a proceeding:

> in which the legal rights, duties, obligations, privileges, benefits or other legal relations of specific parties are required by constitutional right or by statute to be determined by an agency by decisions, determinations or orders, addressed to them or disposing of their interests, after opportunity for an agency hearing ....
>
> N.J.S.A. 52:14B-2(b).

A petition filed under the proposed new rule would implicate rights that are protected by the New Jersey Constitution and statutory law against infringement without due process. It also implicates rights that the governing statutes require be addressed only after opportunity for an agency hearing. N.J.S.A. 48:2-21. Accordingly, petitions for approval of Infrastructure Improvement Programs would meet the definition of a "contested case" and must be handled as such.

In a contested case, the parties must be afforded reasonable notice, an opportunity to present evidence and argument on all issues, and a decision based exclusively on the evidence and matters officially noticed in the record. N.J.S.A. 52:14B-9 and -10. Further, contested cases must be heard in accordance with the New Jersey Uniform Administrative Procedure Rules, N.J.A.C. 1:1-1.1 et seq.

An application for approval of an Infrastructure Investment Program is likely to involve numerous factual issues that will have to be developed to inform the Board's decision. The following are just some of the issues that may require discovery, testimony, and briefing: (1) whether a special rate mechanism is needed for the utility to finance the proposed infrastructure projects; (2) whether the proposed infrastructure projects will provide benefits to ratepayers that

justify the costs; (3) the reasonableness of the proposed budgets; (4) the adequacy of the proposed baseline spending; and (5) whether the proposed accounting methodologies are reasonable and proper. The utilities' ratepayers are entitled to an opportunity to fully explore and, if necessary, litigate these and other issues in order to protect their statutory and constitutional rights to pay only reasonable rates for utility service.

> *(e) Following the Board's approval of a utility's petition in support of an Infrastructure Investment Program, the utility shall file supportive semi-annual status reports with the Board and the Division of Rate Counsel for project management and oversight purposes that, at a minimum, contain the following:*
>
> *1. Forecasted and actual costs of the Infrastructure Investment Program for the applicable reporting period, and for the Infrastructure Investment Program to date, where Infrastructure Investment Program projects are identified by major category;*
>
> *2. The estimated total quantity of work completed under the Infrastructure Investment Program identified by major category. In the event that the work cannot be quantified, major tasks completed shall be provided;*
>
> *3. Estimated completion dates for the Infrastructure Investment Program as a whole, and estimated completion dates for each major Infrastructure Investment Program category;*
>
> *4. Anticipated changes to Infrastructure Investment Program projects, if any;*
>
> *5. Actual capital expenditures made by the utility in the normal course of business on similar projects, identified by major category; and*
>
> *6. Any other performance metrics concerning the Infrastructure Investment Program required by the Board.*

Comments: Rate Counsel suggests that a number of modifications be made to this section of the proposed rule. First, this proposed rule does not require that an earnings test be included in the semi-annual reports, even though proposed N.J.A.C. 14:3-2A.6(h) requires an earnings test for utilities participating in the Infrastructure Investment Program. At a minimum, proposed N.J.A.C. 14:3-2A.5(e) should be modified to require the inclusion of an earnings test, accompanying calculations, and underlying data in the semi-annual reports.

Furthermore, the proposed rule should be modified to require specific performance metrics and targets that utilities must achieve, on an annual basis, in order to continue participation in the IIP. As the proposed rule is currently written, performance metrics and targets are not required. Without a requirement that utilities achieve specific performance targets, the IIP may not serve its intended purpose and utilities will have no accountability to

either the Board or to ratepayers. Absent such targets, utilities cannot justify why ratepayers should pay the higher bills that will inevitably accompany the IIP.

The rule should also include consequences if performance targets are not achieved. Specifically the proposed rule should be modified to include language that if the utility does not achieve these targets, the utility's participation in the program will be suspended.

Rate Counsel also has concerns that the rule does not contain any process for review of the six month filings by Rate Counsel, Board Staff, and possibly an independent monitor. As written, the semi-annual filings appear to be only informational in nature. The proposed rule should be modified to allow some form of regulatory review of the semi-annual filings before utilities can implement semi-annual rate increases.[14] This could be accomplished through a DSIC-type review whereby Board Staff and Rate Counsel conduct discovery on the filings and can object to projects of concern.

14:3-2A.6 Infrastructure Investment Program expenditure recovery

> *(a) A utility may file for annual or semi-annual rate recovery for facilities constructed and placed in service under an Infrastructure Investment Program. "In service" means when a project approved for inclusion in an Infrastructure Investment Program is functioning in its intended purpose, is in use (that is, not under construction) and useful (that is, actively helping the utility provide efficient service).*

Comments: Rate Counsel recommends that infrastructure program surcharge cost-recovery "roll-ins' be reviewed on an annual basis rather than semi-annual. All of the gas and electric utilities file numerous annual petitions for cost recovery due to commodity costs, societal benefit clause initiatives and various tariff provisions. The gas and electric utilities have also filed infrastructure petitions to respond to weather-related events, such as Superstorm Sandy, and for gas, federal pipeline safety mandates. (See 49 C.F.R. 192.1007 et seq., the required elements of an integrity management plan.)

Presently, a review of the current tariffs of PSE&G, New Jersey Natural Gas, Elizabethtown Gas, South Jersey Gas, Jersey Central Power & Light, Atlantic City Electric and Rockland Electric Company reveal that Board Staff and Rate Counsel must respond – on an individual basis – to the following annual rate recovery clauses: Basic Gas Supply Service ("BGSS"), Basic Generation Service ("BGS"), Non-Utility Generation Charge ("NGC"), Securitization Transition Charge ("STC"), Solar Pilot Recovery Charge ("SPRC"), Green Programs Recovery Charge ("GPRC"), Capital Adjustment Charge ("CAC"), Commercial and

[14] As noted in Rate Counsel's comments below, the reviews should be conducted annually rather than semi-annually.

Industrial Energy Pricing Charge ("CIEP"), Margin Adjustment Clause (MAC"), Conservation Initiative Program ("CIP"), Remediation Adjustment Clause or Manufacturing Gas Plant Clause ("RAC/MGP"), Societal Benefits Charge Clause ("SBC"), Transportation Initiation Clause ("TIC"), Weather Normalization Clause or Temperature Adjustment Clause ("WNC/TAC"), Energy Efficiency Tracker ("EET"), Universal Service Fund charge ("USF") and Regional Greenhouse Gas Initiative ("RGGI") charges for renewable energy and distributed energy resource programs. Each of these tariff filings requires Rate Counsel and Board Staff to analyze the petitions for accounting and program/policy issues with the assistance of expert consultants.

Further, if a rate increase is requested, 2 or more public hearings are required within the service territories of the utilities. For example, due to the configuration of PSE&G's service territory, 6 public hearings are held whenever a petition is filed requesting a rate increase. Rate Counsel Staff and Board Staff attend all public hearings. If all of New Jersey's electric and gas utilities file for an IIP, this will result in 16 additional filings a year. If the Board allows semi-annual cost recovery filings for infrastructure projects filed pursuant to the proposal, the strain on already stretched resources for Rate Counsel and Board Staff would be enormous and counter-productive.

Many of the existing infrastructure and tariff filings mentioned above require the utilities to supplement their initial schedules for actual data. This requirement frequently necessitates the implementation of provisional rates by the Board when ratepayers are due a refund or rate decrease. This procedure often results in these matters being completed in 7 to 10 months or within about 4 to 6 weeks before the next cost recovery filing has to be filed. If the Board were to allow semi-annual petitions that require no less scrutiny than the numerous annual petitions currently filed, the result would be unavoidable regulatory lag in both Rate Counsel and Board Staff performing their duties. In the time needed to review the first semi-annual filing, a second filing will be made. The resources are simply not available and the filings would begin to pancake. Pursuant to N.J.S.A. 52:27EE-46 et seq., Rate Counsel has a statutory mandate to scrutinize utility filings to protect the best interests of ratepayers. Adoption of a regulatory scheme which establishes unrealistic procedural deadlines – regardless of detailed minimum filing requirements – would result in ineffective regulation and improper oversight of the utility industry to the detriment of ratepayers.

In the past, the Board has required minimum filings requirements for the annual or semi-annual filings in approved infrastructure investment programs. Rate Counsel recommends minimum filing requirements be imposed for these programs as well: Required information should include detailed project cost reports, change orders and the estimated quantity of work completed to date.

(b) Each filing made by a utility seeking accelerated recovery under an Infrastructure Investment Program shall seek recovery, at a minimum, of at least

10 percent of overall Infrastructure Investment Program expenditures.

Comments: Rate Counsel agrees there should be a threshold below which the utility not file an annual recovery petition. If the utility does not have sufficient plant in service by the time of the filing, it is a waste of resources to review a petition seeking extraordinary relief for a *de minimus* amount. It is unclear in the proposal what is meant by "10 percent of overall Infrastructure Program expenditures." It should require a threshold based upon the approved total budget for that specific utility's IIP. This will ensure that the program is progressing before the utility is rewarded with recovery outside of a base rate case.

Because Rate Counsel believes that the filings should be annual, Rate Counsel recommends that the threshold be 15% of the overall IIP approved budget for the IIP. This is a more reasonable threshold and will better ensure that there is no "rush" to complete projects which could compromise safety. The one-year time frame will provide the utility with sufficient time to deal with any unforeseen contingencies in a safe and efficient manner rather than rush projects to meet the six month 10% threshold.

A utility's expenditures made prior to the Board's approval of an Infrastructure Investment Program shall not be eligible for accelerated recovery.

Comments: Rate Counsel agrees with this proposal.

(c) Rates approved by the Board for recovery of expenditures under an Infrastructure Investment Program shall be accelerated, and recovered through a separate clause of the utility's Board-approved tariff.

Comments: This provision is vague and incomplete. The only thing this sub-section specifies about rate recovery is that is shall be through an accelerated clause mechanism. It is not clear if by "accelerated" the Board envisions some kind of tracker mechanism with periodic "roll-ins" such as implemented for PSE&G's "Energy Strong" program or some other recovery mechanism.

Preliminarily, Rate Counsel disagrees with the practice of accelerating the recovery of any infrastructure program as single-issue ratemaking. It is Rate Counsel's position that utilities can receive adequate recovery of revenues through the traditional ratemaking process that allows a comprehensive review of the utility's entire cost of service and earnings position. Standard base rate cases provide full cost recovery for prudent utility costs and avoid single-issue ratemaking.

To the extent that an infrastructure program with accelerated recovery is authorized, this proposed rule should be modified to include the specific rate components recovered through the surcharges and the details of any "roll-in" process. For example, as discussed in these comments, the regulation should specify that any surcharge will be reviewed on an annual, not

semi-annual basis. Neither Rate Counsel nor other parties have the resources to process semi-annual filings, especially when one considers the multitude of other rider and surcharge mechanisms that have been adopted in New Jersey over the past several years. In addition, the regulation should specify that the surcharge be listed as a separate charge on customers' bills. Ratepayers should know the amount they are paying for utility infrastructure improvements.

Moreover, the regulation fails to specify which expenditures are eligible for accelerated recovery. While the regulation does specify that the utility plant must be "in-service" before rate recovery can begin, the regulation fails to specify the components that will make up the revenue requirement associated with the plant in service and collected through the surcharge. For example, the regulation should specify that the revenue requirement should reflect the rate base at the end of the annual period, including plant in service, accumulated depreciation, and accumulated deferred income taxes. The regulation should also specify that the revenue requirement includes depreciation expense on the related plant additions and whether that depreciation expense surcharge is based on a composite rate that is developed for each utility during the infrastructure project approval process, or on approved depreciation rates for each account. The regulations should also specify whether the revenue requirement should include applicable taxes and uncollectible expense.

Finally, the regulation is silent on the following features of the surcharge mechanism calculation: (1) whether to use the utility's approved capital structure from its last rate case or an updated capital structure; (2) whether to use the utility's current embedded cost of long-term debt and actual short-term debt cost rate (for utilities that include short-term debt in capital structure); and (3) whether to include the utility's approved return on equity ("ROE") from its most recent rate case or whether that ROE should be adjusted for the lower risk associated with the accelerated recovery. The regulation should specify a uniform surcharge calculation methodology so that both regulated entities and ratepayers know what is required.

> *(d) Rates approved by the Board for recovery of expenditures under an Infrastructure Investment Program shall be provisional, subject to refund and interest. Prudence of Infrastructure Investment Program expenditures shall be determined in the utility's next base rate case.*

Comments: Rate Counsel agrees that any rate approved as part of an IIP is provisional and subject to a prudency review at the utility's next base rate case. The rule should state, however, that rates implemented for an infrastructure investment project that is subsequently found to be imprudent would be reversed and any amounts collected under the IIP surcharge for the imprudent investment would be returned with interest to ratepayers effective from the date the rate initially went into effect. While this seems a reasonably simple concept, accurately

refunding to ratepayers amounts collected in rates for a project subsequently found to be imprudent could prove difficult.[15]

The IIP surcharge rate could need to be re-calculated as of the in-service date of the project found to be imprudent. This would entail removing the project from the surcharge rate as well as adjusting AFUDC accrued on the project and any other rate components included in the surcharge for that project (depreciation expense, allowed return etc.) After the offending project(s) is (are) removed, a new rate would have to be re-calculated, applied to the same billing determinants that were used originally and the difference returned to customers.

This calculation becomes even more unwieldy if the surcharge is updated semi-annually, or even annually. Disentanglement of the costs (and re-calculation of revenues) associated with any project found to be imprudent over two or three years of surcharge rate adjustments will be cumbersome. The issue of baseline spending could also come into play. If the removal of the imprudent project reduces the IIP spending below base line levels then the whole process must be reversed.

Finally, although the regulation specifies that the over-collection will be returned to ratepayers "with interest", the regulation does not specify what interest rate will be assessed.

> *(e) A utility shall file its next base rate case not later than five years after the Board's approval of the Infrastructure Investment Program, although the Board, in its discretion, may require a utility to file its next base rate case within a shorter period.*

Comments: This proposed rule, which allows for provisional rates for five years before prudency is determined, is inconsistent with Board precedent and contrary to the public interest and applicable law. While the Board has certainly approved five-year programs previously,[16] it has up to now required that a rate case be filed within three years. The change to a five-year delay before a prudency review is conducted can lead to stale evidence when the prudency review finally occurs. There is also a concern that with so much time between rate cases a utility may be overearning for that period of time.[17] The three year requirement not only ensures that the Board has sufficient fresh evidence to review the prudency of the program measures and their implementation, it has been viewed as necessary to comply with the requirement of an

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[15] Refunds will be even more difficult if the Board waits up to five years to require a base rate case. At that point, evidence will be stale and it is unlikely that adjustments could be made to fairly and adequately compensate ratepayers for excessive rates paid five year prior.

[16] See, e.g. I/M/O the Petition of New Jersey Natural Gas Co. for Approval of the Safety Acceleration and Facility Enhancement Program, Docket No. GO12030255 (October 23, 2012); I/M/O the Petition of Public Service Electric and Gas Company for Approval of Electric and Gas Base Rate Adjustments Pursuant to Energy Strong Program, Docket Nos. ER17030324 and GR17030325 (May 21, 2014)

[17] Rate Counsel recognizes the proposed rule includes an annual earning test, however, the current language is vague and any test may be insufficient to protect from over earning as only a full review in a base rate case can do.

"umbilical cord" to a rate case mandated by the Supreme Court in I/M/O Proposed Increased Intrastate Industrial Sand Rates, 66 N.J. 12(1974). The Board's departure from this well-established and consistently applied requirement is unexplained. While, as discussed below, the Board has authorized "creative responses that respect the law but adapt to extraordinary circumstances,"[18] this proposal transforms previous limited departures from normal ratemaking principles into the normal course. It has gradually become so far removed from the legal requirements designed to ensure prudent spending that it will lead to rates that are neither just nor reasonable.

Industrial Sand Rates is the seminal New Jersey Supreme Court decision regarding the establishment of interim rates under the "negotiation statute," N.J.S.A. 48:2-21.1, which provides the authority for the Board to allow interim rates such as those contemplated by the proposed rule. In that case, the Court reviewed and clarified the "basic principles involved in the rate-regulation function and authority" of the Board. Id. at 19. The Court found that ratemaking is a legislative function, and that:

> For the delegation of the legislative function to be valid under our Constitution it is essential that adequate standards be prescribed by the Legislature and adhered to by its agent, in this instance the Board. The statutory standard prescribing the rate-making powers of the Board is to be found in *R.S. 48:2-21(b)(10)*, which provides that the Board may "Fix just and reasonable individual rates...."
>
> Id. at 21.

Citing prior New Jersey Supreme Court cases and long-standing U.S. Supreme Court jurisprudence on ratemaking, the Court held that determining the justness and reasonableness of a particular rate can only be determined "after an examination of a company's property valuation which constitutes its rate base; its expenses, including income taxes and an allowance for depreciation; and the rate of return developed by relating its income to the rate base." Id. at 21-22. The Court noted that the determination of an adequate rate base "is fundamental" because a utility is entitled to a return only upon "the fair value of the property of the public utility that is used and useful in the public service." Id. at 22. A rate based on an excessive valuation of the utility's property would not be reasonable, the Court cautioned, noting that the theory that "in emergent circumstances... there could sometimes be a valid rate increase, on a permanent basis without exploring the rate base and considering the consequent rate of return thereon," or that the Board could order "a surcharge on newly established rates, to recoup revenue deficiencies..." had been clearly rejected. Id. The Court concluded that "The law has thus developed, no doubt

[18] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for all Gas and Electric Utilities, Docket No. EO09010049, GO09010050, Decision and Order Approving Stipulation, (April 28, 2009) at p 8.

because the system of rate regulation and the fixing of rates thereunder are related to constitutional principles which no legislative or judicial body may overlook." Id. at 23.

> Turning to the validity of the "negotiation statute" under these legal principles, the Court held: The vital justification for the "negotiation statute" and rates established under it, temporarily bypassing the establishment of rate base and fair rate of return, rests upon the legal umbilical cord which ties them to the anticipated eventual determination of these fundamentals; at which time the temporary rates, their legitimacy having been validated, merge into the PUC judgment ordaining the final rate structure or, if and to the extent found to have been excessive, are refunded to the consumers who paid them. Such interim relief permits the utility to escape the unfair and sometimes confiscatory impact of "regulatory lag," *i.e.*, the considerable time necessary for final resolution....
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> Id. at 25.

The New Jersey Supreme Court had an opportunity to review its decision in Industrial Sand Rates the following year. In In re Board's Investigation of Telephone Companies, 66 N.J. 476 (1975), the Court upheld the Board's allowance of a "Comprehensive Adjustment Clause" ("CAC") for New Jersey Bell Telephone Company, allowing the Company to recover certain costs on an interim basis. At the same time that case was being adjudicated, the Board opened a proceeding to investigate Bell's financial situation and thereafter Bell filed for a rate increase. The Court found that, although the CAC was not technically established in a rate case, the three contemporaneous cases, viewed as a whole, provided a sufficient nexus to allow the clause to be upheld. The Court stated,

> We are thus convinced that, so far as protection to the public is concerned, these proceedings (as they involve the validity of the comprehensive adjustment clause) should be viewed as a unit, to the end that the recovery of expenses through the CAC shall be conditionally permitted subject to final validation in the terminal phases of the proceeding in which PUC will be required to fix just and reasonable rates on a permanent basis; at that time PUC should provide for appropriate adjustments, customer credits or refunds, if the evidence indicates that any excessive revenues have been produced by the operation of the clause.
>
> Id. at 492.

The Court then went on to reaffirm that the ultimate validity of the amounts charged in the CAC must be verified in the rate case pursuant to Industrial Sand Rates. The Court stated:

> This Court recently commented on the indispensable "legal umbilical cord" between a temporarily increased rate and the final adjudication of the firmly established and traditional components which enter into the determination of "just and reasonable" rates. *In re Intrastate Industrial Sand Rates, supra*, 66 *N.J.* at 25. Fortuitously, as we have seen, the state of the present litigation is such as to accommodate such a firm and unimpeachable relationship.
>
> In a rate proceeding utility expenses, to be allowable, must be justified. Good company management is required; honest stewardship is demanded; diligence is expected; careful, even hard, bargaining in the marketplace and at the negotiation table is prerequisite. And so it must be with regard to expenses recaptured by "flow through" to consumers by dint of a comprehensive adjustment clause. Tested in the scrutiny of final rate determination and only in that way (despite the impressive monitoring devices built into the instant clause) can such expenses be validated and become demonstrably honest components in the ascertainment of "just and reasonable" rates. Lacking that validation, certainty and justification, the rates would have been unjustly charged and to the extent of that injustice must be refunded to the customers.
>
> Id. at 495.

Since that time, the Board has adhered to the requirement of such an "unimpeachable and firm relationship" between interim rate increases in clauses and the rate case validating the justness and reasonableness of those rates. See, In re Redi-Flo Corp., 76 N.J. 21, 41 (N.J. 1978) (Remanding to the BPU to determine whether the fuel adjustment clause in that case was just and reasonable, but holding that: "Since a fuel adjustment clause would cause an increase in the consumer's out-of-pocket expenditure for fuel, it plainly falls within the statutory definition of a rate increase. Accordingly, we hold that a fuel adjustment clause can be implemented only after a rate proceeding in accordance with N.J.S.A. 48:2-21 or 48:2-21.2,"). For the most part, the early adjustment clauses related to matters, such as rising fuel prices or the cost of purchased water that were outside the utility's control.

In 2006, the Board modified its regulations on Purchased Water Adjustment Clauses ("PWACs") and Purchased Sewer Treatment Adjustment Clauses ("PSTACs") to explicitly require the utilities to establish the nexus to a rate case by ensuring that the utility had been in for a rate case within at least 3 years of filing for an initial PWAC or PSTAC. See, N.J.A.C. 14:9-7.3, 38 N.J.R. 1538(a). This provision was reviewed by the Board in its 2009 Order allowing Shorelands Water Company to file a petition for a PWAC. The Board granted a waiver of the regulation's three year prior base rate case requirement, imposing instead a requirement that the Company file a base rate case within two years from the date of the final PWAC Order. The Board reasoned:

> ...Shorelands must have its rates tested in an appropriate rate-making procedure. Although Shorelands is not within the three year time frame provided in the rules to establish a link between a base rate case and the proposed PWAC filing, Shorelands has agreed to file a base rate case within two years of a final PWAC Board Order so that a "nexus" is established. One of the main purposes of the three year requirement in the PWAC rules is to link the interim rates of the PWAC to a base rate case so that, ultimately, the PWAC rates are reviewed in the context of a base rate proceeding which creates a legal "nexus." The Board's ability to set interim rates in conjunction with this "nexus" requirement has been addressed in several New Jersey Supreme Court cases. In In re Industrial Sand Rates, 66 N.J. 12 (1974), the Court made clear that the authority granted to the Board to negotiate with a utility for an adjustment of rates is confined to interim relief pending a proceeding to determine justness and reasonableness of an existing or proposed rate. Likewise, in In re Investigation of Tele. Cos., 66 N.J. 476 (1975), the Court upheld the Board's implementation of a "comprehensive adjustment clause" which permitted the company in that matter to recover certain expenses as they increased, finding that there was a nexus to the Board's review in that company's rate case. The Court acknowledged the Court's ruling in Industrial Sand that the "legal umbilical cord" between a "temporarily increased rate and the final adjudication of the firmly established and traditional components which enter into the determination of 'just and reasonable' rates" is indispensable. Id. at 495. Therefore, to ensure that a nexus exists, Shorelands will be required to file a petition for a rate adjustment within two years from the date of the final PWAC Board Order.

I/M/O the Application of Shorelands Water Company for a Waiver or Relaxation of Certain Board Rules at N.J.A.C. 14:9-7.3(a), BPU Docket No. WO09020145 Order Granting Waiver Request. (May, 19, 2009) p.3.

At about the same time as the Board's Order in Shorelands, the Board increased its use of clauses and surcharges to address specific emergent issues. In October, 2008, in response to a worldwide economic downturn, then- Governor Jon Corzine called on New Jersey's gas and electric utilities to accelerate already-planned investments in "necessary and beneficial" utility infrastructure. I/M/O a Proceeding for infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities, BPU Docket Nos. EO09010049- 10053 (January 28, 2009). The cost recovery mechanism for those investments was through capital investment charges that allowed for annual recovery through provisional rates. Each of those charges was required to be reviewed in a base rate petition consistent with the nexus requirement established

in Industrial Sand Rates.[19] In its April 28, 2009 Order approving PSE&G's program, the Board recognized that the cost recovery mechanism was unusual because it allowed recovery outside of a rate case, but found that the requirement agreed to by the parties that the company would file a rate case within two years was sufficient to "respect the law but adapt to extraordinary circumstances." I/M/O the Proceeding for infrastructure Investment and a Cost Recovery Mechanism for all Gas and Electric Utilities, BPU Docket No. EO09010049, GO09010050 (April 28, 2009) at pp. 5, 8. The Board concluded:

> Accordingly, the Board will, in this case, allow the Company to begin recovery of capital expenses for these Qualifying Projects on an interim basis subject to refund pending the filing of the Company's base rate case as contemplated by Paragraph 21 of the Stipulation. This authorization in no way sets a new framework for future actions; instead, it reflects the realities of today's economic situation.
>
> Id. p. 10.

Other emergency conditions caused the Board to approve additional programs calling for surcharges and interim rates. After the severe storms of 2012, the Board issued an Order asking the utilities to propose programs to enhance resiliency in the face of potential future storms. Several companies filed for such programs. While once again allowing for interim provisional rate increases, all of the Stipulations and subsequent Board Orders approving them included terms providing that the Companies would have their provisional rates reviewed within three years.[20] Additionally, in response to gas explosions in California and elsewhere, the U.S. Department of Transportation, Pipeline and Hazardous Materials Safety Administration ("PHMSA") issued a "call to action" to encourage utilities to accelerate the replacement of cast iron and unprotected steel mains in their system. In response the Board approved a series of programs designed to accelerate the replacement of such pipes, as deemed necessary to reduce leaks and maintain public safety. These programs were also funded through clause mechanisms that required the utilities to come in for a review of their provisional rates in a base rate case within three years.[21]

In 2008, an application was filed with the BPU by New Jersey American Water ("NJAW") seeking approval to accelerate the replacement of aging water mains. The Company cited the need to replace aging water mains, and the critical need to do so to enhance safety, reliability and water quality. I/M/O the Petition of New Jersey American Water Company For Authorization To Implement A Distribution System Improvement Charge, BPU Docket No.

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[19] See Attachment C- entitled "Exhibit A- Gas and Electric Utility Infrastructure Programs Links to Base Rate Proceeding"

[20] Id.

[21] Id.

WO08050358 Order denying DSIC Petition and Instituting Stakeholder Process, (October 20, 1010). The company sought approval to recover its investments through a Distribution Service Investment Charge (DSIC). During the course of that proceeding, Board Staff recommended allowing the program as a pilot. Board Staff, through the brief filed by the Attorney General's office ("Staff's DSIC Brief"), stated that the Board did have authority under the negotiation statute, N.J.S.A. 48:2-21.1 to order the DSIC, but that to ensure compliance with that statute, it should require the Company to "file a rate case no later than three years from the date of a Board Order approving a DSIC...." See, Initial Brief of the Staff of the Board of Public Utilities, I/M/O the Petition of NJAW for Authorization to Implement a DSIC, BPU Docket No. WO08050358 April 17, 2009 at p. 34 (see Attachment D). Staff understood the nexus requirement established in Industrial Sand Rates and I/M/O Telephone Cos., and the need "to ensure that the DSIC expenses are scrutinized in a final hearing." Id. at p. 36. Staff's Brief stated:

> Consistent with the Board's statutory authority and the nexus requirements in both Tele. Cos. and Industrial Sand, the Board has the authority to implement a DSIC mechanism for NJAW in the form of a pilot program. The Board would be within its authority to implement this pilot program for a period of two years....The pilot program that Staff is proposing would be for an interim period with interim relief until these temporary rates in the pilot program are merged into a base rate case to be filed within three years from the final decision rendered by the Board herein....
>
> Id. at p. 36

While the Board did not grant NJAW's petition, it proceeded instead to develop and promulgate regulations to establish the DSIC. Consistent with its long-standing interpretation of Industrial Sand Rates and Staff's recommendation in the NJAW DSIC petition, the Board included the three-year nexus requirement in the DSIC regulations. N.J.A.C. 14:9-10.4(c) ("No DSIC foundational filing shall be approved unless a water utility has had its base rates set by the Board within the past three years.") That provision was retained earlier this year when the Board re-adopted the DSIC regulations.

With this IIP rule, the Board now seeks to allow interim rates not as part of a response to an emergent issue, but as an institutionalized program in the normal course. It also seeks to extend the already generous three-year base rate case requirement to five years. While it may not seem such a large stretch from the prior three-year requirement, the fact is that a nexus once described by the Supreme Court as an "umbilical cord," will now be able to stretch to half a decade. Rate Counsel submits that the review that would occur a half decade later cannot be comprehensive enough or based on fresh evidence to meet the requirements of Industrial Sand Rates and I/M/O Telephone Cos. The use of clauses and provisional rates has exploded in the last several years to the point where some utilities have nearly half of their distribution revenue

coming from provisional clauses rather than rates that have been reviewed in a rate case. This proposed rule moves even further away from the "firm and unimpeachable relationship" required between provisional rates and the full scrutiny of a rate case. Even worse is that no explanation is given whatsoever for the change in long-standing policy, which, according to Staff and the Attorney General's Office was based on governing case law.[22] A five year period between the establishment of provisional rates of the magnitude contemplated by this proposed rule and the review of those rates in a base rate proceedings does not satisfy the requirement of an "umbilical cord' to a rate case and results in unjust and unreasonable rates.

The proposed rule is also problematic because it does not require an "umbilical cord" to a rate case in order for a utility to receive Board approval to initially implement the Infrastructure Investment Program. The three other clauses that have been promulgated by regulation, the DSIC, PWAC and PSTAC, all require this umbilical cord to a rate case during a utility's initial implementation. The DSIC rules provide that "[n]o DSIC foundational filing shall be approved unless a water utility has had its base rates set by the Board within the past three years...." N.J.A.C. 14:9-10.4(c). This requirement applies when a utility seeks approval to implement a DSIC for the first time. In recently re-adopting the DSIC rules effective August 7, 2017, the Board retained this provision, recognizing that the initial implementation of a DSIC must have a legal umbilical cord to a base rate case. The same is true of the Board's PWAC and PSTAC regulations, which provide that "[n]o initial purchased water adjustment clause shall be approved unless a water utility, within the prior three years, has had its base rates set by the Board in a decision and order which established base level data against which the new cost of purchased water can be measured." N.J.A.C. 14:9-7.3(c).

This requirement exists for a reason. In Industrial Sands, the Supreme Court held that a full base rate case is necessary in order to "provide for appropriate adjustments, customer credits or refunds, if the evidence indicates that any excessive revenues have been produced by the operation of the clause." In re Industrial Sands, supra, 66 N.J. at 492. The legal requirement for having a nexus to a base rate case is not simply to review prudency, but rather to review all expenses, revenues, and cost of capital of a utility, including whether or not a clause mechanism would produce excess revenues. A base rate case before a clause is implemented, is necessary for exactly this reason: to ensure that the utility is not over-earning before the clause is implemented, or would not over-earn if the clause is implemented. Without a base rate case, the implementation of a clause mechanism could exacerbate over-earning by a utility, causing ratepayers to pay rates that are unjust, unreasonable, and in violation of State law.

The proposed rule lacks this required umbilical cord upon implementation. The way the proposed rule is currently written, a utility that has not had a rate case for five, ten, or fifteen years can receive Board approval to make investments under the proposed rule, and then not

[22] Staff DSIC Brief supra, at 35.

have to file a rate case for another five years. Permitting rate recovery through a clause without a rate case for ten or fifteen years is clearly contrary to established case law, current Board regulations, and long-standing Board policy. As with the DSIC, PWAC and PSTAC rules, the proposed rule should require a utility to have had a recent rate case in order to receive initial Board approval of the Infrastructure Investment Program. It should also require the companies to come in for a rate case every three years to maintain the required "umbilical cord."

(f) A utility may continue to file for accelerated recoveries during the approved Infrastructure Investment Program period notwithstanding the filing of the utility's next base rate case.

Comments: In order to limit the financial impact of repeated increases in utility rates on New Jersey ratepayers and to promote rate stability, the Board should limit this provision and direct that a utility cannot reflect an infrastructure rate increase if the utility has had a base rate increase within the prior twelve month period.

(g) An earnings test shall be required, where Return on Equity (ROE) shall be determined based on the actual net income of the utility for the most recent 12-month period divided by the average of the beginning and ending common equity balances for the corresponding period.

Comments: In this proposed subsection, the Board has directed that an earnings review must be incorporated into a utility's annual or semi-annual filing for IIP rate recovery to ensure that a utility is not over-earning. While an earnings test is an important ratepayer protection, this protective benefit is weakened if the calculation is performed on a weakened basis. Thus it is an important consumer protection (and a matter of basic fairness) that the infrastructure surcharge rate increases only be permitted upon a showing that the utility's actual earnings (as discussed below) are not unreasonably excessive. The infrastructure surcharge cost recovery mechanism should not be used to further increase utility earnings that already are excessive. But, because of the many factors that enter into the determination of a utility's earned return, the simple calculation proposed in this sub-part is not sufficiently detailed to ensure that the test will be an accurate picture of a utility's actual earnings.

For example, the proposed earnings test is not based on the utility's rate base but rather on common equity balances. If the test is limited to regulated utility earnings, then the common equity number used in the calculation must be adjusted to exclude non-regulatory components of the common equity balances such as acquisition premiums, goodwill or equity not used in the provision of utility service.

The regulation should also state that the utility's study should incorporate, to the extent practicable, standard Board ratemaking policies and practices. For example, the regulation

should state that the calculation of "actual net income" includes the standard regulatory adjustments such as: 1) the exclusion of charitable contributions and lobbying expenses from the calculation, 2) the exclusion from rate base of assets or liabilities associated with pensions or OPEB costs, 3) the inclusion of only 50% of incentive compensation costs as operating expenses, and (4) utilization of the utility's most recently approved capital structure to calculate the ROE.

In addition, the Board must consider how various typical, more contentious, rate adjustments will be treated. For example, in a year with a significant weather event, how would extraordinary costs associated with the storm be treated? Would the Board include a previously approved amortization? Also, what about increased earnings flowing from an abnormal weather year. Does this mean the Company cannot take the surcharge for that year? In evaluating these factors for the purposes of determining an earnings threshold, the Board should also consider how these factors are treated in other rate proceedings.

> *(h) For any Infrastructure Investment Program approved by the Board, if the calculated ROE exceeds the allowed ROE from the utility's last base rate case by 50 basis points or more, accelerated recovery shall not be allowed for the applicable filing period.*

Comments: This sub-section does not explain what happens to the infrastructure investment that is not included in the surcharge mechanism due to a utility's over-earning. If is not known whether those investments would get rolled in with the next surcharge update or whether recovery for plant placed in service during a period of utility over-earning must wait for the next base rate case. This omission should be corrected.

Conclusion

For all the foregoing reasons, the Board should amend the Proposed Rule to include the ratepayer protections specified above.

Respectfully submitted,

Stefanie A. Brand

Stefanie A. Brand
Director, Division of Rate Counsel

ATTACHMENT A

Gurkas, Lisa

From: Gurkas, Lisa
Sent: Tuesday, October 03, 2017 11:15 AM
To: Gurkas, Lisa
Subject: FW: Straw Proposals
Attachments: Infrastructure Straw Proposal (4-26-2017).pdf; Provisional Rates Straw Proposal (4-26-17).pdf

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From: Gaglioti, Maria [mailto:Maria.Gaglioti@bpu.nj.gov]
Sent: Wednesday, April 26, 2017 3:55 PM
To: Stefanie Brand; Shelly Massey; tamara.linde@pseg.com; joseph.accardo@pseg.com; scocchi@sjindustries.com; smitchell@sjindustries.com; adembia@njng.com; pkeefe@southernco.com; geisenstark@windelsmarx.com; Lauren M. Lepkoski (llepkoski@firstenergycorp.com); philip.passanante@pepcoholdings.com; westark@pepcoholdings.com; jmeyer@riker.com; Carley, John L. - Regulatory; jkooper@middlesexwater.com; robert.brabston@amwater.com; dgern@gordonscornerwater.com; flwcoffice@optonline.net; lwaters@acsewerage.com; jhildabrant@aquaamerica.com; jim.cagle@unitedwater.com; gary.prettyman@suez-na.com; james.mastrokalos@suez-na.com; jmf1294@yahoo.com; movw@goes.com; j.hosking@roxburywater.com; SamSJF@verizon.net; glorstuart@comcast.net; dbsjr@simmonstransport.com; ahendry@njua.com; Goldenberg, Steven (SGoldenberg@foxrothschild.com); eliebman@aarp.org; geoffrey.gersten@dol.lps.state.nj.us
Subject: Straw Proposals

Attached please find the straw proposals issued by BPU today.

Sincerely,

Maria A. Gaglioti

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New Jersey Board of Public Utilities
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ANNOUNCEMENT OF STAKEHOLDER PROCESS

In recent years, the New Jersey Board of Public Utilities ("Board") has approved in excess of $3 billion in "Infrastructure Programs" administered by energy and water utilities related to resiliency and reliability. The Board has approved the Distributed System Improvement Charge ("DSIC") for water companies, and separately, large Infrastructure Programs to implement repairs and replacements after Superstorm Sandy and Hurricane Irene. While each Infrastructure Program has been handled by the Board on an individual basis, the Board has nevertheless developed certain requirements and processes to protect ratepayers and facilitate replacement and repair of aging utility infrastructure.

Board Staff has been directed to establish a stakeholder process to receive comments and proposals regarding potential regulations and filing requirements for additional infrastructure projects that will not be included as part of a utility's Capital Expenditures ("CapEx"). After consideration by the Board, this straw proposal may result in a rule applicable to a utility that wishes to establish or expand an Infrastructure Program.

The straw proposal concerning Infrastructure Programs will be the subject of a stakeholder meeting to be held on May 4, 2017 at 1:00 pm at the Board's offices, located at 44 South Clinton Avenue, Trenton, NJ 08625. Public comments are invited. Written comments are also invited and must be submitted to Irene Kim Asbury, Secretary, New Jersey Board of Public Utilities, 44 South Clinton Avenue, 3rd Floor, Suite 314, CN 350, Trenton, New Jersey 08625, on or before May 12, 2017.

The following topics are included for discussion and comment at the stakeholder meeting and by written submissions:

1. The Infrastructure Program may be for a period of five (5) years or less.

2. The Infrastructure Programs are voluntary.

3. Any Infrastructure Program must be incremental to the Utility's average CapEx over the prior five years.

4. A filing in support of an Infrastructure Program must:

    a) Include projected annual CapEx budgets for a five-year period, broken down by major category of expenditures;

    b) Specify the projects, and include descriptions of project objectives and detailed cost estimates;

    c) Include an Infrastructure Program budget establishing the maximum (or "cap") that can be spent (although year to year variations of ten percent will be allowed, and larger variations may be permitted with Board approval);

    d) Include similar projects within the utility's CapEx budget equal to ten percent of the amount of the Infrastructure Program; and be supported with semi-annual status reports for project management oversight purposes.

5. The projects within the Infrastructure Program must be related to reliability, resiliency, and/or replacement and may include, but are not limited to:

    a) Replacement of Gas Utilization Pressure Cast Iron mains with elevated pressure mains and associated services;

    b) Replacement of Gas bare steel and coated steel mains and services;

    c) Installation of Gas Excess Flow Valves where necessary;

d) Electric distribution automation investments, for example, SCADA equipment, relays, reclosers, Volt/VAR control, communications networks, and Distribution Management System Integration;

e) Resiliency or Redundancy Projects; and

f) Projects deemed by the Board to involve critical interconnections of a utility plant.

6. The projects must be non-revenue producing. Blanket Infrastructure Programs will not be eligible.

7. Cost recovery will be through a surcharge mechanism that will allow accelerated recovery.

8. The Infrastructure Program must include a cost benefit analysis.

9. The maximum annual increase in rates attributable to an Infrastructure Program will be two percent.

10. For combination utilities, separate gas and electric Infrastructure Programs may be established, each with their own respective spending caps.

11. Allowance for Funds Used During Construction ("AFUDC") would be allowed but not deferred accounting once facilities are in service.

12. The utilities will be allowed to file rate recovery petitions on a semi-annual basis provided at least ten percent of the Infrastructure Program's costs were in service during the semi-annual period.

13. Rates will be provisional, with prudency to be determined in the next base rate case, which will be required to be filed no later than five years after the approval of the Infrastructure Program.

14. An annual earnings test shall be required, which shall include an unadjusted cost and revenue study.

15. If the calculated Return on Equity ("ROE") exceeds the allowed ROE from the last base rate case by fifty basis points, there will be no accelerated recovery for the next six months and until a new calculation shows no return over the fifty basis points.

16. Water utilities may use this method for infrastructure improvements or may use the Board's DSIC rules.

ATTACHMENT B

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-1153-14T1

IN THE MATTER OF THE BOARD'S REVIEW OF THE APPLICABILITY AND CALCULATION OF A CONSOLIDATED TAX ADJUSTMENT.

Argued October 25, 2016 – Decided September 18, 2017

Before Judges Fisher, Ostrer and Vernoia.

On appeal from the New Jersey Board of Public Utilities, Docket No. EO12121072.

Diane Schulze argued the cause for appellant Division of Rate Counsel (Stefanie A. Brand, Director, attorney; Ms. Schulze and Christine M. Juarez, on the briefs).

Carolyn A. McIntosh, Deputy Attorney General, argued the cause for respondent New Jersey Board of Public Utilities (Christopher S. Porrino, Attorney General, attorney; Andrea M. Silkowitz, Assistant Attorney General, of counsel; Ms. McIntosh, on the brief).

Stephen B. Genzer argued the cause for respondent Aqua New Jersey, Inc., and United Water New Jersey, Inc. (Saul Ewing LLP, attorneys; Mr. Genzer, on the brief).

Lawrence S. Lustberg argued the cause for respondent Atlantic City Electric Company (Gibbons PC, attorneys; Mr. Lustberg and Amanda B. Protess, on the briefs).

Gregory Eisenstark argued the cause for respondent Jersey Central Power & Light Company (Windels Marx Lane & Mittendorf, LLP, attorneys; Mr. Eisenstark, on the brief).

Ira Megdal argued the cause for respondent New Jersey-American Water Company, Inc. (Cozen O'Connor, PC, attorneys; Mr. Megdal and Mark Lazaroff, on the brief).

James C. Meyer argued the cause for respondent New Jersey Utilities Association (Riker Danzig Scherer Hyland & Perretti, LLP, attorneys; Mr. Meyer, of counsel and on the brief; Diane N. Hickey, on the brief).

Fox Rothschild LLP, attorneys for respondent New Jersey Large Energy Users Coalition (Steven S. Goldenberg, of counsel and on the brief).

Cullen and Dykman LLP, attorneys for respondent Pivotal Utility Holdings, Inc., (Kenneth T. Maloney, on the brief).

Janine G. Bauer argued the cause for amicus curiae AARP (Szaferman, Lakind, Blumstein & Blader, PC, attorneys; Ms. Bauer, on the brief).

PER CURIAM

The Director of the Division of Rate Counsel appeals the Board of Public Utilities' final order revising its policy for calculating the consolidated tax saving adjustment (CTA) the Board utilizes in part to determine just and reasonable utility rates.

Rate Counsel and other interested parties[1] argue the revised CTA is not supported by adequate findings of fact, is not founded on sufficient evidence in the record, and constitutes a rule that was not enacted in accordance with the Administrative Procedure Act (APA), N.J.S.A. 52:14B-1 to -15, and due process requirements. The Board, and respondents, the New Jersey Utilities Authority and various utility companies[2] contend the Board's adoption of the revised CTA did not constitute rulemaking requiring compliance with the APA, is supported by the evidentiary record, and constitutes a proper exercise of the Board's discretion. Because we conclude the Board's adoption of the CTA constitutes rulemaking and the Board failed to comply with the APA's requirements, we reverse.

I.

The Board is charged with supervising and regulating public utility companies, N.J.S.A. 48:2-13(a), and setting "just and reasonable" rates for those utilities, N.J.S.A. 48:2-21(b)(1).

[1] Respondent New Jersey Large Energy Users Coalition and amicus American Association of Retired People (AARP) filed briefs supporting Rate Counsel's appeal. The Coalition participated in the proceeding before the Board. We granted AARP leave to participate in the appeal as amicus curiae.

[2] The respondent utility companies are Aqua New Jersey Inc., United Water New Jersey Inc., Atlantic City Electric Company, Jersey Central Power & Light Company, American Water Company, Inc., and Pivotal Utility Holdings, Inc.

The Division of Rate Counsel is a quasi-independent agency authorized by statute to represent the interests of utility ratepayers in rate-setting matters before the Board. N.J.S.A. 52:27EE-48(a); I/M/O Provision of Basic Generation Serv., 205 N.J. 339, 360 (2011).

To obtain an increase in utility rates, a utility company must petition the Board and prove that an increase is just and reasonable. N.J.S.A. 48:2-21(d). To sustain its burden of proof, a utility must establish "(1) the value of its property or the rate base, (2) the amount of its expenses, including operations, income taxes, and depreciation, and (3) a fair rate of return to investors." In re N.J. Am. Water Co., 169 N.J. 181, 188 (2001).

A company's "rate base" is "the fair value of the property of the public utility that is used and useful in [providing the regulated] public service." In re Petition of Pub. Serv. Coordinated Transport, 5 N.J. 196, 217 (1950). Reasonable rates for the service are generally set at an amount meant to "cover the utilities' expenses plus a return on the shareholders' investment," that is, an amount that permits "the public utility to earn a fair return on its rate base." Penpac, Inc. v. Passaic Cty. Utils. Auth., 367 N.J. Super. 487, 506 (App. Div.), certif. denied, 180 N.J. 457 (2004).

In an assessment of a utility's claimed expenses, a reasonable

rate shall be based only on "actual operating expenses . . . , and not for hypothetical expenses which did not and foreseeably will not occur." In re N.J. Power & Light Co., 9 N.J. 498, 528 (1952). The calculation of a utility company's tax expenses for use in the determination of its rate base is controlled "only by [its] real tax" expense, "rather than that which is purely hypothetical." Lambertville Water Co. v. N.J. Bd. of Public Util. Comm'rs, 153 N.J. Super. 24, 28 (App. Div. 1977), rev'd in part on other grounds, 79 N.J. 449, 458 (1979).

The Board has used a CTA to calculate the real tax expenses of utility companies whose federal tax returns are filed as part of the consolidated tax returns of their parent companies. The filing of a consolidated tax return permits the parent to offset the tax liability resulting from the profits of one or more of its affiliates against the losses of other affiliates. This reduces the tax obligations of each member of the group and saves each member a portion of the tax obligation they would have incurred if they filed their returns separately. Our Supreme Court has made clear that ratepayers must share in the resulting benefit to the utility. N.J. Power & Light Co., supra, 9 N.J. at 528. Otherwise, ratepayers would pay a utility's hypothetical and not real tax expenses. Ibid.

The Board has "the power and function to take into

consideration the tax savings flowing from the filing of [a] consolidated return and determin[e] what proportion of the consolidated tax is reasonably attributable to" the utility. Lambertville Water Co., supra, 153 N.J. Super. at 28. The Board is not bound by any particular methodology and may exercise its sound discretion to determine and make appropriate adjustments for a company's actual tax liability and thus ensure the reasonableness of the resultant rates. In re Revision of Rates Filed by Toms River Water Co., 158 N.J. Super. 57, 60-61 (App. Div. 1978), rev'd on other grounds, 82 N.J. 201 (1980). The Board has exercised its authority by using the CTA as the means to share with the company's ratepayers the benefits of the tax savings resulting from the consolidated tax filings.

The CTA Methodology

Prior to the Board's order challenged on appeal, the Board used what has been characterized as "the Rockland methodology"[3] to determine the CTA. Under the Rockland methodology, calculation of the CTA first requires a determination of the net taxable gains

[3] The Rockland methodology was developed in a series of rate cases culminating in I/M/O The Verified Petition Of Rockland Electric Company, BPU Docket No. ER02100724 (Apr. 20, 2004) (slip op. at 62-64); see also In re Petition of Jersey Cent. Power & Light Co., BRC Docket No. ER91121820J (June 15, 1993) (slip op. at 8); In re Petition of Atlantic City Elec. Co., BRC Docket No. ER90091090J (Oct. 20, 1992) (slip op. at 6).

and losses of all of the companies on the consolidated federal tax return for each year during a review period which begins in 1991 and ends in the most recent tax year. The companies that experienced net taxable gains are grouped together and their net taxable gains are aggregated. The companies that experienced net taxable losses are grouped together and their net taxable losses are aggregated. The aggregated losses are then multiplied by the applicable federal income tax rate to determine the group's consolidated tax benefit. The amount of the consolidated tax benefit is then allocated proportionately to the companies that experienced net taxable gains based on their proportionate share of the total aggregated gains.

If application of the Rockland methodology establishes that a New Jersey utility experienced net taxable gains during the review period, its proportionate share of the consolidated tax benefit constitutes its CTA. The amount of the CTA affects the utility's rate base because the larger the tax savings adjustment under the CTA, the greater the reduction in the utility's rate base.[4]

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[4] The CTA does not result in a dollar-for-dollar reduction in the utility's tax expenses that are used to calculate the rate base. The CTA tax savings are treated as a loan from ratepayers, whose payments contributed to the profits that would otherwise have been taxed if not for the consolidated filing. Jersey Cent. Power &

The Board Modifies the Rockland Methodology

In January 2013, the Board approved an order opening a generic proceeding to review the CTA. The Board noted that its current CTA methodology had been used for approximately twenty years and that federal tax laws and many of the companies' corporate structures had changed. The Board sought "input from stakeholders, including the utilities, customers, and . . . Rate Counsel" to determine the Board's use of the CTA, the calculation of tax savings from the filing of consolidated returns, the manner in which the savings should be shared with the utility companies and ratepayers, and if a rulemaking proceeding should be initiated. The order was posted to the Board's website and circulated to those on its generic stakeholder service list.

In March 2013, the Board posted an official Notice of Opportunity to Comment on its website and circulated it to stakeholders on its service list. The notice requested comments concerning the CTA and responses to requests for information about the stakeholders' respective positions on whether a CTA should be

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Light Co., supra, slip op. at 8. The parent company gains use of those profits earlier than it otherwise would have, and the CTA, in turn, compensates ratepayers for the time-value of their money by adjusting the company's rate base in an amount intended to prospectively credit ratepayers for the carrying costs of the loan. Petition of Atlantic City Elec. Co., supra, slip op. at 6.

utilized and what changes should be made to the CTA. The Board requested that the utility companies calculate their current CTA using the Rockland methodology and include, if applicable, the CTA included in the company's last rate base case. The notice advised that following the Board's review of the responses, it would announce a schedule of hearings to provide all interested parties with the opportunity to provide testimony on CTA issues.

The New Jersey Utilities Authority (NJUA) submitted comments on behalf of its members and various utility companies also submitted written comments. They advocated for the abolition of the CTA, arguing that the adjustment had become arbitrary due to an ever-expanding review period that used 1991 as its fixed starting point, and due to the CTA calculation's inclusion of companies that no longer participated in the consolidated income tax filings. They also asserted that application of the CTA adversely affected the utility companies' ability to attract capital and other investments necessary to ensure the safe and efficient provision of their regulated services.

The utility companies and the NJUA further noted that the relatively small CTAs that resulted from application of the methodology when it was first implemented had been replaced by a CTA that in one case was more than forty times higher. They urged the elimination of the CTA and argued that if the Board continued

its use, the review period should be reduced to as few as three years, electric company transmission assets and other operations should be removed from the analysis because they are not regulated by the Board, and companies that have been divested, dissolved, or are otherwise inactive should be excluded from the calculation.

Rate Counsel also submitted comments acknowledging that the length of the review period could result in inappropriately large adjustments and that changes in the tax code during the twenty years since the adoption of the methodology might impact the propriety of the calculation. Rate Counsel recommended that the CTA be reevaluated and adjusted based on utility specific data in fourteen different areas. Rate Counsel also urged that adoption of a revised CTA be completed through formal rulemaking.

In July 2013, the Board issued a Notice of Opportunity to Provide Additional Information, requesting that the utility companies provide data in each of the fourteen areas suggested by Rate Counsel. The notice further advised that following its review of the requested data, the Board would schedule a hearing to provide interested parties with an opportunity to testify concerning the CTA.

In November 2013, the Board issued a letter request for data concerning the taxable gains and losses for the utility companies and their affiliates for each calendar year from 1991 through

2012, and similar information from electric and gas companies broken down into gains and losses attributable to their separate electric and gas operations.

Based on the information and comments received during the process, at the Board's June 2014 meeting its staff recommended the retention of the Rockland methodology for calculation of the CTA with the following three revisions: (a) reduction of the review period to a fixed span of five calendar years; (b) an allocation of the benefits of consolidated tax savings with the utility company receiving seventy-five percent of the savings and the ratepayers receiving twenty-five percent; and (3) the exclusion of electric company transmission assets from the CTA calculation. The Board published notice of the proposed policy on its website and in the New Jersey Register, 46 N.J.R. 1657(a) (July 7, 2014), and distributed the notice to its service list, advising that public comments would be received until August 18, 2014.

The NJUA, the utility companies, Rate Counsel and the New Jersey Large Energy Users Coalition submitted comments. At its October 2014 meeting, the Board considered the recommended revisions and issued a final decision adopting them. The Board ordered that the CTA Rockland methodology would remain in effect with the following modifications:

> 1. The review period for the calculation shall be for five calendar years including any complete year that is included in the test year.
>
> 2. The [CTA] based on that review period shall be allocated so that the revenue requirement of the company is reduced by 25% of the adjustment; and
>
> 3. Transmission assets of the [electric distribution companies] would not be included in the calculation of the CTA.

The Board further ordered that the modified CTA would be utilized in all pending and future rate cases. The Board permitted the reopening of cases to permit recalculation of the CTA where the record was closed but the Board had not yet rendered a final decision. The Board's decision and order was entered on October 22, 2014. Corrective orders were entered on November 3, 2014 and again on December 17, 2014. Rate Counsel appealed.

II.

Rate Counsel, the Coalition and amicus AARP assert that the Board's decision and order must be reversed because the Board was obligated to promulgate the CTA modifications through formal rulemaking in accordance with the APA. N.J.S.A. 52:14B-4. They contend the Board's order establishes a uniform policy defining the CTA methodology and, therefore, it establishes a rule that can only be adopted in accordance with the APA. In its decision, the Board found that rulemaking was not required because it had

"flexibility to determine how to proceed in matters presented to it, and [could] use its discretion to choose the most appropriate manner, including by contested case, rulemaking or informal process, based on the issues raised and the potential effects of the resolution." The Board, the NJUA and the utility companies do not dispute that the Board did not comply with the APA's procedures for rulemaking, but they contend rulemaking was not required because the CTA does not establish the rates, and application of the CTA can be adjusted in rate cases to ensure that the Board fulfills its obligation to set fair and reasonable rates. See N.J.S.A. 48:2-21(b)(1).

"Administrative agencies possess wide latitude in selecting the appropriate procedures to effectuate their regulatory duties and statutory goals." In re Auth. For Freshwater Wetlands Statewide Gen. Permit 6, Special Activity Transition Area Waiver For Stormwater Mgmt., Water Quality Certification, 433 N.J. Super. 385, 413 (App. Div. 2013); accord In re Request for Solid Waste Util. Customer Lists, 106 N.J. 508, 519 (1987). "[A]gencies enjoy great leeway when selecting among rulemaking procedures, contested hearings, or hybrid informal methods in order to fulfill their statutory mandates." Provision of Basic Generation Serv., supra, 205 N.J. at 347. However, "[a]n agency's ability to select procedures it deems appropriate is limited by 'the strictures of

due process and of the [APA].'" In re Consider Distrib. of Casino Simulcasting Special Fund, 398 N.J. Super. 7, 16 (App. Div. 2008) (quoting Request for Solid Waste Util. Customer Lists, supra, 106 N.J. at 519).

An agency's "discretion to act formally or informally is not absolute." In re N.J.A.C. 7:1B-1.1 Et Seq., 431 N.J. Super. 100, 133 (App. Div.), certif. denied, 216 N.J. 8 (2013). "If an agency determination or action constitutes an 'administrative rule,' then its validity requires compliance with the specific procedures of the APA that control the promulgation of rules." Auth. For Freshwater Wetlands Statewide Gen. Permit 6, supra, 433 N.J. Super. at 413 (quoting Airwork Serv. Div. v. Div. of Taxation, 97 N.J. 290, 300 (1984), cert. denied, 471 U.S. 1127, 105 S. Ct. 2662, 86 L. Ed. 2d 278 (1985)); accord Provision of Basic Generation Serv., supra, 205 N.J. at 347.

"Agencies should act through rulemaking procedures when the action is intended to have a 'widespread, continuing, and prospective effect,' deals with policy issues, materially changes existing laws, or when the action will benefit from rulemaking's flexible fact-finding procedures." Provision of Basic Generation Serv., supra, 205 N.J. at 349-50 (quoting Metromedia, Inc. v. Div. of Taxation, 97 N.J. 313, 329-31 (1984)). To determine if the APA

rulemaking requirements are implicated, we apply the following analysis:

> [A]n agency determination must be considered an administrative rule . . . if it appears that the agency determination, in many or most of the following circumstances, (1) is intended to have wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group; (2) is intended to be applied generally and uniformly to all similarly situated persons; (3) is designed to operate only in future cases, that is, prospectively; (4) prescribes a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization; (5) reflects an administrative policy that (i) was not previously expressed in any official and explicit agency determination, adjudication or rule, or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter; and (6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy.
>
> [Metromedia, supra, 97 N.J. at 331-32.]

"The factors need not be given the same weight, and some factors will clearly be more relevant in a given situation than others," Doe v. Poritz, 142 N.J. 1, 97 (1995), and "[n]ot all factors need be present for an agency action to qualify as an administrative rule," Provision of Basic Generation Serv., supra, 205 N.J. at 350. "The pertinent evaluation focuses on the importance and weight of each factor, and is not based on a

quantitative compilation of the number of factors which weigh for or against labeling the agency determination as a rule." Ibid.

Based on our review of the record, we are satisfied that the Board's order satisfies all of the Metromedia factors and thereby constitutes a rule requiring adoption through rulemaking in accordance with the APA. See Auth. For Freshwater Wetlands Statewide Gen. Permit 6, supra, 433 N.J. Super. at 413. With regard to the first Metromedia factor, the modified CTA applies to all of the utility companies whose tax returns are filed as part of the consolidated returns of their respective holding companies. Cf. Deborah Heart & Lung Ctr. v. Howard, 404 N.J. Super. 491, 506 (App. Div.) (finding rulemaking was not required in part because the nine of eighteen cardiac surgery facilities subject to the policy change constituted a "narrow, select group," and not a "large segment of the regulated public"), certif. denied, 199 N.J. 129 (2009). In addition, because the utility company respondents serve a significant portion of the regulated public and the CTA modifications will "impact the general public in its rate-paying capacity, the first Metromedia factor . . . support[s] closer adherence to rulemaking procedures." Provision of Basic Generation Serv., supra, 205 N.J. at 350-51; see also In re Attorney General's "Directive on Exit Polling: Media and Non-Partisan Public Interest Groups," 402 N.J. Super. 118, 134 (App. Div. 2008) (finding first

Metromedia factor supports rulemaking where the agency's order "is intended to affect a large segment of the public"), aff'd in part and modified in part on other grounds, 200 N.J. 283 (2009).

The second Metromedia factor also favors rulemaking because the modified CTA generally and uniformly applies to all regulated utilities whose tax returns are filed as part of consolidated returns. Metromedia, supra, 97 N.J. at 331. Moreover, the Board's order directs that the modified CTA applies prospectively, including in those cases that were not yet decided but where the record remained open at the time the order was entered. Thus, application of the third Metromedia factor supports a finding that the modified CTA constitutes a rule. Ibid.

As set forth in the Board's order, the modified CTA "prescribes a legal standard [and] directive that is not otherwise expressly provided by or clearly and obviously inferable from the [Board's] enabling statutory authorization." Ibid. The Board is required to set "just and reasonable rates," N.J.S.A. 48:2-21, but there is no statutory directive establishing the methodology for calculating a utility's real, as opposed to hypothetical, tax payments to determine its rate base, and no statute directs the use of a CTA. See Airwork, supra, 97 N.J. at 301 (holding rulemaking is not required for an agency order directing the form of a tax assessment where tax statute is specific concerning the

underlying tax obligation). We are therefore satisfied the fourth Metromedia factor favors a finding that rulemaking is required.

Application of the fifth Metromedia factor also favors rulemaking. Although the use of a CTA and the Rockland methodology were previously expressed in the Board's determinations in adjudicated cases, the shortened and finite review period, the allocation of the tax savings, and the elimination of electric transmission assets constitute "material and significant change[s]" to the Board's prior CTA policy. Metromedia, supra, 97 N.J. at 331. The Board never before employed a finite review period or a defined allocation, and never previously excluded a class of a utility company's assets from its CTA calculation. Further, it is not disputed that the modifications constitute material and significant changes to the CTA. Indeed, Rate Counsel, the Coalition, the NJUA and the utility companies argued before the Board that the CTA required material and significant changes, and the Board's order achieved that result.

Last, the modifications reflect the Board's decision on a regulatory policy "in the nature of an interpretation of law or general policy." Id. at 331-32. The Board acknowledges as much in its decision and order, stating that the modifications are required to recognize "the fact that a fundamental tenet of utility regulation is that any methodology used by a regulator must result

in an end result that is just and reasonable for both ratepayers and shareholders." The Board adopted the modifications based on its finding that the prior CTA methodology "may not be the appropriate means of achieving that fundamental principle." See Provision of Basic Generation Serv., supra, 205 N.J. at 352 (finding the Board's decision to "pass through" certain costs to ratepayers could be viewed as a regulatory policy which was to be applied later in individual rate-recovery hearings).

In sum, all of the Metromedia factors favor rulemaking here. The Board's order constitutes a "statement of general applicability and continuing effect that implements [and] interprets" the Board's "policy" concerning the calculation of tax adjustments to a utility company's rate base, N.J.S.A. 52:14B-2(e), and therefore is a rule within the meaning of the APA. See, e.g., Auth. For Freshwater Wetlands Statewide Gen. Permit 6, supra, 433 N.J. Super. at 413 (finding agency's adoption of a computer-based program used to determine the sufficiency of proposed nonstructural stormwater management measures constituted rulemaking); N.J. Animal Rights Alliance v. N.J. Dep't of Envt'l. Prot., 396 N.J. Super. 358, 369-70 (App. Div. 2007) (finding agency's policy detailing requirements for a public bear hunt constituted a rule requiring APA rulemaking).

Rate counsel, the Coalition and amicus AARP argue the Board's failure to comply with the APA requires reversal of the Board's order. They contend the Board's failure to engage in formal rulemaking deprived the stakeholders of APA procedural safeguards and an opportunity to present evidence and testimony at an evidentiary hearing.

For example, Rate Counsel argues the Board failed to comply with the following APA requirements: publish a proposal containing "a clear and concise explanation of the purpose and effect of the rule, the specific legal authority under which its adoption is authorized, [and] a description of the expected socio-economic impact of the rule," N.J.S.A. 52:14B-4(a)(2), and prepare and distribute "a report listing all parties offering written or oral submissions concerning the rule, summarizing the content of the submissions and providing the agency's response to the data, views, comments, and arguments contained in the submissions," N.J.S.A. 52:14B-4(a)(4). The record supports Rate Counsel's position. These APA requirements were not satisfied in the generic proceeding.

Rate Counsel also argues, and the record shows, that the Board's March 2013 Notice of Opportunity to Comment and July 2013 Notice of Opportunity to Provide Additional Information each stated that following the collection of the requested data and comments, the Board would "announce a schedule for hearings to

provide all interested parties with the opportunity to provide testimony on the CTA issues." The Board, however, never announced such hearings or conducted any hearings providing interested parties with the opportunity to present testimony.

Although agencies enjoy leeway to choose among rulemaking, adjudicatory hearings, and hybrid informal proceedings to fulfill their statutory mandates, Provision of Basic Generation Serv., supra, 205 N.J. at 347, leeway is not a license to ignore the APA's requirements. The Board has discretion to utilize various procedures to fulfill its statutory mandate, but our Supreme Court has held that "administrative action, and an agency's discretionary choice of the procedural mode of action, are valid only when there is compliance with the provisions of the [APA] and due process." Ibid.; see also Airwork, supra, 97 N.J. at 300 ("If an agency determination or action constitutes an 'administrative rule,' then its validity requires compliance with the specific procedures of the APA that control the promulgation of rules."); Consider Distrib. of Casino Simulcasting Special Fund, 398 N.J. Super. 7, 16 (App. Div. 2008) ("An agency's ability to select procedures it deems appropriate is limited by 'the strictures of due process and of the [APA] . . . .'" (quoting In re Request for Solid Waste Util. Customer Lists, supra, 106 N.J. at 519)). Where, as here, the Board promulgates an administrative rule, it is

required to comply with the APA's requirements. Provision of Basic Generation Serv., supra, 205 N.J. at 347. Because the Board failed to do so here, we are constrained to reverse the Board's order.

We are not persuaded that the Court's decision in Provision of Basic Generation Service, requires a different result. There, the Court applied the Metromedia factors to a Board order that in part allowed utility companies to pass through increased energy supplier costs to the ratepayers. Id. at 349-52. The Court found that the first five Metromedia factors supported a finding that the order constituted rulemaking and that the sixth factor "[did] not advance the analysis in any compelling way." Id. at 350-52. In weighing the factors, the Court determined that the preponderance of the "factors favor[ed] treating the [order] as akin to rulemaking" but that in adopting what the Court characterized as a "quasi-rule, the [Board] was entitled to greater flexibility with regard to procedural formalities than if this process could only have been completed by way of a strict rulemaking process." Id. at 352 (emphasis added).

Under those circumstances, the Court found the Board's use of a hybrid proceeding "which had attributes of rulemaking and adjudicative proceedings and included a legislative-type hearing, two opportunity-to-comment periods, discovery periods, and public hearings throughout the state, was sufficient to satisfy the

requirements of the . . . APA." Id. at 353 (emphasis added). But the Court expressly conditioned its conclusion upon the requirement that "evidentiary rate-setting hearings take place which apply to the cases of specific energy providers the principles to be established in" an ongoing contested case before the Board.[5] Ibid. Thus, the court allowed a departure from the APA's rulemaking requirements because the policy was going to be further defined in an ongoing adjudicated case.

Here, all the Metromedia factors clearly favor rulemaking. Therefore, unlike in Provision of Basic Generation Service, we address the requirements for the adoption of an actual, and not a quasi-rule, and the Board did not have the concomitant flexibility to depart from the APA's requirements. See id. at 352. Moreover, in its adoption of the modified CTA, the Board did not utilize the hybrid process the Court found provided the flexibility to abandon the requirements of formal rulemaking in Provision of Basic Generation Service.[6] The Board's order constitutes a general policy

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[5] The ongoing contested case cited by the Court was In re Provision of Basic Generation Service for the Period Beginning June 1, 2008 – BGS SREC Recovery Mechanism Proceeding, BPU Docket No. ER07060379. Ibid.

[6] As an alternative to acting through rulemaking, adjudication or a hybrid proceeding, an agency may act informally. Request for Solid Waste Util. Customer Lists, supra, 106 N.J. at 518. "[I]nformal action constitutes the bulk of the activity of most

that will be applied in future cases without the benefit of any of the adjudicatory proceedings the Court required in Provision of Basic Generation Service. See id. at 353.

"The purpose of APA rulemaking procedures is 'to give those affected by the proposed rule an opportunity to participate in the process, both to ensure fairness and also to inform regulators of consequences which they may not have anticipated.'" Id. at 349 (quoting In re Adoption of 2003 Low Income Hous. Tax Credit Qualified Allocation Plan, 369 N.J. Super. 2, 43 (App. Div.), certif. denied, 182 N.J. 141 (2004)). We find nothing in the Court's decision in Provision of Basic Generation Service supporting an abandonment of the well-settled principle that where an agency adopts a rule, it must proceed through formal rulemaking in accordance with the APA. Id. at 347; Airwork, supra, 97 N.J. at 300; Auth. For Freshwater Wetlands Statewide Gen. Permit 6, supra, 433 N.J. Super. at 413.

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administrative agencies," "and the line between . . . rulemaking . . . , and informal action, . . . can become blurred." Ibid. However, informal action is defined as "statutorily authorized agency action that is neither adjudication nor rulemaking." Id. at 519. "[I]nformal agency action includes investigating, publicizing, planning, and supervising a regulated industry." Ibid. Here, the Board's order did not constitute informal action because, as noted, it satisfied each of the Metromedia factors and therefore constituted a rule that required rulemaking. Metromedia, supra, 97 N.J. at 332. It is only where "the APA does not require rulemaking [that] an agency may act informally." Ibid.; N.J.A.C. 7:1B-1.1 Et Seq., supra, 431 N.J. Super. at 133.

We are also persuaded that the Board's departure from the APA requirements constituted an "irregularity or informality [that] tends to defeat or impair the substantial right or interest of the appellant." N.J.S.A. 48:2-46. In the first instance, the Board's proceeding violated the ratepayers' right to have the new CTA policy adopted in accordance with the APA.

Second, although the Board's process provided opportunities for the submission of evidence and comment and the Board made certain submissions available on its website, the Board failed to comply with the APA's requirements that it publish "a description of the expected socio-economic impact of the rule," N.J.S.A. 52:14B-4(a)(2), and prepare and distribute a report "summarizing the content of the submissions and providing the [Board's] response to the data, views, comments, and arguments contained in the submissions," N.J.S.A. 52:14B-4(a)(4). We do not consider these APA requirements to be insubstantial. They require more of the Board than merely making information available on a website and requesting comment.

Compliance with the requirements provides the stakeholders with the Board's analysis and assessment of the economic impact of a proposed rule and the Board's response to a stakeholder's data, comments and arguments before a rule is adopted. Moreover, compliance provides the stakeholders with the opportunity to

present evidence and address the Board's economic impact assessment and response to the stakeholder's data, comments and argument. In other words, the statutory requirements guarantee that Rate Counsel and the stakeholders are fully informed of the Board's position concerning a rule's economic impact and the Board's response to the submitted data, comments and arguments, thus permitting Rate Counsel and the stakeholders an opportunity to present further evidence and argument. When the requirements are ignored, the Board gathers information and comment, but Rate Counsel and the stakeholders are deprived of the right granted by the APA to consider and contest the Board's assessment of economic impact and responses to the submissions prior to the adoption of a rule.

In our view, the Board's failure to comply with the requirements deprived Rate Counsel of substantial rights and interests under the APA: the right to obtain the Board's assessment of the economic impact of the proposed modified CTA and responses to Rate Counsel and the other stakeholders' submissions, and the right to provide evidence and argument in opposition to them. The failures are of particular significance here because of the conflicting evidence presented concerning the modified CTA's potential economic impact on ratepayers. We are therefore convinced that the Board's failure to comply with the APA's

requirements in its adoption of the modified CTA constituted an irregularity that tended to defeat and impair the rights and interests of Rate Counsel and the other stakeholders.

Because we reverse the Board's order, it is unnecessary to address the arguments that the Board's decision and order lacks sufficient support in the record or is otherwise contrary to applicable law. Any remaining arguments that we have not addressed directly are without sufficient merit to warrant discussion in a written opinion. R. 2:11-3(e)(1)(E).

Reversed.

ATTACHMENT C

GAS AND ELECTRIC UTILITY INFRASTRUCTURE PROGRAMS
LINKS TO BASE RATE PROCEEDINGS

	Utility/Program	Date Approved	Link to Base Rate Case
	ORIGINAL ECONOMIC STIMULUS		
1	NJNG Accelerated Energy Infrastructure Investment Program ("AIP")[i]	April 2009	Company's 2007 base rate case was re-opened for consideration of base rate increases associated with infrastructure investments through August 31, 2011.
2	SJG Capital Investment Recovery Tracker ("CIRT")[ii]	April 2009	Base rate petition to be filed on or before April 1, 2011.
3	PSE&G Capital Infrastructure Investment Program ("CIP")[iii]	April 2009	Base rate petition to be filed between April 3, 2009 and April 1, 2011
4	ETG Utility Infrastructure Enhancement ("UIE") Program[iv]	April 2009	Rate increases associated with infrastructure investments to be considered in Phase II of pending 2009 base rate case
5	ACE Infrastructure Investments Surcharge ("IIS")[v]	April 2009	Base rate petition to be filed on or before April 1, 2011.
	ECONOMIC STIMULUS EXTENSION		
6	NJNG AIP II[vi]	March 2011	Company's 2007 base rate case to remain open to consider infrastructure improvements through October 2012, after which the base rate case will close.
7	SJG CIRT II[vii]	March 2011	Company's 2010 base rate case to remain open for infrastructure investments through October 2012, with recovery for later investments to be considered in subsequent base rate or other proceeding.
8	ETG UIE II[viii]	May 2011	Phase II of Company 2009 base rate case to remain open to consider investments through October 2012, with recovery for later investments to be considered in a subsequent base rate or other proceeding.
9	PSE&G CIP II[ix]	July 2011	Company's 2009 base rate case to remain open for projects to be completed by December 2012, with recovery for later investments to be considered in the Company's next base rate case.

	GAS PIPELINE SAFETY AND MODERNIZATION		
10	ETG Pipeline Replacement Program ("PRP")[x]	Aug. 2006	Previously issued BPU Order approving Company's merger with AGLR required a base rate filing no later than March 2009.
11	NJNG Safety Acceleration and Facility Enhancement ("SAFE") Program[xi]	Oct. 2012	Base rate case to be filed no later than November 15, 2015
12	SJG Accelerated Infrastructure Replacement Program ("AIRP")[xii]	Feb. 2013	Base rate case to be filed no later than December 15, 2015.
13	ETG Accelerated Infrastructure Replacement ("AIR") Program [xiii]	Aug. 2013	Base rate case to be filed no later than September 1, 2016
14	PSE&G Gas System Modernization Program ("GSMP")[xiv]	Nov. 2015	Company previously committed to file a base rate case no later than November 1, 2017.
15	NJNG SAFE II[xv]	Sept. 2016	Base rate case to be filed no later than November 2019.
16	SJG AIRP II[xvi]	Oct. 2016	Company previously committed to file base rate case no later than October 1, 2017. Next base rate case to be filed no later than three years following the Board Order in the 2017 base rate case.
	STORM HARDENING/ RESILIENCE		
17	PSE&G for Approval of the Energy Strong Program[xvii]	May 2014	PSE&G will file its next base rate case no later than November 1, 2017.
18	JCP&L Major Storm Events in 2011 and 2012[xviii]	March 2015	Company is directed to file a base rate case no later than April 1, 2017.
19	RECO Major Storm Events in 2011 and 2012[xix]	May 2014	2011 and 2012 Major Storm Costs recovery to be determined in pending Base Rate Case (ER13111135).
20	RECO Storm Hardening Program[xx]	Jan. 2016	These costs will be subject to review in the next Base Rate Case which the Company has committed to filing by July 31, 2018.
21	ETG Natural Gas Distribution Utility Reinforcement Effort ("ENDURE") Program[xxi]	July 2014	Base rate case to be filed by September 1, 2016.

22	NJNG Reinvestment Enhancement Program ("RISE")[xxii]	July 2014	Company previously committed to file a base rate case no later than November 15, 2015.
23	SJG Storm Hardening and Reliability Program ("SHARP")[xxiii]	Aug. 2014	Company's 2013 base rate case pending at time program approved, and next base rate case to be filed no later than October 1, 2017.

[i] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities and I/M/O the Petition New Jersey Natural Gas Company for Approval of an Accelerated Energy Infrastructure Investment Program Pursuant to N.J.S.A. 48:2-23, and for Approval of Necessary Changes to Gas Rates and Changes in the Company's Tariff for Gas Service Pursuant to N.J.S.A. 48-2-21, BPU Dkt. Nos. EO09010049 & GO09010052 (Apr. 28, 2009).

[ii] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities and I/M/O the Petition of South Jersey Gas Company for Approval of a Capital Investment Recovery Tracker Pursuant to N.J.S.A. 48:2-21.1 and N.J.S.A. 48:2-21, BPU Dkt. Nos. EO09010049 & GO09010051 (Apr. 28, 2009).

[iii] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities and I/M/O the Petition of Public Service Electric & Gas Company for Approval of a Capital Economic Stimulus Investment Program and an Associated Cost Recovery Mechanism Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, BPU Dkt. Nos. EO09010049 & GO09010050 (Apr. 28, 2009).

[iv] I/M/O the Proceeding for Infrastructure Investment and a Cost Recovery Mechanism for All Gas and Electric Utilities and I/M/O the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of a Utility Infrastructure Enhancement Cost Recovery Rider, BPU Dkt. Nos. EO09010049 & GO09010053 (Apr. 28, 2009).

[v] I/M/O the Petition of Atlantic City Electric Company for Approval of Certain Energy Infrastructure Investments and Approval of a Cost Recovery For Such Projects and Related Tariff Modifications Associated Therewith Pursuant to N.J.S.A. 48:2021 and 48:21.1, BPU Dkt. No. GO09010054, Decision and Order Approving Stipulation (Apr. 28, 2009).

[vi] I/M/O the Petition of New Jersey Natural Gas Company for Approval of an Extension of the Accelerated Energy Infrastructure Investment Program Pursuant to N.J.S.A. 48:2-23 and for Approval of Necessary Changes in the Company's Tariff for Gas Service Pursuant to N.J.S.A. 48:2-21 et seq., BPU Dkt. Nos. GR07110889 & GR10100793 (Mar. 30, 2011).

[vii] I/M/O the Annual Filing of South Jersey Gas Company to Adjust its Capital Investment Recovery Tracker ("CIRT") and for Approval of an Extension of the CIRT Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and I/M/O the Petition of South Jersey Gas Company for Approval of Base Tariff Rates and Charges for Gas Service and Other Tariff Rvisions, BPU Dkt. Nos. GR10100765 & GR10010035 (Mar. 31, 2011).

[viii] I/M/O Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas to Extend its Utility Infrastructure Enhancement Program and Revise its Utility Infrastructure Enhancement Rate and I/M/O Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of Increased Base Tariff Rates and Charges for Gas Services and Other Tariff Revisions, BPU Dkt. Nos. GO10120969 & GR09030195 (May 16, 2011).

[ix] I/M/O the Petition of Public Service Electric and Gas Company for Approval of an Extension of the Electric Capital Economic Stimulus Infrastructure Investment Program and Associated Cost Recovery Mechanism and to Roll Into Rate Base the Net Capital Investment for All the Qualifying Projects From the Initial Capital Economic Stimulus Infrastructure Investment Program Upon Completion Pursuant to N.J.S.A. 48:2-23, 48:2-21 and 48:2-21.2 and for Changes in the Tariff for Electric Service, B.P.U.N.J. No. 15 Electric, and the Tariff for Gas Service, B.P.U.N.J. No. 15 Gas Pursuant to N.J.S.A. 48:2-21 and I/M/O the

Petition of Public Service Electric and Gas Company for Approval of an Extension of the Gas Capital Economic Stimulus Infrastructure Investment Program and Associated Cost Recovery Mechanism and to Roll Into Rate Base the Net Capital Investment for All the Qualifying Projects From the Initial Capital Economic Stimulus Infrastructure Investment Program Upon Completion Pursuant to N.J.S.A. 48:2-23, 48:2-21 and 48:2-21.2 and for Changes in the Tariff for Electric Service, B.P.U.N.J. No. 15 Electric, and the Tariff for Gas Service, B.P.U.N.J. No. 15 Gas Pursuant to N.J.S.A. 48:2-21, BPU Dkt. Nos. EO11020088 & GO10110862 (Jul. 14, 2011).

[x] I/M/O the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas Company to Establish a Pipeline Replacement Program Cost Recovery Rider, BPU Dkt. No. GR05040371 (Aug. 18, 2006).

[xi] I/M/O the Petition of New Jersey Natural Gas Company for Approval of the Safety Acceleration and Facility Enhancement Program Pursuant to N.J.S.A. 48:2-23 and for Approval of the Associated Recovery Mechanism Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, BPU Dkt. No. GO21030255 (Oct. 23, 2012).

[xii] I/M/O the Petition of South Jersey Gas Company to Implement an Accelerated Infrastructure Replacement Program and Associated Recovery Mechanism Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, BPU Dkt. No. GO12070670 (Feb. 20, 2013).

[xiii] I/M/O the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of an Accelerated Infrastructure Replacement Program and an Associated Cost Recovery Mechanism, BPU Dkt. No. GO12070693 (Aug. 21, 2013).

[xiv] I/M/O the Petition of Public Service Electric and Gas Company for Approval of a Gas System Modernization Program and Associated Cost Recovery Mechanism, BPU Dkt. No. GR15030272 (Nov. 16, 2015).

[xv] I/M/O the Petition of New Jersey Natural Gas Company for Approval of an Increase in Gas Base Rates and for Changes in its Tariff for Gas Service, and Approval of SAFE Extension and NJ RISE Rate Recovery Mechanism Pursuant to N.J.S.A. 48:2-21, 48:2-21.1 and for Changes to Depreciation Rates for Gas Property Pursuant to N.J.S.A. 48:2-18, BPU Dkt. No. GR15111304 (Sept. 23, 2016).

[xvi] I/M/O the Petition of South Jersey Gas Company to Continue Its Accelerated Infrastructure Replacement Program ("AIRP") Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1 and for Approval of a Base Rate Adjustment to Reflecr AIRP Investments in Base Rates, BPU Dkt. No. GR16020175 (Oct. 31, 2016).

[xvii] I/M/O Public Service Electric and Gas Company for Approval of the Energy Strong Program, Dkt. Nos. EO13020155 and GO13020156, Order Approving Stipulation of Settlement (5/21/14).

[xviii] I/M/O the Board's Establishment of a Generic Proceeding to Review the Prudence of Costs Incurred By New Jersey Utility Companies in Response to Major Storm Events in 2011 and 2012, BPU Dkt. No. AX13030196 and I/M/O the Board's Review of the Prudence of the Costs Incurred By Jersey Central Power and Light Company in Response to Major Storm Events in 2011 and 2012, BPU Dkt. No. ER13050391, Order (3/26/15).

[xix] I/M/O the Board's Review of the Prudency of the Costs Incurred by Rockland Electric Company in Response to Major Storm Events in 2011 and 2012, BPU Dkt. No. EO13070611, Decision and Order Approving Stipulation (May 21, 2014).

[xx] I/M/O the Board's Establishment of a Generic Proceeding to Review the Costs, Benefits and Reliablity Impacts of Major Storm Even Mitigation Efforts, BPU Dkt. No. AX13030197 and I/M/O the Verified Petition of Rockland Electric Company for Establishment of a Storm Hardening Surcharge, BPU Dkt. No. ER14030250, Decision and Order Approving Stipulation (1/28/16).

[xxi] I/M/O the Board's Establishment of a Generic Proceeding to Review the Costs, Benefits and Reliability Impacts of Major Storm Event Mitigation Efforts and I/M/O the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas for Approval of the Elizabethtown Natural Gas Distribution Utility Reinforcement Effort Program and Deferred Accounting Treatment, BPU Dkt. Nos. AX13030197 & GO13090826 (July 23, 2014).

[xxii] I/M/O the Board's Establishment of a Generic Proceeding to Review the Costs, Benefits and Reliability Impacts of Major Storm Event Mitigation Efforts and I/M/O the Petition of New Jersey Natural Gas Company for Approval of the NJ RISE Program and Associated Rate Recovery Mechanism, BPU Dkt. Nos. AX13030197 & GO13090828 (July 23, 2014).

[xxiii] I/M/O the Board's Establishment of a Generic Proceeding to Review the Costs, Benefits and Reliability Impacts of Major Storm Event Mitigation Efforts and I/M/O the Petition of South Jersey Gas Company for Approval of a Storm Hardening and Reliability Program (SHARP) and Associated Recovery Mechanism, BPU Dkt. Nos. AX13030197 & GO13090814 (Aug. 20, 2014).

ATTACHMENT D

EXCERPT

STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE PETITION OF NEW JERSEY AMERICAN WATER COMPANY FOR AUTHORIZATION TO IMPLEMENT A DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC")	:	BPU DOCKET NO. WO08050358

INITIAL BRIEF OF THE STAFF OF THE BOARD OF PUBLIC UTILITIES

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On the Brief

Date: April 17, 2009

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At the Westfield Public Hearing, Mr. Tom Getzendanner, an elected official for the Town of Summit, commented that the self-implementing DSIC rate be capped at a percentage lower than 7.5%, such as at 3%, in light of the Company's recent rate increases. (Westfield Public Hearing Transcript 15-6 to 12). No members of the public spoke at the Maplewood and Westhampton public hearings.

STAFF'S DSIC PROPOSAL

Staff proposes that the Board adopt a DSIC mechanism that would permit NJAW to recover expenditures on the replacement of main that is at least 50 years of age, up to a total of 3% of the Company's annual gross revenues, between rate cases. Staff recommends that in order to collect a DSIC charge from ratepayers, the Company must first file a petition with the Board on or about October 2009 outlining the DSIC-eligible plant that was or is to be placed in service between December 31, 2008 and December 31, 2009. Beginning in 2010, the Company is to submit quarterly reports to reflect DSIC eligible plant that was placed in service after each period.[6] Staff proposes that on or about October 2010, the Company submit a petition for DSIC eligible plant that was or is to be placed in service between December 31, 2009 and December 31, 2010. The Company will also be required to file its "true up" petition which will reconcile the DSIC-eligible plant that was placed in service during the previous year up to and including December 31, 2009, along with a depreciation reserve true up for the associated plant.

Through Staff's proposal, DSIC rates would be changed annually with a filing that includes a public hearing and a Board Order. Staff recommends that the Company be required to file a base rate case no later than three years, but with rates effective no sooner than two years after the Board Order in this docket. At the conclusion of the base rate proceeding, which will

[6] Staff proposes that a January 2010 quarterly report reflect eligible plant placed in service for the fourth quarter of 2009, the April 2010 report reflect activity during the first quarter of 2010, the July 2010 report reflect activity during the second quarter of 2010, and the October 2010 report reflect activity from the third quarter of 2010.

include a prudency review of all DSIC-eligible projects, all DSIC-related costs deemed just and reasonable will be made permanent, and the DSIC clause will be reset to zero. Staff also proposes all over recoveries collected under the DSIC charge be refunded to ratepayers with interest. Moreover, Staff supports the concept of an earnings test.

Additionally, Staff recommends that the implementation of the DSIC be done within the context of a pilot program for at least two years and no more than three years. Furthermore, Staff recommends that the Board begin a generic rulemaking proceeding in order to develop rules to be applied to all regulated water and wastewater utilities within the Board's jurisdiction.

Staff recommendations, including a discussion of method of calculating the DSIC charge, will be further addressed below.

POINT 1

BECAUSE NJAW HAS ESTABLISHED THAT A SUBSTANTIAL PORTION OF ITS MAINS ARE OVER 50 YEARS OLD, STAFF RECOMMENDS THAT THE BOARD IMPLEMENT A DSIC ON A PILOT BASIS AND THAT THE BOARD COMMENCE A GENERIC RULEMAKING CONSISTENT WITH APPLICABLE LAW.

The Board should adopt a DSIC, because the need for one is necessary to address New Jersey's aging water and wastewater infrastructure. According to NJAW, 15% or 1250 miles of its water mains will be in service for 100 years or more by the year 2020 unless they are replaced before then. (PT-2 3-21 to 22). Additionally, mains installed before 1965 account for over 50% of NJAW's water main system. Mains installed during this period pre-dates the common use of cement-lined ductile iron pipe material. (PT-2 10-2 to 8). Moreover, these mains have been subjected to years of corrosion, increased weight loading from heavier vehicles, street repavings and impacts from installation of other underground utilities. (PT-2 10-2 to 8). Further, the mains installed within the NJAW system in the 1920s and those installed between 1945 and 1955 may reach the end of their useful lives at the same time within the next 25-35 years due to factors

such as age, localized conditions, design standards and manufacturing techniques. (PT-2 5-9 to 6-3). Relative to NJAW's collection systems, Ms. Chiavari notes that these mains were constructed 50 to over 100 years ago and that they will reach the end of their useful lives within the next 5-25 years. (PT-2 3-14 to 17).

NJAW argues that traditional ratemaking alone cannot address the growing need to replace and rehabilitate aging water and wastewater infrastructure that is nearing its useful life (PT-2 16-7 to 11) and the implementation of a DSIC would relieve the uncertainly inherent in a rate case and allow the Company to pursue an aggressive replacement and rehabilitation program. (PT-2 19-10 to 13). Staff believes that a DSIC would allow the Company to accelerate its pace of infrastructure replacements at a reasonable cost, resulting in improved water quality, improved pressure and service reliability that will benefit customers. Staff also believes that the replacement and upgrade of deteriorating water and wastewater mains could reduce the number of main breaks, service interruptions, unaccounted for water; improve water quality; and enhance fire protection. Staff agrees with the Company that the DSIC will permit the Company to address its aging infrastructure on a more timely basis and that a DSIC, when properly implemented, can accelerate the replacement of older mains.

Staff notes Rate Counsel's argument that the existing ratemaking mechanism is sufficient to address an accelerated infrastructure program. (2T 94-24 to 95-3). Staff believes that the parameters set forth below address the parties's positions.

First, the Board should find that it is within its authority to order the implementation of a DSIC to customers of NJAW, a public utility under the Board's jurisdiction. Under N.J.S.A. 48:2-13, the Board has general jurisdiction over all public utilities and their "property, property rights, equipment, facilities and franchises so far as may be necessary for the purpose of carrying

out the provisions of [Title 48]." It has been stated in case law that the Board was "intended by the Legislature to have the widest range of regulatory power over public utilities," and that the provisions under N.J.S.A. 48 "are to be construed liberally." County of Bergen v. Dept. of Public Utilities of the State of N.J., 117 N.J. Super. 304, 312 (App. Div. 1971).

Moreover, the Legislature has granted the Board broad discretion to exercise its rulemaking authority to ensure just and reasonable utility rates. In re Petition of Pub. Serv. Coordinated Transp., 5 N.J. 196, 214 (1950). As stated in N.J.S.A. 48:2-21(d), "the Board, either upon written complaint or upon its own initiative, shall have power after hearing, upon notice, by order in writing to determine whether the increase, change or alteration is just and reasonable."

The BPU also has the authority to implement a DSIC because the DSIC is germane to the Board's authority delegated under the provisions of Title 48, including the power to require any public utility to provide safe, adequate and proper service under N.J.S.A. 48:2-23. In In re Petition of New Jersey American Water Co. for an Increase in Rates for Water and Sewer Service, 169 N.J. 181, 197 (2001), the Court reversed the Board's granting of a 50/50 sharing between ratepayers and shareholders of the utility's charitable contributions, because, in part, there was no nexus between utility's charitable contributions and the claimed benefits to ratepayers to justify inclusion of contributions in the utility's operating expenses. Here, the record establishes that the implementation of a DSIC will allow the Company to accelerate on an incremental basis the replacement of aging mains. This will in turn provide improved water quality, pressure and service reliability to NJAW customers. (PT-2 16-9 to 11). Because the record supports a nexus between the implementation of a DSIC and benefit to the ratepayers, and because the Board has the statutory authority to order a DSIC, the Board should find that it is within its power to implement a DSIC under its broad ratemaking authority over public utilities.

Furthermore, there is a line of case law that permits the Board, pursuant to N.J.S.A. 48:2-21.1, the "negotiation statute," to adjust rates on an interim basis pending final review within a rate case, but any such adjustments cannot be regarded as "contractual." Staff proposes that the DSIC charge be implemented under the authority of the negotiation statute. Accordingly, Staff recommends that the Company file a rate case no later than three years from the date of a Board Order approving a DSIC, but with rates to be effective no earlier than two years from the date of a Board Order in this docket, in order to ensure compliance with the N.J.S.A. 48:2-21.1.

The Board's ability to utilize the negotiation statute had been addressed in In re Industrial Sand Rates, 66 N.J. 12 (1974), in which the Court made clear that the authority granted to the Board to negotiate with the utility for an adjustment of rates is confined to interim relief pending a proceeding to determine justness and reasonableness of an existing or proposed rate, and it, therefore, set aside permanent rates negotiated by the Board with the utility without requisite rate base and rate of return findings. The Court explained that

> [t]he vital justification for the "negotiation statute" and rates established under it, temporarily bypassing the establishment of rate base and fair rate of return, rests upon the legal umbilical cord which ties them to the anticipated eventual determination of the fundamentals; at which time the temporary rates, their legitimacy having been validated, merge into the [Board] judgment ordaining the final rate structure or, if and to the extent found to have been excessive, are refunded to the consumers who paid them.
>
> [Id. at 19-20.]

Likewise, in In re Investigation of Tele. Cos., 66 N.J. 476 (1975), the Court upheld the Board's implementation of a "comprehensive adjustment clause," which permitted the company in that matter to recover certain expenses as they increased, finding that there was a nexus to the Board's review in that company's rate case. The Court acknowledged the Court's ruling in Industrial Sand that the "legal umbilical cord" between a "temporarily increased rate and the

final adjudication of the firmly established and traditional components which enter into the determination of 'just and reasonable' rates" is indispensable. Tele. Cos., 66 N.J. at 495. The Court further explained that even expenses that "flow through" to consumers must be "[t]ested in the scrutiny of final rate determination and only in that way (despite the impressive monitoring devices built into the instant clause) can such expenses be validated and become demonstrably honest components in the ascertainment of 'just and reasonable' rates." Ibid.

Consistent with the Board's statutory authority and the nexus requirements in both Tele. Cos. and Industrial Sand, the Board has the authority to implement a DSIC mechanism for NJAW in the form of a pilot program. The Board would be within its authority to implement this pilot program for a period of two years. In Communication Workers of America, AFL-CIO v. N.J. Dept. of Personnel, 154 N.J. 121 (1998), the Supreme Court found that appellant, Department of Personnel, had not exceeded its authority when it adopted new pilot programs for determining eligibility of candidates for civil service appointments without first conducting a rulemaking proceeding. The pilot program that Staff is proposing would be for an interim period with interim relief until these temporary rates in the pilot program are merged into a base rate case to be filed within three years from the final decision rendered by the Board herein. The pilot program is merely interim relief and will aid the Board and Staff in evaluating the efficacy of the processes and procedures for implementation of a DSIC. As discussed below, the Board, while evaluating this pilot program, should concomitantly institute a rulemaking procedure. Therefore, Staff recommends that the Board implement the DSIC on a pilot basis.

Based on the above case law, Staff recommends that the Board require that the Company file a rate case no later than three years from the date of a Board Order approving a DSIC, but with rates to be effective no earlier than two years from the date of a Board Order approving the

DSIC, in order to ensure that the DSIC expenses are scrutinized in a final hearing. *See* Tele. Cos., 66 N.J. at 496.

Staff also recommends that the general implementation of the DSIC process and procedures be promulgated pursuant to a rulemaking under the Administrative Procedure Act, N.J.S.A. 52:14B-1 et seq. (the "Act"). Under the Act, administrative rule is defined as follows:

> "Administrative rule" or "rule" when not otherwise modified, means each agency statement of general applicability and continuing effect that implements or interprets law or policy, or describes the organization, procedure or practice requirements of any agency. The terms includes the amendment or repeal of any rule, but does not include: (1) statements concerning the internal management or discipline of any agency; (2) intra-agency and inter-agency statements; and (3) agency decisions and findings in contested cases.
>
> [N.J.S.A. 52:14B-2(e).]

Administrative rulemaking requirements are grounded in notions of fairness, notice and procedural due process. Crema v. New Jersey Depart. of Environmental Protection, 94 N.J. 286 (1983); Airwork Ser. Div., etc. v. Director, Div. of Taxation, 97 N.J. 290 (1984). They are designed to ensure that affected parties are provided sufficient notice with respect to actions to be taken against them prospectively or which may affect substantial rights including the rights of persons not party to the action.

The statutory definition of administrative rule has been further examined in Metromedia, Inc. v. Director, Div. of Tax'n, 97 N.J. 313 (1984). There, the Supreme Court identified six factors to be weighed in determining whether an agency action must be rendered through formal rulemaking procedures. The Court held that an agency action could be considered an administrative rule:

> If it appears that the agency determination, in many or most of the following circumstances: (1) is intended to have wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group; (2) is intended to be applied generally and uniformly to all similarly

> situated persons; (3) is designed to operate only in future cases, that is, prospectively; (4) prescribes a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization; (5) reflects an administrative policy that (i) was not previously expressed in any official and explicit agency determination, adjudication or rule or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter; and (6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy.
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> [Id. at 331-32].

The six factors "can, either singly or in combination, determine in a given case whether the essential agency action must be rendered through rule-making or adjudication." Id. at 332. The applicability of the Metromedia factors to the case at bar becomes most evident when one attempts an analysis under the six factor test.

The first Metromedia factor is whether the Board's decision to implement a DSIC is "intended to have wide coverage encompassing a large segment of the regulated or general public." Metromedia, supra at 331. The implementation of a DSIC will encompass a large segment of the general public, as it will be applicable to all water companies in New Jersey and their ratepayers.

The next factor, whether the implementation of a DSIC is "intended to be applied generally and uniformly to all similarly situated persons," is met since all water companies and their ratepayers will be generally and uniformly affected by the procedures required by the Board for implementation of a DSIC mechanism. The third factor, whether the agency policy "is designed to operate only in future cases, that is, prospectively," has been met. If adopted, the Board will be approving the implementation of a DSIC for all future cases. The application of the DSIC is, therefore, prospective in nature.

The fourth Metromedia factor is equally satisfied by the case at bar. The implementation of a DSIC mechanism is not "clearly and obviously inferable from the enabling statutory authorization." In In re Solid Waste Util. Cust. Lists, 106 N.J. 508, 518 (1987), although "all six of the Metromedia factors need not be present to characterize agency action as rulemaking," these factors "should not merely be tabulated but weighed." In that case, an order of the Board of Public Utilities was found to satisfy three of the six Metromedia criteria. Nonetheless, the New Jersey Supreme Court determined that the Board's order did not constitute an administrative rule because it was clearly inferable from the applicable enabling legislation and neither changed nor interpreted Board policy concerning solid waste utilities.

As discussed previously, there is no explicit statutory language providing for the process and procedures associated with the implementation of a DSIC. The statutory scheme does not specifically provide statutory guidance on the process and procedure for implementation of a DSIC. The Board's statutory authority allowing it to establish a DSIC is grounded in very broad and all-encompassing statutory language and the more general statutory language addressing the Board's broad discretionary power over all public utilities is applicable. Therefore, the fourth factor in Metromedia has been met, and the Board should promulgate rules in this case. Further, as discussed below, the Board will be interpreting its policies to make a determination as to the process and procedure for the DSIC.

The fifth factor considered in Metromedia is whether the policy "(i) was not previously expressed in any official and explicit agency determination, adjudication or rule or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter." The Board has never previously addressed the DSIC in any official and explicit

agency determination, adjudication or rule. Therefore, the fifth Metromedia factor has been satisfied.

The last Metromedia factor, whether the Board's decision to implement a DSIC mechanism "reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy," is applicable to the case at bar. Here, the Board would be making a decision in the nature of the interpretation of law or general policy. To establish the DSIC mechanism, the Board will be interpreting the law and its general policies to formulate the process and procedure for the DSIC mechanism for all water companies in the State of New Jersey.

From the foregoing, it is clear that the Board's ultimate decision to implement a DSIC mechanism in New Jersey can be readily applied to the six factor test of Metromedia and, therefore, should be written through formal rulemaking procedures.

POINT 2

STAFF RECOMMENDS, AMONG OTHER THINGS, THAT THE BOARD LIMIT THE DSIC ELIGIBLE PLANT TO MAINS THAT ARE OVER 50 YEARS OLD, CAP THE DSIC SURCHARGE AT 3% OF ANNUAL GROSS REVENUES BETWEEN RATE CASES, ALLOW INTEREST ON ANY OVER COLLECTION, AND REQUIRE THE COMPANY TO FILE QUARTERLY REPORTS AND ANNUAL FILINGS.

As Ms. Chiavari testified, 50% of the Company's 8,330 miles of water was installed prior to 1965 and 30% of its pipe was installed before World War II, making a substantial portion of the Company's water main system over 50 years old. (PT-2 10-2 to 5). In light of the age of main in NJAW's system and Staff's recommendation that the Board's initial implementation of a DSIC be a simple process involving one type of plant, Staff proposes that the Board allow only replacement of mains 50 years of age or older to be considered DSIC-