August 16, 2005

VIA HAND DELIVERY
Kristi Izzo, Secretary
State of New Jersey, Board of Public Utilities
Two Gateway Center
Newark, New Jersey 07102

RE: IN THE MATTER OF THE PETITION OF NEW JERSEY NATURAL GAS COMPANY FOR AUTHORITY (a) TO ISSUE AND DELIVER FIRST MORTGAGE BONDS OR SIMILAR FINANCIAL INSTRUMENTS IN AN AGGREGATE PRINCIPAL AMOUNT NOT TO EXCEED $35.8 MILLION; AND (b) TO EXECUTE AND DELIVER SUPPLEMENTAL INDENTURES, LOAN AGREEMENTS, BOND PURCHASE AGREEMENTS, AND RELATED AGREEMENTS AND INSTRUMENTS WITH THE NEW JERSEY ECONOMIC DEVELOPMENT AUTHORITY, BANKS AND/OR INSURANCE COMPANIES IN CONNECTION THEREWITH
BPU Docket No. GF05060544

August 17, 2005 Agenda Item: 2C

Dear Secretary Izzo:

Please accept for filing an original and ten copies of the Division of the Ratepayer Advocate's ("Ratepayer Advocate") comments regarding the above referenced matter. Enclosed is one additional copy. Please date stamp the copy as "filed" and return it to the courier. Thank you for your consideration and attention to this matter.

Background

On June 20, 2005, New Jersey Natural Gas Company ("NJNG" or "Company") filed a Petition with the State of New Jersey, Board of Public Utilities ("BPU" or "Board"), requesting its approval for authority to borrow up to $35.8 million (the "Loan"), and to issue evidences of indebtedness pursuant to the New Jersey Economic Development Authority ("NJEDA") tax-exempt financing program.[1] On June 17, 2005, NJNG filed two (2) applications with the NJEDA for the Loan.[2]

The purpose of the Loan is threefold. First, NJNG proposes to utilize $10.3 million to refinance, at a lower rate of interest of approximately 4.7%, the outstanding balance of its Series W First Mortgage Bonds ("Series W Bonds") over a remaining life of 18 years ("First Refunding Transaction"). The Company claims the refinancing will result in an estimated net present value savings of approximately $650,000 based on current interest rates. The Series W Bonds currently carry an interest rate of 5.38%.[3]

Second, the Company proposes to utilize $10.5 million to refinance, at a lower rate of interest of approximately 4.7%, the outstanding balance of Series Y First Mortgage Bonds ("Series Y Bonds") over a remaining life of 19 years ("Second Refunding Transaction", together with First Refunding Transaction, the "Refunding Transactions").[4] The Series Y Bonds currently carry an interest rate of 6.25%. The Company claims that this refinancing will result in an estimated net present value savings of approximately $1.6 million based on current interest rates, for an aggregate estimated

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[1] Petition, preamble.
[2] Id., Exh. F.
[3] Petition, para. 4.
[4] Note: Per the response to RAR-5, the rate of interest of approximately 4.7% on the Refunding Transactions includes the impact of their associated issuance costs (discussed, *infra*.).

net present value savings resulting from the Refunding Transactions of approximately $2.25 million.[5, 6]

Third, in a separate application to the NJEDA, the Company proposes to utilize $15 million to finance construction in NJNG's Northern Division over the three fiscal year period beginning in 2006 ("Construction Program"). The Construction Program will consist of main extensions of $4.7 million, main renewals and improvements of $1.7 million, new services of $4.3 million, service renewals of $0.6 million, and regulator stations of $3.7 million.[7]

NJNG is engaged in the distribution, transportation and sale of natural gas in Monmouth, Ocean, Middlesex and Morris Counties, New Jersey, where it serves more than 459,000 retail customers.[8]

Analysis

For the First Refinancing Transaction, the Company proposes to enter into a loan agreement with the NJEDA ("First Loan Agreement"), and to issue and deliver Series II First Mortgage Bonds ("Series II Bonds") with a principal amount of $10.3 million to secure its obligations under the First Loan Agreement.[9] Similarly, for the Second Refinancing Transaction, the Company proposes to enter into a loan agreement with the NJEDA ("Second Loan Agreement"), and to issue and deliver Series JJ First Mortgage Bonds ("Series JJ Bonds", together with Series II Bonds, the "Refunding Bonds") with a

[5] Petition, para. 5.
[6] Note: The Company's savings analysis provided in response to RAR-4 (at p.6) and dated Jul 8, 2005, assumes Matched Refunding Maturities and 20-Year New Money Term to arrive at an aggregate net present value savings of approximately $2.256 million.
[7] Petition, para. 6. & Exh. A
[8] Id., para. 2.
[9] Id., para. 4.

principal amount of $10.5 million to secure its obligations under the Second Loan Agreement.[10]

The Company also proposes to enter into a loan agreement with the NJEDA to finance its Construction Program ("Construction Agreement"), and to issue and deliver Series KK First Mortgage Bonds ("Series KK Bonds" or "New Money Bonds") with a principal amount not to exceed $15 million to secure its obligations under the Construction Agreement.[11]

NJNG proposes that principal and interest payments, interest rates, and redemption and maturity provisions for the Series II, JJ and KK Bonds (the "Three Series Bonds") will be identical to the related NJEDA bonds.[12] The Company wishes to use a fixed rate mechanism to establish the rate of interest for the Three Series Bonds, which will each be sold to the winning bidder of a competitive bidding process. [13]

Following are the terms of the Series W and Y Bonds at June 2005:[14]

First Mortgage Bonds	Bond Principal	Maturity Date	Current Interest Rate
Series W	$10,300,000	August 1, 2023	5.375%
Series Y	$10,500,000	August 1, 2024	6.250%

The Company proposes a maturity of not more than 20 years, or no later than December 31, 2025, for the Refunding Bonds, and a maturity of not more than 35 years, or no later than December 31, 2040, for the New Money Bonds.[15]

[10] Id., para. 5.
[11] Id., para. 6.
[12] Id., paras. 4, 5 and 6.
[13] Id., para. 7.
[14] Response to RAR-1, Exh. III-A.
[15] Petition para. 8.

To secure its obligations with the NJEDA under the Loan Agreements, the Company proposes to enter into a Thirty-First Supplemental Indenture of Mortgage with BNY Midwest Trust Company of Chicago, Illinois ("BNY"), as Trustee,[16] to be effected by supplementing the Company's Indenture of Mortgage and Deed of Trust dated April 1, 1952, as previously amended and supplemented ("Mortgage Indenture").[17] The Company states it may also enter into other agreements with banks and/or insurance companies to further secure or remarket the NJEDA bonds.[18]

The Mortgage Indenture is a first lien upon virtually all of NJNG's real estate and personal property, including natural gas supply contracts, except certain items such as gas inventory, cash, and transportation equipment.[19] Additionally, pursuant to the Mortgage Indenture, particular restrictions apply to cash dividends and other common stock distributions as long as certain First Mortgage Bonds remain outstanding.[20]

NJNG's proposed Construction Program will consist of natural gas pipelines and auxiliary equipment that the Company states are needed to provide natural gas service to customers throughout the franchise portion of Morris County, which is located in the Company's Northern Division.[21] Following is a table summarizing the number of customers for NJNG's Northern Division for 2000-2004.[22,]

[16] Id., para. 7. Note: BNY is the successor company to Harris Trust and Savings Bank.
[17] Id.
[18] Id.
[19] Id., para. 12 and Exh. D, p.11, para. 2.
[20] Id., Exh. D, p.11, para. 2.
[21] Response to RAR-1, p.7.
[22] Response to RAR-6.

Northern Division Customers
Fiscal Year Ending September 30

Customers	2000	2001	2002	2003	2004
Residential	41,107	43,870	45,305	46,185	46,922
Commercial, Industrial	4,288	4,557	4,463	4,890	5,071
Firm Transportation*	2,830	1,655	1,604	1,409	1,494
Interruptible	18	18	18	17	20
Total	48,243	50,100	51,390	52,501	53,507
Growth (%)		3.85%	2.57%	2.16%	1.92%

NJNG stated that the decline in the firm transportation customers is due to marketers exiting the service area and customers returning to NJNG for sales service. The Company anticipates adding approximately 1,000 residential customers and 130 commercial customers per year for each of the next three years.[23]

Following is an estimate of the costs to be financed by the Construction Loan:[24]

CONSTRUCTION PROGRAM ESTIMATE

($000)	2006	2007	2008	Total Construction
Main Extensions	$1,724	$1,497	$1,497	$4,718
Main Renewals & Improvements	$1,010	$353	$353	$1,716
Services - New	$1,506	$1,403	$1,403	$4,312
Services - Renewals	$125	$226	$226	$577
Regulator Stations	$1,090	$1,345	$1,242	$3,677
	$5,455	$4,824	$4,721	$15,000

[23] Response to RAR-7
[24] Petition, Exh. A.

These costs are categorized as:[25]

Item	Amount ($000)
Acquisition of Equipment and Machinery	$ 14,700
Finance Fees	215
Accounting Fees	20
Legal Fees	55
Printing / Miscellaneous Costs	10
	$ 15,000

NJNG forecasts total Company capital expenditures of $60,700,000 in fiscal year 2006, and $65,000,000 in each of fiscal years 2007 and 2008.[26] The Company states it plans to finance capital expenditures in its other (non-Northern) divisions through the use of internally generated cash, the issuance of short- and long-term debt, and the continuance of its meter sale-leaseback program at approximately $5 million annually.[27]

The Company states that at September 30, 2004, it had zero short-term bank notes and $107.6 million of commercial paper borrowings outstanding.[28, 29] Following is the Company's long-term debt at December 31, 2004:[30]

[25] Response to RAR-1, p.8.
[26] Response to RAR-9.
[27] Id.
[28] Petition, para. 13.
[29] Note: The Company's 2004 Annual Report at p. 12, note 3, provided at Exh. D to the Petition, states that the Company entered into a $225 million committed credit facility with several banks, which replaced a $200 million facility, and that this facility consisted of $175 million with a 364-day term and a $50 million revolving credit facility expiring in January 2006.
[30] Petition, Exh. D, pp.6 and 11, and Response to RAR-10, pp. 255-257.

Long-Term Debt Outstanding

at December 31, 2004

Rate	Series	Issue Date	Maturity Date		Outstanding ($000)	
	First Mortgage Bonds					
5.38%	Series W	8/1/93	8/1/23	$	10,300	
6.27%	Series X	11/1/93	11/1/08		30,000	
6.25%	Series Y	8/1/94	8/1/24		10,500	
8.25%	Series Z	10/1/94	10/1/04		-	*
Variable	Series AA	8/1/95	8/1/30		25,000	
Variable	Series BB	8/1/95	8/1/30		16,000	
6.88%	Series CC	10/1/95	10/1/10		20,000	
Variable	Series DD	9/1/97	9/1/27		13,500	
Variable	Series EE	1/1/98	1/1/28		9,545	
Variable	Series FF	1/1/98	1/1/28		15,000	
Variable	Series GG	4/1/98	4/1/33		18,000	
5.0%	Series HH	12/1/03	12/1/38		12,000	**
	Sub-Total First Mortgage Bonds			$	179,845	
	Other Long-term debt					
4.77%	Unsecured senior notes		3/15/14	$	60,000	
	Capital lease obligation - Buildings		6/21/21		28,884	***
	Capital lease obligation - Meters		10/1/12		24,894	***
	Sub-Total Other Long Term Debt			$	113,778	
	TOTAL			$	293,623	

* The Company's Series Z Bonds matured on Oct. 1, 2004 (see Exh. D, p.11, Note 2).

** Response to RAR-10 (2004 Annual Report to BPU, p. 257) states the rate on Series HH Bonds is variable, whereas Petition, Exh. D (NJNG 2004 Annual Report, p.6) states the rate is 5.0%.

*** Not identified as long-term debt in NJNG's 2004 Annual Report to BPU, provided in response to RAR-10, but appear as such in NJNG's 2004 Annual Report attached to Petition at Exh. D, p.6.

The Company states it targets a debt ratio "consistent with maintaining its current short and long-term credit ratings (51% to 56.5%)."[31] Following is the Company's

[31] Response to RAR-3.

capitalization at June 30, 2005, as adjusted to reflect the Company's September 30, 2005 forecast adjustments and also the pro forma effect of the Loan:[32]

	6/30/05 Actual		9/30/05 Forecast		9/30/05 Pro Forma	
	Amount	%	Amount	%	Amount	%
Common Equity	$ 461,014	58.3%	$ 449,868	49.7%	$ 449,868	48.9%
Long-Term Debt	293,093	37.1%	293,678	32.5%	308,678	33.6%
Short-Term Debt	36,300	4.6%	161,300	17.8%	161,300	17.5%
TOTAL	$ 790,407	100.0%	$ 904,846	100.0%	$ 919,846	100.0%

Following is the Company's schedule of the interest charged to income during its fiscal year ended September 30, 2004, along with its per annum rate.[33]

Interest Charged to Income - 2004

For Twelve Months Ended September 30, 2004

		AMOUNT ($000)
5.38%	First Mortgage Bonds Series W	$ 554
6.27%	First Mortgage Bonds Series X	1,881
6.25%	First Mortgage Bonds Series Y	656
8.25%	First Mortgage Bonds Series Z	2,063
Variable	First Mortgage Bonds Series AA	260
Variable	First Mortgage Bonds Series BB	167
6.88%	First Mortgage Bonds Series CC	1,375
Variable	First Mortgage Bonds Series DD	141
Variable	First Mortgage Bonds Series EE	99
Variable	First Mortgage Bonds Series FF	151
Variable	First Mortgage Bonds Series GG	190
Variable	First Mortgage Bonds Series HH	170
4.77%	Private Placement Bonds	1,511
	Meter Leases	1,269
	Short-term Notes and Commercial Paper	1,072
	TOTAL	$ 11,559

Redemption premiums and issuance costs will be deducted from the proceeds of the Three Series Bonds.[34] The Company proposes to amortize the issuance costs of the

[32] Response to S-8.
[33] Petition, Exh. E.

Three Series Bonds over the term of the securities, and to continue the amortization of the issuance costs of the Series W and Y Bonds over the remaining term of the Refunding Bonds by monthly charges to Account Number 428, Amortization of Debt Discount and Expense.[35] Following is an estimate of the issuance costs:[36]

Estimated Expenses of proposed Series II, JJ, KK Bonds

Financial Fees & Expenses	$500,000
Legal Fees and Expenses	$150,000
Accounting and Trustee Fees	$60,000
Printing and Miscellaneous	$40,000
	$750,000

Following are the journal entries proposed for the transactions contemplated:[37]

To retire existing Series W and Y Bonds:		FERC#		
Series W	Debt	221	$10,300,000	
	Cash	130		$10,300,000
	Retire bond at par.			
Series Y	Debt	221	$10,500,000	
	Debt Expense	181	$105,000	
	Cash	130		$10,605,000
	Retire bond at premium of 1%.			
To set up Series II, JJ and KK Bonds:				
To record the receipt of gross proceeds from debt offerings				
Series II	Cash	130	$10,300,000	
	Debt	221		$10,300,000
Series JJ	Cash	130	$10,500,000	
	Debt	221		$10,500,000
Series KK	Cash	130	$15,000,000	
	Debt	221		$15,000,000

[34] Response to S-5.
[35] Petition, para. 10.
[36] Id., Exh. C.
[37] Response to S-7.

The Company expects a credit rating of AA- from Standard and Poor's and Aa-3 from Moody's for the Three Series Bonds, and claims the rating will increase to AAA if these bonds are insured.[38]

On July 12, 2005, the NJEDA granted preliminary approval to the Company for the Loan.[39] The Company is seeking an October 2005 timeframe for the Loan closing and the issuance of the NJEDA bonds.[40]

Recommendation

The Division of the Ratepayer Advocate has reviewed the proposed transaction and is not opposed to its approval by the Board. Approximately 58% of the new debt, or $20.8 million, will be used to replace higher cost debt with lower cost debt. The remaining Construction Loan of $15 million will not materially impact on NJNG's capital structure. The net impact of the three proposed transactions is an increase in the long-term debt ratio from 32.5% to 33.6%. Accordingly, the financial integrity of the Company is unlikely to be jeopardized as a result of this transaction. NJNG has been able to meet its debt obligations in the past and there is no reason to believe that this transaction will negatively impact its ability to meet those obligations in the future.

[38] Response to S-4.
[39] See EDA letter dated July 27, 2005 to NJNG for Project # P-16683. Note: It is not evident by this letter that NJNG received preliminary approval for both its applications or only for the application pertaining to the Construction Loan.
[40] Petition, Exh. F.

The Ratepayer Advocate respectfully recommends that any Board Order approving the Company's Petition contain the following language:

1. This Board's approval is expressly limited to the Loan(s) described herein and as more fully described in the Petition and supporting documents. In the event the Loan transaction(s) are not consummated, for any reason, the Company may not obtain financing from any other lender until the approval of this Board has been obtained with respect to the action proposed to be taken.

2. This Order shall not be construed as directly or indirectly fixing, for any purposes whatsoever, any value of any tangible or intangible assets now owned or hereafter to be owned by the Petitioner.

3. This Order shall not be construed as certification that the Loan herein authorized will be represented by tangible or intangible assets of commensurate value or investment cost.

4. This Order shall not affect nor in any way limit the exercise of the authority of the Board or the State of New Jersey, in any future Petition or in any proceedings with respect to any issues, including but not limited to, the cost of debt, recovery of redemption premiums, rates, franchises, service, financing, accounting, capitalization, depreciation, or in any other matter affecting the Petitioner.

5. The authority granted in this Order shall become null and void and of no effect with respect to any portion thereof that is not exercised by December 1, 2005.

These provisions will satisfy the concerns of the Ratepayer Advocate that Board approval is limited to the Loan as described herein, and should not indicate authorization to include any specific assets or amounts in rate base, or indicate authorization for any other ratemaking treatment.

Respectfully submitted,

SEEMA M. SINGH, ESQ.
RATEPAYER ADVOCATE

By: ____________________________
Sarah H. Steindel, Esq.
Asst. Deputy Ratepayer Advocate

c: Jeanne M. Fox, President (via hand delivery)
Frederick F. Butler, Commissioner (via hand delivery)
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Jack Alter, Commissioner (via hand delivery)
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