



State of New Jersey
DIVISION OF RATE COUNSEL
31 CLINTON STREET, 11TH FL
P. O. BOX 46005
NEWARK, NEW JERSEY 07101

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

STEFANIE A. BRAND
Director

April 4, 2011

Via E-Mail & Hand Delivery

Kristi Izzo, Secretary
State of New Jersey, Board of Public Utilities
Two Gateway Center, Suite 801
Newark, New Jersey 07102

**Re: I/M/O The Possible Implementation of a Distribution System Improvement Charge (DSIC) For Water and Wastewater Utilities
BPU Docket No. WO10090655**

Dear Secretary Izzo:

Please accept for filing an original and eleven copies of the Division of Rate Counsel's ("Rate Counsel") supplemental comments regarding the above referenced matter. Please date stamp the additional copy as "filed" and return it in the enclosed, self-addressed, stamped envelope. In addition to the paper copies of our comments, we are also providing our comments via e-mail in Microsoft Word format at rule.comments@bpu.state.nj.us per the instructions in the Notice requesting comments on this issue. Thank you for your consideration and attention to this matter.

On August 4, 2010 the Board of Public Utilities (the "Board" or "BPU") issued an Order in the Matter of the Petition of New Jersey American Water Company for Authorization to Implement a Distribution System Improvement Charge ("DSIC") denying the Petitioner's request and Instituting a Stakeholder Process. The Board in its Order concluded that a broader

examination of whether it is appropriate to adopt a DSIC type mechanism as part of the rate structure of water and wastewater public utilities in New Jersey is warranted. Further, the Board ordered an initiation of an open stakeholder's process to provide the necessary foundation for the Board to determine if and how to implement a global DSIC program. A DSIC is a possible surcharge that would allow water and wastewater utilities to recover the costs of certain non-revenue producing infrastructure improvements outside of the context of a base rate case.

Pursuant to a Notice dated October 25, 2010 a public stakeholders meeting was held on December 7, 2010 at the Board's offices located in Newark, New Jersey. Statements were given by Assemblyman Upendra J. Chivukula, Preston Luitweiler, Vice President, Chief Environmental Officer Aqua America, Karen Alexander, Executive Director, New Jersey Utilities Association, Bob Marshall, Southern New Jersey Development Council, Mitchell Kidd, Vice President and General Manager Atlantic States Cast Iron Pipe Company, Heike Doerr, Investment Analyst, Michael Lahr, Rutgers University, Michael Kerwin, Somerset County Business Partnership, Teresa Peterson, American Society of Civil Engineers, Leonard Cilli, American Society of Civil Engineers, Edward DeHope and Thomas Dillion, Environmental Disposal Corp, Michael Drulis, New Jersey Seed, Jim Walsh, Food & Water Watch, Sarah Bluhm, New Jersey Business and Industries Association, Martin C. Rothfelder, Esq., representing Cogen Technologies and Conoco Phillips and Stefanie A. Brand, Rate Counsel State of New Jersey.

A second Notice dated March 2, 2011 was promulgated by the Board and stakeholders' meetings were held on March 16, 2011 in Trenton, New Jersey and March 21, 2011 in Atlantic City, New Jersey. Individuals speaking at the March 16, 2011 stakeholders meeting included Ed Waters, Director Governmental Affairs for the Chemistry (Pharmaceutical) Industry, Martin C. Rothfelder, Esq., and Ryan Connors of the investment firm of Janney, Montgomery Scott.

Members of the public attending the March 21, 2011 meeting included David Boonin, Founder and President of TBG Consulting, Sarah Bluhm, New Jersey Business and Industries Association, Steve L. Klick, Executive Policy Manager Pennsylvania Public Utility Commission, Robert Kecskes, New Jersey Department of Environmental Protection (Retired) and Debra F. Robinson, Deputy Public Advocate, Division of Rate Counsel.

The Division of Rate Counsel submitted written comments to the Board which supplemented its oral testimony of December 7, 2010. Rate Counsel submits this comment letter to augment its initial filed comments and to address some concerns raised during the course of the stakeholders' meeting process.

Stakeholders representing a broad range of interests participated in the comment phase of this proceeding providing divergent opinions on whether there is a demonstrated need for a DSIC in New Jersey at this time. A concern that developed as an outgrowth of these discussions is the appropriate interim rate of return recovered by the utility to incentivize investment in its aging infrastructure.

Rate Counsel proposed in its initial comments that (1) utilities be required to pursue cleaning and lining rather than replacement where appropriate, (2) cleaning and lining be expensed while it is being recovered in the DSIC, and (3) the utility earn a return on DSIC qualifying capitalized projects at a lower return on investment in between rate case proceedings. Under Rate Counsel's proposal, once the utility completes its next base rate case, these investments would be rolled into rate base and receive full authorized rate of return treatment. This proposal has been met with opposition by the water/sewer utilities. While the water/sewer utilities have expressed a willingness to consider cleaning and relining over replacement, where appropriate, they have indicated a desire to capitalize all DSIC expenses at their full rate of return. Specifically, the utilities are asserting that they need an incentive to make such

expenditures at the accelerated pace necessary to keep up with aging infrastructure demands. The utilities assert that a DSIC mechanism with the utility earning a full authorized rate of return will create an incentive to invest in aging infrastructure that would not otherwise exist if the utility is required to wait until its next rate base proceeding to recover its costs.

This argument for an incentive is disingenuous because a utility should not need an extra incentive to fulfill its obligations to provide safe, adequate, and proper service to New Jersey ratepayers. Our State Supreme Court has found that “[u]nlike other corporations...utilities are subject to a special obligation to serve the public interest. In particular, the primary obligation of a utility is to provide safe, adequate, and proper service at fair and reasonable rates.”¹ While encouraging repair or replacement of aging infrastructure is worthwhile it should not be done in a way that unfairly shifts risks and costs to ratepayers. To relieve the utilities of the risks associated with recovery through rate cases, while allowing them a full return that reflects that risk, is a windfall, not an incentive. It is a windfall that ratepayers cannot and should not be asked to pay.

Rate Counsel’s proposal will allow water and wastewater utilities to renew deteriorating water and sewer infrastructure, while lessening the potentially cumulative impact of surcharges on base rates.

Moreover, as argued by Rate Counsel in the separate DSIC proceeding filed by New Jersey American Water Company², the proposed DSIC surcharge mechanism represents inappropriate single-issue ratemaking. Single-issue ratemaking is an extraordinary remedy. Regulated utilities traditionally receive rate increases by filing rate cases before the Board. Under a traditional ratemaking process, the Board sets rates on a cost of service basis “matching” all the

¹ I/M/O Alleged Violations of Law by Valley Road Sewerage Co., 154 N.J. 224(1998).

² I/M/O the Petition of New Jersey American Water Company for Authorization to Implement a Distribution System Improvement Charge, BPU Docket No. WO08050358.

components in the ratemaking formula. A DSIC is an adjustment clause that would allow utilities to increase rates to collect a return of and on capital additions without examining all components of the revenue requirement, some of which will or may experience decreases. Thus, the proposed DSIC would inappropriately raise rates without regulatory scrutiny of **all** of a utility's revenue requirement components and would most certainly result in an achieved return higher than justified if all components of the ratemaking formula were considered.

Under what is being proposed by some stakeholders, (i.e. a guaranteed, dollar-for-dollar recovery of capital-related revenue requirements related to DSIC plant projects placed into service between rate cases and the recovery of a utility's authorized rate of return) represents a drastic move away from traditional regulation. An important tenet of ratemaking is that utilities are not **guaranteed** a return on investment; rather, the ratemaking process entitles the utility no more than a **reasonable** opportunity to earn a fair rate of return. Regulation is not intended to be a mechanism whereby a utility is guaranteed dollar-for-dollar recovery of either its costs or a particular level of profit and rate of return. As the Board is aware, regulation in this instance is a substitute for competition. This principle of regulation was designed to stimulate a utility to act as it would if it were in a competitive industry. Clearly, if a utility's rate of return is guaranteed, this represents a departure from traditional ratemaking foundations.

Rate Counsel believes that a DSIC mechanism that merely allows a utility to recover a normal level of routine and recurring construction between base rate cases is of no benefit to ratepayers. Such a mechanism would distort the utility's efforts to prioritize the application of capital in the most efficient way possible by giving an incentive to a single class of utility plant property, i.e., DSIC-eligible projects. The utility's system of screening and prioritizing projects according to need and impact would be skewed in favor of those projects that would represent essentially no drag on earnings. This distortion may not result in the best assignment of capital.

For this reason we believe that the utility should provide an engineering justification for a clear need to accelerate work on DSIC eligible projects above the historic level of work completed without the benefit of the DSIC. If a convincing argument can be made to accelerate distribution system renewal work a DSIC- type mechanism may be appropriate. Between base rate cases, a reduced rate of return on DSIC eligible projects would mitigate the drag on earnings and Rate Counsel believes this is a reasonable incentive to accelerate the renewal program that must be undertaken in any event to provide safe, adequate and proper service.

Rate Counsel respectfully urges the Board to favor its proposal that the utility earn a return on DSIC qualifying accelerated infrastructure projects at a lower return on investment in between rate cases. It would be poor regulatory policy to guarantee full rate of return recovery because the production of safe, adequate and proper utility services at the lowest possible cost requires a utility to exert itself and work efficiently without immunity from any cost recovery risks. Respectfully submitted,

STEFANIE A. BRAND
Director, Division of Rate Counsel

By: ***Debra F. Robinson, Esquire***
Debra F. Robinson, Esq.
Deputy Public Advocate

DFR:iaa

- c: Service List (*Via E-Mail, Hand Delivery & Regular Mail*)
- Honorable Lee A. Solomon, President of BPU (*Via Hand Delivery*)
- Honorable Jeanne A. Fox, Commissioner (*Via Hand Delivery*)
- Honorable Joseph L. Fiordaliso, Commissioner (*Via Hand Delivery*)
- Honorable Nicholas Asselta, Commissioner (*Via Hand Delivery*)
- Honorable Elizabeth Randall, Commissioner (*Via Hand Delivery*)