



STATE OF NEW JERSEY
Board of Public Utilities
44 South Clinton Avenue, 9th Floor
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Trenton, New Jersey 08625-0350
www.nj.gov/bpu/

WATER

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| IN THE MATTER OF THE APPLICATION OF THE |) | ORDER APPROVING AN AGREEMENT |
| BAYONNE MUNICIPAL UTILITIES AUTHORITY |) | TO ESTABLISH A PUBLIC-PRIVATE |
| REQUESTING APPROVAL OF AN AGREEMENT |) | CONTRACT BETWEEN THE |
| BETWEEN THE AUTHORITY AND BAYONNE |) | BAYONNE MUNICIPAL UTILITIES |
| WATER JOINT VENTURE, LLC, A JOINT VENTURE |) | AUTHORITY AND UNITED WATER JOINT |
| BETWEEN UNITED WATER OPERATIONS |) | VENTURE, LLC. |
| CONTRACT, INC., AND KOHLBERG, KRAVIS, |) | |
| ROBERTS & CO., IN CONNECTION WITH THE |) | |
| OPERATION, MAINTENANCE AND MANAGEMENT |) | |
| OF THE AUTHORITY'S WATER, WASTEWATER, |) | |
| STORM WATER AND CSO SYSTEMS PURSUANT |) | |
| TO THE PROVISIONS OF THE NEW JERSEY WATER |) | |
| SUPPLY PUBLIC-PRIVATE CONTRACTING ACT, |) | |
| <u>N.J.S.A. 58:26-19 ET. SEQ. AND NEW JERSEY</u> |) | |
| WASTEWATER TREATMENT PUBLIC-PRIVATE |) | |
| CONTRACTING ACT, <u>N.J.S.A. 58:27-19 ET SEQ.</u> |) | BPU DOCKET NO. WM12080777 |

Parties of Record:

Joseph P. Baumann, Jr., Esq. and Jong Sook Nee, Esq. McManimon, Scotland & Baumann, LLC, on behalf of the Bayonne Municipal Utilities Authority
Mary Campbell, Esq., on behalf of United Water Operations Contract, Inc.
Kent Rowey, Esq. and Claire Watson, Esq. Allen & Overy LLP, on behalf of Kohlberg, Kravis, Robert & Co.

BY THE BOARD¹:

On August 23, 2012, pursuant to the New Jersey Water Supply Public-Private Contracting Act (the "Water Act") N.J.S.A. 58:26-19 et. seq. and N.J.S.A. 58:27-19, et. seq., the Bayonne Municipal Utilities Authority (the "Authority"), submitted an application (the "Petition") for approval of a proposed agreement (the "Agreement") for the operation, maintenance and management of the Authority's water, wastewater, storm water and CSO systems (the "Systems") by Bayonne Water Joint Venture, LLC (the "Concessionaire"), a joint venture between United Water Operations Contract, Inc. ("United Water") and Kohlberg, Kravis, Robert

¹ Commissioner Mary-Anna Holden did not participate.

& Co. ("KKR"). The Authority makes this application in accordance with N.J.S.A. 58:26-25(b) and N.J.S.A. 58:27-24 (f), to the New Jersey Board of Public Utilities ("Board"), the New Jersey Department of Community Affairs, Division of Local Government Services, Local Finance Board ("DCA") and the New Jersey Department of Environmental Protection ("DEP") (collectively, the "Agencies").²

The Water Act authorizes public entities to enter into contracts with private firms for the provision of water supply services. Water supply services, as defined by the Water Act, mean the financing, designing, construction, improvement, operation, maintenance, administration or any combination thereof, of a water supply facility (i.e., water system). Public-Private Contracts for water supply services must be submitted to the Board for review and approval. However, N.J.S.A. 58:26-25, confines the scope of the Board's review of such contracts to four specific areas. In its review of the contract the Board shall apply the following criteria in determining whether to approve the contract:

1. The private firm entering into the contract has the financial capacity and technical and administrative expertise to ensure continuity of service over the term of the contract and that the standards and requirements contained in the application documents concerning financial, technical and administrative capacity of the private firm are necessary and sufficient to protect the public interest.
2. The terms of the contract are not unreasonable. In determining whether the terms of the contract are not unreasonable, the Board shall review the fees and charges to be charged or assessed under the contract to determine that they are reasonable to the public entity, taking into consideration all of the obligations undertaken by the private firm and all benefits obtained by the public entity. In making this determination, the Board shall not use the traditional rate base/rate of return methodology.
3. The franchised customers of a public utility participating in a contract are protected from the risks of the proposed contract and that they are not subsidizing the contract. If a private firm is not a public utility, the Board shall ensure that under the terms of the proposed contract the users of water outside of the jurisdiction or service area that will receive water supply services under the contract are also protected from the risks of the contract and that water users outside the jurisdiction or service area are not subsidizing the contract through increased charges, rates or fees for the supply of water.
4. The contract contains the provisions required by paragraph (1) (2) and (6) of subsection e. of section 5 of P.L. 1995, c 101 (C 58:26-23).

The Water Act further states that once the Board approves a proposed contract, the jurisdiction of the Board terminates until or unless the contract is amended to change the formula or other basis of determining charges.

The Courts have held that the Legislature has not conferred any jurisdiction on the Board to regulate water utilities operated by municipalities, as distinct from those privately owned, except in certain circumstances where such municipalities undertake to service residents in other municipalities. See Petition of South Lakewood Water Co., (61 N.J. 230 (1972)). Pursuant to N.J.S.A. 40A:31-23 (d) (1) the Board does not have regulatory oversight with respect to the

² Pursuant to N.J.A.C. 14:1-5.2(a) (2), the City filed a separate application with the Local Finance Board of the DCA.

setting of rates if the municipality services 1,000 customers or less outside its jurisdictional boundaries. In addition, it has been held that the sovereign powers of a municipality should not be subordinated to Board jurisdiction "by inference" or "lightly implied." Jersey City Incinerator Authority v. Dept. of Pub. Util., 146 N.J. Super. 243, 255-56 (App. Div. 1976). Rather, a grant of such power "must be firmly anchored in some clear legislative delegation of jurisdiction." Id. at 256. Furthermore, the Board's own enabling statute expressly limits the Board's jurisdiction over contracts of the type under review here to the parameters of the Public-Private Contracting Act. N.J.S.A. 48:2-13 states:

Except as provided in [N.J.S.A. 58:26-25] the Board shall have no regulatory authority over the parties to a contract negotiated between a public entity and a private firm pursuant to [N.J.S.A. 58:26-19] in connection with the performance of their respective obligations thereunder. Nothing contained in this title shall extend the powers of the Board to include any supervision and regulation of, or jurisdiction and control over, any public-private contract for the provision of water supply services established pursuant to [N.J.S.A. 58:28-19].

In accordance with this legal mandate, the Board has limited the scope of its review to the four criteria set forth above and, for reasons discussed below, concludes that the contract meets the applicable criteria. Because the Legislature has carefully circumscribed our authority over the rates to be charged to end-use customers and other issues, the Board does not make any determination with respect to issues related to the ultimate rates to be charged by Bayonne to its residents for services.

BACKGROUND/PROCEDURAL HISTORY

The City of Bayonne ("City") is located in Hudson County, and is a highly urbanized area across the Hudson River from New York City with approximately 63,024 residents. The Authority owns and operates the Systems that provide water supply and wastewater treatment and manages storm water and sewer overflows for the City. The Systems consist of over 96 miles of mains for water distribution, fire hydrants, meters, over 83 miles of combined sewers, 9 pumping stations and numerous appurtenances and equipment to service the City residents.

The Authority receives water through a contract with the North Jersey District Water Supply Commission. Sewer treatment is provided by the Passaic Valley Sewerage Commission. Over the years, the Authority has incurred significant debt to pay for various capital improvements spurred by litigation and otherwise incurred by the needs of the Systems over time. While the costs of the operation and maintenance of the Systems have increased over time, the rates for both water and sewer were not always raised to reflect the cost increases. The last increase approved by the Authority occurred in October 2006, and resulted in an approximately 27% increase in rates for taxpayers. Recently, the Authority's licensed operator for the Systems retired and despite the Authority's attempts to hire new licensed operators, the Authority has been forced to contract with private firms to comply with its licensing requirements.

Given the long-term debt obligations of the Systems, the facts that rates do not always cover costs and the on-going licensing requirements, the Authority sought to identify opportunities to reduce operating costs, increase effectiveness and address some of the structural budget deficits over the long-term. The Authority considered the potential benefits of a public-private contract for the operation of the Systems for a set period of time.

On March 2011, the Authority issued a draft Request for Qualifications and Proposals seeking comments from potential private operators. After receiving numerous inquiries and comments from interested parties, on June 2, 2011, the Authority issued a final Request for Qualifications and Proposals (the "RFQ/RFP"). Pursuant to N.J.S.A. 58:26-23 et seq., The City of Bayonne issued a public notice of intent to contract for an operations and maintenance services agreement. The notice was published on June 9, 2011. A RFQ/RFP was available to all interested proposers at the following FTP site at <http://.mandslaw.ftptoday.com>. Proposals were to be submitted no later than July 29, 2011.

Notice of the Authority's intent to enter into a public-private contract was delivered to the Board and the DEP on June 14, 2011, in accordance with the Acts.

The RFQ/RFP sought two proposals: (a) Proposal A was for the operation, maintenance, and management of the Systems for a 20 year period in return for a service fee, and required the operator to proposed a concession fee to the Authority of at least \$10,000,000; and (b) Proposal B was for the operation, maintenance and management of the Systems for a 40 year period whereby the operator would receive and retain all of the Systems revenues while paying consideration to the Authority in an amount at least sufficient to defease all of the outstanding debt obligations relating to the Systems.

On August 19, 2011, the Authority received a proposal (the "Proposal") from United Water. The Proposal provided responses for both a 20 year term and a 40 year term. Proposal B required United Water to joint venture with KKR, a private equity firm; to finance the larger initial capital needed to defease the Authority's outstanding debt obligations.

Upon reviewing the technical qualifications of United Water's Proposal, on September 12, 2011, the Authority qualified United Water as the selected respondent and commenced negotiations with United Water. Over a 10 month period the Authority engaged United Water and KKR in detailed negotiations considering the benefits and limitations of both a 20 year and 40 year term contract. Eventually, the Authority determined the 40 year term provided the quality of service, on-going capital improvements and consideration at a rate structure that was sustainable and mitigated against large, single increases.

Terms of the Public-Private Contract

The Concessionaire will undertake the operation, maintenance and management of the Systems for a 40 year term. The Concessionaire is a joint venture between United Watered and KKR. United Water will provide management, comprehensive operational services and capital improvements. KKR is partnering with United Water solely to be relied upon for financing in this matter. The services include the following:

- General management, maintenance, repair and replacement of the Systems in compliance with all federal, state, local and Authority rules and regulations;
- Provision of all materials, equipment, machinery, consumables, etc.;
- Response to all service calls, emergencies, complaints and inquiries within contractual and statutory time lines;
- Development and implementation of a comprehensive computer-based maintenance management system;
- Provision for all billing and collection; and
- Maintenance of all existing permits and licenses.

The operation of the Systems will be conducted in accordance with law and operating and technical standards that are included in the Agreement. In addition to the general services, the Concessionaire will undertake a comprehensive capital improvement program that will increase efficiencies in reporting and billing and collection. This improvement cost is expected to exceed \$7,000,000 and will be completed at the Concessionaire's cost within the first two years of the Agreement. Any cost overruns shall be at the sole cost of the Concessionaire and shall not be passed on to ratepayers. In addition to the meters, the Concessionaire will implement an annual capital improvement program that will identify capital needs on an on-going basis and in each of the first two years provide up to \$2,150,000 and thereafter up to \$2,500,000 in additional capital improvement funds annually. This amount will increase annually and any unused amounts will roll forward for use in later years. These improvements will include a new SCADA system, improvements to some of the pump stations, updating GIS mapping, and other capital needs that are identified by the Concessionaire and agreed to by the Authority.

In return for the services, the Concessionaire shall be entitled to a specific revenue stream (the "Revenue Path"). In order to achieve the Revenue Path, the Concessionaire shall collect all revenues generated by the Systems. These revenues include the rates for the services, tapping fees, connection fees, and the sale of any excess water by the Authority to a third party. The Concessionaire shall pay the Authority an upfront payment and the Annual Fee. The upfront payment (the "Consideration") is \$150,000,000 and shall be used primarily to defease all of the outstanding debt relating to the Systems.

Over the years the Authority had financed capital and operating costs for both the water and sewer portions of the Systems through the issuance of tax-exempt bonds and notes and through participation in the New Jersey Environmental Infrastructure Trust Financing Program (the "NJEIT Program"). In addition, water and sewer infrastructure improvements were made at the former Military Ocean Terminal in Bayonne, now known as the Peninsula at Bayonne Harbor (the "Peninsula"). While the debt relating to the infrastructure for the Peninsula was issued by the Bayonne Local Redevelopment Authority (the "BLRA"), it was issued as tax-exempt debt through the NJEIT Program and the infrastructure is operating and maintained by the Authority. That infrastructure would be operated and maintained by the Concessionaire under the Agreement. Under the federal tax code, in order to enter into a long-term operations agreement with a private operator, the debt of the BLRA relating to the infrastructure on the Peninsula will also have to be defeased. In total, the Authority will defease approximately \$125,000,000 in outstanding bonds and notes.

The remaining portion of the Consideration will be used to fund \$6,500,000 to the Concessionaire to address its transaction-related fees and expenses and to assist cash flows in the early years. The residual shall be paid to (a) the Authority, to address standard costs of the Authority, and (b) the City, as a concession fee.

In addition to the Consideration, the Concessionaire shall pay to the Authority an annual fee ("Annual Fee") in the amount of \$500,000 (increasing annually as provided in the Agreement). The Annual Fee shall be used to cover the on-going administrative costs of the Authority including insurance, pension contributions, minimal administrative staff and costs of monitoring the Concessionaire's contract compliance.

The ratepayers will be assessed an 8.5% increase for both water and sewer charges. This rate increase will amount to an additional charge of approximately \$5.00 per month per residential ratepayer. After the initial rate increase, the rates will be subject to a freeze until January 1, 2015. The purpose of the rate freeze is to mitigate the impact on ratepayers of the transition of

the operations of the Systems to the Concessionaire. Thereafter, the rates will be increase based on a simple formula designed to achieve the Revenue Path. The rate structure has been formulated to permit the Concessionaire a return on its investment while ensuring there will be funds available to address the general operating needs of the Systems as well as any expenses that may arise for capital improvement.

The Authority currently has 30 employees. Under the Agreement, United Water shall hire all of the employees for a minimum term of one year and retain 19 employees thereafter. Employees not needed to work on the Systems after the first year may be offered employment opportunities elsewhere for United Water. United Water will use good faith efforts to grant all Authority employees locational preferences close to the City, if possible.

Neither the Concessionaire nor United Water has the authority to sell any excess water to third parties through a bulk sale. The Authority retains the exclusive right to sell any excess water. Further, the Authority is currently in negotiations for the sale of excess water to United Water, subject to approval by the NJDWSC and DEP. As stated above, the revenues from such sale shall be considered part of the revenue collected by the Concessionaire and used to ensure there is sufficient revenue to fund the operations of the Systems. Any revenues in excess of the Systems' needs and costs shall be retained in the stabilization fund or allocated to the Authority.

The Concessionaire shall assume all of the operations relating to the Systems, including capital improvements. While the Concessionaire shall be compensated for its services under the Agreement, some of the risks of certain obligations shall be borne solely by the Concessionaire, which are as follows:

- Costs overruns for the meter replacement;
- Costs of services and the costs relating to the Systems, including repayment of any debt relating to the Agreement;
- Interest rate risk on its investment; and
- Increases in United Water's operating costs, as a subcontractor for the Concessionaire.

By letter dated October 11, 2012, the Division of Rate Counsel ("Rate Counsel") advised the Board that it did not object to the Public-Private contract and was not opposed to the Board's approval of the Petition.

DISCUSSIONS AND FINDINGS

After review of the record herein, the Board FINDS that the statute-imposed criteria listed, hereinabove, has been met.

1. The Bayonne Joint Venture, LLC has the financial capacity, technical and administrative experience to ensure continuity of service over the term of the contract (N.J.S.A. 58:26-25 (c) (1)). The City of Bayonne entered into the Agreement with Bayonne Joint Venture, LLC, which will rely on the management and expertise of United Water Operations Contract, Inc. The main office for United Water Operations Contract is 200 Old Hook Road, Harrington Park, NJ, 07640. United Water Operations is an entity within the United Water group's organizational structure that holds contracts for similar non-regulated projects such as Jersey City, Hoboken, and Rahway. United Water Operations Contract, Inc. has demonstrated over the years that it has the financial capacity, and technical and administrative expertise to meet all the demands of the proposed contract.

United Water, Inc. is the parent company of United Water Operations Contract, Inc., as well as certain regulated entities, including United Water New Jersey. United Water, Inc. is a wholly owned subsidiary of Suez Environmental North America, Inc., which is itself a wholly owned subsidiary of Suez Environmental SA, a French *societe` anonyme*. Suez Environmental is controlled by GDF Suez SA, also a French *societe` anonyme*. United Water Environmental Services, Inc. (and its predecessors) has demonstrated over the years that it has the financial capacity, and technical and administrative expertise to meet all the demands of the proposed contract. KKR will provide additional financial support to the Bayonne Joint Venture, LLC.

2. The terms of the contract are not unreasonable given the services that are to be performed by the Bayonne Joint Venture, LLC (N.J.S.A. 58:26-25 (c) (2)). The Board believes that under the circumstances of this matter and as set forth in the Contract, a 40 year term is appropriate.
3. N.J.S.A. 58:26-25(c) (3) is intended to protect franchise customers outside the City of Bayonne. All of Bayonne's customers are located within Bayonne's boundaries.
4. The contract contains provisions addressing the following:

N.J.S.A. 58:26-23 (e)(1): The charges, rates, fees or formulas to be used to determine the charges, rates or fees to be charged by the public utility for the water supply services to be provided are incorporated. Bayonne fixes the rates for the water service pursuant to N.J.S.A. 40:14B-21. There is no subsidization of customers outside the municipal boundaries.

N.J.S.A. 58:26 (e)(2): The allocation of the risks of financing and constructing planned capital additions or upgrades to existing water supply facilities are incorporated; and

N.J.S.A. 58:26-23 (e)(6): The employment of current employees of the public entity whose petitions of employment will be affected by the terms of the contract are addressed.

On August 9, 2012, the DEP submitted a Hearing Report and the Authority notified the Board within 10 days of receipt of any DEP comments made pursuant to N.J.S.A. 58:26-25(a).

Therefore, based upon the above, the Board HEREBY APPROVES the Public-Private Contract between Bayonne Municipal Utilities Authority and the Bayonne Water Joint Venture, LLC, a joint venture between United Water Operations Contract, Inc. and Kohlberg, Kravis, Robert & Co. subject to the following provisions:

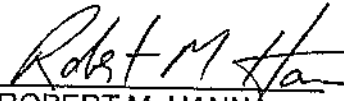
1. The City of Bayonne, within ten (10) days of receipt of this Order, shall submit the approval of the Local Finance Board within the Division of Local Government Services in the Department of Community Affairs, as required by N.J.S.A. 58:26-25 (a).
2. The Bayonne Municipal Utilities Authority shall obtain the final opinion of Bond Counsel, pursuant to N.J.S.A. 58:26-23(g) and submit the same to the Board within thirty (30) days of closing on the proposed Public-Private Contract.

3. The Bayonne Municipal Utilities Authority shall notify the Board if the proposed Public-Private Contract is not executed within forty-five days (45) of the date of this Order and advise as to why such contract has not been executed.
4. Any extension of the contract beyond the 40 year term shall be subject to Board review and approval.

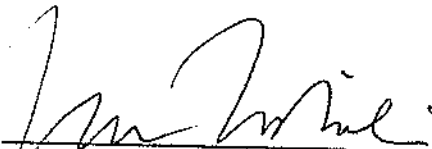
This Order shall be effective on November 2, 2012.

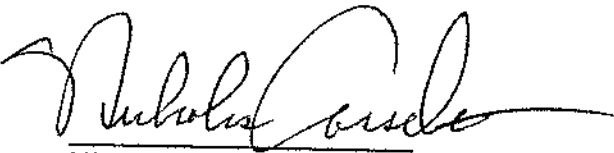
DATED: 10/23/12

BOARD OF PUBLIC UTILITIES
BY:


ROBERT M. HANNA
PRESIDENT


JEANNE M. FOX
COMMISSIONER

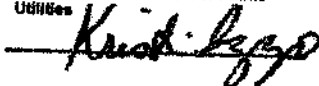

JOSEPH L. FIORDALISO
COMMISSIONER


NICHOLAS ASSELTA
COMMISSIONER

ATTEST:


KRISTI IZZO
SECRETARY

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



In the Matter of the Application for Approval
of a Public-Private Contract Between the Bayonne Municipal
Utilities Authority and the Bayonne Joint Venture, LLC.
BPU Docket No. WM12080777

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