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Via Electronic and U.S. Regular Mail

Mr. Kenneth Sheehan, Secretary
Board of Public Utilities
44 South Clinton St., 9th floor
P.O. Box 350
Trenton, New Jersey 08625-0350

Re: I/M/O The Board's Main Extension Rules, N.J.A.C. 14:3-8.1 et seq.
Docket No. AX12070601

Dear Mr. Sheehan:

The New Jersey Division of Rate Counsel ("Rate Counsel") hereby submits its comments in this matter, on the proposed rules published by the Board of Public Utilities ("the Board") in the December 1, 2014 New Jersey Register, 46 N.J.R. 2323(a) (the "Proposed Rules"). The Proposed Rules would amend the former "Smart Growth" regulations for extensions to provide regulated services,¹ and would address both cost-sharing issues related to future regulated utility service extensions and requests for reimbursement of utility main extension costs that were not refunded due to restrictions introduced under the former rules.²

¹ The amendments, repeal and propose new rules, at N.J.A.C. 14:3-8.1 through -8.13.

² The prospective rules would apply to requests for reimbursement subsequent to the Appellate Division decisions that invalidated the prior Smart Growth rules. I/M/O The

1. **Background**

The rules governing extensions to provide regulated services, N.J.A.C. 14:3-8.1 through -8.13 (“Main Extension Rules”), govern the payment of deposits by an applicant for extension of new utility service to a property or properties currently unserved by that utility, and to what extent the regulated utility company must refund those deposits after service has commenced.

A utility’s obligation to extend service to new customers is governed by N.J.S.A. 48:2-27, which provides:

The board may, after hearing, upon notice, by order in writing, require any public utility to establish, construct, maintain and operate any reasonable extension of its existing facilities where, in the judgment of the board, the extension is reasonable and practicable and will furnish sufficient business to justify the construction and maintenance of the same and when the financial condition of the public utility reasonably warrants the original expenditure required in making and operating the extension.

Prior to 2004, the Board’s service extension rules had a limited objective: providing guidelines for the Board’s Staff to assist in the informal resolution of disputes between utilities and real estate developers seeking the extension of utility service to newly developed areas. The pre-2004 rule provided, as a rule of thumb, that an investment in an extension would be considered economic at costs up to the annual expected revenue from the extension times a multiplier that varied based on the type of utility. The multiplier was two and one half times annual revenues for water and wastewater utilities and five times annual revenues for other utilities. In order to allocate the risk that the expected customers might not materialize, the utility could require a deposit from the developer.

Board’s Main Extension Rules, N.J.A.C. 14:3-8.1 et seq., 426 N.J. Super. 538 (App. Div. 2012) and I/M/O Centex Homes, LLC Petition for Extension of Service, 411 N.J. Super. 244 (App. Div. 2009).

As new customers began receiving service and generating revenues for the utility, the developer would receive refunds, up to the cost of the extension, in the amount of the applicable multiplier times the estimated revenue expected from the customers receiving service. N.J.A.C. 14:3-8.2(c) (as amended effective July 31, 2002, 34 N.J.R. 3216(b)(2002)).

In 2004, the Board amended its Main Extension Rules to incorporate “Smart Growth” principles. Essentially, the Board revised the rules to establish different deposit and reimbursement standards for properties depending on whether or not they were located in areas designated for growth. With limited exceptions, the utilities were prohibited from paying the costs of service extensions in areas not designated for growth. Such costs were paid for by developers or individual customers, and were required to be reflected by the utilities as permanent contributions in aid of construction (“CIAC”). N.J.A.C. 14:3-8.5(b). The Board also adopted more generous provisions for refunds to incentivize service extensions in areas designated for growth. Applicants for service in areas designated for growth were entitled to refunds up to ten times the annual revenues resulting from the extension. E.g. N.J.A.C. 14:3-8.10(d) (multi-unit or nonresidential development).

Developers successfully challenged the 2004 amendments to the Main Extension Rules. The Appellate Division invalidated the amended rules, holding that the Board had no authority to incorporate “Smart Growth” principles in its main extension rules, and therefore no legal basis to deny refunds for extensions in areas not designated for growth, while allowing refunds in designated growth areas. I/M/O Centex Homes, LLC Petition for Extension of Service, 411 N.J. Super. 244 (App. Div. 2009). The court also directed

to the Board to refund appropriate costs to those whose refunds had been denied under the 2004 amended rules, and to revise the rules in accordance with the Board's authority. On October 5, 2011, the Board posted on its web site proposed draft rules and began a stakeholder process. Those rules had not yet been finalized, and refunds had not yet been paid, when the rule challengers returned to court and received further relief. I/M/O The Board's Main Extension Rules, N.J.A.C. 14:3-8.1 et seq., 426 N.J. Super. 538 (App. Div. 2012).

Board Staff continued the stakeholder process, holding a stakeholders meeting on January 11, 2013 and on January 18, 2013 circulating questions to stakeholders about issues discussed at the meeting as well as on its October 5, 2011 proposed draft rules. Rate Counsel submitted responsive comments in this matter on February 15, 2013. The December 1, 2014 rule proposal follows from that stakeholder process.

The prospective refund formulas in the Proposed Rules include only limited recognition of the important distinctions between different types of utilities. The costs to install and the revenue generated by different utilities vary widely. For example, water and wastewater utilities and gas utilities may have different revenues from similar extensions. While the Proposed Rules include a different multiplier for water and wastewater utilities (two and one half times estimated annual revenue), they would apply the same multiplier for gas, electric and telecommunications utilities (ten times estimated annual revenue). The resulting refunds may be unrealistic and unfair.

The Board has applied the multiplier of ten times the estimated average annual revenue for all utility refunds since its July 19, 2013 Order in I/M/O The Board's Main Extension Rules N.J.A.C. 14:3-8.1 Et Seq., Docket No. AX12070601. The Board also

had used this enhanced multiplier when calculating refunds of utility service extension costs in areas designated for growth under the former “Smart Growth” rules that the Appellate Division invalidated in 2009. Rate Counsel considers it inappropriate to apply the accelerated Smart Growth multipliers. First, those multipliers were included in the “Smart Growth” rules to incentivize infrastructure investment in areas designated for growth under the State Development and Redevelopment Act. See 36 N.J.R. 276(a) (Jan. 20, 2004). The Centex Court invalidated the legal basis for those rules, and there is no rational basis for this incentive formula. Second, there is no factual basis for the multipliers chosen. The Board should solicit data from regulated utility companies to set realistic and fair refund formulas for each utility sector.

Rate Counsel believes that prospective use of the Proposed Rules’ refund multiplier of ten times estimated annual distribution revenue resulting from new customer extensions, for all new gas, electric and telecommunications service extensions, may excessively increase refunds above the suggested formulas under the pre-Smart Growth rules. This unfairly shifts main extension costs from the customers and developers who request a new service extension to the utility’s other ratepayers, who may be required, subsidize utility investments that are not economic. See Proposed N.J.A.C. 14:3-8.10 (multi-unit or non-residential development), -8.11 (single residential customer). Rate Counsel recommends that the rules include a refund formula multiplier that is appropriate for each utility industry sector. Rate Counsel suggests a reimbursement formula not to exceed two and one half times annual revenue for up to five years for water and wastewater, and not to exceed five times annual revenue for up to five years for gas and electric.

A related issue is the current definition of “distribution revenue” for electric and gas utilities. The current definition of “distribution revenues,” which is proposed to remain unchanged, defines gas distribution revenues as total revenues including sales and use tax (“SUT”), less charges, including SUT, for basic gas supply service. N.J.A.C. 14:3-8.2. Similarly, for electric utilities, “distribution revenues” are defined as total revenues, including SUT, less revenues including the associated SUT for basic generation service and transmission charges. N.J.A.C. 14:3-8.2. Thus the revenues used to apply the multiplier include the Societal Benefit Charge and other surcharges unrelated to the recovery of the utilities’ costs of providing electric or gas distribution service. This exacerbates the potential for refunds that unfairly shift costs to the utilities’ other customers. The recommended multipliers for electric and gas utilities should be applied to revenues from charges intended to recover the utilities costs to provide electric and gas distribution service.

The rules governing prospective main extension costs should apply only to residential main extensions and should distinguish single residential customers from multi-unit residential customers.

The Proposed Rules would apply to construction of new utility extensions to all customers, residential or non-residential. Proposed N.J.A.C. 14:3-8.1(c). Rate Counsel recommends that the rules should not apply to all types of development. Instead, Rate Counsel suggests that the proposed rules should apply only to residential buildings. This

is consistent with the old main extension rules that did not directly address the allocation of costs and refund formulas for non-residential customers.³

Rate Counsel concurs generally that the prospective rules should include a separate provision for extensions of service to single residential customers; however, the rule should be simpler and easier to apply. At the October 11, 2011 stakeholder meeting, Board Staff reported a large number of complaints by ratepayers who did not understand regulated utilities' calculation of costs to extend service to their single residential unit.⁴

For new service not requiring extension of a main, Rate Counsel recommends that the Proposed Rules require utilities to submit a tariff for Board approval setting forth the length and type of individual service connection available at no cost to the applicant to extend utility service to a single residential unit. Such terms were included in Board-approved tariffs before the Smart Growth rules.

Where a utility must extend a main to provide service to a single residential unit, Rate Counsel recommends a simpler cost-sharing formula. Essentially, Rate Counsel proposes a truncated formula that would set the amount of the customer's contribution and eliminate subsequent refunds. Rate Counsel thinks that this will be sufficient to address utility service extensions for single residential units. The Proposed Rules, at N.J.A.C. 14:3-8.11(d), would require this customer to pay a contribution based on the cost and projected revenues with the utility paying the balance of the extension cost. Rate Counsel considers additional refunds unnecessary for single residential units.

³ See former N.J.A.C. 14:3-8.1, -8.2 and -8.3 (current through Dec. 6, 2004) (suggesting formulas for residential developers and individual residential customers); 36 N.J.R. 276(a) (Jan. 20, 2004), at p.4 (stating that the revised rules will establish that they apply to extensions made by all regulated utilities, except for electric transmission systems).

⁴ The Board may want to extend the rule to apply to two-family homes as well, since they are a common residential arrangement for New Jersey families.

Accordingly, we recommend deleting Proposed N.J.A.C. 14:3-8.11(c) though (g) entirely and replacing it with a standard one-time payment for each type of new utility service extension to a single residential unit. Should the Board decide nevertheless to provide refunds for main extensions for single residential units, Rate Counsel recommends that the refund formula multiplier for all utility service extensions should not exceed two and one-half times estimated annual revenue.

In addition, Rate Counsel is concerned that the reimbursement formula retains the incentive reimbursement multiplier rate that the court overturned in I/M/O Centex Homes. There is no basis for retaining a reimbursement formula that was established to incentivize new development based on land use designations. Rate Counsel also is concerned that the Economic Impact analysis of the Proposed Rules does not mention their impact on ratepayers. The Proposed Rules state that they have two primary purposes: to amend the current rules for prospective applications in accordance with the Centex Homes decision, and to provide for payment of refunds that were denied in reliance on the invalidated rules.

In accordance with N.J.S.A. 48:2-27, the Proposed Rules are intended to ensure payment of refunds for only those main extensions that generate sufficient revenue to justify their expense. If an applicant requests service that costs more than the regulated utility's or the industry's system design standards, or if an extension presents "an unusual situation in which providing standard service is substantially more expensive than usual," the utility may charge the applicant or the customer for the extra expense and this extra charge is not refundable. N.J.A.C. 14:3-8.9(d)(3). In addition, under N.J.A.C. 14:3-8.9(h), the following portions of the deposit will constitute a nonrefundable CIAC:

1. For all extensions, the cost of extra service, or of extra work required to provide standards service, in accordance with N.J.A.C. 14:3-8.9(d)3; and
2. For an underground extension of electricity or telecommunications service, the additional cost for underground service over and above the amount it would cost to serve those customers overhead. This shall include the cost of any temporary overhead installation and/or removal under N.J.A.C. 14:3-8.4(g).

The Proposed Rules also provide that, “In no event shall a regulated entity refund more than the total deposit amount to the applicant.” N.J.A.C. 14:3-8.9(f). This provision is important since excessively costly service extensions would not be cost-effective to the regulated utility company, the above limitations on refunds appropriately consider the interests of other ratepayers who ultimately would bear those costs. Accordingly, Rate Counsel supports these provisions of the Proposed Rules.

2. The Prospective Rules

The Proposed Rules are intended to regulate “whether a regulated entity may require a deposit from an applicant for an extension, and if so how much of the deposit will be refunded to the applicant and on what schedule.” Proposed N.J.A.C. 14:3-8.1(d). Prospectively, cost-sharing should be primarily determined through negotiation, with the formulas applicable only if negotiations between the regulated utility and the applicant for a service extension reach an impasse. As noted above, except for water and wastewater utilities, the proposed rule would require refunds only to the extent the utility’s investment exceeded ten times the annual revenues resulting from the extension. Proposed N.J.A.C. 14:3-8.5(a).

The Proposed Rules require each regulated entity to submit for Board approval a proposed tariff containing charges for services, including installation charges, as well as the amount of a deposit or CIAC and the formula for any refund. The amount of deposit

or CIAC, as well as refund formulas, must comply with the formulas suggested in the Proposed Rules at N.J.A.C. 14:3-8.9, 8.10, or 8.11, as applicable. Proposed N.J.A.C. 14:3-8.5(e). The Proposed Rules therefore essentially propose mandatory reimbursement formulas.

If negotiations over sharing the costs of extending utility service should fail, either party may petition for an order directing the provision of service, as per N.J.S.A. 48:2-27, wherein the Board would apply the applicable cost-sharing formula from N.J.A.C. 14:3-8.9, -8.10, or -8.11. Proposed N.J.A.C. 14:3-8.5(a). However, the Board must ensure that the formulas suggested in the Proposed Rules are fair to the regulated utility, the applicant for utility service and other ratepayers. This is especially important if, as it seems, the Board intends the formulas to be mandatory.

Finally, with regard to the current definition of “plant and/or facilities,” in N.J.A.C. 14:3-8.2, it should be amended to include “the collection of wastewater” in the enumeration of the applicable services in the first sentence.

Additionally, the Proposed Rules require estimates of the distribution revenue that will be derived from the customer, e.g. N.J.A.C. 14:3-8.11(b)2 (estimated revenue used to determine if a deposit is required), but do not state how to calculate that estimate. Rate Counsel suggests that the proposed rules do so.

3. Smart Growth Refunds

For purposes of resolving refunds improperly denied under the “Smart Growth” rules, the Proposed Rules require the parties to “agree upon the appropriate amount of the refund.” Proposed N.J.A.C. 14:3-8.14(c)(4). If they cannot agree as to the amount, the Board will apply “the refund formula for extensions in existence at the time of the

extension request to determine the amount that would have been refunded if the extension were built to serve an area designated for growth.” Proposed N.J.A.C. 14:3-8.14(c)(7).

Rate Counsel concurs with paying any refunds denied under the “Smart Growth” rules only to the person or developer that paid for the utility service extension, as per proposed N.J.A.C. 14:3-8.14(c)(2) and -8.14(c)(3).

Rate Counsel concurs that the onus should be upon the person or entity that paid the deposit to apply for a refund, and do so by submitting its request to the relevant utility, as per proposed N.J.A.C. 14:3-8.14(c)(1). Rate Counsel also concurs that each applicant should document the specific amount of the service extension deposit that it paid. However, Rate Counsel recommends amending the proposed rule to require rather than suggest documentation of payment of the requested deposit. See proposed N.J.A.C. 14:3-8.14(c)(5).

Rate Counsel concurs that each utility company should provide individual or public notice, depending on their ability to identify eligible customers, as per proposed N.J.A.C. 14:3-8.14(b).

Rate Counsel concurs with the general process for reviewing refund applications, in particular the recommendation that the parties first attempt to negotiate the amount of the refund, as per proposed N.J.A.C. 14:3-8.14(c). Rate Counsel recommends, however, that the Board require each applicant to agree to hold harmless and indemnify the utility against any competing claim for the refund by a third party.

Rate Counsel agrees that the applicant must submit a claim for the refund to the utility within a reasonable time; however, Rate Counsel suggests that the request should be submitted no later than six months from the effective date of the Proposed Rules,

rather than within one year (365 days) as per proposed N.J.A.C. 14:3-8.14(c)(1). The Appellate Division struck down the Board's "Smart Growth" Main Extension Rules over five years ago, and that decision as well as the published decision two years ago and the Board's stakeholder process and several public notices should have advised interested parties by now that refund denials under those rules are invalid.

We thank the Board for the opportunity to comment on these proposed rules. Please feel free to contact the undersigned if you have any questions or need any further information on this matter.

Respectfully submitted,

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