



**STATE OF NEW JERSEY**  
**Board of Public Utilities**  
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ENERGY

IN THE MATTER OF THE PETITION OF SOUTH JERSEY ) ORDER  
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. )  
DOCKET NO. GO12070670

**Ira G. Megdal, Esq., (Cozen O'Connor)** Attorney for Petitioner, South Jersey Gas Company  
**Stefanie A. Brand, Esq., Director,** New Jersey Division of Rate Counsel

BY THE BOARD:

This matter comes before the New Jersey Board of Public Utilities ("Board") on a petition filed by South Jersey Gas Company ("SJG" or "Company") on July 23, 2012 ("July Filing"), seeking the Board's approval of an "Accelerated Infrastructure Replacement Program" ("AIRP"). As proposed in the July Filing, under the AIRP the Company would replace infrastructure, such as unprotected steel and cast-iron mains, and related services on an accelerated basis, and then recover such costs on an expedited basis through a special ratemaking mechanism. SJG requested expedited treatment of the July Filing, and also requested that the Board retain jurisdiction over this matter, in light of the scheduled expiration of its Capital Investment Recovery Tracker ("CIRT") program on December 31, 2012.

SJG is subject to regulation by the Board for the purposes of assuring that safe, adequate and proper natural gas service is provided to its customers. N.J.S.A. 48:2-23. The Company is obligated to maintain its utility infrastructure in such condition as to enable it to meet its regulated obligations to provide the requisite service. That infrastructure is comprised of the property, plant, facilities and equipment within the Company's natural gas distribution and transmission systems throughout its service territory. SJG is also subject to regulation by the Board for the purposes of setting its retail rates to assure that those rates are just and reasonable, N.J.S.A. 48:2-21, and is subject to the regulatory standards set by the U.S. Department of Transportation, including those set by the Pipeline and Hazardous Materials Safety Administration.

Specifically, the July Filing requested Board approval to implement a five-year capital investment program through which the Company would invest \$250 million prior to the capitalization of Allowance For Funds Used During Construction ("AFUDC") to replace cast iron and unprotected steel<sup>1</sup> distribution lines, services and meters. Many of SJG's older mains and services were constructed of cast iron and/or unprotected steel, the most popular and readily available materials used in the industry prior to 1970. The Company maintains that its cast iron and unprotected steel infrastructure is generally more susceptible to corrosion damage, leaks, and material failure than the Company's other mains and services. While SJG states that it has been consistently addressing the replacement of such assets through its annual capital construction planning for many years, the Company's testimony maintains that an accelerated approach is necessary now to shorten the overall time it will take to replace this aged infrastructure. Additionally, there are national efforts underway to increase the safety, reliability and integrity of the country's pipeline infrastructure. SJG noted in its filing that U.S. Secretary of Transportation, Ray LaHood, in his "Call to Action," encourages an increased focus on pipeline replacement and the associated cost recovery. As a result, significant efforts are being made to address older pipelines that have a greater likelihood of corrosion damage or leaks.

SJG proposed a five-year program for accelerated replacement of cast iron and unprotected steel infrastructure. By relying on a multi-year approach, the Company maintains that it and its ratepayers would benefit from cost and scheduling efficiencies. SJG proposed that through the AIRP, cast iron and unprotected steel distribution lines and services could be replaced in a coordinated and systematic manner over the proposed five-year time period.

SJG asserts that it has been making a concerted effort to replace cast iron and unprotected steel infrastructure in order to maintain reliability to best serve customers and to ensure the continuation of safe, adequate and proper service. However, at this time, the Company believes that an accelerated replacement program will lessen SJG's exposure to operational risk, increase operational efficiencies and reliability while improving safety throughout the service territory.

In the July Filing, SJG also sought approval to use, for the AIRP investments, the same cost recovery mechanism that was previously approved by the Board for its CIRT II and CIRT III.<sup>2</sup> That mechanism defers construction costs for a period of time, generally one year, and then seeks Board approval of a base rate increase to reflect the investment in customers' base rates.

After public notice, two public hearings on the July Filing were held on December 3, 2012 in Voorhees, New Jersey. No members of the public appeared at any of the public hearings, nor were any comments received by the Board in writing from interested parties.

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<sup>1</sup> Included in the category of "unprotected steel" is pipe that is uncoated or that is coated but not cathodically protected. For convenience, these two categories of steel pipe are referred to as unprotected steel.

<sup>2</sup> In the Matter of 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. 48:2021 and N.J.S.A. 48:2-21.1, Docket No. GR10100765, Board Approval Date March 30, 2011 ("CIRT II") and In the Matter of the Petition of South Jersey Gas Company to Modify and Extend Its Existing Capital Investment Recovery Tracker ("CIRT II") Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, Docket No. GO11100632, Board Approval Date May 1, 2012 ("CIRT III").

## **PROPOSED STIPULATION FOR AIRP:**

On February 1, 2013, after engaging in settlement negotiations, the Company, Rate Counsel and Board Staff, the only parties to this proceeding, executed a Stipulation ("Stipulation")<sup>3</sup> and agreed as follows:

- "AIRP Projects" represent the efforts by the Company to reduce, through replacement, the Company's existing inventory of cast iron and unprotected steel mains and services.
- For the construction work in the first year (12 months) in which the AIRP is applicable, the Company will prepare a detailed listing of the specific AIRP Projects to be addressed, including estimated costs, locations of the infrastructure replacement and the expected schedule within which the work will be completed. That information will be provided to Board Staff and Rate Counsel within ninety (90) days of the effective date of the Board Order approving the Company's AIRP. Subsequently, SJG will provide Board Staff and Rate Counsel with anticipated schedules, along with the estimated cost and projected timelines and completion dates, on an annual basis, in a filing to be made by July 1<sup>st</sup> of each of the subsequent years the AIRP is in effect. This project list may be modified without further review during the year based on permitting, cost or other considerations.
- The AIRP spending levels will not include the replacement of associated gas meter sets.
- The AIRP is to be in effect for four (4) years to replace a significant number of cast iron and/or unprotected steel mains and services in a cost-efficient manner.
- The Company will use reasonable efforts to prioritize the replacement of large diameter (greater than 8") cast iron mains and older (greater than 72 years old) service lines, with higher priority given to the replacement of higher pressure pipes; however, the Company shall still accord primacy to the consideration of safety, reliability and efficiency.
- During the four (4) year AIRP period, the annual AIRP investments of \$35.3 million shall be incremental to the Company's base spending level of \$13.2 million annually on the replacement of cast iron and/or unprotected bare steel mains and services. SJG can annually apply the accounting procedures set forth in Paragraph 19 of the Stipulation to the estimated \$35.3 million of incremental capital investments up to a cumulative total of no more than \$141.2 million Program total for AIRP Projects. The annual \$35.3 million and \$141.2 million four (4) year total amounts are exclusive of AFUDC accruals.
- The Company's incremental construction cost target of \$35.3 million annually may be under or over spent by 15 percent in any given year. This 15% margin shall be applicable to incremental expenditures, over the base level of \$13.2 million. Any over spending on incremental expenditures in a given year will be accompanied by a reduction of an equal amount in one or more periods. Similarly, any under spending in a given year may be offset by additional spending that exceeds the annual target in other periods. In either event, the amount of incremental investment that is subject to the accounting procedures set forth in Paragraph 19 of the Stipulation during any given year will be the Company's actual total AIRP investment costs less \$13.2 million. In no event will the total incremental AIRP Project expenditures, subject to the accounting treatment procedures set forth in the Stipulation, exceed the total AIRP incremental capital investment spending limit of \$141.2 million over four (4) years.

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<sup>3</sup> Although summarized in this Order, should there be any conflict between this summary and the Stipulation, the detailed terms of the Stipulation control, subject to the findings and conclusions of this Order.

- All reasonable and prudently incurred incremental investment costs, in amounts determined as described above and in Paragraph 18 of the Stipulation, associated with AIRP Projects including, but not limited to, the costs of engineering, design and construction, including labor, materials and other overheads, will be subject to the following accounting treatment for ratemaking purposes:
  - (i) The AFUDC rate for AIRP projects shall be based upon the modified FERC method as depicted in Exhibit A to the Stipulation. The Company will provide quarterly reports to the Board Staff and the Division of Rate Counsel detailing the application of AFUDC.
  - (ii) AFUDC will be accrued on a monthly basis.
  - (iii) From the time an AIRP Project is placed in service (when natural gas is reintroduced to the Company's gas distribution system) until it is rolled into rate base, the Company will accrue to utility plant a carrying cost of 7.33%. It is understood that the Company will also accrue to utility plant carrying costs of 7.98% and 7.72% on CIRT II and CIRT III projects, respectively, from the time they were placed in service until they are rolled into rate base.
  - (iv) In its next base rate case, the Company will roll-in to rate base the plant, construction period AFUDC and post construction carrying costs associated with AIRP Projects.
  - (v) AIRP Projects that are in service will include a ratable monthly deduction for Accumulated Deferred Income Tax ("ADIT") prior to calculating the monthly carrying cost. The Repair Allowance provided for in the Internal Revenue Code will be included in the calculation of ADIT at such time as the Company receives an economic benefit from the Repair Allowance.
  - (vi) The depreciation expense for AIRP projects will be based on South Jersey's depreciation rates. During the deferral period when AIRP projects are closed to Plant in Service, depreciation expense will be charged (debited) with a corresponding credit to the accumulated depreciation reserve. The recorded depreciation expense will then be deferred in a separate regulatory asset account by charging (debiting) a regulatory asset and crediting the depreciation expense. At the time AIRP projects are recognized in rate base within a regulatory proceeding, the regulatory asset related to the deferred depreciation expense that had been created pursuant to the accounting treatment set forth herein will be eliminated by crediting the balance with a corresponding charge (debit) to the accumulated depreciation reserve related to the AIRP investments that were created for this purpose, and will have no impact on the income or rate base. As a result of these entries there will be no recovery of depreciation expense or adjustments to the rate base associated with the accumulated depreciation reserve until the deferred AIRP project investments are included in rate base within a regulatory proceeding. The depreciation rate for AIRP main replacements will be 1.92% and the depreciation rate for AIRP service replacements will be 2%.
  - (vii) The rate to be used for calculating the carrying cost applicable to AIRP Projects after construction will be 7.33% per annum.
- AIRP investment costs will be subject to review in the Company's next base rate case. A base rate case shall be filed no later than December 15, 2015.
- The Company's next base rate case filing will be filed based upon three (3) months of actual data and nine (9) months of projected data for the test year which test year will be updated throughout the course of the proceeding for twelve (12) months of actual data.

- No rate increase for AIRP Projects shall be put into effect until the issuance of an Order by the Board establishing base rates for the Company in the prospective base rate case proceeding.
- For ratemaking purposes, the Parties have utilized a capital structure with a 51.2% equity component and a return on equity of 9.75%.
- The Company's current base rates reflect an Operation and Maintenance ("O&M") expense related to leak repair of approximately \$320,000. The Company agrees to record and defer in a separate regulatory liability account any amount below \$320,000 per calendar year for O&M expense associated with leak repair. At the time AIRP Projects are recognized in rate base within a regulatory proceeding, the regulatory liability associated with leak repair will be amortized into rates over a four-year period.
- The continuation of the AIRP beyond those investments reflected in rates at the conclusion of the Company's next base rate case will be subject to review and consideration by the Board in that rate case or a subsequent proceeding.
- SJG will provide a quarterly report to Board Staff and Rate Counsel in a format similar to that currently being used for the Company's CIRT programs.
- The Company's leak reports demonstrate an active leak inventory as of October 31, 2012 of 1054 leaks.
- The Company will use best efforts to annually reduce the inventory of open leaks by 15 percent. This level of leak reduction is based upon the AIRP spending level set forth above.
- The Company will use its best efforts to reduce that active leak inventory by 632 leaks (158 per year) or approximately 60 percent during the AIRP term. This metric is irrespective of incremental, new, post-October 31, 2012 leaks which will not be counted in such metric.
- During the Company's next base rate case proceeding, the Parties shall review the relevant reports, and such discovery requests as may be appropriate, to determine whether the Company's leak inventory has been reduced by 632 or more from October 31, 2012 through the conclusion of the AIRP . If it is reduced by less than 632, the amount of carrying costs to be included in rates shall be reduced. The amount of carrying costs to be included in rates shall equal the total amount of the carrying cost accrual on AIRP Projects from the date of the Board Order accepting the Stipulation until the effective date of the Company's prospective base rate case multiplied by a fraction. The numerator of that fraction will be the amount of leak reduction actually obtained expressed numerically, without giving any recognition to new leaks arising subsequent to October 31, 2012. The denominator of the fraction will be 632.

## DISCUSSION AND FINDING

The Board has carefully reviewed the attached Stipulation and its terms as described in this Order, and **FINDS** the Stipulation to be reasonable, in the public interest, and in accordance with the law. The Board believes that an accelerated replacement program for cast iron and unprotected steel infrastructure, if prudently implemented, will lessen the Company's exposure to operational risk, increase operational efficiencies and reliability while improving safety throughout the service territory. Many of SJG's older gas mains and services were constructed of cast iron and/or unprotected steel, the most popular and readily available materials used in the industry prior to 1970. The Company's cast iron and unprotected steel infrastructure is generally more susceptible to corrosion damage, leaks and material failure than the Company's other mains and services. The Board recognizes that SJG has been addressing the replacement of such assets in its annual capital construction planning for many years. The Board agrees with the Company that an accelerated approach will shorten the overall time it will take to replace this aged infrastructure.

The Board believes it is appropriate to approve the accounting treatment proposed in the Stipulation. The Board has previously authorized the use of deferred accounting treatment in prior proceedings.<sup>4</sup> Moreover, similar accounting treatment was previously approved by the Board in the Company's CIRT II and III proceedings.<sup>5</sup> The major difference between the previously approved treatment and the instant matter is that the Company will not seek any periodic or annual increases during the multi-year AIRP but rather will make the investments subject to the future base rate case proceeding that the Company has committed to file where the AIRP Program investment costs will be subject to review. Additionally, some aspects of the cost recovery are dependent on a showing of the effectiveness of the program on leakage reduction appropriately allocating a portion of the risk of recovery on performance. The Company will also provide quarterly reports to permit oversight by Staff and Rate Counsel of the progress of the program.

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<sup>4</sup> See, In the Matter of Public Service Electric and Gas Company's Request for Deferral Accounting Authority for the Energy Information and Control Network Pilot Program, Decision and Order Authorizing Deferred Accounting Treatment of Pilot Program Costs, Docket No. EO04060395 (August 24, 2004), and In the Matter of the Petition of Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas Company to Establish a Pipeline Replacement Program Cost Recovery Rider, Docket No. GR05040371 (August 18, 2006).

<sup>5</sup> In the Matter of 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. 48:2021 and N.J.S.A. 48:2-21.1, Docket No. GR10100765, (Order dated March 30, 2011) ("CIRT II"), and In the Matter of the Petition of South Jersey Gas Company to Modify and Extend Its Existing Capital Investment Recovery Tracker ("CIRT II") Pursuant to N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, Docket No. GO11100632, (Order dated May 1, 2012) ("CIRT III").

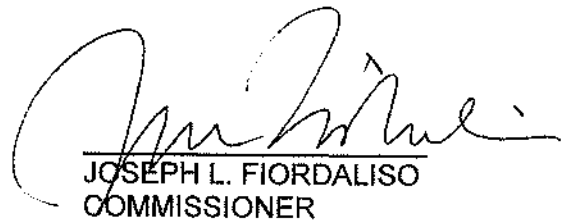
Accordingly, the Board **HEREBY ADOPTS** the terms of the Stipulation in their entirety, as if fully set forth herein.

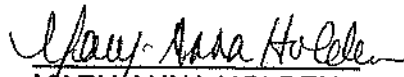
DATED: 2/20/13

BOARD OF PUBLIC UTILITIES  
BY:


  
ROBERT M. HANNA  
PRESIDENT

  
JEANNE M. FOX  
COMMISSIONER

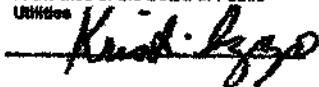
  
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ATTEST:

  
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 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 DOCKET NO. GO12070670

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