

DIMENSIONS

Newsletter of the New Jersey Builders Association

Board of Public Utilities Adopts New Utility Extension Rules

By Walter G. Reinhard, Esq.

EDITOR'S NOTE: *This special issue of Dimensions will discuss changes affecting the cost of extending public utility facilities to new construction around the state. On December 20, 2004, the New Jersey Register contained a notice of the adoption by the Board of Public Utilities (BPU) of new regulations governing extensions of public utility service. The new rules, which become operative on March 20, 2005, dramatically change the way in which utilities and builders will pay for extensions of utility facilities to new customers in areas designated for growth by the State Planning Commission, the Meadowlands Commission, the Pinelands Commission, and areas not so designated. It marks the first time the BPU has differentiated among utility customers based upon where they live. The new rules are complex and, as with all of government, the devil is in the details.*



BPU Changes the Rules of the Game for Utility Installations

BPU requires homebuyers and tenants to pay all costs outside of Smart Growth areas

As of March 20, 2005, any person who needs basic utility service for a project to be built outside the State's designated growth areas will have to pay for it; the public utility, which has a monopoly grip on the service territory, will be off the hook entirely. Thus, builders, residential and commercial real property developers, homeowners, anyone requiring utility service outside designated growth areas (described below) will foot the entire bill for the installation of all of the required utility facilities, including gas, electric, telephone, water and wastewater; cable television was considered, but those rules were deferred.

On the other hand, for new customers within designated growth areas, the new rules make it likely that the utility will pay the entire cost of the extension by making accelerated refunds to the builder.

As you can see, these new rules are an undisguised attempt to use utility regulatory power to further the Administration's Smart Growth agenda.

The Changing Playing Field

The old regulations were complicated, but were understandable considering the utility's monopoly and

its corresponding obligation to serve. In exchange for its regional monopoly, a utility is required to provide safe, adequate and proper service to all of the customers located within its franchise area. It cannot pick and choose among applicants for service, nor cream-skin only the best or wealthiest customers; it must serve all. It has the corresponding duty to anticipate growth and to make gradual extensions of its facilities to serve that growth – all at its own expense.

On the other hand it has been recognized that the obligation to serve may create a financial hardship on the existing customers when the utility is called upon to expend large sums to extend utility service to remote portions of the franchise territory. Prior laws recognized the conundrum and provided that a utility would be required to extend service at its own cost only where the extension will furnish sufficient business to justify the construction and maintenance costs. Otherwise, under the prior regulations, a utility could call on the property owner or developer to initially pay the cost of the required new facilities. If and when new customers come on line, the property

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owner or developer would be entitled to a refund from the revenues generated by the new business. Refunds were generally pegged at about five times annual revenues. At these levels, the refunds usually paid back some, but not all, of the developer's deposit. In short, the prior regulations provided that the costs were shared between the utility and the builder in a way that assured economic vitality to the utility and service to the new customers.

The Times They are A Changin'

Today this logical system, based upon the twin ideals of an efficient monopoly and the obligation to serve, has been discarded like yesterday's news. Now some customers will have their utilities installed for free and some will pay the entire cost – and it will all depend upon where you live. Under the new system, you can be rich or poor, living in a mansion or be the beneficiary of affordable housing, but if you live where the government doesn't want you, you'll pay; if you live where the government thinks growth is good, you'll ride for free. It's that simple.

How did it come to this?

It seems reasonable to ask how the BPU got mixed up in the Smart Growth movement. After all, its enabling legislation, in place since 1911, authorizes it to regulate public utilities so as to assure that they provide safe, adequate and proper service to all within the franchise area and, in doing so, also assure that they neither make nor give any undue preference or advantage to any particular person or locality. So how do these principles relate to proper land use planning?

Although it requires a leap of

faith to make the connection, the BPU relied upon relatively recent language in its enabling legislation that requires utilities to perform their service “in a manner that tends to preserve and conserve the



quality of the environment”. The BPU used this environmental protection mandate to justify its foray into land use planning because “sprawl development is a major threat to New Jersey’s environment.” From this jumping-off point the BPU leaped to wholesale adoption of the Smart Growth principles and cobbled together its authority to help in any way possible. Take a look at the sidebar on page 3 for a summary of the legal issues involved.

What does it mean to you?

First let's be a little bit more specific about what the BPU sees as growth versus no-growth areas. The regulations define a Designated Growth Area as one depicted on the State Plan Policy Map as either Planning Area 1 or 2 (PA-1: Metropolitan Planning Area; PA-2:

Suburban Planning Area) or a designated center. Also included as Designated Growth Areas are areas identified for growth as a result of an approved petition for a plan endorsement, a smart growth area designated in the New Jersey Meadowlands Commission Master Plan, and certain growth areas designated in the Comprehensive Management Plan adopted under the Pinelands Protection Act.

If you build in one of these areas, life is good - - at least as regards your utility costs. Here's what happens. First, you and the utility will agree on the total cost of the extension. Where the utility expects substantial revenues from the extension, it will pay the entire cost. Where it does not expect to receive a “substantial portion” of the revenue from the extension within the first 5 years, the utility can require that a deposit for the full cost of the extension, which will be refunded to you later. If there is a disagreement, the BPU staff is authorized to referee the dispute and apply the new refund formula. While not explicitly stated, you can also expect BPU staff to be involved in questions of whether any deposit at all is justified.

For multi-unit or non-residential development, the refund is calculated according to a detailed formula, fully set out in the regulations with multiple examples. For simplicity, the refunds may be thought of as being equal to 10 times the estimated revenue from each new customer that comes on line for a period of 10 years. By our estimates, this will usually result in a full refund of all refundable utility extension costs. There are also

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certain circumstances where, under the Smart Growth Infrastructure Incentive Program (“SGIIP”), the refund multiplier jumps to 20 times revenues where the customer is in the PA-1 area and where the State Planning Commission has approved. Of course, some costs are not refundable at all, even in a Designated Growth Area, but that generally refers to costs you are already paying anyway, such as the additional costs of under-grounding electric facilities.

For a single residential customer there is a further benefit. For extensions to only one customer, the initial deposit will not be equal to the total cost of the extension; instead, the initial deposit is determined by deducting an amount equal to 10 times anticipated annual revenues from the cost of the extension. Refunds are thereafter provided to the extent that actual revenues exceed the estimated revenues.

The Flip Side of the Coin

That brings us to the question what happens when you build where the BPU doesn’t want you to build? Well, this will be a very short paragraph. When you build anywhere outside of a Designated Growth Area, you will be responsible for all of the costs of extending public utility facilities from the existing utility infrastructure to your new construction. The costs will be ratcheted-up to account for the taxes that the utility will have to pay and will likely include related utility

overheads— a process that often results in a payment of up to double the cost of the facilities themselves.

revenues in year two (.75 times for water); and that there will be a sunset for refunds in year three.

There are certain limited exemptions from these rules which allow utilities to pay for extensions for purely agricultural buildings, for projects where a prior BPU Order controls the costs, for projects already in progress on March 20, 2005, and for general categories of hardship and significant public good, even in areas not designated for growth. However, we can rest assured that these exemptions will be granted sparingly.

What about the hybrids?

The real fun starts when a project straddles a growth area and a no-growth zone, when a

community is to be built in stages or where additional capacity must be added for good planning and utility reliability purposes.

Where issues like this present themselves, the parties must fall back on the general rules and principles enunciated by the BPU: where an extension is requested to serve both a Designated Growth Area and an area not so designated, the utility may pay only for that portion of the extension that is necessary for and will be used to serve the growth area; unless, the utility for its own purposes wishes

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Is it Legal?

As noted, 33 different parties (including NJBA), had something to say about the proposed regulations. Comments ranged from general to very specific and technical, and they covered the waterfront from fawning approval to reasoned, but strong, criticism. Although a decision whether to make an appellate challenge of the new regulations has not yet been made, we think the new regulations fail to meet required standards in several areas.

Although the BPU conducted a lengthy and comprehensive adoption process, no factual record was made to support and verify the sweeping statements used by the BPU to justify the adoption.

The new regulations also run afoul of the requirements in the BPU’s enabling legislation that utilities are obligated to extend service at no cost where sufficient business exists to justify the extension and that utilities neither make nor grant any undue preference or advantage to a particular customer or locale.

Finally, it appears clear that the BPU has way overstepped the scope of its authority. If a residential or other type of construction project which is proposed for an area not designated for growth receives each and every other required land use planning and environmental approval, then how can the BPU regulations be permitted to override those planning approvals? The BPU’s job is utility regulation, not land use and planning.



Phase-in and Exemptions

This new rule will be phased-in over a 3-year period during which time the utility will be permitted to contribute to the costs of the extension even outside of a Designated Growth Area. However, this special dispensation authorized during the phase-in period appears to be wholly within the discretion of the utility. Thus, the new regulations provide that if during the phase-in the utility “chooses to contribute” to the cost of the extension, then it shall make a refund of 3 times revenues in year one (1.5 times for water); 1.5 times

to construct additional capacity.

This is an area of the new regulations where the BPU struggled. Many commenters (there were 33 in all, including NJBA) criticized the impact of the new rules on sound utility planning. The utilities in particular cried out for the ability to plan for future growth and to be permitted to install adequately sized facilities to sustain that growth. Not



surprisingly, the utilities were heard and were (quite logically) granted authority to install sufficient capacity to comply with industry standards and to anticipate system growth. Also not surprising, you will have to pay for it!

In response to the comments, the BPU explained the truly draconian impact we might anticipate. There are four increments of capacity addressed in the rules; that is, the size (and therefore the cost) of the facilities to be built: first, the amount of capacity the proposed new customers actually need; second, the amount of capacity to meet basic system design and industry standards; third, additional capacity installed by the utility to improve

safety and reliability for existing customers in the area; and fourth, additional capacity to serve future development. The new rules permit a utility to install capacity for any and all of these purposes, but in an area not designated for growth (or a hybrid area), the utility and the BPU can require the applicant, that's you, to pay for all of the capacity added to serve both your needs and others.

The BPU acknowledges that all these changes will require modifications to utility planning and construction principles, but expressed confidence that its new rules will soon become but one component of a coordinated set of planning practices followed Statewide to achieve Smart Growth. We'll see.

What's next?

Unfortunately, the BPU is not done. Its responses to the comments declare that yet another new set of rules is in the planning stages, this time to address core utility facilities that cannot be directly traced to the needs of a particular

customer or set of customers. The BPU has already stated its intention that new customers in no-growth areas will pay for these costs too. It sounds like it may be leading to something like a system of connection fees for investor-owned utilities. Stay tuned; there is more to come.

This summary hits the high spots, but feel free to call upon Mr. Reinhard or George Spais, NJBA Director of Codes, with questions about the specifics. The regulation and comments can be found on the BPU web site at <http://www.state.nj.us/bpu/wwwroot/secretary/extensionrulesadoption.pdf>



Walter "Skip" Reinhard, Esq. is with the law firm Norris, McLaughlin & Marcus in Somerville, New Jersey. Mr. Reinhard is a former Chairman of the Public Utility Law Section of the New Jersey State Bar Association and has represented a number of NJBA members on utility issues for many years.



His email address is wgreinhard@nmmlaw.com.



500 Horizon Center Dr.
Suite 530
Robbinsville, NJ 08691
609-587-5577
www.njba.org

Dimensions newsletter is produced by the New Jersey Builders Association (NJBA). A housing industry trade association of 2,000 member firms including builders, developers, suppliers, engineers, architects, consultants and other professionals, the NJBA is dedicated to providing safe, healthful homes for New Jersey residents. The Association is committed to finding balanced solutions to the state's critical housing shortage.

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EDITOR: Susan Sands CONTRIBUTING STAFF: Kim Cornelius