

APPENDIX E – QUESTIONS AND ANSWERS

These notes contain questions, comments, and suggestions made during the Dec. 12, 2012 Inform Meeting, and subsequent questions posed by residents and by the WC itself. Slide numbers refer to that presentation, which is available on the MKL website. Items beginning with a “Q:” are questions, and are followed by lines beginning with “A:” which are answers. Most “Comments” are followed by “Responses”. Answers to questions or responses to comments, except where noted by names in parentheses, are from the Water Committee.

These items incorporate the items registered on the easel by Don Kuhn.

As new questions are asked, this document will be updated when the research into their answers is completed. As new questions are asked and answered the date of the question is also supplied.

This document was last updated on February 27, 2013 and reflects the fact that the Middlesex Water Company has withdrawn its bid because of changing priorities for 2013. Now only Aqua NJ America is bidding.

1) Q: Who were the other Commercial Water Companies (CWCs) contacted?

A: White Water Utilities Inc., NJ American Water Co., United Water. Southeast Morris County Municipal Utilities Authority Board (SMCMUA) was contacted subsequent to the 12/12/12 Inform meeting.

2) Q: If the CWC bills Lakeshore (community meter) would they bill at a commercial rate?

A: This option is not available through Aqua NJ.

3) Q: Is Aqua NJ facing any material burden from Sandy damage?
A: (Aqua NJ): “No.”

4) Q: How many households are in the NJ water system and how many are served by wells?

A: (12/22/12) According to the DEP there are approximately 8.8 million NJ residents. Of these about 7.9 million are served by Community Water Systems and .94 million are served by individual wells. Aqua NJ has indicated that 100% of the water they deliver in NJ is from “groundwater sources (wells).”

5) Q: Has the committee looked at leasing vs. selling the assets? Leasing would give us option to move to different provider.

A: (1/9/13) Aqua NJ expressed no interest in leasing when asked by the WC.

6) Q to Aqua NJ: Briefly list any factors that would suggest why you would/or would not truck water from our system to other locations?

A: (1/9/13) (Aqua NJ): “If requested by a government authority in the event of some emergency on a limited basis. Otherwise, your system does not have a sufficient abundance of excess water, nor the pumping capacity nor storage capability, and trucking water for any extended period of time would be cost prohibitive.”

6a) Q to Aqua NJ: Briefly list any factors that would suggest why you might/or might not find it attractive to try to link to our system other residents of Harding that are presently served by individual wells.

A: (1/9/13) (Aqua NJ): “Most likely not. It is much cheaper for an individual to rehab an existing private well or drill a new private well than to connect to a nearby water system. Under your scenario, each resident looking to connect would be financially responsible for their pro rata share of the cost to connect. Doing so would be cost prohibitive for most people. In the unlikely event of some wide-spread failure of private wells or some

environmental contamination preventing the use of these private wells, the EPA and/or DEP could subsidize the cost for these homeowners to connect to the nearest potable water supply system.”

7) Q: Were the tariffs current?

A: Yes, they are 2012 tariffs. They are now posted on the MKL website.

8) Q: What is basis for water use?

A: We assume 250/gals per day per residence.

9) Q: What is included in the improvements proposed by Aqua NJ? Are the generator and the chlorine analyzer in the cost?

A: Aqua NJ's bid includes about \$100K of improvements. About \$40K of the \$100K is for meters. The remaining \$60K includes gas generators, and chlorine analyzers. See slide 11.

10) Q: Is the amount Lakeshore plans to spend in its capital plan for the water system more or less than Aqua NJ will spend?

A: It is a bit difficult to compare. MKLA's capital plan estimates spending of \$182K between 2013 and 2019. This includes \$82K for Alpine main replacement in 2018. The current MKLA plan is given on slide 28 (a backup slide not shown at the Inform meeting). The CWCs said they will initially spend \$100K (of which \$40K is for meters) for upgrades. However they will also repair and replace any piping that gives them trouble. So they would replace the Alpine mains if necessary, and do many of the other repairs indicated in the MKLA plan.

11) Q: What has been the history of rate increases by the CWCs?

A. Between 5.5% and 6.5% per year. See slide 13 for an historical cost analysis.

- 12) Comment: The rates the CWCs would charge look attractive considering that MKLA has gaps in its insurance (e.g. product liability).
Response: The MKLA costs may rise if we buy more insurance.
- 13) Q: If the tanks are destroyed is there insurance coverage?
A: We are insured for the damage to the tanks, but we are not insured for the cost of delivering water while the tanks are repaired/replaced.
- 14) Q: Would we have to wait to put in the generator if the closing will take 1-2 years in the future?
A: If we buy a generator before the purchase is completed, Aqua NJ will reimburse us for its cost. (As a condition of this, they would want input into the selection of the generator).
- 15) Q: Do we know how much water we lose through leakage?
A: The average for water companies such as ours is about 10%. Later in the meeting, Ken Heiden asserted that about 1/3 of the water pumped was lost to leakage. Committee will investigate. See item # 58 and Appendix J.
- 16) Q: Would the CWC perform a leakage evaluation prior to taking over the system?
A: The CWC would perform a leakage test **after** taking over the system.
- 17) Q: Has Aqua NJ considered the cost of replacing the water tanks and mains?
A: Aqua NJ has performed on-site inspections of our system. They know what they are buying. The costs of replacing any aged infrastructure will, in effect, be borne by all (approx. 60,000) of their NJ customers. They receive reimbursement for their

investments through rate increases for all their customers, if approved by the BPU.

18) Q: Did Aqua NJ ask about the 2 inches steel pipes?

A: Aqua NJ is aware of the 2 inch steel pipes.

19) Q: Is Aqua NJ aware of the state of well #3?

A: Yes.

20) Q: Is there a risk of Aqua NJ going bankrupt?

A: Aqua NJ has been around more than 100 years, and is in solid financial position. Having said that, mismanagement could always produce a bankruptcy. In this case Aqua NJ would be liquidated, and its assets would probably be bought by another water company. In no case would MKL be left without a functioning water supply.

21) Q: If they go bankrupt would the community have a say in the transfer?

A: Very likely not. This would proceed through a bankruptcy court.

22) Q: Would Aqua NJ be required to include more additives than a self-maintained system?

A: No. The only additive required of a purchaser is chlorine. All water companies are held to the same standards in chlorine treatment of water.

(1/9/13) Aqua NJ has indicated that they would not raise the chlorine levels above that are currently maintained by Agra Environmental, so long as NJDEP standards are met.

23) Q: How does the size of our system compare to the company's portfolio of customers?

A: Most of their customers are larger than us, but they have as customers some in communities roughly the size of MKL.

24) Q: Slide 10 indicates that Middlesex has only 60,000 of its 450,000 customers in NJ. Yet you say it is primarily a NJ company. How can that be? **This question is no longer relevant as MSW has dropped out of the bidding.**

A: Most of the other customers are indirect – Middlesex sells wholesale water to other water companies.

25) Q: Where is Aqua NJ's nearest operations center to MKL?

A: Sussex and Warren counties.

26) Q: Do you have a standard agreement for service quality standards (such as response time to problems, water quality, etc.) and road repair that we can review?

A: (1/9/13) (Aqua NJ): "We do not. Such standards are set and enforced by the BPU and the DEP."

27) Q: Chlorine is very corrosive to machinery. How frequently would the monitoring of our system be conducted by the CWC?

A: Automated monitoring equipment would be installed to give daily chlorine readings. In person visits would occur approximately weekly.

28) Q: Was Southeast Morris County Municipal Utilities Authority Board (SMCMUA) contacted for interest in our system?

A: SMCMUA was contacted subsequent to the 12/12/12 Inform meeting. They are not interested in bidding on the MKL system.

29) Comment: The risk to the MKL of its water system running dry is not listed on slide 19. The CWC would be responsible to bring the community water.

Response: We have added that to the second row on slide 19.

- 30) Comment: DEP regulations change over time. There is no proactive planning at MKL on regulatory requirements. The committee should add this risk to slide 19.
Response: We have added that to slide 19.
- 31) Comment: AWWA and NJ water source provide information on water regulation.
- 32) Q: What is the condition of our aquifer? Past validation of water during droughts showed we had plenty.
A: (Chris Allyn paraphrased) Our source of water is through fractured rock. It is not one big pool of water. Pump #1 is an artesian well, and running pump #2 will reduce the artesian flow in well #1. (Jim Irving) During droughts the wells have had no drop in “draw down”.
- 33) Q: Would Aqua NJ’s NJ customer base be exposed to impacts of fracking?
A: (1/9/13) (Aqua NJ): “None. Fracking is not permitted in New Jersey”
- 34) Q: Did Aqua NJ answer the question about selling MKL well water outside of MKL?
A: (1/9/13) Aqua NJ answered the question subsequent to the 12/12 inform meeting. See items #6 & #6A.
- 35) Q: Would Harding need to approve the piping and sale of water to other customers?
A: Yes.
- 36) Q: What are the min & max levels that the CWC would be allowed to chlorinate our water? Would the increase in chlorine be used to offset some insurance risks?

A: CWCs are held to the same standards as MKL. These levels are available from the DEP. Aqua NJ would not raise the chlorine levels unless they failed to meet DEP standards.

36a) Q : Does Aqua NJ have a system wide standard for chlorine levels or does it vary depending on the conditions at a given locale?

A: (1/9/13) Aqua NJ: "It can vary from one location to another depending on naturally occurring elements. NJDEP's standards are maintained at all locations."

37) Comment: The CWC might be incented to replace our mains due to the age of the pipes, but it is unlikely given the good condition of our 4 inch mains. Later comment: Law requires 6" mains so the CWC could use that as a basis for increasing investment.

Response: The cost of main replacement would be borne by all 60,000 of the CWCs customers. Other than the dislocation of such construction, MKL would get a good deal.

38) Q: Do we have access to company client references?

A: Yes. The committee will be checking references. The reference interviews will be posted on the MKL website.

39) Q: Who would pay for the meters?

A: The CWC.

40) Comment: The pay back to start paying more than we are now for water would be over 7 years based on price difference.

Response: If the net proceeds of the sale were fully distributed to the community, it would have the effect of offsetting water charges for a number of years. Depending on the amount distributed and what taxes were owed on this distribution, it is reasonable to estimate that the price difference between what a CWC charges and what is paid in dues to upkeep the water system would be zero for five+ years.

41) Q: If community-wide (aggregate) metering were in effect, would leakage be built into the price? **This question is no longer relevant.**

A: Yes, the CWC would build in such leakage. Extraordinary spikes in usage would be investigated by the CWC. Other leakage, e.g. someone leaving a hose on, would be borne by the community if metering is community-wide. Metering at the houses removes considerations of paying for leakage in the system.

42) Q: Would the investment include adding non-existent curb-stops?

A: (1/9/13) If meters were installed, Aqua NJ has indicated that non-existent curb stops would also be added.

43) Q: How do the rates increase over time?

A: Slide 13 shows the history of rate increases. The average increase is about 5-6%/yr. The increases come every 2-3 years.

43a) Q: Is there any reason to anticipate that Aqua NJ's average rate changes over the last ten years would not be representative of future rate increases?

A: (1/9/13) (Aqua NJ): "No, but we cannot predict new laws and regulations that may be imposed by governmental authorities."

44) Q: Were there any requests by the CWCs to be able to access the lake water as a source?

A: (Dave Molendyke) No, lake water is not suitable for residential consumption.

45) Q: How did we pay for the repairs required for past large piping repairs?

A: The question is directed at the large MKL water expense spike in 2007. Because of bureaucracy at the state level, our payments for lake dredging were delayed. This delay allowed us to have

sufficient cash on hand to pay for the spike in 2007 water system costs.

46) Q: Are there any notes from previous discussions by the MKL Boards with water companies?

A: (Chris Allyn): Check in the history room.

47) Q: If we go with a CWC will we face a higher Compound Annual Growth Rate (CAGR) in rates than the cost of self-maintaining the system?

A: It appears that the current MKLA CAGR for water expenses is about 1% - 2% lower than the CWCs' CAGR (this equates to \$6 - \$12 less per year).

48) Q: How far do we need to get into negotiation to see the CWC's contract terms?

A: We assume the CWCs have a generic contract and we will ask for it, if it is available. At this point both the committee and the CWCs are reluctant to do contact work until there is apparent willingness on the part of the community to sell. This may be a chicken-or-egg problem: Some residents may condition their vote on a contract, but we don't proceed to contract until we know that there is a sentiment to sell. Since we can't have 95 people negotiating the contract, we will need to defer the actual negotiations to the committee and the Lakeshore lawyer, with the MKLA and Lakeshore Boards approving the contract. What the committee needs to know is what terms/conditions are "show stoppers" for the community.

49) Q: How much due diligence have CWCs done on MKL's water system?

A: They have done on-site inspections of our water plant and have gotten historical records on operations (e.g. amount of water pumped, age of equipment, etc).

50) Q: Would the CWC need to perform additional due diligence when we decided to move forward?

A: If we decide to move forward the companies would need to perform some additional due diligence procedures in advance of the contracting process.

51) Q: Have the bidders talked to Agra Environmental? (note: Agra Environmental is a firm under contract to MKL to be its licensed operator for the MKL water system).

A: The committee has talked to Agra Environmental. Agra Environmental also has a relationship with the bidders, and possibly could be a sub-contractor to them in the event of a sale.

52) Q: What is Agra Environmental's viewpoint on the potential sale?

A: Agra Environmental has been helpful in helping the WC analyze the situation. Agra Environmental's position on sell/hold is neutral.

53) Q: Is there any benefit from a real estate perspective to have a CWC run the water system?

A: This question was directed to the real-estate professionals in the room. No answer was recorded.

54) Q: Has it been easy or difficult to get volunteers to support the water system?

A: The VSA is currently staffed. There was some discussion on whether or not in the future we would have the engineering-oriented skills necessary to support the water system. A suggestion was made to consider promoting to new residents an interest in maintenance and familiarity with the existing system.

55) Q: What is the financial impact on me if we sell?

A: If you are an **average consumer**, you will see an increase in cost of water of about \$100/yr. These figures do not take into account the benefit of the net sale-proceeds, approximately \$700 per resident.

56) Q: What are the tax implications on sale of assets?

A: We need to investigate the amount, if any, of the capital gains tax on a sale.

57) Q: Has the need for additional insurance to protect the community in the event of an impact to our water supply been discussed with the board?

A: The Board is aware of the insurance questions. The WC is still investigating.

58) Comment (Ken Heiden): During the power outage the water usage was not significantly reduced, so there must be considerable leakage in the system. If we use residence meters, residents don't assume the cost of any leakage in the system (other than leaks in their own property). The average cost of metered water might be less than the \$600 the committee is using for CWC pricing. Ken believes there might be as much as 1/3 leakage of the amount pumped. Residence level metering would thus reduce the average metered bill by \$200/yr (from \$600/yr to \$400/yr.)

Response: We agree that the more leakage there is in the current system the lower the average bill will be if individually metered.

However, our usage is believed to be about average for communities with our demographics. The WC will review volumes during the hurricane. See item #15.

59) Q: When conducting due diligence can you see if there have been any restrictions placed on other water systems after their takeover?

A: The committee will follow up on this.

60) Q: Might there be benefit in interconnecting with a local water company to provide back up?

A: The only local company with pipes nearby is SE Morris. They are not interested in purchasing the MKL water System (see item #28).

61) Suggestion – Put on website the follow up points that will be included in the due diligence.

A: The follow-up points (from the easel sheet) are included in this document, which is posted on the MKL website.

62) Q: Would the CWC increase water pressure so the hydrants can be used to fight fires?

A: The fire department seems to prefer pumping lake water to fight fires at MKL.

63) Q: When was the last time the rate of return was changed for the CWC?

A: both companies received rate increases in 2012, and seem to get them every 2 years or so. We are not sure when the actual rate of return itself was changed.

64) What restrictions on water use could the CWC impose on the community?

A: The main restrictions on use come from government authorities during drought. It is not in the CWCs economic interest to restrict water use.

65) Comment: Thanks to the Committee for its commendable work.

66) Q: Does Aqua NJ carry liability insurance for environmental contamination of the drinking water, which contamination could cause either (1) illness or (2) limit the availability of water and necessitate getting the water from a different source? Have you had instances of such contamination and, if yes, what has been the frequency, has it resulted in litigation and what was the general cost of resolution? We do not currently carry any insurance for

such risks, but have discussed it. The costs for a small company such as ours could be high.

A: (Aqua NJ) Yes, but we have experienced no such instances.

67) Q (1/9/13): Does Aqua NJ's financial offer allow Lakeshore to receive adequate payment for what its water operations are worth?

A: The WC believes the ultimate test of something's worth is what the market is willing to pay for it. Lakeshore has received two independent offers for about the same amount of money. Additionally four other companies declined to bid. So it would seem that at this time the market has spoken. A number of other metrics, e.g. ratio of price to yearly revenue, and a guesstimate at earnings on investment seem to be in the ballpark for the water system.

68) Q(2/20/13): Will a change of ownership from our existing status to a Public Utility have an impact upon the proximity restrictions of wells and septic systems?

A: The following from Gary Annibal of Harding Township: "There are septic system requirements regarding distance to potable water wells. The requirements are the same regardless if the well is private, public community or public non-community and are irrespective of the owner of the system."

69) Q(2/20/13): What are the rights of a Public Utility with regards to accessing or traversing private property? What were the circumstances surrounding the gas line extension from Trails End to the non-MKL property located to the north - alongside the Tennis parking? Should a well fail, how much input would MKL have as to the location of a replacement well?

A: So far as the WC knows, utilities must seek the permission of private property owners, and in some instances pay them compensation, for easements on their property. The

circumstances of the gas line extension across MKL property were these: the property owner approached MKL requesting permission and MKL negotiated a specific right of way agreement with the utility. The utility could not have proceeded without the agreement. Regarding a well failure, the WC assumes that the next logical place for another well would be on Lakeshore property. Indeed a third well was started near pump house 2 but never completed. So that location would seem to be a first candidate – it has easy access to the water mains that fill the tanks but would need improvement in order to be used.

70) Q(2/20/13): Will MKL residents share in the cost of the liabilities related to Aqua NJ's other 60,000 customers? What are the liabilities presented by those customers and their potentially equally aged systems? What has Aqua NJ identified as their anticipated expenditures on behalf of their existing customers for the next 5-10 years.

A: As mentioned slide 8 of the 12/12 Inform presentation, MKL would be in a "pool" of water properties and through charges to its residents would "pay" for upgrades throughout the pool. Likewise the pool would pay for upgrades to the MKL system. While it would be desirable to be in a pool needing little investment (so that the pool would pay for MKL updates, but not vice-versa), that likely is not to be the case. In its investigations, the WC has seen good, average and poor systems recently added to Aqua NJ's NJ pool. As a for profit company, Aqua NJ is interested in profiting from its investments in running and upgrading water systems. As slide 7 indicates, the BPU is the arbiter of what improvements the company gets to include in rate increases. While Aqua NJ has little incentive to make improvements for which it can't charge, it is also incented to provide water efficiently. Here is Aqua NJ's forward looking statement from its 2011 10K report related to capital improvements (figures are in thousands):

Our planned 2012 capital program, exclusive of the costs of new mains financed by advances and contributions in aid of construction, is estimated to continue at similar levels as 2011. The 2012 capital program is expected to include \$127,639 for infrastructure rehabilitation surcharge-qualified projects. Our planned capital program includes spending for infrastructure rehabilitation that qualifies for infrastructure rehabilitation surcharge mechanisms, and should these mechanisms be discontinued for any reason, which is not anticipated, we would re-evaluate the magnitude of this portion our capital program. Our 2012 capital program, along with \$80,765 of sinking fund obligations and debt maturities, and \$166,455 of other contractual cash obligations, as reported in the section captioned "Contractual Obligations", has been or is expected to be financed through internally-generated funds, our revolving credit facilities, the issuance of equity, and the issuance of long-term debt.

Future utility construction in the period 2013 through 2016, including recurring programs, such as the ongoing replacement or rehabilitation of water meters, water mains, water treatment plant upgrades, storage facility renovations, and additional transmission mains to meet customer demands, exclusive of the costs of new mains financed by advances and contributions in aid of construction, is estimated to require aggregate expenditures of approximately \$1,104,000. We anticipate that less than one-half of these expenditures will require external financing with debt and the additional issuance of common stock through our dividend reinvestment and stock purchase plans. We expect to refinance \$219,941 of sinking fund obligations and debt maturities during this period as they become due with new issues of long-term debt, internally-generated funds, and our revolving credit facilities. The estimates discussed above do not include any amounts for possible future acquisitions of water systems or the financing necessary to support them.

71) Q(2/20/13): Does the BPU have data that guides the purchase of a water system on a per customer basis. Participation by a single bidder may also indicate that this is not the time for your asset to reach the market. It just seems that \$200,00 (purchase price plus improvements) might be inexpensive for +/- \$3 million (guesstimate) of in-place infrastructure, along with a guaranteed \$56,000 in annual revenue that comes with a +/-6% annual increase for perpetuity.

A: Aqua NJ indicated they were constrained in their offer by BPU considerations and Middlesex Water Company said the maximum the BPU will allow for a new hook-up to a house as a recoverable expense is \$2,000, which is close to Aqua NJ's offered purchase price plus first year's improvements. The WC does not believe that the BPU sets a standard for purchases but merely approves them if they are reasonable. MKL had two offers, both in the same price range. Additionally 10-15 years ago Lakeshore received another offer in the \$40K range. Bringing that offer forward in time (say \$45K at 5% inflation over 15 years), MKL has had three offers in the same range. The WC believes we are not likely to get a higher price. Having said that, the actual price is not, in the WC's opinion, a determining factor in the consideration on whether or not to sell. The determining factors in the WC's recommendation will be outlined in the WC's forthcoming report to the board.

\$3M is probably in the ballpark to replace the entire MKL water infrastructure. Much of this infrastructure is outdated (e.g. 4" water pipes vs. current standard of 6", beer tank used as water tank). The \$56K/yr is revenues. Lakeshore's annual water expenses run about \$47K/yr. Assuming the same for Aqua NJ, this would give them a \$9K pre-tax profit on their \$97K (+\$100K) investment. However, this is irrelevant, because their business model does not work this way. As a regulated monopoly they make their money by operating and upgrading water systems. If they chose to replace all the distribution pipes (WC estimate of \$1.7M) they could charge that to the "pool" (if approved by the BPU) and make a profit thereon (also charged to the pool).

72) C (2/2013): Please disclose any financial interests that members of the WC have in Aqua NJ America.

A: None of the members of the WC owns stock in Aqua NJ or any of its competitors. Other than the MKL purchase transaction, no member has any financial interest, or friends/family, etc., in Aqua NJ or its competitors.