

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

**BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION**

**IN RE:
CITY OF NEWPORT, UTILITIES DEPARTMENT,
WATER DIVISION APPLICATION TO CHANGE
RATE SCHEDULES**

Docket No. 3675

Surrebuttal Testimony of

Ernest Harwig

On behalf of

The United States Department of the Navy

Project 8409
October 20, 2005



BRUBAKER & ASSOCIATES, INC.

St. Louis, MO 63141-2000

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1 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A My name is Ernest Harwig. My business address is 57 Cedar Summit Road, Asheville,
3 North Carolina, 28803.

4 Q DID YOU PREVIOUSLY FILE DIRECT TESTIMONY IN THIS DOCKET?

5 A Yes, I did.

6 Q WHAT IS THE SUBJECT OF YOU SURREBUTTAL TESTIMONY?

7 A I will comment on certain elements of the calculation of Newport Water Division's
8 (Newport or NWD) revenue requirement in the Rebuttal Testimony of Mr. Harold J.
9 Smith. I will also respond to his comments on the portion of my Direct Testimony that
10 discussed revenue allocation among the various classes of NWD's water customers.

11 Finally, I will respond to Mr. Smith's objections to my suggestion, in my Direct
12 Testimony, regarding the phasing in any increase granted to Newport in this proceeding.

1 **REVENUE REQUIREMENTS**

2 **Q WHAT LEVEL OF REVENUES DOES MR. SMITH RECOMMEND FOR NWD IN HIS**
3 **REBUTTAL TESTIMONY?**

4 A Mr. Smith recommends that Newport be given the opportunity to collect \$9,153,614 from
5 rates for water service. This figure reflects Mr. Smith's acceptance of some, but by no
6 means all, of the recommendations offered in the Direct Testimony of Mr. Catlin, the
7 witness for the Division of Public Utilities and Carriers, and in the Direct Testimony of Mr.
8 Woodcock, the witness for Portsmouth Water and Fire District. This figure compares to
9 rates-generated revenues of \$9,344,214 in Mr. Smith's Supplemental Direct Testimony.

10 **Q IT WOULD APPEAR THAT MR. SMITH HAS MADE A DOWNWARD ADJUSTMENT**
11 **OF NEARLY \$191,000 TO THE LEVEL OF REVENUES REQUESTED BY NEWPORT.**
12 **SHOULD THE PARTIES TO THIS CASE ACCEPT MR. SMITH'S ADJUSTMENT AS A**
13 **REASONABLE COMPROMISE?**

14 A No, they should not, for two reasons. First, Newport's revised revenue requirement
15 includes an over-allocation of the costs of certain administrative services provided by the
16 City to NWD.

17 Second, a significant proportion of the requested increase, and thus the revised
18 revenue requirement, consists of proposed increases in payments to the City for various
19 administrative services. Several of these increases are based upon the ratio of NWD's
20 budget to the City's total budget, instead of some more objective measure of services
21 actually provided to NWD by the City. Consequently NWD, and thus Newport's water
22 customers, could be forced to make excessive contributions to the City's General Fund
23 in perpetuity if this allocation method remains in place.

1 **Q PLEASE EXPLAIN THE BASIS FOR YOUR CONTENTION THAT MR. SMITH'S**
2 **REVENUE REQUIREMENT INCLUDES AN OVER-ALLOCATION OF THE COSTS OF**
3 **CERTAIN ADMINISTRATIVE SERVICES TO NWD.**

4 **A**This is evident by referring to the second page of Schedule RFC-C (Supplemental)
5 accompanying Mr. Smith's Supplemental Direct Testimony, and Mr. Catlin's Schedule
6 TSC-7. Mr. Smith's Schedule shows that he used a NWD budget of \$10.8 million,
7 compared to a total City budget of \$69.0 million, to calculate a ratio of about 15.7%
8 (\$10.8 million divided by \$69 million equals 15.7%). Mr. Smith then allocated 15.7% of
9 the costs of certain administrative services to NWD on that basis.

10 At Page 16 of his Direct Testimony, Mr. Catlin correctly noted that the \$10.8
11 million figure exceeded Newport's \$9.6¹ million cost of service claimed in its
12 supplemental filing. Mr. Catlin thereupon revised NWD's share of the total City budget
13 downward to reflect its claim in the supplemental filing. Mr. Catlin's adjustment
14 produced a 14.16% share of administrative expenses for NWD, as compared to Mr.
15 Smith's 15.7%.

16 Mr. Smith then stated at Page 9 of his Rebuttal Testimony that he accepted Mr.
17 Catlin's result of 14.16%.

18 **Q ARE THERE ANY PROBLEMS ASSOCIATED WITH THE USE OF THE \$9.6 MILLION**
19 **NWD BUDGET FOR CALCULATING ITS SHARE OF CITY ADMINISTRATIVE**
20 **EXPENSES?**

21

¹ NWD's originally claimed cost of service was \$9.8 million. This was subsequently reduced to \$9.6 million in NWD's Supplemental Filing. However, in both cases, the Water Department budget assumed for allocation purposes was \$10.8 million. NWD's Rebuttal cost of service is \$9.4 million. Nonetheless, the allocation of costs to the Water Department does not reflect this figure.

1 A Yes. An examination of Page 2 of Mr. Smith's Schedule RFC-C (Supplemental) shows
2 that the \$10.8 million cost of service originally used by Mr. Smith was itself a factor in the
3 calculation of the administrative cost component of the \$9.6 million cost of service in the
4 supplemental filing. Thus, the administrative cost component of the supplemental cost of
5 service is overstated, because 15.7% of City administrative costs (and not 14.16%) are included
6 in the \$9.6 million.

7 However, there is a more serious methodological problem to consider.

8 **Q PLEASE EXPLAIN.**

9 A The methodological problem arises because the NWD budget figure already includes its
10 share of City administrative expenses and Data Processing expenses. According to
11 Page 2 of Schedule RFC-C (Supplemental), these amounts are \$446,764 and \$289,663,
12 respectively. Together, these total \$736,427, or 7.7% of the \$9.6 million cost of service
13 in the supplemental testimony. The inflated share of 14.16% cost responsibility for NWD
14 is based on this \$9.6 million figure.

15 However, it is used on Page 2 of Schedule RFC-C (Rebuttal) once again, to
16 allocate City administrative expenses and Data Processing expenses to NWD in the
17 calculation of Newport's rebuttal cost of service. Clearly, this is a case of double
18 counting.

19 **Q WHY IS THIS A PROBLEM?**

20 A It is a problem because it forces Newport's water customers to shoulder a portion of the
21 City's administrative costs that should be derived from other sources, such as property
22 tax revenues.

1 **Q HOW DO YOU RECOMMEND THAT THIS PROBLEM BE ELIMINATED?**

2 A For purposes of this case only, NWD's revenue requirement should first be calculated
3 absent any administrative and data processing costs. This figure should be compared to
4 a City budget calculated on a similar basis. The resulting ratio could then be applied to
5 the City's administrative and data processing costs to determine NWD's share.

6 **Q WHY ARE YOU RECOMMENDING THAT THIS PROCEDURE BE FOLLOWED FOR**
7 **PURPOSES OF THIS CASE ONLY?**

8 A The ratio of NWD's budget to the total City budget may not be the best measure of the
9 degree to which NWD benefits from the City's administrative services. Besides, 60% of
10 the Water Utility's requested increase in operating expenses is represented by
11 administrative costs. In this regard, Mr. Woodcock's observation at Page 7, Lines 14
12 and 15 of his Direct Testimony, namely that nearly one-third of Newport's total operating
13 costs are related to administration, is well taken.

14 **Q WHAT IS YOUR RECOMMENDATION IN THIS REGARD?**

15 A I recommend that the Commission encourage Newport to reduce the proportion of its
16 total water operating expense that is represented by administrative costs, and by the
17 same token to increase the proportion of its total operating expense that is related to the
18 actual provision of water service. Otherwise, Newport's water customers run the risk of
19 paying an excessive share of the City's administrative costs in perpetuity.

20 **ALLOCATION OF RATE INCREASE**

21 **Q AT PAGE 21 OF HIS REBUTTAL TESTIMONY, MR. SMITH STATES THAT YOUR**
22 **DIRECT TESTIMONY INCORRECTLY CONCLUDED THAT NEWPORT FAILED TO**

1 **ABIDE BY THE TERMS OF THE *SETTLEMENT AGREEMENT* IN DOCKET 3578.**
2 **WHAT IS YOUR RESPONSE?**

3 A Mr. Smith claims that I fail to recognize that costs in this Docket have not been allocated
4 among functional categories such as transmission, distribution, supply and treatment,
5 and thus Newport is not seeking to allocate a share of such costs to Portsmouth Water
6 and Fire District. The *Settlement Agreement* stated that Newport would conduct a
7 customer class demand study and provide a corresponding cost of service study in the
8 event that it sought to allocate such costs to Portsmouth.

9 The only attempt Newport ever made to insulate Portsmouth from the allocation
10 of peak treatment, storage, and distribution costs was found in the cost of service study
11 prepared by Mr. Smith on behalf of Newport in its last rate case, Docket 3578. All the
12 parties agree that Newport's cost study in Docket 3578 is not the basis for the present
13 rate design. Newport has also failed to show that rates ordered in Docket 2985, which
14 are the rates currently in effect, excluded such costs from Portsmouth.

15 Thus, the across the board increase now proposed by Newport does in fact
16 cause Portsmouth to continue to defray such costs in its rates, contrary to the terms of
17 the *Settlement Agreement*.

18 At Page 22 of his Rebuttal Testimony, Mr. Smith does agree that setting rates on
19 a proper and well-supported cost allocation study is desirable. Had such a study been
20 produced by Newport as a part of its evidence in this Docket, perhaps an equal percent
21 increase for all customer classes, as now proposed by Newport, would not have been
22 indicated.

23 In light of this, the Navy renews its recommendation that the Commission order
24 Newport to initiate a customer class demand study for incorporation into a cost of service
25 study.

1 **PHASE-IN OF RATE INCREASE**

2 **Q AT PAGES 24 AND 25 OF HIS REBUTTAL TESTIMONY, MR. SMITH TAKES ISSUE**
3 **WITH YOUR RECOMMENDATION THAT THE COMMISSION CONSIDER PHASING**
4 **IN ANY INCREASE GRANTED TO NEWPORT. PLEASE COMMENT.**

5 A Mr. Smith argues that a 22.7% increase (since revised upward to 23.89% in his Rebuttal
6 Testimony) does not constitute rate shock, since it mirrors increases in the Consumer
7 Price Index (albeit on a cumulative basis) between 2000 and 2005. However, consumer
8 prices did not remain absolutely constant between 2000 and 2004, only to increase
9 suddenly by 23% in 2005. It would certainly seem that a one-step increase of this
10 magnitude would be felt as a shock to many of Newport's customers. Certainly, with the
11 prospect of much higher heating costs this winter, it would not be inappropriate for the
12 Commission to consider a phase-in of any increase granted to Newport in this Docket.

13 **Q DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

14 A Yes, it does.