

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

Testimony of
Ernest Harwig

On behalf of
The United States Department of the Navy

Project 8409
September 14, 2005



St. Louis, MO 63141-2000

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Testimony of Ernest Harwig

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 WHAT IS YOUR OCCUPATION?**

5 **A** I have been a consultant in the field of public utility regulation for over 25 years with an
6 emphasis on water and wastewater utilities.

7 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

8 **A** These are set forth in Appendix A of my testimony.

9 **Q ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING**

10 **A** I am under contract to Brubaker & Associates, Inc. and have been asked to testify on
11 behalf of the United States Department of the Navy. The Navy Base in Newport, Rhode
12 Island (Navy) purchases large volumes of water from the Water Division of the City of

1 Newport (NWD or Utility), and it would experience a significant increase in its cost of
2 water if the rates proposed by NWD were to become effective.

3 **Q WHAT IS THE SUBJECT OF YOUR TESTIMONY?**

4 A My direct testimony is limited to a discussion of NWD's claimed basis for the allocation of
5 revenue requirements in this proceeding, as stated in the direct testimony of Mr. Harold
6 Smith of Raftelis Financial Consulting (RFC) on behalf of the Utility. I will also comment
7 on the issue of rate shock, brought about by the Utility's proposed 22.67% increase in
8 rates to all customers.

9 My electing not to address other elements of the Utility's direct or supplemental
10 direct testimony should not be construed as an endorsement of the positions put forth by
11 it on any other issues.

12 **Q PLEASE SUMMARIZE YOUR TESTIMONY.**

13 A 1. NWD is proposing to increase all rates for water service by 22.67% across-the-
14 board. It claims that the basis for allocating revenue requirements among the retail
15 and wholesale customer classes in this Docket is "...the cost allocations agreed to
16 by the parties in Docket # 3578", Newport Water Department's most recent prior rate
17 case. In that Docket, the parties, including the Navy and Portsmouth Water and Fire
18 District (Portsmouth or PWFD), negotiated several understandings that were
19 memorialized in a *Settlement Agreement (Agreement)*. The Commission later
20 approved the *Agreement*.

21 2. Paragraph 13 of the *Agreement* states that the rates charged to PWFD and the Navy
22 remain unchanged, in accordance with the tariffs in Docket No. 2985, the Newport
23 rate case that preceded Docket No. 3578. However, this Paragraph makes no
24 reference to "cost allocations."

25 3. Paragraph 23 of the *Agreement* states that NWD shall be required to submit a
26 demand study with any cost allocation study if NWD seeks to charge PWFD with
27 transmission, distribution, or peak costs associated with supply or treatment. While
28 NWD's cost of service study in Docket No. 3578 did not seek to allocate the costs
29 enumerated above to PWFD, NWD has provided no evidence showing that the
30 exclusion of such costs had a bearing on the calculation of PWFD's rate in Docket
31 No. 2985. Likewise, it has not shown that such costs are excluded from the

- 1 calculation of PWFD's revenue requirement in this Docket. Thus, NWD's assertion
2 that it is not seeking to impose these costs on PWFD, and therefore need not provide
3 either a demand study or a cost of service study in this Docket, is not supported. In
4 effect, NWD has not met the terms of the *Agreement*.
- 5 4. Because NWD has not provided customer class demand data or a cost of service
6 study in this Docket, the Navy and other parties have no means to determine
7 whether an across-the-board increase to all classes is appropriate for them.
- 8 5. NWD's customers should be afforded the opportunity to determine the appropriate
9 percent increases by customer class on a cost-causation basis. This opportunity is
10 particularly urgent, and long overdue, in light of NWD's own statements that the
11 Commission has not accepted NWD's cost study in any of the prior dockets in the
12 past ten years. The conjecture that NWD may or may not have included certain
13 operating and capital costs into PWFD's commodity rate should not be the deciding
14 factor in deciding whether or not NWD should conduct the requisite studies
15 referenced in the *Agreement* for all customer classes. The Commission should order
16 NWD to conduct a customer class demand study in a prompt manner, and to
17 incorporate the results of the demand study in a class cost of service study.
- 18 6. NWD originally requested a 15.73% increase in its rates. It has since filed
19 Supplemental Testimony, based on a downward revision in test year sales volumes,
20 supporting a 22.67% increase. An increase of this magnitude, if implemented in one
21 step, could be construed as rate shock. Given the context of a recent run-up in
22 energy prices that affects everyone's budgets, the Commission should give serious
23 consideration to phasing in any increase it may grant to NWD.

24 **NWD's Revenue Requirement Allocation**

25 **Q WHAT IS NWD'S PROPOSAL FOR INCREASING RATES IN THIS CASE?**

26 A NWD is requesting permission to increase rates to all classes of customers by a uniform
27 22.67%.

28 **Q WHAT IS NWD'S RATIONALE FOR PROPOSING AN ACROSS-THE-BOARD RATE**
29 **INCREASE?**

30 A At Pages 8 and 9 of his direct testimony, Mr. Smith argues that:

31 "[s]ince the way in which Newport Water provides service to its
32 customers has not changed significantly since Newport Water's most
33 recent previous rate filing (Docket # 3578) the cost allocations agreed to
34 by the parties in Docket # 3578 have been used again in this filing.

1 Further, pursuant to the terms of the Settlement Agreement in Docket
2 3578, Newport is not seeking to charge Portsmouth with transmission,
3 distribution or peak costs associated with supply or treatment. Therefore,
4 a detailed cost of service study was not performed for this rate filing.”

5 **Q PLEASE SUMMARIZE THE RELEVANT TERMS OF THE SETTLEMENT**
6 **AGREEMENT REFERENCED BY MR. SMITH.**

7 A Paragraph 13 on Page 4 of the *Agreement* states in part that the commodity rates
8 charged to Portsmouth and to the Navy, NWD’s two wholesale customers, will remain
9 unchanged, in accordance with the tariffs approved for them in Docket No. 2985.
10 Docket No. 2985 was NWD’s rate case prior to Docket No. 3578.

11 **Q DOES PARAGRAPH 13 MAKE ANY REFERENCE TO COST ALLOCATIONS**
12 **AMONG CUSTOMER CLASSES?**

13 A No, it does not.

14 **Q WAS COST ALLOCATION AMONG CUSTOMER CLASSES AN ISSUE IN DOCKET**
15 **NO. 3578?**

16 A Yes, it was. NWD submitted a fully allocated cost of service study for its retail,
17 wholesale and fire protection customer classes. Both the Navy and PWFD submitted
18 testimony on Newport’s cost of service study. They testified that one of the major
19 defects in NWD’s cost of service study was the lack of reliable class demand data to
20 calculate class peak demand factors.

1 **Q PLEASE CONTINUE.**

2 A Paragraph 23 on Page 7 of the *Agreement* states that NWD shall be required to submit a
3 demand study with any cost allocation study if NWD should seek to charge PWFD with
4 transmission, distribution, or peak costs associated with supply or treatment.

5 **Q DID NWD'S COST OF SERVICE STUDY IN DOCKET NO. 3578 EXCLUDE**
6 **TRANSMISSION, DISTRIBUTION AND PEAK-RELATED SUPPLY AND TREATMENT**
7 **COSTS FROM THE CALCULATION OF PWFD'S COST OF SERVICE?**

8 A Yes, it did.

9 **Q DID NWD'S COST OF SERVICE STUDY HAVE ANY BEARING WHATSOEVER ON**
10 **THE COMMODITY RATE FOR PWFD STIPULATED IN THE *AGREEMENT*?**

11 A No, it did not. As stated above, the commodity rate stipulated for PWFD in Docket No.
12 3578 was simply a continuation of the rate previously approved for it in Docket No. 2985.
13 Thus, the allocation procedures used in NWD's cost study, which excluded the costs
14 enumerated above from PWFD's cost of service, could not possibly have had any effect
15 on the rate previously approved for PWFD in a prior Docket. Likewise, these procedures
16 could not have been "agreed to" by the parties as a basis for the commodity rates
17 approved for PWFD and the Navy in Docket No. 3578. To sum up, there is simply no
18 connection between NWD's cost study in Docket No. 3578 and the wholesale rates for
19 PWFD and the Navy that were stipulated in that case.

20 **Q DOES NWD'S ACROSS-THE-BOARD RATE INCREASE PROPOSAL INSULATE**
21 **PWFD FROM PAYING FOR TRANSMISSION, DISTRIBUTION AND PEAK COSTS**
22 **RELATED TO SUPPLY AND TREATMENT?**

1 A Absolutely not. If all rates are increased by an equal percent, then each class bears the
2 burden of the increased revenue requirement in exactly the same proportion as it now
3 bears for the current revenue requirement. Thus, each class is forced to defray a portion
4 of the additional expenditures in proportion to its individual revenue contribution,
5 regardless of the degree to which it may (or may not) have contributed to the causation
6 of those costs.

7 **Q CAN YOU PROVIDE AN EXAMPLE OF THIS?**

8 A Yes, I can. Newport's Schedule RFC-1 Supplemental summarizes the rate year
9 adjustments the Utility claims are necessary to provide adequate revenues. Even a
10 cursory inspection of this Schedule shows that several operating cost adjustments are
11 related to supply, treatment, transmission and distribution. Further, Schedule RFC-5
12 Supplemental shows that PWFD contributes 9.71% of the utility's revenues. Thus, it will
13 bear 9.71% of the increased supply, treatment, transmission and distribution costs.

14 **Q PLEASE SUMMARIZE YOUR TESTIMONY THUS FAR.**

15 A It is not at all clear that PWFD's current commodity rate excludes transmission,
16 distribution and peak-related supply and treatment costs. Further, NWD's across-the-
17 board increase requires PWFD to pay a share of all costs that contribute to the rate year
18 adjustments.

1 **Q IF NEWPORT IS INCLUDING THE RECOVERY OF THESE ADDITIONAL COSTS IN**
2 **PWFD’S PROPOSED RATES, SHOULD IT HAVE ALSO FILED A DEMAND STUDY**
3 **AND A COST OF SERVICE STUDY TO BE IN COMPLIANCE WITH THE**
4 **AGREEMENT?**

5 A I believe that it should have done so.

6 **Q WHAT ARE THE RAMIFICATIONS OF NWD’S FAILURE TO PROVIDE THE**
7 **REQUISITE DEMAND AND COST OF SERVICE STUDIES?**

8 A Because NWD has provided neither the customer class demand data nor a
9 corresponding cost of service study, PWFD, the Navy and other parties have no means
10 to determine whether an across-the-board increase to all classes, as proposed by
11 Newport, is appropriate for them. This is truly unfortunate, since class cost allocation is
12 a major unsettled issue from Newport’s last rate case. It could well be the case that an
13 across-the-board increase will merely perpetuate a situation where rates do not
14 correspond to cost causation, and some customer classes unnecessarily and unduly
15 subsidize other rate classes as a result. Indeed, the Navy submitted testimony in Docket
16 No. 3578 that supported a reduction in its rate. The failure of NWD to provide a demand
17 study and corresponding cost of service study prevents the Navy from determining
18 whether this is still a valid argument in this case.

19 **Q WHY DOESN’T THE NAVY OFFER TESTIMONY ON COST ALLOCATION AMONG**
20 **CUSTOMER CLASSES IN THIS CASE?**

21 A Given the existence of the *Agreement* that resulted from Docket No. 3578, the Navy had
22 anticipated that a customer class demand study and an updated cost of service study

1 would be available for Newport's subsequent rate case. Obviously, this has not
2 happened.

3 The Navy could have attempted, at considerable expense, to modify its cost of
4 service study from Docket No. 3578, but, as stated previously, reliable class demand
5 data is still lacking. Further, the components of Newport's revenue requirement since
6 that case have been superceded.

7 **Mandatory Customer Demand and Cost Studies**

8 **Q DO YOU RECOMMEND THAT THE COMMISSION REQUIRE NEWPORT TO**
9 **CONDUCT CUSTOMER DEMAND STUDIES AND INCORPORATE THE RESULTS**
10 **INTO A CLASS COST OF SERVICE STUDY?**

11 A Yes, I do. NWD's customers should be afforded the opportunity to determine the
12 appropriate percent increases by customer class on a cost-causation basis. This
13 opportunity is particularly urgent, and long overdue, in light of NWD's own statements
14 that the Commission has not accepted NWD's cost study in any of the prior dockets in
15 the past ten years. The conjecture that NWD may or may not have included certain
16 operating and capital costs into PWFD's commodity rate should not be the deciding
17 factor in deciding whether or not NWD should conduct the requisite studies referenced in
18 the *Agreement*. The Commission should order NWD to conduct a customer class
19 demand study, generating data from a peak usage season, in accordance with the terms
20 stated in Exhibit 2 appended to the *Agreement*, and to incorporate the results of the
21 demand study in a class cost of service study.

22 **Q WOULD CONDUCTING A CUSTOMER DEMAND STUDY ALSO BE OF BENEFIT TO**
23 **NWD?**

1 A Yes, it would. A customer demand study would provide valuable information to NWD
2 that would enable it to more efficiently plan its operations and set priorities for budgeting
3 purposes. The data would also assist in planning the sequence and capacities of future
4 capital expenditures related to rehabilitation and expansion. This would enable NWD to
5 provide service to its customers in a more efficient manner.

6 **Avoidance of Rate Shock**

7 **Q A POTENTIAL INCREASE OF NEARLY 23% IN PERIODIC WATER BILLS WOULD**
8 **SEEM TO CAUSE A SIGNIFICANT ECONOMIC IMPACT ON NEWPORT'S**
9 **CUSTOMERS. IN VIEW OF THIS, WHAT COULD THE COMMISSION DO TO**
10 **AMELIORATE THE SHOCK OF AN INCREASE OF THIS MAGNITUDE?**

11 A An increase of this magnitude, if implemented in one step, may be difficult for customers
12 to absorb. Given the context of a recent run-up in energy prices that affects everyone's
13 budgets, particularly for heating, the commission should give serious consideration to
14 phasing in any increase it may grant to Newport. The amount and timing of phased in
15 rate increases would depend on the level of rate increase, if any, ultimately granted to
16 NWD by the Commission.

17 **Q DOES THIS CONCLUDE YOUR TESTIMONY?**

18 A Yes, it does.

Qualifications of Ernest Harwig

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Ernest Harwig. My business mailing address is 57 Cedar Summit Road, Asheville, NC
3 28803.

4 **Q WHAT IS YOUR OCCUPATION?**

5 A I am a consultant in the field of public utility regulation and am employed by Brubaker &
6 Associates, Inc., energy, economic and regulatory consultants.

7 **Q PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

8 A I graduated from Austin College with a Bachelor of Arts Degree in Economics.
9 Subsequently, I received a Master of Arts Degree in International Economics from Texas
10 Tech University. I later attended seminars in Economics at the University of Cologne in
11 the Federal Republic of Germany. I also received a Master of Arts Degree while
12 completing all course work towards the Ph.D. at Southern Methodist University. My
13 major field was Industrial Organization.

14 Prior to joining Drazen-Brubaker & Associates, Inc., I was employed as a utility
15 rate analyst with the Public Service Commission of Wisconsin, where I represented the
16 Staff in private and municipal electric utility rate cases. I also prepared exhibits for
17 presentation in major electric utility rate cases.

18 I joined the firm of Drazen-Brubaker & Associates, Inc., in September 1975. In
19 addition to our main office in St. Louis, the firm also has branch offices in Phoenix,
20 Arizona; Chicago, Illinois; Corpus Christi, Texas; and Plano, Texas. In April 1995, the

1 firm of Brubaker & Associates, Inc. was formed. It includes most of the former DBA
2 principals and staff. At the firm, I have been engaged in the preparation of testimony
3 and exhibits relating to electric, gas, water, wastewater and steam utilities. These
4 included determinations of rate base, operating income and depreciation rates; the
5 performance of cost of service studies; and the design of rates for utility services. I have
6 also provided technical assistance in the negotiation of contracts for water and
7 wastewater services between municipal suppliers and industrial customers. I have been
8 a member of the American Water Works Association since 1986.

9 **Q ARE YOU AUTHOR OF ANY PUBLICATIONS?**

10 A Yes. I am the co-author of two articles: "Municipal Electric Utility Pricing," which
11 appeared in the February 1976 issue of Governmental Finance, and "Water Rates: An
12 Industrial User's View," which appeared in the May 1986 issue of Journal AWWA.

13 **Q HAVE YOU PREVIOUSLY APPEARED BEFORE A REGULATORY COMMISSION?**

14 A Yes. I have testified before the public utility regulatory commissions of Alabama,
15 California, Delaware, Illinois, Indiana, Kentucky, Minnesota, Missouri, New Hampshire,
16 Pennsylvania, Rhode Island, Tennessee, Texas, West Virginia and Wisconsin. In
17 addition, I have assisted both utility customers and suppliers in local rate proceedings
18 and contract negotiations for water and wastewater services in about twenty states.

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