

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS**

**BEFORE THE  
RHODE ISLAND PUBLIC SERVICE COMMISSION**

**IN RE:**

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

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\* **CASE NO. 3818**  
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**INITIAL POST-HEARING BRIEF  
OF  
THE DEPARTMENT OF THE NAVY**

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**INITIAL POST-HEARING BRIEF OF THE FEDERAL EXECUTIVE AGENCIES**

**OVERVIEW AND SUMMARY OF CASE**

The Department of the Navy (DON) hereby provides its initial post-hearing brief in this matter. The DON purchases large quantities of water from the Water Division of the City of Newport (NWD) (Newport) and is vitally interested in the outcome of this proceeding. The DON participated in the hearing convened by the State Office of Rhode Island and Providence Plantations and filed both direct and rebuttal testimony in this docket.

The DON's direct testimony contested several adjustments proposed by NWD and the lack of the filing and approval of a fully allocated cost of service study (COS).

**REVENUE REQUIREMENT AND RATE ADJUSTMENTS**

The DON utilized a test period consisting of the twelve months ended June 2006, which is consistent with the test period used by NWD. This period represents the most recent period for which actual data is available. DON adjustments differ from NWD's due to the treatment of expenses, not the choice of test period. The revenue requirement and all the adjustments are based on actual results provided by NWD in response to Navy Data Response 1-7. This response provided actual fiscal year-end audited accounts that

presented a much clearer understanding of the treatment of Operations and Maintenance (O&M) accounting by NWD and the amounts booked in each account. Due to several year-end adjustments, many accounts in the initial test-year filing had to be adjusted to allow for changes to the actual account amounts for the test period.

Mr. Harold J. Smith states in his rebuttal testimony that the adjustments were made knowing NWD had serious cash flow problems.<sup>1</sup> The NDW test year adjustments were based on what should have been spent if water demand had been as expected.

Mr. Smith is correct that in projecting O&M expenses normalization factors such as changes in water demand should be considered. However, NWD adjustments are made on what should have happened and in many of the adjustments are not known and measurable, they are merely a guess. The American Water Works Association Manual recommends that when projecting O&M expenses, recent experience serves as an important base for projecting expenses.<sup>2</sup>

It is a widely accepted rate-making principal that historical analysis of expense accounts be included as a major factor in estimating future O&M costs. The financial information presented by NWD in its response to Date Request 1-7 included five years of actual account experience. Although the NWD had the financial data available, it chose not to use it in its initial filing and simply based its projections on unsubstantiated data. The amounts projected in NWD's initial filing simply are unrealistic in many instances and not supported historically by the evidence provided.

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<sup>1</sup> Rebuttal Testimony of Harold J. Smith Docket No. 3818, page 7, lines 14-18

<sup>2</sup> American Water Works Association of Water Supply Practices Revenue Requirements AWWA M35 page 19

The DON has altered its position related to “Allowance for Doubtful Accounts” and “Transfer to Equipment Replacement” on certain accounts based upon the rebuttal testimony of Mr. Smith and accepts the adjustments as filed by NWD.

### **COST ALLOCATION AND RATE DESIGN**

The American Water Works Association says it is a basic premise that in establishing rate schedules, the schedules should reflect the cost of providing service.<sup>3</sup> To accomplish this, a sound analysis must be made to assess customer’s service requirements. This will ensure allocations among customer classes are consistent with cost causation and the correct rates are assessed to those customers for their service requirements.

Mr. Smith in his rebuttal testimony page 29 lines 9-10, *“I do agree that Newport should prepare a full cost allocation study as soon as it has the data to do so.”* Mr. Larry Allen states in his testimony on page 6, lines 10-11, *“NWD has not filed a COS study in over a decade which would be acceptable to the Commission.”* The lack of an updated fully allocated cost allocation study exacerbates the inequities and cross subsidies that are occurring between the customer classes served by NWD. Mr. Thomas S. Catlin testifies that the rate increase is spread evenly across the customer classes.<sup>4</sup> While the proposal may seem reasonable at first glance, it only serves to further exacerbate the cross subsidy being borne by some customer classes and compounds the effect of class subsidization.

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<sup>3</sup> American Water Works Association ,AWWA M1, Chapter 2

<sup>4</sup> Case No. 3818 Direct Testimony page 32, lines21-23

The DON urges the Rhode Island Public Service Commission (Commission) to order NWD conduct and present a fully allocated cost of service study to the Commission for approval on or before September 1, 2009.

The DON in Data Request Navy 2-5 asked Newport to provide a copy of Newport's cost allocation manual or the basis on which the allocations were made. NWD responded that the rate case did not involve the preparation of a cost allocation model. Additionally, DON in Data Request Navy 3-3 asked if the City of Newport (City) has a cost allocation manual that is used as a basis for allocations to departments. NWD stated, "*The City of Newport does not have a cost allocation manual.*"

A Cost Allocation Manual (CAM) should be created by the City of Newport. A cost allocation manual is a comprehensive distribution guide of agency-wide administrative costs to all departments that benefit from or receive services. Costs of central service departments such as Police Services, Human Resources, Payroll and Law Services are distributed to all departments that benefit from their services by unique, fair and equitable allocation factors. Customers of NWD that are not City of Newport residents should not be responsible for funding city services that do not directly or indirectly benefit from those services.

The DON urges the Commission to request the City of Newport create a CAM that would allow for more transparency of its allocation of costs to its departments. The CAM would also allow the City of Newport to outline the procedures for accounting of transactions between the City and its operating departments. The purpose of these accounting procedures would be to ensure that each department is assigned a fair and equitable share of costs associated with beneficial services provided by the City.

The CAM would identify the administrative, management and support services provided by the City to the city departments and specify the allocation method to reasonably assign costs. The manual would also identify the shared services utilized by the City and its departments and the allocation method used to distribute these costs. The City would review the CAM periodically and revise when there are significant changes in cost allocation.

### **CONCLUSIONS AND RECOMMENDATIONS**

For the reasons set forth in this brief, the DON respectfully requests that the Commission:

1. Reject the projection of costs as presented by NWD in its filing and accept the DON's adjustments which are based upon historical costs.
2. Order NWD to file a fully allocated cost of service study before the Commission on or before September 1, 2009.
3. Request the City of Newport to develop a Cost Allocation Manual that would clearly define and utilize cost allocation procedures and distribute shared services fairly and equitably to its departments.

DON's positions on these issues are not inconsistent with Commission precedent. Moreover, these positions comport with sound principles of cost-causation and thus ensure equitable treatment of all customer classes.

The DON also requests all other relief at law or in equity to which it may be entitled.

Respectfully submitted,

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