

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
PUBLIC UTILITIES COMMISSION

IN RE: PROVIDENCE WATER SUPPLY :  
BOARD'S APPLICATION TO CHANGE : DOCKET NO. 3832  
RATE SCHEDULES :

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**REPORT AND ORDER**

**I. Introduction**

On March 30, 2007, Providence Water Supply Board ("Providence Water") made a general rate filing with the Public Utilities Commission ("Commission"). The rate filing, if approved, would result in an overall revenue increase of \$9,688,321 or 19.07 percent, increasing rates by 19.6 percent, for a total cost of service of \$60,495,441. The effect on a typical residential customer with annual consumption of 100 HCF would be an increase of \$41.60 or 17 percent, from \$244.56 to \$286.16 per year or approximately

\$10.40 per quarter.<sup>1</sup> Providence Water requested an effective date of April 30, 2007.<sup>2</sup> On April 19, 2007, the Commission suspended the filing. On May 14, 2007, Kent County Water Authority (“KCWA”) filed a Motion to Intervene based on its status as a wholesale purchaser of water from Providence Water.<sup>3</sup> No objection was filed and the Motion was granted in accordance with Rule 1.13(e) of the Commission’s Rules of Practice and Procedure.<sup>4</sup>

This is Providence Water’s third request for rate adjustments in the past eight years. A brief history follows:

Docket No.	Filing Date	Effective Date	Increase Requested	Increase Allowed	Percentage Increase
3684	6/30/05	1/1/06	\$4,957,115	\$4,065,347	9.2%
3446	7/1/02	1/1/03	\$5,448,798	\$4,658,599	11.1%
3163	6/30/00	1/1/01	\$5,416,622	\$2,813,974	7.34%

In its filing, Providence Water indicated that the rate increase was necessary primarily due to the following: (1) increases for Infrastructure Replacement (“IFR”) (\$2,000,000); (2) increases in insurance costs (\$1,000,000); (3) increases in chemical and sludge costs (\$1,073,654); (4) increased costs associated with post-retirement health care benefits (\$403,243); (5) request to recover past retiree health care benefits paid by the City of Providence, but not charged to Providence Water (\$300,000); (6) increases in property taxes (\$540,738); (7) an increase in operations revenue allowance (\$862,860);

<sup>1</sup> Providence Water Exhibit 7 (Pre-Filed Testimony of Harold J. Smith), p. 9.

<sup>2</sup> Although Providence Water requested an effective date of April 30, 2007, it presented its filing based on an effective date of January 1, 2008.

<sup>3</sup> In his Direct Testimony on behalf of KCWA, Mr. Woodcock lists co-intervenors as: East Smithfield Water District, the Town of Lincoln-Lincoln Water Commission, Greenville Water District, the City of East Providence, and the City of Warwick.

<sup>4</sup> On May 21, 2007, KCWA filed a Motion to Pass Through Wholesale Rates. This Motion was assigned Commission Docket No. 3843.

(8) funding for strategic planning (\$150,000); (9) increase in City Service Expense (\$515,958); (10) wages and benefits (\$1,831,163); (11) Purchase Power (\$543,698); and (12) other known and measurable increases.<sup>5</sup>

## **II. Providence Water's Pre-Filed Testimony**

Providence Water submitted the Direct Pre-Filed Testimony of Pamela Marchand, P.E., General Manager, Jeanne Bondarevskis, Director of Finance, Paul Gadoury, Director of Engineering, David Bebyn, consultant to Providence Water, Walter E Edge, Jr., consultant to Providence Water, and Harold Smith, consultant to Providence Water. Ms. Marchand provided an overview of the filing and the general reasons for the requested increase.<sup>6</sup> Ms. Marchand indicated that while Providence Water used a rate year ending calendar year 2008, Providence Water was requesting rates be implemented for usage on and after November 1, 2007.<sup>7</sup>

In addressing proposed changes to the methodology of funding Providence Water's IFR program, Ms. Marchand recognized that in the past, the utility has depended on the pay-as-you-go approach as being the most economical to customers because it carries with it no interest. However, she noted that in the past year, Providence Water has identified additional major capital expenses which would be more appropriately addressed through bonding in order to maintain customer rates at a reasonable level. She stated that Providence Water was requesting funds for debt service in order to replace seven percent of the utility's lead services per year and to renovate the water treatment filtration system and sedimentation system.<sup>8</sup> Ms. Marchand explained that Providence

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<sup>5</sup> Providence Water Exhibit 2 (Pre-Filed Testimony of Pamela Marchand), pp. 3-4.

<sup>6</sup> *Id.* at 1-5.

<sup>7</sup> *Id.* at 5.

<sup>8</sup> *Id.* at 6.

Water must replace the lead services because the utility exceeded the EPA Action Level for lead in water samples taken from customer taps in August 2006.<sup>9</sup>

Addressing the request for a 100 percent increase in Providence Water's operating reserve, Ms. Marchand listed the costs which increased during fiscal year 2007, the same period of time during which Providence Water experienced decreased consumption.<sup>10</sup> Finally, Ms. Marchand addressed the need for a strategic plan, explaining that it would include "an asset management program to focus the funding and manpower where it is the most effective in accomplishing the mission of Providence Water and to direct the most efficient use of ratepayer funds."<sup>11</sup> She testified that this would not be a one-time expense, but rather, in subsequent rate years the funds requested for the study would be paid to a consultant to implement the plan developed.<sup>12</sup>

Ms. Bondarevskis provided more detail regarding the lead abatement program and water treatment projects, noting that the financial effect of implementing these changes would result in a projected deficit of \$83 million over the next twenty years without additional debt service.<sup>13</sup> Addressing changes to the Automated Meter Reading ("AMR") fund, Ms. Bondarevskis noted that meter installation has been funded through the AMR fund while replacements have been funded by IFR funds. Now that the AMR fund is nearing completion, Ms. Bondarevskis suggested that transferring funds from IFR to the AMR fund would allow all AMR related activities to be funded from one account.<sup>14</sup>

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<sup>9</sup> *Id.* at 7.

<sup>10</sup> *Id.* at 7-8.

<sup>11</sup> *Id.* at 10.

<sup>12</sup> *Id.* at 11.

<sup>13</sup> Providence Water Exhibit 3 (Pre-Filed Testimony of Jeanne Bondarevskis), pp. 2-5.

<sup>14</sup> *Id.* at 5-6.

Explaining Providence Water's request to pay to the City of Providence ("City") approximately \$1.6 million over five and one-half years, Ms. Bondarevskis stated that Providence Water had not been reimbursing the City for the cost of Providence Water's retirees' health care. She stated that "this was discovered in fiscal year 2006."<sup>15</sup> She opined that it was not discovered earlier because "[f]or some time now Providence Water has not reimbursed the City for Health care costs for employees in a direct manner," but rather, when payroll is completed, the City wires the amount needed for payroll and fringe benefits.<sup>16</sup> Therefore, there was no invoice for Providence Water to process and according to Ms. Bondarevskis, Providence Water was unaware that the utility was not being charged for its retirees' health care.<sup>17</sup> In order to calculate the amount to be paid back, the City Controller's office started with actual costs for fiscal years 2005 and 2004, discounted the costs back for each fiscal year 2003 through 1997, based on the annual working rate increase.<sup>18</sup> In Ms. Bondarevskis' opinion, this was "a reasonable method of estimating the outstanding liability."<sup>19</sup>

Finally, addressing cash flow issues, Ms. Bondarevskis expressed support for Providence Water's proposed changes to rate design which would allow Providence Water to collect more revenue from fixed service charges rather than from metered consumption charges. In addition, she expressed support for the increased net operating revenue allowance. She indicated that this would provide more of a cushion against reduced revenues.<sup>20</sup>

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<sup>15</sup> *Id.* at 6-7.

<sup>16</sup> *Id.* at 7.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 8.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 8-9.

Mr. Gadoury provided testimony regarding modifications to Providence Water's Infrastructure Replacement ("IFR") Plan and the impact of weather on consumption. Providence Water's IFR plan, approved by the Rhode Island Department of Health on February 7, 2007 was estimated to cost approximately \$248,425,000 over 20 years. However, since then, Providence Water has expanded and accelerated the replacement of lead services in order to comply with EPA regulations and State and Federal regulatory orders, has expanded the scope of work for the Water Treatment Plant Filter Rehabilitation project, and has modified its approach to rehabilitate the sedimentation basins.<sup>21</sup> He explained that the lead service replacements will cost more than double what was originally planned and has to be completed in a shorter time frame.<sup>22</sup> Modifications to the filter project are estimated to add \$15 million to the previously estimated \$25 million cost, but Mr. Gadoury indicated that benefits would include the ability to increase the depth of the filters in order to meet current minimum standards, the ability to utilize granulated active carbon ("GAC") filter media in the future, eliminate hidden filtration system components for easier monitoring, simplify the repair and replacement process of filters, and eliminate the problem of groundwater contamination.<sup>23</sup> Because of the proposed changes to the filtration system, Mr. Gadoury explained that the original plan to rehabilitate the plant's sedimentation basins needed to be revised.<sup>24</sup> Mr. Gadoury confirmed that plans are being submitted to RIDOH for

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<sup>21</sup> Providence Water Exhibit 4 (Pre-Filed Testimony of Paul Gadoury), pp. 2-5.

<sup>22</sup> *Id.* at 5.

<sup>23</sup> *Id.* at 8-10.

<sup>24</sup> *Id.* at 10-12.

review and the costs would be paid for through bonds and an increase in IFR rate revenue.<sup>25</sup>

Discussing annual demand for water, Mr. Gadoury indicated that summer weather patterns have the most effect on the demand. Mr. Gadoury noted that over the most recent 10 year period, average demand had fluctuated from year to year. Because of the “up and down variations in the total demand from year to year,” he noted that Providence Water was proposing changes to the rate structure to reduce the effect of demand fluctuations on revenue.<sup>26</sup>

Mr. Bebyn provided testimony to explain the normalizing adjustments he made to the Test Year (FYE June 2006).<sup>27</sup> Mr. Bebyn also provided testimony regarding the proposed \$1.24 million City Service expenditures for the Rate Year (CY 2008), an increase of almost 50 percent over the previously allowed City Service expense. Mr. Bebyn discussed his review of City Service expenses, including meeting with some department heads, reviewing actual fiscal year expenses for each department and reviewing the fiscal year 2007 budgeted expenses. He indicated that the previous allocation model used for City Service expense was not detailed enough to properly allocate the costs. He stated that using the prior model approved in Docket No. 3163, City Service expense would increase to almost \$2.1 million.<sup>28</sup>

Mr. Bebyn summarized his reasons for allocating costs to Providence Water from various City departments. He stated that the mayor’s office “deals with Providence

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<sup>25</sup> *Id.* at 12-13.

<sup>26</sup> *Id.* at 13-15.

<sup>27</sup> Providence Water Exhibit 5 (Pre-Filed Testimony of David Bebyn), pp. 2-3.

<sup>28</sup> *Id.* at 5-6.

Water issues on a regular basis.”<sup>29</sup> He indicated that the City Council and City Council Administration are appropriately allocated to Providence Water because the Council passes laws and ordinances affecting Providence Water and approves its budget.<sup>30</sup> Mr. Bebyn testified that the City Finance Department does not provide a duplication of services to the Providence Water Finance Department because the City Department “provides oversight for all Providence Water’s financial transaction[s] and monitors their budget.”<sup>31</sup> He also allocated a portion of two non-departmental service costs, including Stop Loss Insurance and a new GASB 43/45 consultant expense.<sup>32</sup> Once Mr. Bebyn had reviewed the various departments, he created allocators which he applied to the various departments.<sup>33</sup>

The General Overhead Allocator of 8.14 percent, applied to the Mayor’s office, City Council, City Council Administration, Law Department, Finance Department, Controller’s Office, Data Processing, Internal Auditors, and Archives, was developed by taking the total Providence Water audited operating expenses less depreciation and dividing it by Providence Water operating expenses less depreciation plus the City operating expenses less debt service. The factor was then applied to the Total Departmental Expense less any amount clearly not at all related to Providence Water plus 72 percent fringe benefits not expensed in department accounts.<sup>34</sup>

A separate allocator of 12.48 percent was created for the City Clerk’s office by taking the number of Providence Water activities (bid processing) divided by the total for

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<sup>29</sup> *Id.* at 7.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 9.

<sup>32</sup> *Id.* at 13-14.

<sup>33</sup> *Id.* at DGB-6.

<sup>34</sup> *Id.* at DGB-4, DGB-6.



the clerk's department.<sup>35</sup> The allocator was applied to the total City Clerk's departmental expense plus a 72 percent fringe benefit allowance.<sup>36</sup> A 10.99 percent employee related allocator was created by taking the number of Providence Water employees compared to the total of City and Providence Water employees and was applied to total expenses of the Retirement and Personnel Departments plus a 72 percent fringe benefit allowance.<sup>37</sup> This allocator was also applied to the Stop Loss Insurance and Annual GASB 43/45 consulting fee. A separate Treasury Allocator of 9.0 percent was created by taking the Providence Water checks processed and dividing that number by the total of City checks plus Providence Water checks. This allocator was then applied to the total Treasury department expense minus two accounts not related to Providence Water plus fringe benefits in the amount of 72 percent.<sup>38</sup> Finally, a 12.16 percent purchasing allocator was developed by taking the number of Providence Water contracts divided by the total of City and Providence Water contracts. The factor was applied to the total Personnel Department costs minus three accounts not related to Providence Water plus 72 percent in fringe benefits.<sup>39</sup> Mr. Bebyn arrived at a total City Service expense allocation to Providence Water of \$1,245,952; this included \$62,599 for Stop Loss Insurance and GASB 43/45 consulting fees and an inflation allowance of \$60,234.

Mr. Edge's testimony addressed specific adjustments related to the requested increase. He noted that Providence Water was requesting a 19.07 percent increase in revenues, but that the increase would not be uniform across-the-board based on the rate

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<sup>35</sup> *Id.* at DGB-6. Mr. Bebyn originally testified that he counted the number of resolutions and bid notifications, but clarified on cross-examination at the hearing that he only compared bids. *See Id.* at 8, Tr. 9/13/07, p. 77.

<sup>36</sup> Providence Water Exhibit 5, DGB-4, p. 1.

<sup>37</sup> *Id.* at DGB-4, p. 2, DGB-6.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

design model developed by Mr. Smith in this proceeding.<sup>40</sup> Discussing the Rate Year of CYE December 31, 2008, Mr. Edge proposed increases to twelve groups of accounts: (1) Salaries and Wages (\$947,203); (2) Property Taxes (\$540,738); (3) Insurance expense (\$1,000,000); (4) Pension and Other Benefits (\$884,140); (5) Regulatory and Rate Case expense (\$89,036); (6) Chemicals and Sludge (\$1,073,654); (7) Purchased Power (\$543,698); (8) IFR/Restricted Funding (\$2,000,000); (9) GASB 43/45 Health Insurance (\$403,243); (10) Health Insurance Liability (City) (\$300,000); (11) City Services (\$515,958) to match the results of Mr. Bebyn's study; and (12) Study for Strategic Planning (\$150,000). Additionally, Mr. Edge "increased all remaining accounts for inflation (2.5% per year), and made an adjustment for the net operating income allowance at 3%."<sup>41</sup>

Adjusting salaries and wages, Mr. Edge increased test year levels upward by 3.0 percent per year through CY 2008, in accordance with historical increases, for a total of 7.5 percent despite the fact that there is no current union contract for FY 2008 and 2009. He rationalized the adjustment by noting that when labor contracts are finalized, the salaries and wages are usually implemented retroactively back to the end of the last contract.<sup>42</sup>

Because he did not have actual property tax bills, Mr. Edge increased fiscal year 2007 tax bills by 7.5 percent to reflect the maximum allowed five percent increase for each municipality for FY 2008 and CY 2008. However, he indicated he would advise the

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<sup>40</sup> Providence Water Exhibit 6 (Pre-Filed Testimony of Walter E. Edge), p. 4.

<sup>41</sup> *Id.* at 6, 17. The 2.5 percent was allowed in the prior rate case. *Id.* at 18. The \$1,725,719 operating reserve was calculated by subtracting miscellaneous revenue from total expense and multiplying the result by 3.0 percent, the request in this docket. *Id.* at 19.

<sup>42</sup> *Id.* at 7-8.

parties of the actual costs when they become known.<sup>43</sup> Similarly, to project the rate year insurance expense, Mr. Edge used the actual insurance expense for FY 2007 and increased the expense by 10 percent for FY 2008 and 5 percent for CY 2008, an amount Providence Water's insurance carrier indicated was reasonable. However, Mr. Edge also noted that the insurance fund had a shortfall which needs to be addressed. Therefore, he increased the account by an additional \$600,396 to avoid future shortfalls.<sup>44</sup>

With regard to pension and other benefits, Mr. Edge left Union Combined Benefits, Laborers International Pension and Life Insurance Premium at test year levels. He increased FICA and wage assignment in accordance with his projected wage increase. He increased dental and health care over test year levels by 10.68 percent and 27.35 percent, respectively. Additionally, he increased the relatively new GASB 43/45 reserve to cover Providence Water's contribution to the reserve for future retiree health care in a percentage equal to that which will be deposited by the City. He also included \$300,000 to reimburse the City for past retiree health care costs. Finally, Mr. Edge increased Providence Water's contribution to the City Retirement fund per the consultant's report.<sup>45</sup>

Mr. Edge increased Regulatory Commission expense to \$186,587, and he amortized the current rate filing costs over two years for an annual amount of \$105,400. The total Regulatory/Rate Case expenses for the rate year totals \$291,987, an increase of \$89,036. He increased restricted Chemicals and Sludge by multiplying the projected FY 2008 usage by the CY 2008 projected price. He also increased the rate year amount by \$200,000 to cover a projected deficit in the Chemical account in FY 2010. With regard to Purchased Power expense, Mr. Edge noted that there was a 46 percent increase from

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<sup>43</sup> *Id.* at 8-9.

<sup>44</sup> *Id.* at 9-11.

FY 2004 through FY 2006, and although Mr. Edge was uncertain such an increase would occur, he utilized that increase to project the increase from FY 2006 through FY 2008 and then increased that result by an additional 5 percent to derive the pro forma rate year expense.<sup>46</sup> The resulting total of IFR funds requested for the rate year amount to \$14.9 million (\$1 million for meter replacements and \$13.9 million for other IFR expenditures.)

Mr. Edge increased the IFR funding by \$2,000,000 to fund improvements to the treatment facility and the revised lead abatement program. In addition, a \$35,000,000 borrowing from the Clean Water Finance Agency will flow through IFR. Finally, Mr. Edge indicated that \$600,000 should be transferred to the AMR restricted account so that meter related items will come out of a single account.<sup>47</sup>

With regard to funding the proposed Strategic Planning Study, Mr. Edge explained that while the total funding requested was \$150,000, he was posting the adjustment to an account which had a carry-over balance of \$32,000 from the test year for a study that was to be completed then. Therefore, the net adjustment was \$118,000.<sup>48</sup>

Regarding the proposed rate design in this case, Mr. Smith explained that he worked with Providence Water to perform cost allocations and develop cost based rates and charges.<sup>49</sup> Mr. Smith indicated that he used the same approach in this case as had been used in previous Providence Water cases, or “a modified base/extra capacity approach in which costs are allocated to cost of service categories based on the type of service being provided and then to customer classes on the way in which each class

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<sup>45</sup> *Id.* at 12, 15-16, WEE-6.

<sup>46</sup> *Id.* at 12-13.

<sup>47</sup> *Id.* at 13-15.

<sup>48</sup> *Id.* at 17.

<sup>49</sup> Providence Water Exhibit 7 (Pre-Filed Testimony of Harold J. Smith), p. 2.

demands service.”<sup>50</sup> Mr. Smith noted that “with the exception of the costs to be recovered from public fire protection charges and wholesale customers, costs are allocated to each customer class based on the way in which the class contributes to the demand for base and excess capacity.”<sup>51</sup> He indicated that consistent with the prior rate filing, costs are allocated to wholesale customers based on their proportionate share of total consumption without consideration to their demand characteristics.<sup>52</sup>

In this case, rather than utilizing the “relatively common practice” of allocating costs to fire protection based on a theoretical maximum day and maximum hour demand that fire protection may place on a system, Mr. Smith reduced the demand component of the fire protection charge by 50 percent.<sup>53</sup> The result of this adjustment is that half of the demand related costs would be recovered from the public fire protection charge paid by the Cities of Providence and Cranston and the Towns of Johnston and North Providence while the remaining half would be recovered from the retail consumption charge. Mr. Smith stated that the rationale was to ensure that tax-exempt water customers pay a portion of the for fire protection charges which they avoid as being tax-exempt institutions.<sup>54</sup>

Mr. Smith explained that, with the exception of fire protection and the new wholesale service charge, the rates are calculated in the same way they were in the previous rate case. Retail service charges are calculated from costs allocated to Meters & Services and from Billing & Collection costs utilizing the number of equivalent meters

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<sup>50</sup> *Id.* at 4.

<sup>51</sup> *Id.* at 5.

<sup>52</sup> *Id.* at 6.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

and the number of customer billings.<sup>55</sup> Commodity rates are calculated by dividing the total base and extra capacity costs allocated to each customer class by the projected rate year consumption of that customer class.<sup>56</sup>

Addressing proposed changes to the methodology of assessing wholesale customers, Mr. Smith explained that wholesale customers are only assessed a commodity charge whereas in this filing, Providence Water is proposing to implement a 25 percent service charge to be assessed to wholesale customers on a monthly basis based on their annual revenues. The remaining 75 percent of the revenues to be collected from wholesale customers would be divided by the customers' anticipated rate year volumes to calculate the charge per hcf.<sup>57</sup> The stated purpose for this change would be to help stabilize Providence Water's revenues while not imposing an "inordinate" burden on wholesale customers. He stated that if pro forma usage is consistent with projections, their costs should not differ from a commodity-only charge.<sup>58</sup>

### **III. KCWA's Pre-Filed Testimony**

On July 18, 2007, KCWA filed the Direct Pre-Filed Testimony of Christopher P.N. Woodcock, its consultant. Mr. Woodcock concluded that a reasonable increase in revenues would be sixteen percent, with the increase to wholesale customers set at 19.6 percent.<sup>59</sup> Mr. Woodcock noted that several of the requests for funding of restricted accounts extend beyond the rate year, including Insurance and Chemicals. Mr. Woodcock indicated that because Providence Water has historically used the accounts for their designated purposes, he did not object, as long as sufficient oversight remains in

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<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 7.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.* at 8.

place in the future.<sup>60</sup> Additionally, he believed that approving this approach would allow utilities to have sufficient funding to avoid the expense of rate cases as often and this approach should be adopted for other water utilities.<sup>61</sup>

Mr. Woodcock proposed adjustments to Providence Water's City Service Expense, projected property taxes, regulatory expenses, purchased power, and operating revenue allowance. Addressing City Service Expense, Mr. Woodcock noted that while Mr. Bebyn had prepared a detailed analysis with which Mr. Woodcock generally agreed, he proposed several adjustments. He also expressed concern that the fringe benefits added to the labor costs of each City department were more than 72% of salaries, opining that this was a high level of fringe benefits.<sup>62</sup>

With regard to the development of the General Overhead ("O") allocation factor, Mr. Woodcock maintained that the numerator (Providence Water's expenses) should not include the City Service Expense where the equation was designed to determine the appropriate percentage for City Service Expense and to include it amounts to double counting of City Services. He also argued that the payment of property taxes does not require much involvement by most City Departments and should be excluded from Providence Water's operating costs when developing the "O" allocation factor. He further noted that Mr. Bebyn had only included one of the three enterprise funds in the overall City budget, and believed all three should be included. Finally, Mr. Woodcock argued that expenses covered by federal and state grants should not be backed out of the

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<sup>59</sup> KCWA Exhibit 1 (Pre-Filed Testimony of Christopher P.N. Woodcock), p. 4.

<sup>60</sup> *Id.* at 5.

<sup>61</sup> *Id.* at 5-6.

<sup>62</sup> *Id.* At 10.

City budget for purposes of developing the “O” allocation factor. He concluded that the “O” allocation factor should be reduced to 6.51 percent.<sup>63</sup>

Reviewing specific departmental costs, Mr. Woodcock believed the City Council cost allocated to Providence Water was overstated and proposed applying half of the reduced “O” allocator, or 3.26 percent to the City Council and also to the City Council Administration budgets to derive the City Service costs.<sup>64</sup> Similarly, because Providence Water has its own finance department, he indicated that while the City Finance Department provides some services to Providence Water, he recommended applying half of the reduced “O” allocator to the City Finance budget to derive the City Service costs.<sup>65</sup> Mr. Woodcock also took issue with the tasks Mr. Bebyn utilized in developing his factor for the City Clerk’s Department and recommended applying no more than half of the “O” allocation factor.<sup>66</sup>

Next, addressing Providence Water’s increase in property taxes, Mr. Woodcock proposed using less than the maximum 5 percent increase based on past experience, but agreed with Mr. Edge’s proposal to update the property tax requirements when more information becomes available.<sup>67</sup> Mr. Woodcock proposed eliminating a \$5,000 regulatory expense entitled “City Services” because the basis for the request was unclear.<sup>68</sup> He eliminated the adjustment to the test year power costs on the basis that the power contract between Providence Water and Constellation New Energy provided for no rate increase in the rate year.<sup>69</sup> Additionally, Mr. Woodcock proposed eliminating an

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<sup>63</sup> *Id.* at 6-8.

<sup>64</sup> *Id.* at 8-9.

<sup>65</sup> *Id.* at 9.

<sup>66</sup> *Id.* at 9-10.

<sup>67</sup> *Id.* at 10-11.

<sup>68</sup> *Id.* at 11.

<sup>69</sup> *Id.*



adjustment reflecting reduced sales to Bristol County on the basis that it appears those reductions would not occur in the rate year. He also added back the under-billing to Johnston which resulted in a change to the four year average for Johnston, affecting the overall wholesale sales and revenues for the rate year.<sup>70</sup>

Addressing the requested 3.0 percent operating allowance, Mr. Woodcock expressed support, but proposed that 1.5 percent be unrestricted and used in the manner of the current 1.5 percent operating allowance while the remaining 1.5 percent should be restricted and used to cover reduced revenues as a result of reduced water sales. He proposed a procedure for Providence Water to follow in order to gain access to the restricted portion of the account.<sup>71</sup>

Turning to Providence Water's proposed cost allocations, Mr. Woodcock first noted that Providence Water did not provide an allowance for unaccounted for water in the allocations between retail and wholesale service. He also took issue with the allocation of costs associated with pumping stations, noting that certain pumping costs and related labor should not be associated with wholesale service.<sup>72</sup> Next, he discussed the fact that in the past, the Commission has not allowed inclusion of all employee benefits in the allocation to the customer service charge in order to control the level of the charge. In this filing, Providence Water assigned employee benefits to the category in which the employees function. Therefore, because of the new reporting capabilities of Providence Water, Mr. Woodcock believed that the Commission approach should be revisited. Specifically, he suggested that within each functional area, the employee benefits and pension costs should be allocated in the same manner as salary and wage

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<sup>70</sup> *Id.* at 11-12.

<sup>71</sup> *Id.* at 12.

costs because he maintained that customer accounting pension and benefits are unrelated to wholesale sales.<sup>73</sup>

Mr. Woodcock proposed several changes to the calculation of allocation symbols based on updated information using the same methodology used in prior dockets. With regard to allocator A, which is used to allocate costs between retail and wholesale service based on sales, Mr. Woodcock maintained that Providence Water had not accounted for lost or unaccounted for water. Therefore, Mr. Woodcock performed several calculations in order to derive an updated allocator A which would take into account lost or unaccounted for water. However, he noted that while losses are typically associated with under-registering water meters as well as line losses, the parties have historically assigned the losses only between transmission losses (responsibility of wholesale and retail customers) and distribution losses (responsibility of retail customers only). He maintained that in the future, the Commission should recognize meter losses and service pipe losses as well.<sup>74</sup>

Mr. Woodcock recalculated allocator F which is used to allocate some transmission and distribution costs, primarily those costs associated with pipes where it is unknown if the cost is related to transmission or distribution pipes in order to update the allocator based on usage and inch miles of pipe. He also recalculated allocators HM, HMC, and HOC which are used to allocate various transmission and distribution costs in order to account for updated information, but using the same methods used in prior dockets.<sup>75</sup>

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<sup>72</sup> *Id.* at 13.

<sup>73</sup> *Id.* at 14-16.

<sup>74</sup> *Id.* at 16-17, 19.

<sup>75</sup> *Id.* at 17-18.

Mr. Woodcock also adjusted allocators CRAN, K1, K2, and T which are derived from the allocation of investment or the net value of Providence Water's assets. He made an adjustment to the plant allocation by splitting transmission and distribution investment.<sup>76</sup>

With regard to allocators TD and N which are used to allocate distribution pipe costs (TD) and pumping costs (N), Mr. Woodcock indicated that in Providence Water's assignment of costs to customer classes, no base or average use costs were assigned to fire protection. As a result, according to Mr. Woodcock, the amount of water used for fire fighting was not considered in the allocation of line items with these costs; only the peak demand portion was considered. Mr. Woodcock opined that this symbol must be modified to reflect the fact that some base water use that goes through pipes and pumps goes to fire services. Therefore, he included 1% for fire protection and adjusted the other symbols accordingly.<sup>77</sup>

Mr. Woodcock proposed several new allocators to arguably derive a more equitable allocation of costs and to properly recognize the layout and operation of the Providence Water system. He proposed allocators DY, HMY, and YY to remove all benefit costs assigned to billing and meters within the Transmission & Distribution, Customer Accounts, and Administration functions. He proposed allocator NO to assign the pumping O&M costs to reflect the fact that the Raw Water Pumping Station costs are not part of those unlike allocator N which he indicated assumes that the Raw Water Pumping Station is a part of the pumping operating costs. He proposed allocator NP to allocate the pump station power costs in place of allocator N that includes the Raw Water

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<sup>76</sup> *Id.* at 18.

<sup>77</sup> *Id.* at 18-19.

Station from this cost maintaining that it is a more equitable calculation based on actual costs.<sup>78</sup>

Mr. Woodcock indicated that allocator WC, proposed to allocate the capital costs associated with the Western Cranston system, have nothing to do with the provision of wholesale service. He noted that while the pro forma costs are minimal (\$62,069), he also argued that if impact fees or future fund balances are insufficient to cover projected investment, wholesale customers should not be required to contribute to this retail only investment.<sup>79</sup>

Mr. Woodcock indicated that that pumping costs should continue to be recognized differently because Providence Water's system includes some costs that are shared by all customers and some costs that are only for retail customers. The wholesale customers distribute the water to their own individual customers rather than from Providence Water. Therefore, wholesale customers should not have to pay for retail service they do not receive including those of some of Providence Water's pumping stations. As such, he proposed estimating labor and benefit costs for the operation of Providence Water's pumping stations and moving them from treatment to pumping operating costs for ratemaking. He also promoted the adoption of new pumping allocators to reflect the fact that the Raw Water Pumping Station costs are not part of the Pumping O&M expenses.<sup>80</sup>

Further addressing the reasons Mr. Woodcock advocated elimination of the COMM Y allocator which he believed was adopted to move costs from the billing or customer service charge to the metered rate, Mr. Woodcock argued that the continued use of this allocator results in the assignment of costs related to customer service employee

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<sup>78</sup> *Id.* at 20-21.

<sup>79</sup> *Id.* at 21.

benefit costs to wholesale customers only.<sup>81</sup> He maintained that the adoption of the new symbols he recommended for the Customer Service, Transmission & Distribution, Administrative, and Insurance functions will assure that the cost of benefits continue to be removed from the retail customer service charges to the metered rates while eliminating the inequities of allocating such costs to wholesale customers.<sup>82</sup> Additionally, for Water Treatment O&M, Transmission & Distribution, Customer Accounts, and Administration he replaced allocator COMM Y with AA for the allocation of employee benefits consistent with Mr. Smith's agreement that employee related costs should be allocated in the same manner as the salaries and wages for that function.<sup>83</sup>

Mr. Woodcock's final cost allocation adjustments were related to the manner in which specific line items are allocated. With regard to pumping operating costs, he indicated he had taken some of the expenses related to salaries and benefits from treatment and moved them to operating costs where they are properly reflected. He maintained that these adjustments did not change the overall costs but rather, moved some salary and benefit costs from one area (treatment) to another (pumping) to better reflect actual conditions.<sup>84</sup> He proposed using his recommended new allocator NO for the pumping operating costs and allocator NP for the power related pumping costs.<sup>85</sup> Mr. Woodcock noted that the Western Cranston portion of the system did not relate to wholesale service, and he recommended that the Western Cranston capital fund should only be allocated to retail customers.

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<sup>80</sup> *Id.* at 21-22.

<sup>81</sup> *Id.* at 22-23.

<sup>82</sup> *Id.* at 23.

<sup>83</sup> *Id.* at 24.

<sup>84</sup> *Id.* at 23-24.

<sup>85</sup> *Id.* at 24.

Turning to rate design issues, Mr. Woodcock noted that Providence Water proposed two significant rate design changes: (1) a fixed wholesale charge and (2) a reduced public fire service charge. In addition to these changes, he indicated that Providence Water proposed retail rates that are based on peaking factors for various retail customers, something that does not affect wholesale customers in this docket, but which could have an effect on subsequent rate cases.<sup>86</sup>

Addressing the proposed fixed charge to wholesale customers, Mr. Woodcock indicated that wholesale customers oppose the proposal because wholesale water sales will not be exactly as projected by Providence Water and there will either be a loss or a gain from this class of customers. He agreed that revenue stability is a reasonable goal of a utility, but he argued that Providence Water was not attempting to stabilize the right rates or revenues from the right customers. For example, he stated that Providence Water's proposal to move fixed hydrant revenues to variable use based revenues was contrary to its goal of stabilizing revenues.<sup>87</sup> Elaborating, Mr. Woodcock noted that review of the adjusted historic retail and wholesale sales shows that the retail customers exhibit a much greater variation from the average than do the wholesale customers. He indicated that in nearly every year, the retail difference from the average is twice that of the wholesale customers. Therefore, he concluded that the variation in revenues or instability is caused more by retail customers than wholesale customers. Noting that Providence Water's proposal would recover less than 20 percent of the retail costs from fixed retail charges, Mr. Woodcock questioned why Providence Water believed a higher

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<sup>86</sup> *Id.* at 26.

<sup>87</sup> *Id.*

percentage of fixed revenues from a more stable, but smaller revenue base made sense.<sup>88</sup> Furthermore, he argued that proposing 50% of the fixed fire protection revenue be transferred to the most unstable source, retail metered rates, is inconsistent with the goal of revenue stability.<sup>89</sup>

Elaborating on the proposed reduction in fire charges, Mr. Woodcock agreed with Mr. Smith that there are tax exempt properties that avoid paying their share of fire protection costs, but argued that switching the fire protection costs to water use may not be any more equitable because it assumes that the level of fire protection is proportional to water use rather than property value, and Mr. Woodcock opined that the evidence did not support that assumption.<sup>90</sup>

Discussing the peaking factors for various classes of customers, Mr. Woodcock agreed that revisions in methodology are accepted from time to time, but expressed concern that the factors presented by Providence Water are not appropriate because these factors are presented as coincident peaks for each customer class, which is the peak demand by each class at the time of the system peak. He believed the correct methodology would be to use non-coincident peaks. Regardless, he argued that the peaking factors proposed by Providence Water were incorrect.<sup>91</sup>

#### **IV. Division's Pre-Filed Testimony**

On July 18, 2007, the Division of Public Utilities and Carriers ("Division") filed the Direct Pre-Filed Testimony of Thomas Catlin, its consultant on revenue requirement and Jerome Mierzwa, its consultant on cost allocation. Mr. Catlin recommended a total

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<sup>88</sup> *Id.* at 27.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* at 28.

<sup>91</sup> *Id.* at 28-29.

cost of service of \$58,710,135, necessitating a revenue increase of \$7,389,179 or 12.6 percent.<sup>92</sup>

In arriving at his revenue requirement, Mr. Catlin made adjustments to rate year revenue to reflect a current count of the number of retail and private fire service customers and to properly account for changes to wholesale sales and associated variable costs.<sup>93</sup> He proposed adjustments to salaries and wages in order to account for employee vacancies that normally develop during any given year.<sup>94</sup> He made adjustments to operating expenses and to the IFR and CIP expenses to properly account for capitalized expenses in accordance with the Commission's Order in Docket No. 3446.<sup>95</sup> After reviewing Providence Water's electric supply contract, Mr. Catlin made a \$543,699 downward adjustment to Providence Water's proposal.<sup>96</sup> He proposed setting the PUC assessment at the test year level on the basis that the 2007 assessment was slightly less than the 2006 assessment. This resulted in a \$14,008 reduction to Providence Water's proposal.<sup>97</sup> Mr. Catlin also made two adjustments to the Contractual Services - Engineer and Legal Accounts on the basis that Providence Water's request was for increased costs that did not represent a normal recurring costs. This resulted in a \$73,185 reduction to Providence Water's request.<sup>98</sup> Mr. Catlin did accept Providence Water's proposed chemical expense on the basis that even though updated bid prices showed those costs to be increasing, there should be sufficient funds in the restricted account to absorb those

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<sup>92</sup> Division Exhibit 1 (Pre-Filed Testimony of Thomas Catlin), Schedule TSC-1.

<sup>93</sup> *Id.* at 5-6, 10-11.

<sup>94</sup> *Id.* at 7-8.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* at 9-10.

<sup>97</sup> *Id.* at 10-11.

<sup>98</sup> *Id.* at 11-12.



increases through FY 2009 and possibly 2010.<sup>99</sup> Additionally, Mr. Catlin identified a concern with the methodology Mr. Edge used to forecast property tax expense for the rate year, but relying on Mr. Edge's representation that he would adjust the request when updated property tax bills become available, Mr. Catlin made no adjustment, instead indicating that he would reevaluate the request after the rebuttal phase of the case.<sup>100</sup>

Addressing Providence Water's request to reimburse the City of Providence for the cost of health insurance provided for retirees during the period 1997 through 2005, Mr. Catlin noted that Providence Water was requesting retroactive recovery of costs applicable to prior periods for which it failed to seek timely recovery. He indicated that because Providence Water is not an investor owned utility and the City of Providence is in financial difficulty, he would not oppose recovery. He did note that during discovery, Providence Water reduced the recoverable amount to \$1,489,081 and Mr. Catlin proposed a six year recovery period instead of the five and one-half years requested by Providence Water.<sup>101</sup> Furthermore, with regard to the requirement under GASB 43/45 requiring municipalities to recognize their future liabilities for postretirement benefits, Mr. Catlin accepted Providence Water's calculation which was based on a 50 percent contribution level, designed to match the City of Providence's contribution level. However, he recommended that in the event the City does not fund its portion at the 50 percent level, Providence Water only fund the same percentage and deposit the remainder in a restricted account.<sup>102</sup>

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<sup>99</sup> *Id.* at 12-13.

<sup>100</sup> *Id.* at 16.

<sup>101</sup> *Id.* at 8-9.

<sup>102</sup> *Id.* at 13-14.

Addressing Providence Water's claim for City Service Expense, Mr. Catlin indicated that he was concerned that when developing the General Overhead allocator, Mr. Bebyn did not include all enterprise funds of the City of Providence in the City's overall expenses. The result was a \$5,597 reduction to the City Service Expense which Mr. Catlin assumed Mr. Bebyn would make as part of his rebuttal testimony. Mr. Catlin also identified a \$5,000 City Service expense included in the estimated rate case expense, but was unable to identify the nature of the expense and recommended it not be included without such detail.<sup>103</sup>

Finally, discussing Providence Water's proposed 3.0 percent Operating Revenue Allowance, Mr. Catlin recommended the Commission continue to set it at 1.5 percent. Mr. Catlin noted that Providence Water had not only made adjustments for known and measurable costs, but also for other expenses by applying an inflationary factor. He also noted that recent Commission decisions appear to show a policy of reducing operating revenue allowances rather than increasing them. He recommended that if the Commission decides to increase the Operating Revenue Allowance, it cut the inflationary factor that is currently included in Providence Water's projections. He also recommended that restricted fund expenditures for capital related items be excluded from the calculation of the Operating Revenue Allowance if it is increased to 3.0 percent. Such an adjustment would decrease Providence Water's request by approximately \$500,000. Allowing only 1.5 percent would decrease Providence Water's request by half, or approximately \$850,000.<sup>104</sup>

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<sup>103</sup> *Id.* at 14-15.

<sup>104</sup> *Id.* at 16-19.

In addressing the cost allocations in Providence Water's filing, Mr. Mierzwa noted that Providence Water had used the base-extra capacity method, one of the two generally accepted methods for allocating costs to customer classes. Under this method, investment and costs are first classified into four primary functional cost categories: base or average capacity, extra capacity, customer and direct fire protection. The costs within the four primary functional costs are then further divided and allocated.<sup>105</sup> Mr. Mierzwa proposed several changes to Providence Water's cost allocations used in its cost of service study including: (1) rejecting Providence Water's proposal to reduce the demand component of fire protection service by 50 percent; (2) revising the allocation of transmission and distribution mains investment; (3) updating several cost allocation factors from those initially developed in Docket No. 3163, Providence Water's most recent cost of service study with cost allocations; (4) modifying the allocation of miscellaneous revenue; (5) recognizing the costs associated with lost and unaccounted-for water; and (6) revising the allocation of certain source of supply operation and maintenance expenses. Mr. Mierzwa also addressed Providence Water's allocation of pension and benefits expenses.<sup>106</sup> However, because he was still waiting for some updated information from Providence Water, he did not incorporate the Division's revenue requirement adjustments into his study, but would do so in surrebuttal.<sup>107</sup>

First addressing the fire protection demand component, Mr. Mierzwa explained that in Docket No. 3163, certain costs were allocated to fire protection service based on the maximum day and maximum hour demands that fire protection could potentially place on the Providence Water system. In this case, Providence Water reduced the

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<sup>105</sup> Division Exhibit 2 (Pre-Filed Testimony of Jerome Mierzwa), p. 4.

<sup>106</sup> *Id.* at 5.

maximum day and maximum hour demands assigned to fire protection service by 50 percent. The result of this proposal is to collect half of the demand costs from fire protection and half from retail volumetric charges rather than 100 percent from fire protection as was allowed in Docket No. 3163.<sup>108</sup>

With regard to this proposal, Mr. Mierzwa recommended it be rejected for several reasons. First, that it also reduces demand to private fire protection service, thereby requiring general water service customers to bear a portion of those costs. Second, with regard to Providence Water's argument that tax exempt entities are unfairly benefiting from the system, Mr. Mierzwa stated that Providence Water does not know the usage of tax exempt customers on its systems and as a result, cannot determine the extent to which its proposal will provide for the recovery of public fire protection costs from tax exempt customers. Third, IFR costs are not recovered through fire protection rates, but through volumetric rates, thus already reducing the costs associated with fire protection which need to be recovered from other customers. Fourth, the recovery of 50 percent of the demand charge through volumetric rates rather than a fixed fire protection charge is inconsistent with Providence Water's desire for revenue stability. Finally, Mr. Mierzwa disagreed with Providence Water's assertion that recovery of fire protection services through usage rates provide for a better match between benefits and costs than the current procedures, providing the example of a commercial warehouse with high-cost inventory and very little water usage. He explained that this customer receives a significant benefit from fire protection service but would avoid paying for a significant portion of this benefit under Providence Water's proposal. Another customer with high water usage

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<sup>107</sup> *Id.* at 13.

<sup>108</sup> *Id.* at 6.

because of a pool or irrigation needs, but a lower tax rate would contribute disproportionately to the recovery of fire protection service costs.<sup>109</sup>

Second, addressing Providence Water's allocation of transmission and distribution ("T&D"), Mr. Mierzwa noted that none of the investment had been allocated to wholesale customers despite the fact that transmission mains are used to serve those customers. Because the cost of service study in this docket did not separately identify transmission and distribution mains investment, Mr. Mierzwa prepared an inch-mile study to estimate Providence Water's transmission investment. Because his study indicated that 41.42 percent of Providence Water's mains investment was transmission related, he allocated this portion of Providence Water's total T&D mains investment to wholesale customers based on annual consumption.<sup>110</sup>

Third, Mr. Mierzwa proposed updating factors to allocate T&D salaries and wages (Factor HM), T&D contractual services (Factors HOC and HM), and T&D operation and maintenance expenses (Factor F). He noted that the values of the factors were based on fiscal year 1999 data. Through discovery, Mr. Mierzwa requested that Providence Water update the detailed analysis performed in Docket No. 3163 and Providence Water did so, utilizing fiscal year 2006 data. Mr. Mierzwa noted that costs can change from year to year and as such, a multi-year average would be appropriate. He stated that he is awaiting detailed analyses from Providence Water for fiscal years 2004 and 2005. Therefore, with the exception of the T&D operation and maintenance expense factor, he would make the adjustments in his surrebuttal testimony. With regard to the

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<sup>109</sup> *Id.* at 6-8.

<sup>110</sup> *Id.* at 8-9.

T&D operation and maintenance expense factor, Mr. Mierzwa proposed updating the allocation for wholesale customers based on his updated inch-mile analysis.<sup>111</sup>

Fourth, with regard to Miscellaneous Revenue, Mr. Mierzwa noted that it had been credited to cost function based on labor-related O&M expenses where, in his opinion, it should have been allocated to function consistent with the source of revenue. He indicated he would address the issue further in his surrebuttal testimony.<sup>112</sup>

Fifth, addressing lost and unaccounted-for water, Mr. Mierzwa defined it as the difference between metered production and metered consumption which can result from things like leaks and inaccurate meters. He noted that because Providence Water did not separate out the differences for the distribution and transmission portions of the system, under its cost allocation, wholesale customers would bear some responsibility for the distribution system, something that is incorrect in light of the fact that the distribution system does not serve wholesale customers. He noted that Providence Water had agreed with his position and he adjusted the study based on the actual average of lost and unaccounted-for water for the period fiscal years 2003 through 2006, with an additional adjustment to account for an under-registering meter in Johnston.<sup>113</sup>

Sixth, addressing the allocation of source of supply investment to the functional category, Mr. Mierzwa indicated that all source of supply investment should be allocated based on annual consumption. He noted that Providence Water had allocated Land and Land Rights, Structures and Improvements and Collecting and Impounding Reservoirs in

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<sup>111</sup> *Id.* at 9-10.

<sup>112</sup> *Id.* at 10-11.

<sup>113</sup> *Id.* at 11.

such a manner, but not the Supply Mains and Other Water Source Plant. He opined that this may have been a clerical error.<sup>114</sup>

Finally, addressing the allocation of pensions and benefits, Mr. Mierzwa noted that Providence Water had allocated pension and benefits to source of supply, water treatment, T&D, customer accounting and administrative and general O&M categories, while pension and benefits expenses within each O&M category were allocated to functional category based on total wages, with those costs allocated to meters and services and billing and collections allocated to other retail cost functions using Factor Comm Y in order to follow past Commission directives to limit the increases in service charges. He maintained that because these costs are labor-related, they would ordinarily be allocated without the additional reallocation of costs associated with meters and service and billing and collections, but noted that not allocating the costs based on Factor Comm Y would result in a 102 percent increase in the quarterly service charge.<sup>115</sup>

#### **V. Providence Water's Rebuttal Testimony**

On August 21, 2007, Providence Water submitted the Rebuttal Testimony of Ms. Marchand, Ms. Bondarevskis, Mr. Gadoury, Mr. Edge and Mr. Smith. In addition to responding to the positions of the Division and KCWA, Providence Water provided testimony regarding rate treatment of a tax refund it received from the City of Cranston to settle a property tax dispute.

Ms. Marchand explained that on August 15, 2007, the Providence Water Supply Board voted to accept a settlement agreement with the City of Cranston for contested taxes. The total due to Providence Water from the City of Cranston was \$1,508,362 plus

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<sup>114</sup> *Id.* at 12.

<sup>115</sup> *Id.* at 12-13.

interest of \$216.77 per day from August 16, 2007 until payment was made. Ms. Marchand proposed that the money received be placed in a restricted account to fund further expenses resulting from contesting property tax bill and to cover higher than expected property tax increases. Ms. Marchand implied that this treatment of the tax refund would allow Providence Water to agree with the Division's recommended reduction of engineering and contractual legal expense.<sup>116</sup>

Addressing the parties' positions regarding Providence Water's three percent operating revenue allowance, Ms. Marchand noted that KCWA agreed with the request but recommended part of the amount be restricted. Ms. Marchand proposed that since restricted funds account for 41 percent of total expenses, that 40 percent of the 3.0 percent allowance, or 1.2 percent, be allocated to a separate restricted account to ensure funding of the restricted accounts when there is a shortfall in revenues. The remaining 1.8 percent operating revenue allowance would be unrestricted.<sup>117</sup> With regard to the Division's position, Ms. Marchand noted that Mr. Catlin indicated that if Providence Water was allowed three percent, then the proposed inflationary factor should not be considered. Ms. Marchand argued that inflation had been higher than the proposed factor for the prior two years. She also did not believe the operating revenue allowance should be restricted to fluctuating expenses, but also be used for unanticipated expenses.<sup>118</sup>

Ms. Bondarevskis provided Providence Water's response to the parties' positions on various expense items. Ms. Bondarevskis explained that Providence Water agreed to Mr. Catlin's recalculation of the past retiree health care amount and revised repayment period. She indicated that Providence Water would also agree to Mr. Catlin's adjustment

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<sup>116</sup> Providence Water Ex. 12 (Rebuttal Testimony of Pamela Marchand), pp. 2-3.

<sup>117</sup> *Id.*



to the Contract Service – Legal and Engineering if Providence Water is allowed to charge all rate year and future expenses for defending property tax bills to a restricted account set up from the Cranston property tax refund.<sup>119</sup>

However, Ms. Bondarevskis disagreed with Mr. Catlin's proposed adjustment to the PUC Assessment portion of Regulatory Commission Expense. In support of Providence Water's position, she prepared a schedule of the PUC Assessment History from FY 2002 through FY 2007. She noted that based on the methodology for calculating the PUC assessment, she expected the FY 2008 assessment to be higher than the test year assessment. The result of her calculation was a \$4,600 increase over what was presented in Providence Water's direct testimony.<sup>120</sup> Addressing a line item that was questioned relative to the Rate Case Expense, entitled City Services, Ms. Bondarevskis explained that a separate \$5,000 line item was the bid price for B&E Consulting to prepare the City Service analysis and she maintained the expenses should remain part of the rate filing costs.<sup>121</sup> Finally, Ms. Bondarevskis noted that in the process of responding to Commission data request 3-15, Providence Water noticed that it had contributed 90 percent of the actuarial amount to the pension fund for FY 2004 while the City of Providence had contributed 86 percent. Therefore, she indicated that Providence Water will make a \$99,746 adjustment to its FY 2008 contribution in order to adjust for the difference between Providence Water's contribution and the City's.<sup>122</sup>

Mr. Gadoury provided testimony in response to the Division's submission of the Woodard & Curran report relative to the filter effluent piping improvements associated

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<sup>118</sup> *Id.* at 4-5.

<sup>119</sup> Providence Water Exhibit 11 (Rebuttal Testimony of Jeanne Bondarevskis), pp. 1, 3-4.

<sup>120</sup> *Id.* at 2-3.

<sup>121</sup> *Id.* at 3.

with the filter upgrade project. He noted that Woodard & Curran agreed with the necessity of the project, but had suggestions regarding methodology. Mr. Gadoury expressed concerns with Woodard & Curran's proposals on the basis of cost and feasibility given the current structural conditions. Therefore, Mr. Gadoury concluded that based on his experience as a Registered Professional Engineer, he concurred with the report of the Maquire Group, his design consultant, that rejected the comments and suggestions of the Woodard & Curran report.<sup>123</sup>

Mr. Edge accepted the Division's adjustments to Wholesale Water Sales, Capital Reimbursement, and to the City Services overhead allocator to account for other enterprise funds of the City.<sup>124</sup> The City Services overhead allocator was now proposed at 8.08 percent. Mr. Edge also agreed with Mr. Catlin's proposal to fund its GASB 43/45 requirement for future retiree health care liability at the same percentage as the City of Providence, with any remainder of that which is already built into rates deposited into a restricted account.<sup>125</sup> Mr. Edge noted that Mr. Catlin made no adjustment to Providence Water's projected chemical costs despite the fact that those costs have increased since Providence Water's initial filing. However, he agreed with Mr. Catlin that there should be enough in the restricted chemical account to offset the increased costs.<sup>126</sup>

Mr. Edge conceded that his original percentage increase for purchased power expense was too high, but believed Mr. Catlin's was too low. He conceded that the purchased power contract between Providence Water and Constellation, Inc., New England would provide savings in the test year, but not necessarily during the interim and

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<sup>122</sup> *Id.* at 4-5.

<sup>123</sup> Providence Water Exhibit 8 (Rebuttal Testimony of Paul Gadoury), pp. 1-6.

<sup>124</sup> Providence Water Exhibit 10 (Rebuttal Testimony of Walter Edge), pp 1-2.

<sup>125</sup> *Id.* at 5.

rate years. He provided a schedule to show increased purchased power expense during the interim year and based on that schedule, proposed a 1.05 percent in the electric purchased power expense applied to the interim year actual electric cost and a 3.75 percent increase in the purchased gas cost applied to the interim year actual gas cost.<sup>127</sup> Mr. Edge noted that Mr. Catlin had not made any adjustments to the rate year property tax projection, but was awaiting actual FY 2008 property tax bills. After receiving those bills and increasing them by 1.55 percent to address the projected increases from July 1, 2008 through December 31, 2008, Mr. Edge updated his projection for the rate year. His new projection of \$6,325,081 represented a \$245,711 reduction from his initial projection.<sup>128</sup>

Mr. Smith provided rebuttal testimony to address: (1) the allocation of fire protection demand; (2) peaking factors; (3) the wholesale fixed charge proposal; and (4) various cost allocations.<sup>129</sup> With regard to the proposed fire protection demand, Mr. Smith indicated that because of recent Commission decisions not to increase private fire connection charges Providence Water was attempting to find another equitable manner of recovering fire protection costs. He argued that the testimony of the Division and KCWA witnesses did not prove the proposal to be inequitable and that the previous methodology was not equitable because it did not collect fire protection charges from tax exempt entities.<sup>130</sup>

Mr. Smith disagreed with Mr. Woodcock's position that the peaking factors Providence Water used were not reasonable. He agreed that the methodology was not

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<sup>126</sup> *Id.* at 5-6.

<sup>127</sup> *Id.* at 3-4.

<sup>128</sup> *Id.* at 4-5.

<sup>129</sup> Providence Water Exhibit 9 (Rebuttal Testimony of Harold Smith), p. 1.

ideal, but provided a reasonable allocation of costs among retail customer classes. He also recognized that the peaking factors do not take into account whether a wholesale customer has storage capabilities. However, he explained that wholesale customers do not currently share in maximum day and maximum hour costs, but are allocated costs based only on their relative share of average day capacity. Therefore, they are basically allocated a share of maximum day and maximum hour costs based on the average of the system. This is why the peaking factors for wholesale customers tend to approximate those of the entire system.<sup>131</sup>

With regard to Mr. Woodcock's assertion that the fixed wholesale charge would provide Providence Water with lower revenues than it would realize under the current consumption based model if wholesale water usage increased, Mr. Smith indicated that Providence Water believes the benefits of stabilizing wholesale revenues outweigh the possibility of reduced revenues. He noted that Mr. Woodcock testified that wholesale consumption has historically been close to historical average. Responding to Mr. Woodcock's argument that it was incongruous to apply a wholesale fixed charge while decreasing fire protection fixed charges, Mr. Smith argued that wholesale revenues make up 25 percent of revenues versus 6 percent for fire protection revenues, and therefore, under the proposal, a larger portion of revenues would be derived from fixed charges than under the previous rate structure.<sup>132</sup>

Addressing cost allocations, Mr. Smith agreed to include unaccounted for water in the cost allocation, affecting Allocation Factor A. He updated Allocation Factor F using June 30, 2007 data. He proposed updating Allocation Factors HM, HMC and HOC based

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<sup>130</sup> *Id.* at 2.

<sup>131</sup> *Id.* at 3.

on multiyear data. Finally, Mr. Smith agreed with Mr. Woodcock's proposal to reallocate benefit and pension expenses to Base for Transmission & Distribution, and Administration in order to more equitably distribute those costs.<sup>133</sup>

## **VI. Kent County Water Authority's Surrebuttal**

On September 7, 2007, KCWA submitted the pre-filed Surrebuttal testimony of Christopher Woodcock. Mr. Woodcock noted that there were three remaining issues in dispute between the parties related to revenue requirements: (1) the disposition of the Cranston property tax refund and associated expenses claimed for tax case litigation; (2) the cost of City Services; and (3) the level of operating revenue allowance and how it might be used or restricted.<sup>134</sup>

First, with regard to the Cranston property tax refund, Mr. Woodcock explained that there appeared to be an agreement among the parties to remove the legal and engineering expenses associated with the tax litigation from the Administrative General and Legal Contract Services line items and to utilize a portion of the tax refund for those costs. He indicated that \$375,000 would be returned to ratepayers for the next three years while the balance of the tax refund would be restricted for legal and engineering costs related to the tax litigation. He did suggest five conditions for the restricted account: (1) Providence Water should be required to report activity in the account to all parties to this docket on a regular basis; (2) that funds only be used for tax litigation support and not for paying increased property taxes; (3) that the amounts returned to ratepayers should be based on the allocation of Cranston property taxes decided upon by the Commission; (4) if after three years, there is any money remaining in the account, it is to be held for

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<sup>132</sup> *Id.* at 3-4.

<sup>133</sup> *Id.* at 5-6.

disbursement back to ratepayers in proportion to the current tax allocation or reconsideration by the Commission with notification to all parties in this docket; and (5) any additional tax settlement/refund dollars must be deposited to this account and not used for any other purpose.<sup>135</sup>

Second, with regard to City Service expense, Mr. Woodcock indicated that he had not changed the position he took in his direct testimony. While noting that Providence Water had agreed to include other enterprise funds in its calculations, he continued to express concern with three issues: (1) a purported double counting of City Services; (2) the inclusion of over \$6 million of property taxes as water expense that he maintained have no bearing on the services provided by most City Departments; and (3) the exclusion of expenses covered by external sources of funding. Mr. Woodcock argued that Providence Water had addressed none of his concerns related to support for the allocators used for City Council, City Council Administration, Finance Department and City Clerk's office.<sup>136</sup> He indicated that his position was not to deny any cost allocation to these departments, but rather, he had "recommended that most of the offices where there is no apparent service or where the service is a duplication of internal Providence Water functions be funded at only half [of his] revised "O" allocator."<sup>137</sup>

Third, with regard to the operating revenue allowance, Mr. Woodcock testified that KCWA continued to support an increase from 1.5 percent to 3.0 percent of total

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<sup>134</sup> KCWA Exhibit 2 (Surrebuttal Testimony of Christopher Woodcock), p. 2.

<sup>135</sup> *Id.* at 2-3.

<sup>136</sup> *Id.* at 3-5.

<sup>137</sup> *Id.* at 5.

expenses, with a portion being unrestricted and the balance restricted for use if there were a revenue shortfall.<sup>138</sup>

Turning to cost allocation issues, Mr. Woodcock addressed the calculation of unaccounted for water, expressing concern that the reported amounts for unaccounted for water were not based on actual meter readings. He noted that Providence Water had indicated a willingness to provide those numbers. He also indicated that KCWA disagreed with the amount Providence Water and the Division had used to calculate unaccounted for water. He noted that the four year average used by the witnesses included under registered use by Johnston, thus affecting the accuracy of the calculations. He proposed reducing the reported unaccounted for water by the Johnston under registration because he maintained the water is now “accounted for.”<sup>139</sup>

Finally, with regard to unaccounted for water, Mr. Woodcock proposed not using the inch-foot method of allocating unaccounted for water because he maintained it assigns too large a portion of water losses to transmission pipes and fails to recognize losses on the retail side. He recognized that the inch-foot method has been the accepted methodology, but argued that as new information becomes available, it should be considered by the Commission. In support of his argument, Mr. Woodcock indicated that since the filing of his direct testimony he had performed some research and he referenced an American Water Works Association Water Loss Task Force report which concluded that “the annual volume of unavoidable losses is a function of the length of water mains, number of service connections, and length of private service connections. Most notably, the size or diameter of the pipe is not one of the elements considered – it is simply the

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<sup>138</sup> *Id.* at 6.

<sup>139</sup> *Id.* at 6-8.

length of the pipe.”<sup>140</sup> Mr. Woodcock noted that while he raised this issue, he had not made an adjustment in this case which would assign more use to retail customers, but wanted the Commission to recognize that “the allocation of unaccounted for water should reflect the length of service pipe, including service connections, and not the inch-feet of pipe excluding service connections” and he believed such related adjustments should be considered in the next docket.<sup>141</sup>

Next, addressing Providence Water’s proposal to apply a fixed wholesale charge of 25% rather than using actual sales, KCWA maintained that this was not a fair revision to the tariff. Mr. Woodcock argued that while the proposal would increase revenue stability for Providence Water, it would only be on the wholesale side, particularly when Providence Water was proposing a reduction in the demand charge for fire protection. He also argued that if the fixed charge is based on a year of high wholesale consumption, the wholesale customers would be overcharged in lower consumption years. Finally, he noted that the State of Rhode Island appears to be very interested in conservation and this proposal is not in alignment with that goal.<sup>142</sup>

Mr. Woodcock also addressed four other areas of concern, including: (1) the classification of pumping labor and allocation of those costs; (2) the recognition that the raw water pump station should not be considered in the allocation of pumping operating costs, particularly power; (3) the allocation of benefits; and (4) the allocation of capital other power production within treatment.<sup>143</sup>

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<sup>140</sup> *Id.* at 8-9.

<sup>141</sup> *Id.* at 9-11.

<sup>142</sup> *Id.* at 11-13.

<sup>143</sup> *Id.* at 13-14.



Mr. Woodcock stated that under what had been filed, the pumping stations included retail only or distribution pump stations as well as pump stations where some costs should be shared by wholesale customers. He indicated that it would be incorrect to allocate the pumping costs the same as the treatment costs because some of the pumping costs are unrelated to service to wholesale customers. He noted that in the past, these different costs have been recognized in rate setting for Providence Water and that this should continue.<sup>144</sup>

According to Mr. Woodcock, his reclassification of labor and benefit costs to pumping allows for the proper allocation of retail only costs to retail service and joint costs to both wholesale and retail customers. Therefore, under his proposal, he maintained that wholesale customers not be allocated costs that have nothing to do with service that is provided to them.<sup>145</sup>

He indicated that because the pumping O&M costs do not include the raw water pumping station it was necessary to develop a new allocation symbol that only included the pumping stations in question and excluded the raw water pump station. He split the costs between retail and wholesale as in prior dockets, but excluded the raw water pumping station. Further, he stated, because the pumping power costs do not include the raw water pumping station it was also necessary to develop a new allocation symbol for pumping power.<sup>146</sup>

Addressing the differences among the parties regarding the allocation of benefits, Mr. Woodcock stated that in prior dockets the employee benefits had been included as a separate line item expense under Administration. He disagreed with Mr. Mierzwa's

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<sup>144</sup> *Id.* at 14.

<sup>145</sup> *Id.* at 15.

allocation, but believed that Mr. Smith's updated cost allocation properly allocated the employee benefit costs within each O&M cost category based on the labor allocation within that category. Mr. Woodcock stated that this is correct because the benefits are related to the labor costs and should be allocated the same way. Mr. Woodcock did disagree with the fact that Mr. Smith did not move the allocation of any benefits from the billing and meter & service categories which resulted in Mr. Smith calculating a significant increase in the service charges.<sup>147</sup>

Mr. Woodcock concluded that the Commission's prior directive to not allocate benefits to the service charge can be accomplished along with the individual allocation of benefits within each cost category by developing a new allocation for each category's benefits that moves the billing and the meter & service pieces to the retail base charge. According to Mr. Woodcock, these new allocation symbols keep the benefits allocated properly within each category and preserve the Commission's past desire to minimize the retail service charges.<sup>148</sup>

Addressing the allocation of capital other power production within treatment, Mr. Woodcock noted that he had allocated the Other Power Production Equipment using allocation symbol A upon the belief that this equipment is related to the overall production of water and that it should not be allocated like the retail and distribution pumping stations as Mr. Mierzwa has allocated it. He indicated that Mr. Smith's allocation of this capital expense was consistent with the method he had used. He stated that while Mr. Mierzwa's allocation is beneficial to the wholesale customers, this capital

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<sup>146</sup> *Id.*

<sup>147</sup> *Id.* at 15-16.

<sup>148</sup> *Id.* at 16.

item only includes supply pumping and that the method used by Mr. Smith is more correct.<sup>149</sup>

Addressing the proposal to reduce fire protection demand, Mr. Woodcock stated that in general, rates should be based on the cost to provide service and that Providence Water had not provided a valid reason why the fire protection charges should be reduced by 50 percent.<sup>150</sup> The result of Mr. Woodcock's proposed adjustments would allow Providence Water a 14.2 percent increase in rate revenues or \$7,092,248, with an increase to wholesale rates of 13.8 percent to \$1,406.42 per million gallons with no fixed charge.<sup>151</sup>

## **VII. Division's Surrebuttal**

On September 7, 2007, the Division submitted the pre-filed Surrebuttal testimony of Thomas Catlin and Jerome Mierzwa.<sup>152</sup> The Division also submitted the second engineering report of Helen Gordon, in response to the Maguire Group's comments included with Providence Water's Rebuttal testimony. The Division's attorney noted that the engineering reviews have been presented "for the purpose of demonstrating that an independent firm has concluded that the significant upgrades proposed by Providence [Water] to its treatment facility are necessary."<sup>153</sup> The level of professional disagreement over one design aspect, according to the Division's attorney, did not rise to the level where additional Division involvement appears necessary.<sup>154</sup>

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<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at 18.

<sup>152</sup> On September 10, 2007, the Division submitted corrected schedules. On September 12, 2007, the Division provided a full copy of Mr. Mierzwa's Surrebuttal Testimony with Corrected Exhibits which was marked Division Exhibit 5.

<sup>153</sup> Filing Letter to Luly Massaro, dated 9/6/07, p.2, referencing Division Exhibit 6.

<sup>154</sup> *Id.*

In his testimony, Mr. Catlin noted that Providence Water had accepted his adjustments to wholesale water revenue, capital reimbursement, retiree health expense and City Service expense. Mr. Catlin indicated that property tax expense updates and purchased power cost revisions appeared reasonable. In addition, Mr. Catlin accepted Ms. Bondarevskis' adjustment to address a recent year where Providence Water's contribution to the City pension was in excess of that which was contributed by the City of Providence.<sup>155</sup> Finally, after a review of additional information from Providence Water, Mr. Catlin is no longer proposing an adjustment to regulatory commission expense or rate case expense.<sup>156</sup>

Addressing the first remaining item in dispute, treatment of the City of Cranston tax refund, which would provide a refund of \$1,508,362 plus interest to Providence Water, Mr. Catlin did not agree that the creation of a reserve fund with a balance of \$1.5 million to cover future property tax litigation costs would be reasonable.<sup>157</sup> Noting that the total spending on these types of matters over the past five years has been approximately \$550,000, even with projected increases in litigation related to the Scituate tax dispute, Mr. Catlin did not believe there was evidence that the costs would approach three times that amount. He also did not support using such a fund to pay future property tax increases because annual increases should be less than \$60,000, something which could be covered by the operating revenue allowance. However, he did recommend that the refund Providence Water receives from Cranston be deposited into an restricted interest bearing account with \$375,000 refunded to ratepayers as a reduction to the cost of service for the upcoming three years. The remaining \$385,000 plus interest, under Mr.

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<sup>155</sup> Division Exhibit 4 (Surrebuttal Testimony of Thomas Catlin), pp. 1-2.

<sup>156</sup> *Id.* at 5.

Catlin's proposal, could be available to Providence Water to pay for the continuing cost of contesting property tax disputes.<sup>158</sup> This account would be subject to review annually by the Division or in Providence Water's next rate case. Furthermore, all future refunds or rebates from any other taxing authorities would be deposited into the account automatically for review after three years.<sup>159</sup> As a result of this proposal, Mr. Catlin continued to recommend a reduction to Administrative and General Contract Legal and Engineering Services, updated to reflect the actual test year expense associated with property tax litigation. The adjustment is \$100,027.<sup>160</sup>

Addressing the proposed increased operating revenue allowance, Mr. Catlin noted that the Commission recently set Newport Water Department's operating revenue allowance at 1.5 percent of total expenses and indicated a desire to open a generic docket to develop a consistent policy for setting operating revenue allowances for the non-investor owned water utilities in Rhode Island. Therefore, he continued to recommend that the operating revenue allowance for Providence Water be set at 1.5 percent of total operating expenses less miscellaneous revenue.<sup>161</sup>

Mr. Mierzwa noted that Providence Water and KCWA accepted his proposed revisions to allocation of T&D mains investment, to updates of several allocation factors initially developed in Docket No. 3163, to recognize costs relative to lost and unaccounted-for water, and to revisions related to the allocation of some source of supply

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<sup>157</sup> *Id.* at 2.

<sup>158</sup> *Id.* at 2-3.

<sup>159</sup> *Id.* at 4.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* at 6.

O&M expenses. He also noted that neither Providence Water nor KCWA opposed his proposed modifications to the allocation of miscellaneous revenue.<sup>162</sup>

Mr. Mierzwa presented a revision to the inch-mile study to include several transmission main sizes that were previously omitted. The revised study indicated that 48.95 percent of Providence Water's mains investment are transmission related. Mr. Mierzwa stated that he reflected the revised study results in his adjustment in order to recognize the costs associated with lost and unaccounted-for water.<sup>163</sup> Mr. Mierzwa noted that in his rebuttal testimony, Mr. Smith had agreed with the proposal made by Mr. Woodcock relative to the allocation of benefits and pension costs for Customer Service, T&D, Administrative and Insurance functions, but that Mr. Smith had not assigned these costs to the Base category in his rebuttal schedules. Mr. Mierzwa indicated that his prior concerns regarding these allocations were addressed by Mr. Woodcock's methodology.<sup>164</sup>

Addressing additional revenue requirement adjustments made by Mr. Catlin, Mr. Mierzwa stated that he had included them in his cost allocation study. With regard to the property tax refund from the City of Cranston, Mr. Mierzwa indicated that he had allocated that refund consistent with the historical manner upon which it had been allocated to the various cost categories.<sup>165</sup>

Turning to the allocation of fire protection demand, Mr. Mierzwa continued to recommend not accepting Providence Water's proposal to reduce the demand costs assigned to fire protection service by 50 percent. He reiterated that

if the Commission is going to adopt a policy of recovering less than the cost of service through fire protection charges, the full cost of providing fire protection

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<sup>162</sup> Division Ex. 5 (Surrebuttal Testimony of Jerome Mierzwa), pp. 2-3.

<sup>163</sup> *Id.* at 3.

<sup>164</sup> *Id.* at 3-4.

<sup>165</sup> *Id.* at 4.

service should be identified, and then an explicit decision should be made as to which customers should pay for the unrecovered fire protection service costs. Under [Providence Water's] proposal to reduce demands by 50 percent, the full cost of providing fire protection service is unknown.<sup>166</sup>

### **VIII. Hearing**

Following public notice, a public hearing was held at the Commission's offices, 89 Jefferson Boulevard, Warwick, Rhode Island, on September 12-13, 2007 for the purposes of hearing evidence and cross examining witnesses in the instant matter. The following appearances were entered:

FOR PROVIDENCE WATER:	Michael McElroy, Esq.
FOR KENT COUNTY WATER:	Joseph McGair, Esq.
FOR THE DIVISION:	William Lueker, Esq. Special Assistant Attorney General
FOR THE COMMISSION:	Cynthia G. Wilson-Frias, Esq. Senior Legal Counsel

Providence Water presented Ms. Marchand, Mr. Gadoury, Ms. Bondarevskis, Mr. Boyce Spinelli, Deputy General Manager of Providence Water, Mr. Bebyn, Mr. Edge, and Mr. Smith. KCWA presented Mr. Woodcock. The Division presented Mr. Catlin.

Addressing the proposed repayment to the City of Providence of past retiree health care costs, Ms. Bondarevskis confirmed that the \$248,180 to be paid in each of the following six years, would be entirely for past money owed for the period 1997 through 2005.<sup>167</sup> She indicated that Providence Water was able to pay the cost for fiscal year 2006.<sup>168</sup> She conceded that Providence Water is asking the Commission for recovery

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<sup>166</sup> *Id.* at 5-6.

<sup>167</sup> Tr. 9/12/07, p. 129, 139.

<sup>168</sup> *Id.* at 139.

through future rates of past estimated costs that accrued over a nine year period.<sup>169</sup> She agreed that the amount being sought by the City was “interest free and it is an estimated amount, but it seemed reasonable.”<sup>170</sup> Ms. Bondarevskis conceded that when Providence Water was filing for previous rate cases, it knew this cost existed.<sup>171</sup> She agreed that there was no loan documentation between the City and Providence Water for any of those years.<sup>172</sup>

While Ms. Bondarevskis stated that Providence Water verifies the amounts charged by the City to Providence Water for active employees, her testimony seems to indicate that there is no verification for inactive/retired employees.<sup>173</sup> Furthermore, she stated that the City does not “even track the retirees based on what departments they originally came from.”<sup>174</sup> Ms. Bondarevskis could not confirm the amount spent on retiree health care costs during the period 1997 through 2005. Furthermore, she clarified that there was no actual data on expenses for 1997 and 1998 for the entire City.<sup>175</sup>

Chairman: “Well, how do you know what the amount is; don’t they have a record of what their retirees’ healthcare costs were during those years?”

Witness: “They would – I believe that was another data request. I’m not sure they have that information. They would have to go back and look up Joe Smow, each

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<sup>169</sup> *Id.* at 144.

<sup>170</sup> *Id.* at 131.

<sup>171</sup> *Id.* She agreed that she knew retirees are entitled to health care after they retire, but never asked if Providence Water was paying those costs because “it just never occurred to me with all the day-to-day things that come across our desk, day-to-day work that goes on. It never occurred to us.” *Id.* at 147-48. She also agreed that the City has always had this cost, but had never asked to be reimbursed. *Id.* at 149.

<sup>172</sup> *Id.* at 145.

<sup>173</sup> *Id.* at 132-33.

<sup>174</sup> *Id.* at 134. She clarified that during discovery, Providence Water did provide a schedule that included only Providence Water employees. *Id.* at 140. Later, Ms. Bondarevskis indicated that the retirement department is separate and it is responsible for its own payroll to retirees. *Id.* at 146-57. Therefore, the City should have some record of the relevant retirees and related healthcare costs.

<sup>175</sup> *Id.* at 140.



individual person and then try to get the records for all of those people, but what they – how they charge us now, the city is self insured.”<sup>176</sup>

Relying on information received from the City’s GASB 43/45 consultant, Ms. Bondarevskis agreed that in 2007, the City began tracking retirees separately from active employees for healthcare expenses and she agreed that before 2004, the costs requested are based on estimates.<sup>177</sup> In fact, prior to 2004, Ms. Bondarevskis agreed that she did not have information from the City regarding how many of the total retirees were former Providence Water employees, but estimated that it would have been approximately in the “80 range”.<sup>178</sup> Mr. Spinelli indicated that the rates set by the City to recover the cost of healthcare separated active employees from those that are retired and attain the age of 65. At that age, most retirees are then transferred to a medicare supplement plan such as Plan 65.<sup>179</sup> However, Mr. Spinelli could not recall whether, when the actual claim experience was broken out and provided to the City, retirees were in a separate category from active employees or not.<sup>180</sup> He conceded that the funding rates for which the City is seeking reimbursement are still estimates.<sup>181</sup>

Revisiting issues of Commission concern in the past, Mr. Spinelli agreed that despite the adjustments Providence Water made to its pension contributions in the past, Providence Water had still contributed a percentage of the actuarial recommendation

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<sup>176</sup> *Id.* at 135-36.

<sup>177</sup> *Id.* at 141-42.

<sup>178</sup> *Id.* at 142-43.

<sup>179</sup> *Id.* at 154-55.

<sup>180</sup> *Id.* at 162. The working rates provided to the City by the health insurance carrier are estimates of future costs. The City is later provided with the actual claim experience.

<sup>181</sup> *Id.* at 160, 163.

greater than that which was contributed by the School Department and the City of Providence. However, Providence Water was recommending no further adjustments.<sup>182</sup>

On cross-examination, Mr. Catlin testified that Providence Water had some obligation to ensure they were paying costs incurred in the past, but he could understand how the oversight related to retiree health care occurred. When asked to define retroactive ratemaking, Mr. Catlin stated, “It’s seeking recovery for an expense or variation in expense that you could have sought recovery before or you became aware of after the fact and now seeking to recovery it.”<sup>183</sup> He reiterated that if Providence Water had been an investor owned utility, he would have recommended rejecting the request.<sup>184</sup> However, because Providence Water is regulated on a cash basis, he was recommending approval. He explained that because the Commission presumably would have granted recovery of the expense if requested in the past, it would be reasonable to do so now.<sup>185</sup> In Mr. Catlin’s opinion, the Commission’s decision on this issue really is a judgment call based on equities.<sup>186</sup>

Addressing City Service Expense, Mr. Bebyn discussed his methodology for developing the allocators assigned to various departments. He indicated he had met with department heads, reviewed personnel responsibilities to eliminate duplication of efforts and reviewed expenses to determine if any could be removed. He maintained that, contrary to Mr. Woodcock’s suggestion, the City Service Expense and Property Tax expense are legitimate expenses of Providence Water and should be included in the calculation to develop the Overhead allocator. He indicated that the Clerk allocator was

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<sup>182</sup> *Id.* at 168-77.

<sup>183</sup> *Id.* at 212.

<sup>184</sup> *Id.*

<sup>185</sup> *Id.* at 209-10.

derived after interviews with personnel and a review of documents. Mr. Bebyn outlined several of his adjustments to various departments and suggested that Mr. Woodcock's proposed adjustments were based on his own opinion rather than an objective critique of City Services.<sup>187</sup>

On cross-examination, Mr. Bebyn indicated that he did not review City Council minutes as part of his review of the City Council duties relative to Providence Water.<sup>188</sup> He was also unable to provide information where the City Council administration provided the Council with research and/or drafting of ordinances.<sup>189</sup> He clarified his testimony relative to the development of the Clerk's office allocator "C", indicating that the allocator was developed by using the number of bids of Providence Water relative to the total of the City plus Providence Water.<sup>190</sup> In order to determine whether his allocator was correct for the Clerk's office, he discussed it with them and was told it was reasonable.<sup>191</sup>

In response to the question that despite the fact that the personnel information related to the mayor's office was not made available to Providence Water, was Mr. Bebyn "confident that all these people spend 8.14 percent of their time on Providence Water related activities," Mr. Bebyn responded, "It was a function of not just time, it was a function of oversight." When asked if that included somebody in the Mayor's office who "goes out to get coffee for the Mayor or goes and gets lunch, his driver, those kinds of things," Mr. Bebyn answered, "I don't have that detail, no." However, the department

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<sup>186</sup> *Id.* at 227.

<sup>187</sup> Tr. 9/13/07, pp. 51-64.

<sup>188</sup> *Id.* at 71.

<sup>189</sup> *Id.* at 79.

<sup>190</sup> *Id.* at 77.

<sup>191</sup> *Id.* at 75.

was assigned the general overhead allocator.<sup>192</sup> Other instances of questioning regarding specific functions of departments were met with similar responses.<sup>193</sup>

Mr. Bebyn confirmed that the calculation of the fringe benefit factor of 72 percent applied to salaries was correct while Providence Water's fringe benefits are calculated at 60 percent, or 12 percent lower. Mr. Bebyn was unable to explain the difference.<sup>194</sup>

On cross-examination, Mr. Woodcock testified that he had done no independent studies of the city departments to determine their functions relative to the support of Providence Water, but had instead based his adjustments off of Mr. Bebyn's analysis.<sup>195</sup> Mr. Woodcock opined, when questioned by the Commission and Providence Water's attorney, that the existence or non-existence of a water board would be a relevant factor to review when considering the level of services necessary for a host city to support its water utility.<sup>196</sup>

On cross-examination, Mr. Catlin testified that with regard to City Services, he "looked at the overall level of the costs and looked at the overall allocation," stating that in most cases one cannot "directly identify which services are provided to which agencies by any particular city office." Therefore, he testified, "I made an evaluation that the overall allocation factor that Mr. Bebyn...used was appropriate." He stated that he chose not to "look at each individual department that couldn't be allocated because I'm sure you could find, as Mr. Woodcock did in his opinion, departments where not as much

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<sup>192</sup> *Id.* at 84.

<sup>193</sup> *See id.* at 70, 85-86.

<sup>194</sup> *Id.* at 88-89.

<sup>195</sup> *Id.* at 111.

<sup>196</sup> *Id.* at 134, 144.

service....” was provided and other departments where more service was provided than that which was allocated.<sup>197</sup>

Addressing the proposed reduction in demand allocated to fire protection, Mr. Smith explained that Providence Water started with the assumed demand that was accepted in the prior general rate filing and reduced that max day and max hour demand by 50 percent. He reiterated that the primary reason was “to reduce the amount of money that the Water Supply Board was recovering through public fire protection” because of inequities relating to the fact that tax exempt institutions were not paying for fire protection through property taxes.<sup>198</sup> He conceded that this was a policy determination by Providence Water as opposed to rectifying an incorrectly developed cost of service in the past.<sup>199</sup> Mr. Smith also conceded that, assuming the Commission’s policy has been to bring public and private fire protection rates in line with their respective costs of service, this proposal would not coincide with that policy.<sup>200</sup>

## **IX. Post-Hearing Briefs**

On October 12, 2007, the parties submitted post-hearing briefs responding to the Commission’s request to address whether or not the request for funding through rates to reimburse the City of Providence for prior years’ retiree health care benefits would constitute retroactive ratemaking. Each of the parties opined that, based on R.I.Gen.Laws § 39-3-11.1 and related Supreme Court interpretations of the statute, the request is either not retroactive ratemaking or exempt from the prohibition on retroactive ratemaking.<sup>201</sup>

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<sup>197</sup> Tr. 9/12/07, p. 203.

<sup>198</sup> Tr. 9/13/07, p. 195.

<sup>199</sup> *Id.* at 195-96.

<sup>200</sup> *Id.* at 196.

<sup>201</sup> Providence Water Brief, pp. 10-12; KCWA Brief, pp. 1-2; Division Brief, pp. 1-8. R.I. Gen. Laws § 39-1-11.1(a) states: Notwithstanding any other provisions of this chapter, the commission shall not have the power to suspend the taking effect of any change or changes in the rates, tolls, and charges filed and

Providence Water also argued that because the City had not requested payment for the retiree health care costs for the period 1997-2005 until 2006, it was not a past obligation, but rather a current one. Furthermore, Providence Water argued that this expense was unexpected.<sup>202</sup>

In addition to discussing issues upon which the parties agreed, Providence Water indicated it was prepared to send out conservation notices in compliance with R.I. Gen. Laws § 39-3-37.1 as long as they are funded.<sup>203</sup> Providence Water argued in favor of its proposed three percent operating reserve with a portion restricted and a portion unrestricted.<sup>204</sup> Providence Water also argued that KCWA's proposed adjustments to City Service expense were unsupported by the record and that its proposal to change the methodology for calculating lost and unaccounted for water should not be entertained by the Commission.<sup>205</sup> Additionally, Providence Water argued that the proposed 25 percent fixed wholesale charge is reasonable and would provide revenue stability.<sup>206</sup> Another argument made was that more public fire protection should be included in consumption charges rather than in the fire protection charge "in order to have tax exempt properties

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published in compliance with the requirements of §§ 39-3-10 and 39-3-11 by any public waterworks or water service owned or furnished by a city, town, or any other municipal corporation defined as a public utility in § 39-1-2, when the change or changes are proposed to be made solely for the purpose of making payments or compensation to any city or town for reimbursement of any loans or advances of money previously issued to any public waterworks or water service by any city or town under existing contracts or arrangements; provided, however, that the change or changes shall take effect subject to refund or credit pending further investigation, hearing, and order by the commission within eight (8) months after the effective date. The public waterworks or water service shall file with the commission the new rate schedule along with the documentary evidence of the indebtedness supporting the new rates. Further, the rate schedule shall be published in a newspaper of general circulation in the service area by the waterworks or water service at least ten (10) days prior to the effective date thereof.

<sup>202</sup> Providence Water Brief, pp. 11-12.

<sup>203</sup> *Id.* at 3

<sup>204</sup> *Id.* at 5-8.

<sup>205</sup> *Id.* at 12-15, 17-18.

<sup>206</sup> *Id.* at 15.

pay their fair share.”<sup>207</sup> Finally, Providence Water argued that the Commission should reconsider its prior decision regarding the allocation of employee pension and benefit costs.<sup>208</sup>

In its Brief, KCWA reiterated its arguments regarding adjustments to City Service expense, pumping expense, the fixed wholesale charge, and cost allocations. The Division agreed with Providence Water that the Commission should not consider KCWA’s position to change the methodology for calculating lost and unaccounted-for water. The Division also agreed with Providence Water that the Commission should revisit its prior decision regarding the allocation of employee pensions and benefits. The Division reiterated its arguments regarding the operating revenue allowance, and Cranston tax refund, noting that Providence Water had agreed to the Division’s proposal regarding treatment of the refund.<sup>209</sup> Discussing the proposed fire protection charges, the Division noted that Providence Water’s proposal also reduces the demand allocated to private fire protection service, requiring all water customers to bear a portion of private fire protection costs as part of their consumption charge, that IFR costs are already required to be included only in consumption charges and as a result, fire protection charges are already subsidized, and that the proposal provides less revenue stability to Providence Water when their goal is for revenue stability.<sup>210</sup>

## **X. Commission Findings**

On October 30, 2007, the Commission conducted an open meeting for the purposes of considering Providence Water’s rate application. The Commission notes that

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<sup>207</sup> *Id.* at 16.

<sup>208</sup> *Id.* at 16-17.

<sup>209</sup> *Id.* at 8-14.

<sup>210</sup> *Id.* at 15.

few issues regarding cost of service remained between the parties. The Commission ruled on the following cost of service issues: Pro forma consumption, conservation notice, restricted accounts, reporting requirements, number of funded positions, treatment of salary increases, treatment of the Cranston property tax refund, net operating reserve, repayment to City of past retiree health care expense, and City Service expense. Additionally, there were issues remaining regarding cost allocations and rate design: proposed wholesale fixed charge, proposed demand reduction to fire service, methodology for measuring lost and unaccounted-for water, reallocation of pensions and benefits in Customer Accounts, labor allocation relating to pumping costs, allocation of Western Cranston Fund, and Allocation of Miscellaneous Revenues.

As a result of the Commission's decision, Providence Water Supply Board is granted a revenue increase of \$6,935,500 versus the \$9,688,321 originally proposed, for a total cost of service of \$58,086,064 to be applied to usage on and after November 1, 2007.<sup>211</sup>

**A. Pro Forma Consumption, Number of Services, Meters & Connections, Conservation Notice**

The parties agree that the rate year consumption calculation should be based on an average of years that includes the most recent data available, namely FY 2007 consumption. The Commission also agrees and will use the average consumption from the 2004 through FY 2007 period. The Commission also directs Providence Water to utilize the updated customer counts for services, meters and hydrants. This will provide the most accurate calculation of rates.

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<sup>211</sup> See Appendix A and Appendix B, attached (Providence Water Supply Board, Docket 3832 Cost of Service and Cost of Service Adjustments).



During the hearing, it became clear that Providence Water has not been sending out conservation notices required by R.I. Gen. Laws § 39-3-37.1. Providence Water recognizes and agrees to the requirement. Estimates provided by its printer vendor indicate that a simple bill insert setting forth the information listed in the statute would cost approximately \$2,016.<sup>212</sup> The Commission directs Providence Water to send out such a conservation notice annually and allows \$2,100 in rates to cover the cost.

**B. Reimbursement to the City of Past Retiree Health Care**

Providence Water is seeking recovery through future rates of \$1,489,080 over six years to pay the City of Providence for Providence Water's portion of retiree health care that has supposedly been paid by the City on the utility's behalf for over nine years. According to Providence Water, the City never billed Providence Water for the retiree health care when the costs were incurred. Providence Water is now requesting reimbursement on behalf of the City for the period 1997 through 2005.<sup>213</sup> Providence Water's main argument is that this is a cost the utility should have been paying all along and they were not. Therefore, it would only be fair to repay the City out of future rates, for the estimated costs the City incurred in the past. For the reasons set forth herein, the Commission rejects Providence Water's request. The resulting adjustment is a reduction to Providence Water's request in the amount of \$248,180.

The prohibition against retroactive ratemaking is a fundamental principle of utility regulation. As the Supreme Court has stated, "One of the central principles of ratemaking is that rates must be prospective. It is well settled that rates are exclusively

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<sup>212</sup> Providence Water Response to Commission Record Request 3 (dated September 21, 2007).

<sup>213</sup> Providence Water was billed for and paid the 2006 retiree health care from existing rates.

prospective in nature and that future rates may not be designed to recoup past losses.”<sup>214</sup> Furthermore, the rule against retroactive ratemaking “protects the public by ensuring that present consumers will not be required to pay for past deficits of the company in their future payments.”<sup>215</sup> The prohibition against retroactive ratemaking is important because, to summarize the Indiana commission, it serves to protect customers by ensuring current users pay for service they receive as opposed to costs associated with past service and to require utilities to bear losses and enjoy benefits based on their efficiency of management.<sup>216</sup>

At the hearing, the Division’s witness defined “retroactive ratemaking” as “seeking recovery for an expense that you could have sought recovery before or you became aware of after the fact and now seeking to recover it.”<sup>217</sup> In this case, Providence Water is requesting that over the next six years, ratepayers be required to pay for nine years’ worth of past retiree health care costs for which the utility was responsible but for which it did not pay. This is clearly an example of retroactive ratemaking.<sup>218</sup>

Providence Water claims that because the City did not bill it for the expense for over nine years, it is a current, not past expense. Therefore, Providence Water maintains, there would be no retroactive ratemaking. The Commission does not accept this rationale because the expense existed for the past ten years and could have been recognized by any

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<sup>214</sup> *Providence Gas Co. v. Burke*, 475 A.2d 193, 197 (R.I. 1984).

<sup>215</sup> *Narragansett Electric Company v. Burke*, 415 A.2d 177, 179 (R.I. 1980).

<sup>216</sup> 1 LEONARD SAUL GOODMAN, *THE PROCESS OF RULEMAKING* 165-166 (Public Utilities Reports, Inc., 1998) (citations omitted). The third purpose behind the rule against retroactive ratemaking is to prevent “utilities from using future rates to protect the financial investment of their stockholders...” *Id.* See Division’s Brief, p. 2.

<sup>217</sup> Tr. 9/12/07, p. 212. The Division’s witness claimed that if this had been an investor owned utility, he would recommend denial based on retroactive ratemaking.

<sup>218</sup> See Tr. 9/12/07, p. 212.

number of officials at Providence Water or in the City of Providence within a reasonable time period.

Furthermore, payment for the health care is due each year and therefore, each year's expense was due in the year during which it was incurred. Had the City appropriately charged Providence Water for the annual expenses, Providence Water would have had the opportunity to pay its bills. In fact, in 2006, when Providence Water was charged for the retiree health care expense for that year, it was paid out of operating revenues. Therefore, the rationale cited by Providence Water and KCWA, arguing that the Supreme Court has already found this type of situation not to be retroactive ratemaking, is not persuasive.<sup>219</sup> Under these circumstances, it is clear that Providence Water is seeking future recovery of past costs, which falls squarely under the definition of retroactive ratemaking.

Like all rules, the Supreme Court has recognized limited exceptions to the rule against retroactive ratemaking, noting that "no rule shall be blindly applied, however, without prior consideration of the underlying policy that the application of the rule in a

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<sup>219</sup> KCWA cites the Supreme Court's decision in *Kent County Water Authority v. State Dept. of Health*, 723 A.2d 1132 (R.I. 1999) as a basis for determining that this situation does not constitute retroactive ratemaking. In that case, KCWA argued that because it did not have funds in its rates to pay an annual DOH licensing fee, billing it for past due accounts would require it to make a rate filing to the PUC seeking a retroactive rate case. The Supreme Court disagreed with this contention, finding that "DOH always billed petitioner for the annual approval fee in advance of each fiscal year for which petitioner was obliged to obtain DOH's approval to operate its public water-supply system. The mere fact that DOH has continued to demand payment from petitioner of these past-due, multi-year arrearages...does not constitute a coercion of petitioner into retroactive ratemaking." *Id.* at 1137. The Supreme Court noted that there were many ways KCWA could have paid the annual fee out of its then current rates or it could have initiated a rate case in order to avoid the arguable retroactive ratemaking situation. *Id.* at 1137. Providence Water was not billed on an annual basis by the City, appears to have been in the position where they should have been aware of the retiree health care obligation, and had multiple rate cases before the Commission during the time in question when it was apparently supposed to be paying these expenses. Providence Water's cost is not a current charge by the City like DOH's. DOH acted responsibly in assessing the fee on an annual prospective basis. The City did not. Therefore, Providence Water's argument that this is not a retroactive obligation, but a current obligation owed by Providence Water to the City is unsupported by the evidence where all parties agree that this was an expense Providence Water should have been paying all along. Relying on the City's delay in billing does not make this a current expense. It is still a prior obligation.

particular instance will not undermine its original purpose.”<sup>220</sup> First, there is an emergency exception, where there is an extraordinary expense caused by an event that is unpredictable and not within the control of the utility. In such circumstances, the Court found that the public interest in having the utility expend extra costs in order to quickly restore power after an extreme storm outweighed the rationale behind the prohibition on retroactive ratemaking.<sup>221</sup> Second, there is an exception for reviews of past costs in conjunction with a reconciliation tariff. For instance, noting that “the specter of retroactive ratemaking must not be viewed as a talismanic inhibition against the application of principles based upon equity and common sense,” the Court found that a review of past costs associated with a reconciliation tariff was not retroactive ratemaking, but a necessary function of the Commission under that type of tariff.<sup>222</sup> Third, the Court has recognized the statutory exception of R.I. Gen. Laws § 39-3-11.1(a) which applies to a municipally owned water utility when it is repaying a loan or advance to its host city or town. The statute allows an immediate rate increase followed by a Commission review.<sup>223</sup> As will be discussed further, the Commission finds that none of these exceptions applies to Providence Water’s instant request.

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<sup>220</sup> *Narragansett Electric Company v. Burke*, 415 A.2d at 178.

<sup>221</sup> *Id.* at 179, stating (“the rule [prohibiting retroactive ratemaking] serves to protect present customers from paying for a utility’s past operating deficits. This aspect of the rule must be weighed against the interest of providing immediate service to customers when a destructive, unexpected storm occurs. On such an occasion the public interest in quickly restoring heat and electricity to the homes of customers must prevail....The next time a storm of this magnitude occurs, the company would have no incentive to hire outside line and tree crews to restore service efficiently and swiftly to customers if no reimbursement for extraordinary expenses would be forthcoming. Thus, application of the rule to expenses related to such an emergency situation so inextricably related to the public health and safety would serve to thwart the goal of effective customer service.”) *Id.* at 179-80.

<sup>222</sup> *Roberts v. Narragansett Electric Co.*, 470 A.2d 215, 217 (R.I. 1984). See *Blackstone Valley Electric Co. v. PUC*, 42 A.2d 242 (R.I. 1988) (noting that this case involved a reconciliation tariff requiring the Commission to review past costs). Such a situation does not exist in this case. These are general operating expenses, not expenses designed to be passed through on a regularly-occurring reconciliation basis.

<sup>223</sup> See *Providence Water v. Malachowski*, 624 A.2d 305, 310 (R.I. 1993) *finding*, “The PWSB claims that the rate-making statute limits the commission’s inquiry to the existence and legitimacy of loans and

Regarding the statutory exception, R.I. Gen. Laws § 39-3-11.1(a) states in part, that a municipal water utility can change its rates without being subject to suspension by the Commission where “the change or changes are proposed to be made solely for the purpose of making payments or compensation to any city or town *for reimbursement of any loans or advances of money* previously issued to any public waterworks or water service by any city or town under existing contracts or arrangements.”<sup>224</sup> Thus, to determine whether the statutory exception applies, the Commission’s first inquiry is into “the existence and legitimacy of loans and advances.” made by a host city or town to the utility.<sup>225</sup> Based on the following reasoning, the Commission finds that there was no existence of a loan or advance.

According to Black’s Law Dictionary, a loan is a sum of money provided for the payment of something with the expectation of repayment.<sup>226</sup> In every case cited by the parties, it was clear that there was a loan or advance.<sup>227</sup> Providence Water admits no loan documentation exists in this case and neither the Annual Reports for the City nor the Providence Water Supply Board appear to contain reference to any amount owed by Providence Water to the City of Providence for past retiree health care expense in the

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advances. We disagree with this interpretation of the statute. Section 39-3-11.1 leaves the commission with substantive review of the PWSB’s rate filing....We now reiterate that § 39-3-11.1 does not abrogate the review provisions of the regulatory scheme in chapter 3 of title 39. It merely defers them.” (citations omitted).

<sup>224</sup> R.I. Gen. Laws § 39-3-11.1(a) (emphasis added).

<sup>225</sup> See *Providence Water v. Malachowski*, 624 A.2d 305, 310 (R.I. 1993).

<sup>226</sup> BLACK’S LAW DICTIONARY 936 (6<sup>th</sup> ed. 1990).

<sup>227</sup> See *In re: Woonsocket Water Dept.*, 538 A.2d 1011, 1015 (R.I. 1988); See *Providence Water Supply Board v. Malachowski*, 624 A.2d 305, 306 (R.I. 1993).

reports reviewed by the Commission.<sup>228</sup> In fact, Providence Water never claimed that this expense constituted repayment of a loan or advance.

According to Black's Law Dictionary and Webster's Dictionary, an advance is to pay (money or interest) before legally due.<sup>229</sup> This was not a situation where the City was paying Providence Water's obligation before it came due and ten years later, it is now due from Providence Water. Retiree health care expense is an annual expense and should have been paid as incurred.

Because the Commission finds that there was no loan made during the years 1997 through 2005 and no advance of money, the statute does not appear to apply to Providence Water's request. In order for the statute to apply, a loan or advance would have to now be defined as any money, whether known or unknown, paid by a City, not charged to the utility, and where repayment is demanded up to 10 years later. This would be an unreasonable interpretation which the Commission will not adopt.

The intent of this statute is not to create a blanket exception for municipal water utilities from the rule against retroactive ratemaking.<sup>230</sup> When the Supreme Court speaks

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<sup>228</sup> Tr. 9/12/07, p. 145. Commission Exhibit 1 (Providence Water Response to Commission Data Requests 3-1, 3-8). Providence Water's Annual Reports are on file with the Commission. The Division's brief also notes that there is no loan documentation, not even an informal note between the City and utility.

<sup>229</sup> BLACK'S LAW DICTIONARY 52 (6<sup>th</sup> ed. 1990); Webster's II New College Dictionary, 16 (Houghton Mifflin 1999).

<sup>230</sup> Providence Water quotes, "a publicly owned water authority is exempted from the ban on retroactive rate making normally applied to privately owned public utilities." See *O'Neil v. Malachowski*, 604 A.2d 1268 (R.I. 1992). In fact, this holding only applies if R.I. Gen Laws § 39-3-11.1 is applicable, which it is not under the current circumstances. Furthermore, in the subsequent case reviewing the same issue, the Court upheld the Commission's decision to disallow a portion of the loan Providence Water could repay the City. See *Providence Water Supply Board v. Malachowski*, 624 A.2d 305 (R.I. 1993). That *Providence Water* decision specifically stated that the Commission's review under the statute "exceeds mere regulation. Section 39-1-1 vests the commission with the power to regulate and to *supervise* the conduct of the PWSB for the purpose of controlling its efficiency and protecting the public against improper and unreasonable rates." *Id.* at 309 (emphasis in original). Furthermore, "without the commission's guidance, the PWSB will have little incentive either to adopt proper fiscal management or to adhere to statutory requirements." *Id.* at 311. A blanket exception from the prohibition on retroactive ratemaking for municipal water utilities would make it very difficult for the Commission to fulfill this statutory mandate and discourage efficiency while encouraging inefficiency and allowing Providence Water to be used by the

to the reason the statute allows for retroactive recovery of expenses by municipal water utilities, it speaks in terms of revenue deficiencies that have to be covered by taxpayers.<sup>231</sup> In finding that the surcharge allowed under R.I. Gen. Laws § 39-3-11.1 applied despite the fact that it collects past expenses from future ratepayers, the Supreme Court has stated, “[t]hose revenues that the water utility *cannot* recover from the users, the city provides through taxes, not voluntary investors.”<sup>232</sup> There was no claim by Providence Water that it could not pay its retiree health care because of revenue deficiencies during the years such expenses should have been paid. In fact, in 2006, Providence Water met its obligation without a request for rate relief. Therefore, the Commission does not believe the intent behind R.I. Gen. Laws § 39-3-11.1 applies to Providence Water’s request.

The next question is whether there is a non-statutory exception to the prohibition against retroactive ratemaking that would apply to Providence Water’s situation. Utilizing broad policy statements made by the Supreme Court when reviewing matters related to retroactive ratemaking, either under the statute or not, Providence Water maintains there is. The Commission does not agree.

Regarding the exception to the prohibition against retroactive ratemaking where there was an event, unforeseeable by the utility and not within the utility’s control, the Court found an exception where an electric utility was seeking recovery of expenses it had incurred to restore service “after the crippling ice storm of January 14,

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City to rectify its own prior mismanagement, thus thwarting the Court’s finding that proper supervision and the exercise of fiscal prudence by the Commission will also protect taxpayers. *See id.*

<sup>231</sup> *In re: Woonsocket Water Dept.*, 538 A.2d 1011, 1014-15 (R.I. 1988).

<sup>232</sup> *In re: Woonsocket Water Dept.*, 538 A.2d at 1014-15 (emphasis added).

1978...described as the most destructive in the company's experience."<sup>233</sup> The Court has also recognized the exception where a utility was faced with an unexpected supplemental tax increase. The Court found that "the company, in establishing its rates for 1981, necessarily had to predict the tax rate for 1980. However, it would have been impossible for them to have predicted the *supplemental* tax surcharge assessed by the city. This expense itself was extraordinary....It is clear that the company is faced with a one-time surcharge and is seeking recovery not for an improperly anticipated property tax increase but for a retroactive charge that would be impossible to foresee."<sup>234</sup>

Likewise, in *Blackstone Valley Electric Co. v. PUC*, the Court found that Blackstone Valley Electric (BVE) was entitled to collect from ratepayers past additional expense charged by its wholesale supplier for coal even though the supplier did not recognize that there would be an additional expense for almost one year and did not charge the utility for 18 months.<sup>235</sup> In holding that the Commission erred in denying the pass-through cost as retroactive ratemaking, the Court held that this case fit under the emergency exception as an unexpected event, noting that "the fuel adjustment clause will apply to reflect fluctuations in the cost of fuel charged by the Company's wholesale suppliers of power."<sup>236</sup> According to the Court, "Blackstone *could not* have foreseen a decrease in the energy value of Montaup's coal pile in Somerset. For almost one year even the managers at Montaup were unaware of the moisture content problem. In short,

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<sup>233</sup> *Narragansett Electric Company v. Burke*, 415 A.2d 177 (R.I. 1980). See *supra* notes 178-79 and accompanying text.

<sup>234</sup> *Providence Gas Co. v. Burke*, 475 A.2d 193, 198 (R.I. 1984). Finally, the Court has recognized an exception where a federal or state reconciliation tariff applied to a past charge. That situation does not exist here.

<sup>235</sup> *Blackstone Valley Electric Co. v. PUC*, 542 A.2d 242, 243-44 (R.I. 1988).

<sup>236</sup> *Blackstone Valley Electric Co.*, 542 A.2d at 244.



the situation that led to the surcharge was an extraordinary event that is unlikely to occur.”<sup>237</sup>

The Commission finds that just because neither the City nor Providence Water recognized the expense for over nine years that does not mean they could not have. BVE had no control over the storage of the coal or the testing. Providence Water had control over its own books and knew they were paying for current employees’ healthcare. Providence Water knew that retirees were entitled to health care, but “it never occurred to [them]” to inquire.<sup>238</sup> Therefore, this was not an unforeseen event over which Providence Water had no control, and thus, the facts of the BVE case are inapplicable to the circumstances surrounding Providence Water’s request.

In addition, Providence Water’s failure to pay retiree health care from 1997 through 2005 was not unforeseeable, extraordinary or beyond the control of the utility. This is not a situation where the expense was unforeseeable. In fact, Ms. Bondarevskis, Providence Water’s Director of Finance, testified that she was aware Providence Water retirees were receiving health care coverage.<sup>239</sup> This was also not a situation outside of the control of the utility. Anyone at Providence Water or the City could have raised the issue, and the expense could have been paid as incurred. Finally, the expense was not extraordinary. These were regular annual operating expenses that, but for the poor management of the City, were not charged to Providence Water. Additionally, at any time, Providence Water could have questioned why it was not paying these charges.

Regarding the exception for reconciliation tariffs, in *Providence Gas Co. v. Burke*, the Court found an exception to the prohibition against retroactive ratemaking

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<sup>237</sup> *Id.* at 245 (emphasis added).

<sup>238</sup> Tr. 9/12/07, p. 149.

where a federal or state reconciliation tariff applied to a past charge. In another case, the Court held that the “commission also erred by not allowing a fuel adjustment assessment pass through in accordance with the provisions of Blackstone’s tariff.”<sup>240</sup> That situation does not exist here. Providence Water is not seeking recovery for charges that are permitted through a federal or state reconciliation tariff.

Even if the Commission found that the prohibition against retroactive ratemaking should not apply, it is unclear what amount for retiree health care should be allowed. In order to calculate the amount to be paid back, according to Ms. Bondarevskis, the City Controller’s office started with actual costs for fiscal years 2005 and 2004, discounted the costs back for each fiscal year 2003 through 1997, based on the annual working rate increase. In Ms. Bondarevskis’ opinion, this was “a reasonable method of *estimating* the outstanding liability.”<sup>241</sup> The claimed expense is an *estimate*. Ms. Bondarevskis used this term in her pre-filed testimony and two Providence Water witnesses testified at the hearing that, no matter how close the estimates may be to actuals, they are still estimates.<sup>242</sup> The Commission can set rates based on estimates. However, those are *prospective* costs, not *past* expenses. Past expenses must be accurate and verifiable. Providence Water was presented with the opportunity to provide the Commission with actual retiree health care expenses. The utility objected to the question on that basis that it was overly broad and unduly burdensome. At the hearing, Ms. Bondarevskis testified that it could be done.<sup>243</sup> Under R.I. Gen. Laws § 39-3-12, the burden of proof is on the

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<sup>239</sup> Tr. 9/12/07, p. 147.

<sup>240</sup> *Blackstone Valley Electric Co.* 542 A.2d at 245.

<sup>241</sup> Providence Water Ex. 3, p. 7-8 (emphasis added).

<sup>242</sup> Tr. 9/12/07, pp. 131, 139, 142, 144, 160, 163.

<sup>243</sup> See Tr. 9/12/07, pp. 136, 141. In fact, Providence Water refused to answer a related data request, not based on impossibility, but on the claim that the request was overly broad and unduly burdensome. Commission Exhibit 1 (Providence Water Response to Commission Data Request 7).

utility to present and prove its expense, but Providence Water objected and refused to provide the information.<sup>244</sup> Therefore, Providence Water failed to prove its case.

Finally, with regard to the “it’s only fair to pay what we should have been paying” argument, which the Commission notes is what retroactive ratemaking is, the Commission also points out that over several years, Providence Water contributed a percentage of its actuarially recommended contribution to the City’s pension system higher than what the City and School Department contributed. Although Providence Water reduced its contributions in order to balance the contributions for a short period subsequent to 2002, the ratepayers still have subsidized taxpayers in the past in the range of \$494,859-\$979,002, depending on how many years are reviewed.<sup>245</sup> The Commission notes that neither the City of Providence nor Providence Water is proposing to have the City’s taxpayers reimburse Providence Water’s ratepayers for such subsidization.

For all of these reasons, the Commission reiterates its determination that the request to repay past retiree health care is denied.

### **C. City Services Expense**

In Docket No. 3163 (Rate Year 2001), the Commission approved a Settlement wherein \$806,769 was allowed for Providence Water’s City Service Expense. As part of the Settlement, Providence Water agreed to reevaluate and study these expenses in its next rate filing. In Docket No. 3446 (Rate Year 2003), the Commission approved a

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<sup>244</sup> Commission Exhibit 1 (Providence Water Response to Commission Data Request 7). Because the City never distinguished prior to 2006 between active and retired (but younger than 65 years old) employees until for purposes of setting premiums, it is unclear whether some of the retiree costs were already included in active employee premiums. This would affect the amount owed.

<sup>245</sup> *Order No. 18496* (issued January 11, 2006). Commission Exhibit 4. For the time period 1997 through 2002, the comparable time period for which repayment to the City is being requested, Providence Water’s payment in excess of the contribution by the City and School Department was \$494,859 and looking back at the time period 1992 through 2002, a comparable number of years, it was \$979,002. Providence Water’s response to Commission Record Request 6 (dated October 3, 2007).

Settlement wherein City Services was reduced to \$729,994. In Docket No. 3684 (Rate Year 2006), Providence Water did not request an adjustment to City Service Expense. In this rate filing, Providence Water is requesting an increase of \$515,958 for a total City Service Expense of \$1,245,952.

The Commission has the legal authority to modify City Service Expense just like any other expense if it either finds the expense not to be just and reasonable or if it is unsupported by the facts presented to the Commission. City Services has been a cause of concern for the Commission since at least 1988.<sup>246</sup> In the instant docket, Providence Water has provided the Commission with a study which reviews the functions of various departments of the City and assigns an allocator to each departmental budget (after removing some personnel in some instances). Each department then has a dollar amount assigned to it.<sup>247</sup> Providence Water's witness indicated that he met with department heads to discuss the functions and after assigning the allocators, asked them if they believed the amounts were reasonable.<sup>248</sup> At the hearing, Providence Water's witness was subject to extensive cross examination during which he was unable to explain what various positions within departments did to provide support to Providence Water despite the fact that all positions were included as providing support to the Providence Water Supply Board.

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<sup>246</sup> In Docket No. 1900, the Commission allowed contested City Service Expenses relying on Providence Water's assertion that "City Services expenses are 'based on actual costs incurred by the Board as verified by its auditors.'" *Order No. 12796* (issued November 14, 1988). See *Audobon Society of Rhode Island v. Malachowski*, 569 A.2d 1 (R.I. 1990) (affirming Commission's adjustments to City Service Expense). In the instant docket, Providence Water provided the Commission with a study, but does not allege the associated costs are based on actual costs incurred by the Board from the departments.

<sup>247</sup> The Commission notes that this is similar to the methodology used in Docket No. 3163.

<sup>248</sup> See Tr. 9/13/07, p. 75.

KCWA's witness argued several issues and made adjustments to allocators based on his double counting argument as well as adjustments to specific departments.<sup>249</sup> However, at the hearing, KCWA's witness conceded that he had done no independent review of the departments, but rather, had made specific adjustments based on his own judgment. The Division made the decision to "look at the overall level of the costs and look at the overall allocation," but not at specific allocations in the way KCWA's witness did, noting that some departments may be over-allocated and some under-allocated.<sup>250</sup>

The Commission is concerned that departmental costs included a fringe benefits amount of 72 percent of wages which is 12 percent higher than the fringe benefits assigned to Providence Water. While the Commission believes this is an accurate calculation of the City personnel's fringe benefits, the Commission is concerned that ratepayers are being asked to subsidize such a high level of benefits. Troubling also to the Commission is that the Division requested information regarding personnel in the mayor's office. However, despite the fact that this is information required to be disclosed under an Access to Public Records Act request, Providence Water stated it was unavailable.<sup>251</sup>

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<sup>249</sup> The Commission also believes that while Mr. Woodcock's testimony that property taxes require no support by the City, the Commission does agree with the concept that the level of property taxes does not correlate to the level of support provided by the City to issue checks.

<sup>250</sup> Tr. 9/12/07, p. 203.

<sup>251</sup> Information related to specific personnel costs of the mayor's office was withheld from the parties, and therefore, from Commission review. Based on information the Commission was able to gather, the mayor's salary and benefits total \$215,000. The average salary and benefits for the remaining employees total \$101,762. Therefore, the total of \$264,287 allocated from the mayor's office includes the equivalent of 2 full time equivalents (3640 hours per year) plus more than 8.08% of the mayor's salary. (See Commission Exhibit 1). The General Overhead allocator is 8.08 percent of total departmental costs. It is difficult to envision this level of service being provided to Providence Water in light of the fact that this would be significantly more than the oversight described by Mr. Bebyn in his testimony. Additionally, the Commission is skeptical of the level of support provided in light of the fact that Mr. Bebyn conceded that he did not have information to discount positions such as the mayor's driver, a position that might, at best, tangentially benefit ratepayers.

Because the Commission does not find Mr. Bebyn's study to be sufficient evidence upon which to review the reasonableness of the City Service expense requested to be funded through rates and Mr. Woodcock's alternatives appeared to be based more on subjective evaluation rather than objective criteria, the Commission was unable to determine the known and measurable City Service expense from the evidence presented. Under R.I. Gen. Laws § 39-3-12, Providence Water has the burden of proof which it failed to meet on this issue. Therefore, the Commission determines that the best approach is to take the last amount approved as just and reasonable for calendar year 2006 and to adjust it upward by the inflation percentage utilized for certain other expenses in this filing to reach an appropriate expense for Calendar Year 2008.

Therefore, because the Commission does not have sufficient evidence upon which to make a determination as to the just and reasonableness of the parties' respective positions, but recognizes that there are services provided to Providence Water by the City, the Commission is taking the last approved City Service Expense of \$729,994 and increasing it by the 2.5 percent per year inflationary level that has been agreed to in this rate filing in order to adjust from Rate Year 2006 to Rate Year 2008. The total City Service Expense is \$776,568 plus Stop Loss Insurance and GASB 43/45 Consulting totaling \$62,559 for a total of \$839,167.<sup>252</sup> The adjustment is a \$401,188 reduction to Providence Water's request. All regulated municipal water utilities are now on notice that in the future, the Commission will approve only verifiable departmental expenses

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<sup>252</sup> The Stop Loss Insurance is a verifiable number and is based on the number of Providence Water employees divided by the number of (Providence Water + City of Providence) employees as the insurance relates to each employee. Therefore, this is a reasonable calculation that was not previously included in City Services. In addition, the GASB 43/45 Consulting allocation is a new charge due to the change in regulations. The Commission finds the calculation and allocation of this verifiable charge to also be reasonable.

charged by the City Departments to the respective water boards, departments or divisions for services rendered.

**D. Restricted Accounts, Positions and Salaries, Cranston Property Tax Refund, Operating Revenue Allowance, Reporting Requirements**

The Providence Water Supply Board shall continue to restrict the following accounts in the following amounts collected through rates: Capital Improvements - \$2,450,000; Western Cranston Fund - \$62,069; IFR - \$13,900,000; Meter Replacement - \$1,000,000; Insurance Fund - \$2,967,655; Chemicals and Sludge - \$3,132,565; and Equipment Replacement - \$600,000. As in the past, unspent funds within the restricted accounts at the end of each year shall remain in the respective accounts, subject to any modifications stated herein. Providence Water shall report the activity within its restricted accounts three times per year, or once every four months.

Providence Water shall file timely reports with the Commission. Semi-annual Reports shall be filed with the Commission no later than 90 days from the end of the reporting period. Failure to file all required reports prior to filing another rate case shall result in rejection of such rate case under the Commission's Rules of Practice and Procedure. In addition to the current requirements of the semi-annual reports, Providence Water shall also include the following with its semi-annual reports: (1) Pensions: amount of contribution, percentage of actuarial recommendation compared to the City's and the School Department's, any changes to the pension plan, the cost of the pension contribution as a percentage of actual payroll of those who are in the pension system, and once per year, shall provide the annual report from Providence Water's actuary on the pension plan and the annual audited report on the pension plan;<sup>253</sup> (2) Retiree Health Care

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<sup>253</sup> Providence Water agreed to the additional reporting. Tr. 9/12/07, pp. 123-24.

Reporting related to GASB 43/45 actuarial recommendations: amount of contribution, percentage of the actuary's recommendation compared to the City's and the School Department's. Any amounts allowed in rates in excess of the actual contribution shall be restricted.

In addition, Providence Water shall create a separate restricted account entitled Property Tax Refund into which the funds received from the City of Cranston (\$1,510,096.16) shall be deposited. Out of that account, \$375,000 shall be credited to customers annually, for a total over three years of \$1,125,000.<sup>254</sup> The remaining balance in the account shall be used for litigation expenses related to property tax challenges, but not increased property taxes. Funds may be expended only on invoices for services rendered on and after November 1, 2007. In addition, any future tax refunds or adjustments in Providence Water's favor shall be deposited into this account for further disposition as ordered by the Commission. In conjunction with its semi-annual financial report, Providence Water shall provide to the Commission, with a copy to the parties to this docket, a reconciliation of the activity in the account. Finally, there was no objection to KCWA's proposal that if after three years, there is any money remaining in the account, it is to be held for disbursement back to ratepayers in proportion to the current tax allocation or reconsideration by the Commission with notification to all parties in this docket. However, because the Commission does not know how long the currently pending tax challenges will take, the Commission will review the balance of the account and entertain proposals by Providence Water regarding the appropriate future treatment

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<sup>254</sup> In reality, the \$375,000 per year has been calculated into the rates approved by the Commission in this docket and will not constitute an additional rate credit to customers. The Commission presumes that Providence Water will credit the amount to its operating revenues on a schedule that will allow it to withdraw no more than the \$375,000 annually.



of the funds within the account. Because the Commission has accepted the proposal of the parties with regard to the appropriate treatment of the City of Cranston tax refund, the Commission is reducing the Administrative and General Contract Services by the increase requested, or \$100,027.

The number of positions funded in this rate case is 263, including full-time and part-time. Providence Water indicated that this is the average over the most recent 14 month period.<sup>255</sup> Providence Water shall also restrict the equivalent of a 3 percent increase in salaries and benefits (\$947,203) for the purpose of covering anticipated salary and benefits increases when a new labor contract is entered into between the City of Providence and Public Employees' Local Union 1033.<sup>256</sup> In the event the contract entered into requires less than a 3 percent increase or there are funds remaining after application of the any contractual increase, any excess funds remaining in the account, or which would otherwise accrue shall be reported to the Commission and deposited into the IFR restricted account.

Providence Water requested a 3 percent net operating revenue allowance and agreed with KCWA's proposal to restrict a portion of it to cover shortfalls resulting from reduced revenues and the remainder unrestricted to cover unanticipated expenses. The Division recommended maintaining the 1.5 percent net operating revenue reserve previously allowed to Providence Water in light of the Commission's recent decision in Docket No. 3818 to deny a requested increase in Newport Water Department's operating

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<sup>255</sup> Commission Exhibit 1 (Providence Water Response to Commission Data Request 3-12); Providence Water Response to Commission Record Requests 5, 6 (dated September 21, 2007). Tr. 9/12/07, pp. 121-22.

<sup>256</sup> Benefits includes union combined benefits and laborers' international pension.

revenue allowance pending the outcome of a new docket to address the appropriateness and funding for such reserve.<sup>257</sup>

By a decision of 2-1, Providence Water is allowed a 3 percent net operating reserve, with 2 percent of it restricted to cover revenue shortfalls resulting from reduced consumption once Providence Water demonstrates to the Commission the need for such funds as a result of reduced sales levels. However, because the State of Rhode Island has made it a priority to encourage conservation, the Commission is requiring Providence Water to file a rate proposal on or before July 1, 2009 which includes proposed conservation rates. If Providence Water fails to file such a proposal by that date, the 2 percent revenue reserve will end at July 1, 2009, and Providence Water shall immediately file with the Commission to adjust rates to eliminate collection of the 2.0 percent revenue reserve for usage on and after July 1, 2009. The Commission notes that Providence Water advocated many rate design proposals which would shift more costs from consumption based rates to fixed service charges. While the Commission recognizes Providence Water's desire for such revenue stability, conservation is an equally important goal. With the allowed operating revenue allowance, Providence Water should be able to find an appropriate balance between expenses and revenues.

The Commission recognizes the impact of fluctuating sales on revenues which puts pressure on the non-investor owned water utilities to manage expenses. While weather has a big impact on usage and sales, so too does conservation, which is a priority of the State of Rhode Island. As conservation becomes more important and customers take measures to reduce their usage, revenues are reduced while many fixed costs remain in place. When sales are reduced, either due to weather or conservation, some expenses

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<sup>257</sup> Public Utilities Commission, Minutes of Open Meeting, August 30, 2007.

are likewise reduced. However, items such as capital projects, infrastructure, and personnel expenses resulting from labor contracts not within the control of the water utility management do not decrease. Therefore, like other non-investor owned water utilities, Providence Water experiences challenges in funding restricted accounts such as IFR and Capital Improvements due to prioritization of bills. When this occurs, the competing interests of conservation and the desire to keep rates low collide as water utilities petition the Commission for rate increases to cover increased costs and reduced sales. Of course, not all water utilities are the same. Some have been experiencing clear downward trends in water sales while others, like Providence Water have been experiencing fluctuations from year to year. In addition, looking at Providence Water in light of long-standing Commission policy to attempt rate stabilization, the Commission believes that a net operating revenue reserve of 3 percent with 2 percent restricted, continuation of which is contingent upon filing a conservation rate, will further this policy.

#### **E. Cost Allocations and Rate Design**

Providence Water proposed a fixed, monthly wholesale service charge based on 25 percent of the wholesale customer's revenues. The Division did not oppose this fixed charge because the Division agreed with Providence Water that this would improve revenue stability from the wholesale class. KCWA opposed the fixed charge for the following reasons: (1) as water use among wholesale customers changes, the fixed charge will result in rates that are not cost-based and (2) that allocating 25 percent of wholesale revenues to a fixed charge results in a lower commodity rate which provides less

incentive to conserve.<sup>258</sup> The Commission agrees with KCWA's analysis and rejects Providence Water's proposal.

Providence Water proposed to decrease the demand costs allocated to fire service by 50 percent and recover this amount from other customers through consumption rates. Providence Water's main argument in favor of this change was that the City of Providence is home to several tax exempt properties and it is unfair that they do not have to pay public fire protection charges which are collected by the City through property taxes. The Division and KCWA opposed the change. Three reasons provided were: (1) it reduces the cost allocations to private service, requiring general water service customers to bear a portion of private fire service; (2) IFR costs are not allocated to fire service charges under state law, resulting in a subsidy to fire protection services; and (3) it provides less revenue stability in contradiction to Providence Water's goal. On cross examination, Providence Water's witness conceded that this change was a policy decision by Providence Water rather than a better cost based methodology than had been used before. Providence Water's witness also conceded that, assuming Commission policy has been to try to bring public and private fire protection closer to their respective actual cost of service, Providence Water's proposal "does not necessarily coincide with that policy."<sup>259</sup>

The Commission notes that since 2000, it has been a policy objective of the Commission to bring public and private fire service rates in line with their respective

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<sup>258</sup> The Commission also notes that at the hearing, when asked to explain a provision of his surrebuttal testimony, Mr. Woodcock stated that "general, higher meter based or consumption charges give customers more control over how much their total water bills are versus a fixed service charge where it doesn't matter how much water they use, so the higher the consumption based charge, the greater the conservation incentive there is." Tr. 9/13/07, p. 232.

<sup>259</sup> Tr. 9/13/07, p. 196.

actual cost of service.<sup>260</sup> However, the Commission also did not want to cause rate shock to the public entities collecting such charges through property taxes. Therefore, the Commission has been requiring Providence Water to hold private fire service rates level and increase public fire service rates incrementally over the past seven years.<sup>261</sup> Providence Water has presented no evidence to persuade the Commission to deviate from this stated policy. In fact, the Commission questions whether Providence Water's rationale for arbitrarily reducing the demand by 50 percent is a reasonable basis upon which the Commission could change its policy.<sup>262</sup> Furthermore, the Commission is persuaded by the rationale posited by the Division not to reduce the demand and further adds that fire protection is a city responsibility and if there is an abandoned building, the city is not going to refuse to put out the fire because the taxes are overdue.<sup>263</sup> For all of these reasons, the Commission rejects Providence Water's proposal to reduce demand costs allocated to fire service by 50 percent.

While Providence Water's initial filing did not include an allocation for lost and unaccounted for water, the Division utilized the inch-mile method and Providence Water did the same in its Rebuttal. This approach is consistent with prior cost studies and with prior Commission orders. KCWA suggested the Commission consider a different

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<sup>260</sup> *Order No. 16552* (issued March 27, 2001), *Order No. 17344* (issued January 23, 2003), *Order No. 18496* (issued January 11, 2006).

<sup>261</sup> In *Order No. 17344*, p. 19, the Commission stated, "Despite this increase, the public fire rates would still be below the cost of service for public fire service." (citations omitted). As quoted in *Order No. 18496*, p. 13, the Division's witness opined that "'it's probably that the public hydrant charge is tool low, [and] it may not be that the private fire service charge is too high compared to costs.'" (citations omitted).

<sup>262</sup> The Supreme Court has indicated that the Commission cannot review the ability to pay as a basis for setting rates. See *Narragansett Electric Co. v. Harsch*, 117 R.I. 395, 427-30, 368 A.2d 1194 (R.I. 1977) (stating that in setting the utility's return on equity, "that specific reliance by the commission on the consumers' ability to pay is error).

<sup>263</sup> As a side note, the Commission notes that through discovery, it became apparent that the City of Providence is receiving a Payment in Lieu of Taxes from tax exempt organizations in the amount of \$1 million per year. Whether or not this is sufficient compensation for the services those entities received is

approach which it claimed would take into account losses of water from service mains. Providence Water and the Division objected to the new approach, citing the fact that KCWA really presented this approach in its Surrebuttal. KCWA argued that although this is a new approach, it would more accurately allocate lost and unaccounted for water and the Commission should not approve a methodology simply because it had been used in the past. The Commission allowed Providence Water and the Division the opportunity at the hearing to rebut KCWA's position through additional direct testimony and to cross examine KCWA. The Commission finds that KCWA did not present sufficient evidence to support its methodology in this docket. However, the Commission agrees that if there are alternative methodologies for allocating lost and unaccounted for water in a more accurate manner, they should be considered. Therefore, the Commission accepts the continued use of the inch-mile method for purposes of this rate case. However, in the next case, Providence Water is directed to also consider whether there is another methodology that would more accurately allocate lost and unaccounted for water. KCWA is also reminded to present its positions in its Direct Testimony and not wait for the Surrebuttal stage.

Providence Water proposed allocating the pension costs and fringe benefits of personnel in the Customer Accounts cost center to Meters/Service and Billing/Collections. This results in 50 to 70 percent increases in customer charges. The Division opposed that allocation of costs, noting that the Commission had previously rejected such cost allocation in order to allocate a larger amount of the revenue requirement to consumption based rates. The Division proposed continuing to reallocate

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not for Commission consideration. However, those entities are contributing to the City. (Commission Exhibit 1, Annual Reports of the City of Providence).

these costs to the “Base” category so as to minimize fixed rates and increase commodity rates that provide a price signal to customers to encourage conservation and reduce their billings. KCWA supported Providence Water’s allocation as the appropriate methodology. The Commission notes that this allocation represents a decision of whether or not to continue following a prior policy. While Providence Water’s proposal may be more technically correct, the Commission declines to accept it for the same reasons it made the change previously. In addition, the Commission notes that the Division’s allocation will still result in a 30 percent increase in the residential quarterly service charge, not an insignificant amount to be collected through a fixed charge that does not encourage conservation.

KCWA proposed allocating labor and power costs related to pumping separately from treatment costs because Providence Water’s Pumping costs do not reflect any allocation of labor. The Division agrees with KCWA’s position. The Commission accepts KCWA’s allocation of labor and power costs related to Pumping. KCWA also proposed that the capital fund related to the Western Cranston expansion be allocated entirely to retail customers because none of the project serves wholesale customers. Providence Water agreed in its rebuttal. The Division disagreed, maintaining that over time, the payment of debt or rate funded capital will generally be in proportion to the asset values. The Commission notes that the dollar amount involved in this disagreement is \$62,069 and accepts KCWA’s argument and approach as adopted by Providence Water on the basis that the Western Cranston Capital Fund does not appear to benefit wholesale customers. The Commission notes that this is a somewhat unique situation. In most cases, costs related to system expansions are shared by all customers because it can be

shown that all customers benefit to some extent from the increased customer base. Therefore, the Commission does not anticipate this becoming a generalized policy. Finally, KCWA proposed an adjustment to the allocation of Miscellaneous revenues on the basis that rental income is derived from easements on supply land and therefore, the rental revenues should be allocated to supply using the supply allocator. Because of the de minimus nature of the rental income (\$20,000 to a total of \$1,245,739 in miscellaneous revenues), the Commission will not require the adjustment to be made, noting that this would be a deviation from the methodology used in prior approved cost studies.

Accordingly, it is hereby

(19145 ) ORDERED

1. Providence Water Supply Board's Rate Filing of March 30, 2007, is hereby denied and dismissed.
2. Providence Water Supply Board is granted a revenue increase of \$6,935,500, for a total cost of service of \$58,086,064 to be applied to usage on and after November 1, 2007.
3. The compliance tariffs filed by the Providence Water Supply Board on October 7, 2007 are hereby approved.
4. The Providence Water Supply Board shall continue to restrict the following accounts in the following amounts collected through rates: Capital Improvements - \$2,450,000; Western Cranston Fund - \$62,069; IFR - \$13,900,000; Meter Replacement - \$1,000,000; Insurance Fund - \$2,967,655; Chemicals and Sludge - \$3,132,565; and Equipment



Replacement - \$600,000. In addition, Providence Water Supply Board shall restrict the following amount in a separate account - Property Tax Refund - \$1,510,096.16. Providence Water shall report on the funding of its restricted accounts every four (4) months.

5. Providence Water shall also restrict the equivalent of a 3 percent increase in salaries (\$947,203) for the purpose of covering anticipated salary increases when a new labor contract is entered into between the City of Providence and Public Employees' Local Union 1033.
6. Out of the Property Tax Refund account, \$375,000 shall be credited to customers annually, for a total over three years of \$1,125,000. The remaining balance in the account shall be used for litigation expenses related to property tax challenges, but not increased property taxes. Funds may be expended only on invoices for services rendered on and after November 1, 2007. In conjunction with its semi-annual financial report, Providence Water shall provide to the Commission, with a copy to the parties to this docket, a reconciliation of the activity in the account. Any future tax refunds or adjustments in Providence Water's favor shall be deposited into this account for further disposition as ordered by the Commission.
7. Providence Water Supply Board shall file its semi-annual reports no later than ninety (90) days after the respective reporting period ends.
8. Providence Water Supply Board shall include in its semi-annual reports a line item that breaks out capitalized labor in its reports on IFR and CIP

projects. Providence Water Supply Board shall also include the following:

Pensions: amount of contribution, percentage of actuarial recommendation compared to the City's and the School Department's, any changes to the pension plan, the cost of the pension contribution as a percentage of actual payroll of those who are in the pension system, and once per year, shall provide the annual report from Providence Water' actuary on the pension plan and the annual audited report on the pension plan. Retiree Health Care Reporting related to GASB 43/45 actuarial recommendations: amount of contribution, percentage of the actuary's recommendation compared to the City's and the School Department's. Any amounts allowed in rates in excess of the actual contributions shall be restricted.

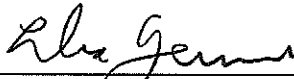
9. The Providence Water Supply Board is allowed a 3.0 percent net operating reserve. Two percent of the reserve shall be restricted and may only be used to cover shortfalls in allowed revenues upon a showing by Providence Water Supply Board that the shortfall resulted from reduced consumption. Providence Water Supply Board shall file a rate proposal on or before July 1, 2009 which includes proposed conservation rates. In the event Providence Water Supply Board fails to make such a filing, the 2 percent reserve shall cease and Providence Water Supply Board shall immediately file to adjust rates to eliminate collection of the 2 percent Revenue Reserve for usage on and after July 1, 2009.


10. Providence Water Supply Board's request to fund through future rates repayment of the City of Providence \$1,489,081 over six years, or \$248,180 annually for past retiree health care expense is denied.
11. Providence Water Supply Board's proposal to reduce demand allocated to fire protection by 50 percent is denied.
12. For purposes of this rate case, City Service Expense is set at \$839,167.
13. The Providence Water Supply Board shall comply with the reporting requirements and all other terms, conditions, and instructions imposed by this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND ON NOVEMBER 1, 2007  
PURSUANT TO OPEN MEETING DECISIONS ON OCTOBER 30, 2007,  
NOVEMBER 8, 2007. WRITTEN ORDER ISSUED DECEMBER 13, 2007.

PUBLIC UTILITIES COMMISSION



  
Elia Germani, Chairman

  
Robert B. Holbrook, Commissioner

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\*Mary E. Bray, Commissioner

\* Commissioner Bray dissented from the majority, indicating that while she agreed in principle with the reasoning provided by the majority, she did not believe a basis existed for treating Providence Water differently from Newport Water Department absent a determination in the generic docket.

**NOTICE OF RIGHT OF APPEAL:** PURSUANT TO R.I.G.L. § 39-5-1, ANY PERSON AGGRIEVED BY A DECISION OR ORDER OF THE COMMISSION MAY, WITHIN SEVEN (7) DAYS FROM THE DATE OF THE DECISION OR ORDER, PETITION THE SUPREME COURT FOR A WRIT OF CERTIORARI TO REVIEW THE LEGALITY AND REASONABLENESS OF THE DECISION OR ORDER.

## Appendix A

### Providence Water Supply Board Docket 3832 - Cost of Service

	PWSB Position	Commission Adjustments	Proforma Cost of Service
<u>Revenues</u>			
Retail Water Sales	\$ 30,026,250		\$ 30,026,250
Wholesale Water Sales	13,180,648		13,180,648
Retail Service Charges	3,914,325		3,914,325
Private Fire Service	1,266,618		1,266,618
Public Fire Service	1,516,984		1,516,984
Miscellaneous Income	<u>1,245,739</u>		<u>1,245,739</u>
Total Revenues	\$ 51,150,564		\$ 51,150,564
<u>Expenses</u>			
Operation and Maintenance	\$ 26,866,182	\$ (246,080)	\$ 26,620,102
Insurance *	2,967,655		2,967,655
Chemical & Sludge *	3,132,565		3,132,565
City Service Expenses	1,240,355	(401,188)	839,167
Property Taxes	5,843,681		5,843,681
Capital Labor	<u>(984,719)</u>	<u>-</u>	<u>(984,719)</u>
Total Operating Expenses	\$ 39,065,719	\$ ( 647,268)	\$ 38,418,451
<u>Capital Funds</u>			
Capital Improvement Fund *	\$ 2,450,000		\$ 2,450,000
Western Cranston Fund *	62,069		62,069
Infrastructure Replacement *	13,900,000		13,900,000
Meter Replacement *	1,000,000		1,000,000
Equipment Replacement *	<u>600,000</u>		<u>600,000</u>
Total Capital Funds	\$ 18,012,069		\$ 18,012,069
Total Expenses	\$ 57,077,788	\$ (647,268)	\$ 56,430,520
Net Operating Reserve	\$ 1,674,961	\$ (1,123,113)	\$ 551,848
Revenue Reserve *	<u>-</u>	<u>1,103,696</u>	<u>1,103,696</u>
Total Cost of Service	\$ 58,752,749	\$ (666,685)	\$ 58,086,064
Rate Year Revenues at Present Rates			51,150,564
Revenue Increase			\$ 6,935,500

\* Restricted Funding Account

## Appendix B

Providence Water Supply Board  
Docket 3832  
Cost of Service Adjustments

	Increase / (Decrease) <u>In Amounts</u>
Operation and Maintenance Expenses	
Disallowance of amount to pay prior years' retirees' health care costs	\$ ( 248,180)
Increase in O & M expense for conservation notice	<u>2,100</u>
Total Operation and Maintenance Expense Adjustment	<u>\$ ( 246,080)</u>
 City Service Expenses	 \$ (401,188)
 Net Operating / Revenue Reserves	
Reduction in Net Operating Reserve to 1% level	\$ (1,123,113)
Provision for Revenue Reserve at 2% level	\$ 1,103,696