STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: KENT COUNT WATER AUTHORITY APPLICATION TO CHANGE RATES : DOCKET NO. 3942

REPORT AND ORDER

On March 31, 2008, the Kent County Water Authority ("KCWA") filed a rate application with the Rhode Island Public Utilities Commission ("Commission") seeking a rate increase of $5,464,556 or 35.0%. The proposed increase for public and private fire customers would be 24.8% and 16.5% respectively.[1] On April 9, 2008, the Commission suspended KCWA's proposed rate increase. The current rate case filing represents KCWA's third general or abbreviated rate case filing in the last seven years. The following table provides a brief history:

Docket No.	Date Filed	Increase Requested	Increase Allowed	Authorized Revenue	Percentage of Request
3311	3/30/01	$3,094,995	$1,820,684	$13,956,116	59%
3660	1/14/05	$3,172,794	$3,172,665	$16,545,493	100%
3942	3/31/08	$5,464,556	$3,423,044	$19,798,031	63%

On May 23, 2008, the City of Warwick ("Warwick") moved to intervene in this matter. No party objected and Warwick's Motion was granted pursuant to Commission Rule of Practice and Procedure 1.13(e). Pursuant to the Commission's procedural schedule dated May 2, 2008, Intervenor testimony was due to be filed with the Commission on July 30, 2008. On July 28, 2008, Warwick moved for a forty-five (45) day extension of time to file direct testimony.[2] KCWA filed an objection to Warwick's request on the basis that it would cause undue delay and that Warwick had caused its own

[1] A prior rate increase request filed on February 29, 2008 by KCWA was withdrawn after the Commission advised KCWA that it had not yet filed its most recent Annual Report.
[2] City of Warwick's Motion to Extend Time, p. 1.

dilemma through delay.[3] The Division objected to the length of the extension.[4] On August 7, 2008, at its open meeting, the Commission rejected Warwick's Motion for an Extension of time on the basis that it would cause undue delay and could cause the Commission to miss the statutory deadline for rendering a decision in this matter. The Commission determined that Warwick had sufficient time to find a consultant who did not have a conflict and file testimony by the deadline. Warwick was allowed to cross examine witnesses at the hearing and participate in the briefing stage of this matter.

I. KCWA'S DIRECT

In support of its filing, KCWA submitted the pre-filed testimonies of Timothy Brown, General Manager of KCWA, and Christopher Woodcock, an outside consultant. In his pre-filed testimony, Mr. Brown generally described the KCWA water system and indicated that he believed recent water sales showed a downward trend.[5] He indicated that KCWA was seeking a $1,194,626 increase in IFR funding from the $4.8 million allowed in the last rate case to $6.0 million, the amount anticipated in the approved IFR plan. He noted that KCWA attempts to undertake as many projects as possible each year, but noted that it is KCWA's policy "not to expend funds (commit to a contract) unless the finances are available for the complete project."[6] In other words, unless the funds are already in the restricted IFR account or he is certain they will be there at the end of the project, Mr. Brown will not bid a contract. He noted that because of a revenue shorfall,

[3] KCWA's Objection and Motion to Strike City of Warwic's Motion for Extension of Time, pp. 1-3.
[4] Division's Objection to City of Warwick's Motion for Extension of Time
[5] KCWA Exhibit 1 (Pre-Filed Testimony of Timothy Brown), pp. 2-4.
[6] *Id.* at 4-5.

as of February 2008, KCWA had missed four payments to the IFR account, the last one funded, for a total of $1,601,791.[7]

Mr. Brown explained that because KCWA's new GIS system is operational, the Company is requesting an additional employee to maintain and implement the system to provide both field services for data collection and implementation and to update the system database daily. The proposed salary for the position, excluding benefits is $40,000.[8] The additional position would increase KCWA's authorized funded positions from 34 to 35.

Mr. Brown indicated that KCWA was proposing to implement a "Turn-Off Charge" of $55.00 and to decrease the "Turn-On Charge" from $50.00 to $45.00. According to Mr. Brown, these charges are based on those incurred by KCWA and should not be assessed to customers who pay their bills on time, but rather to those who are incurring the charges as a result of delinquent payments.[9]

In addition, Mr. Brown outlined a new enforcement charge for violation of moratoriums on water usage and violations of water use restrictions. The current penalty is the $50.00 Turn-On Charge. In rare cases, customers repeatedly ignore the rules. Therefore, KCWA was proposing a list of increasing monetary penalties for each occurrence, with the final step being service termination until the end of the restriction/moratorium.[10]

With regard to the proposed seasonal rates, Mr. Brown explained that it has been discussed as a demand management tool to help manage the summer peak demands. He

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[7] *Id.* at 5-6.
[8] *Id.* at 7.
[9] *Id.* at 8.
[10] *Id.* at 9-10.

noted that "it is not an ideal seasonal rate," but that it is designed as a first step. However, because of a concern that it would result in reduced revenues, Mr. Brown indicated that KCWA would not support its adoption unless the operating revenue allowance is increased.[11]

With regard to the Commission's requirement in the last rate order to review medical benefits and costs, Mr. Brown explained that an independent broker had undertaken two reviews during the past two years and had found savings as a result of miscalculations by Blue Cross. Additionally, retiree health care rates were reduced by changing the pharmacy benefit. Also, a comparison of Blue Cross and United Healthcare resulted in a determination that United Healthcare was not competitive with Blue Cross' rates. Finally, with regard to dental coverage, while Blue Cross was competitive, KCWA would have to terminate a contract with Delta Dental early and pay a penalty.[12]

In his testimony, Mr. Woodcock stated that KCWA's rate year revenue requirement is $21,657,097. Because his calculations showed that revenues at current rates would provide rate revenues of $16,192,541, he determined that KCWA needs to increase its revenues by $5,464,556, or 35%. Because Mr. Woodcock performed a cost allocation study, the increase would not be applied across-the-board, but would vary based on customer class. The test year Mr. Woodcock used was the twelve months ending June 30, 2007. The rate year proposed by Mr. Woodcock is the 12-month period

[11] *Id.* at 9.
[12] *Id.* at 10-11.

from November 1, 2008 – October 31, 2009.[13] The effect on an average residential customer using 2,730 cu ft per quarter would be an increase of about $13 per month.[14]

Summarizing the major changes in revenue requirements, Mr. Woodcock noted that the single largest adjustment is to the amount allowed for infrastructure replacement ("IFR"). He indicated that the approved IFR report presented an annual expense of $6 million and although in prior dockets KCWA had been provided less than the full amount included in the IFR report, KCWA was seeking the full funding in this docket. The second largest item is KCWA's requested increase in its operating revenue allowance to 5% of total revenues. According to Mr. Woodcock, this represents slightly more than $1 million of the proposed increase. Mr. Woodcock noted that nearly $1 million of the request is to bring various reserves back to full funding levels. He explained that between the test year and rate year, KCWA was granted a pass through to its rates to reflect the recent increase in the wholesale water rates charged by Providence Water. This adjustment results in an increased expense of $500,000 over test year costs. He also noted that KCWA is requesting one additional employee and salary increases in this docket accounting for $325,000 of the request. The remaining revenue shortfall is affected by lower sales than those upon which prior rates were set.[15] In order to address this last concern, Mr. Woodcock proposed using test year sales, adjusted for the loss of Clariant Corporation's pigment manufacturing facility and for reduced sales at Amgen, as

[13] KCWA Exhibit 3 (Pre-Filed Testimony of Christopher Woodcock), p. 4. Mr. Woodcock noted that with the exception of proposed seasonal rates, there had been no major changes to the cost allocation procedures approved by the Commission in the past. *Id.* at 5.
[14] *Id.* at 23-24.
[15] *Id.* at 5-6.

the basis for rates. KCWA used test year wholesale water purchases to derive those related costs for the rate year.[16]

Mr. Woodcock made adjustments to the chemical expense at twice "the normal inflation rate" to reflect higher expected increases in energy and chemicals. He made a $500,000 adjustment to the O&M Reserve and a $463,000 adjustment to the R&R Reserve required by debt service trust indentures. He made a $1,995,5222 adjustment over the test year to the IFR fund to reflect the $6 million anticipated in the IFR plan. He increased property and liability insurance by 4.9% to reflect the average increase from FY 2006 through FY 2008. He increased salary and worker's compensation expenses by the proposed 4 percent salary increases. Finally, Mr. Woodcock applied an inflationary increase based on the CPI-Northeast to non-labor items not adjusted elsewhere.[17]

Mr. Woodcock stated that KCWA is seeking a 5% allowance on total rate revenues, with 1.5% unrestricted and the remaining 3.5% restricted for use in cases where revenues have fallen short of expectations. Under KCWA's proposal, the Company would make a filing with the Commission to use the funds when circumstances so dictate, and the Commission would rule on such requests within 60 days. Mr. Woodcock argued that while this is more than was recently allowed in a Providence Water Supply Board case, unlike Providence Water, KCWA is experiencing clear downward trends in water sales.[18]

Mr. Woodcock also noted that KCWA has offered a seasonal water rate in this docket. The intent of this rate structure is to encourage water use reductions during peak summer months, but KCWA made no allowance or drop in sales to account for any such

[16] *Id.* at 11, 19-20.
[17] *Id.* at 12-14, Schedule 1D.
[18] KCWA Ex. 2, pp. 16-17.

reduction. Therefore, he argued, if there is a further downward drop in sales, KCWA would once again realize less than expected revenues and he believed that a provision for a reduction in sales and revenues was reasonable given the Authority's willingness to present and adopt a seasonal rate structure.[19] Thus, Mr. Woodcock stated, "If a seasonal rate is approved it is reasonable to assume further reductions in sales for the rate year. We have not made any such projections; instead we ask that the Commission provide the Authority with a reasonable level of operating revenue that can be used if there are such reductions."[20]

In discussing KCWA's proposed seasonal rate, Mr. Woodcock stated that this alternative is not what he would consider a "strong" seasonal rate, but rather is a first step. He noted that there are numerous questions and issues associated with the adoption of seasonal rates. He conceded that ideally, KCWA would be billing customers monthly so a seasonal surcharge or rate could be assessed to all customers for the same billing periods. However, he indicated that monthly billing will require more advanced metering, which KCWA hopes to have in place in several years.

To develop this rate proposal, Mr. Woodcock reviewed the quarterly billings and determined that the July, August and September billings are the highest use periods. Noting that these billings do not cover the same months for all customers, Mr. Woodcock indicated that they do appear to cover the highest use periods. He had prepared two seasonal rate alternatives that charge higher rates for all use during these billing periods and somewhat lower rates for the other billing periods.[21]

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[19] *Id.* at 17.
[20] *Id.* at 19.
[21] *Id.* at 22. Mr. Woodcock also noted that there is a consideration of the differential between peak and off-peak rates. He prepared seasonal rate alternatives that provide a relatively small differential. While a

The first alternative was a variable seasonal surcharge and was the one recommended by Mr. Woodcock because it provides a slightly greater incentive to smaller metered customers. He claimed that typically, it is the smaller residential customers that have the larger non-essential water demands that can be most impacted by a seasonal water rate. This alternative provides for a similar percentage differential between the peak and non-peak rates. Under this Alternative, explained Mr. Woodcock, the small meter customer class will have a higher $/ccf differential than the larger meter sizes. The second alternative provides for an equal rate differential for all classes, but because the larger meter class rates are slightly lower than those of the smaller meter class, the percentage impact on larger customers is greater.[22]

He explained that these alternatives are intended to be revenue neutral in that the proposed cost of service and either seasonal rate alternative will provide the same annual revenues. He noted that this assumes the same metered water sales, yet the seasonal rate alternatives are hoped to result in lower summer sales and thus lower overall revenues. Mr. Woodcock indicated that he had not tried to quantify the impact of that.[23]

II. <u>DIVISION'S DIRECT</u>

On July 31, 2008, the Division of Public Utilities and Carriers ("Division") submitted the pre-filed testimony of Thomas Catlin, its consultant. Mr. Catlin recommended that KCWA receive a revenue increase of $2,622,427 in this proceeding, $2,842,129 less than the increase of $5,464,556 that KCWA requested in this proceeding.

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higher rate differential would tend to encourage greater water savings, KCWA remained concerned about the reaction of customers and the impact on revenues. As a result, KCWA's suggestion was to consider a minimal rate differential as a first step. He explained that this would provide notice to the Authority's customers and allow them to adjust water use habits, it will allow us more time to implement radio read metering that will allow for monthly billing, and it will provide KCWA real data on how customer's water use patterns may change as a result of a seasonal rate structure. *Id.*

[22] *Id.* at 22-23.

[23] *Id.* at 23.

He accepted Mr. Woodcock's proposed cost study as appropriate for use in determining cost responsibility and setting rates in this proceeding. He stated that he did not oppose implementing rates that include the small seasonal differential, but did not advocate the adoption of seasonal rates in this docket.[24]

Addressing KCWA's proposed adjustments to sales volumes, Mr. Catlin accepted KCWA's adjustment to reflect the loss of sales to Clariant Corporation at the end of 2008, but did not accept the adjustment to reflect a decline in the sales to Amgen, stating that the decline in Amgen's consumption subsequent to the test year has been offset by an increase in the sales to other new and existing customers. He stated that because overall sales have increased despite the decline in sales to Amgen, he eliminated KCWA's adjustment to reflect reduced purchases by Amgen, resulting in an adjustment increasing test year revenues at present rates by $162,302.[25]

Mr. Catlin expressed concerns regarding the application and gravity of KCWA's proposed new set of enforcement charges for violations of moratoriums on use of water and violations of water use restrictions called for in an emergency. Mr. Catlin interpreted KCWA's proposal to mean that KCWA's enforcement charges would apply cumulatively even if the violations occurred months or even years apart and therefore, taken to the extreme, as written, the tariff could result in the permanent loss of water service on the fifth violation of the permanent odd-even watering restriction even if that violation occurred years after the first violation. Therefore, he recommended several modifications. He also recommended that KCWA track the amount of any revenue it

[24] Division Exhibit 1 (Pre-Filed Testimony of Thomas Catlin), p. 5.
[25] *Id.* at 6.

receives from these tariffs, deposit the funds into a restricted account and report the amounts annually to the Commission and Division.[26]

With regard to KCWA's proposed wage increase of four percent, Mr. Catlin adjusted the test year wages for existing employees in the rate year to include wage rate increases of 3.2 percent for 2.33 years, reflecting the overall average increases in FY 2008 and 2009. This adjustment results in a total reduction to O&M payroll and related costs of $37,697.[27]

Addressing proposed health care costs, Mr. Catlin adjusted KCWA's projected expenses to reflect updated data and further proposed to reduce the employee insurance costs (but not retirees) to be included in rates to reflect a ten percent employee contribution toward medical insurance premiums. Mr. Catlin noted that KCWA does not require employees to make any contribution toward either medical or dental insurance premiums despite the fact that requiring employee contributions toward health insurance premiums has become more and more prevalent in recent years as insurance premiums have increased dramatically. He clarified that he was not recommending the Commission require a 10 percent employee contribution, but that only 90 percent of the cost be recognized as an expense for ratemaking. He noted that to the extent that KCWA elects not to require employee contributions, it could cover the differential through the operating revenue allowance. The effect of his adjustments to update health insurance premiums and reflect a ten percent employee contribution to medical insurance premiums was to reduce health insurance expense by $45,145.[28]

[26] *Id.* at 7-10.
[27] *Id.* at 10-11.
[28] *Id.* at 11-12.

Regarding chemical expense, Mr. Catlin noted that the quantities of chemicals used in the test year are significantly higher than either FY 2005, FY 2006 or FY 2008 and therefore, proposed to adjust chemical expense to reflect the average quantities of chemicals utilized over the last four years. He also updated chemical prices to reflect the most recent purchase price for each chemical used. Because these prices are more recent, he applied KCWA's growth rate of 6.64 percent for only one year rather than 2.33 years resulting in a reduction in projected rate year chemical costs of $29,989.[29]

With regard to T&D mains maintenance expense, Mr. Catlin made an adjustment to reflect an average of the costs incurred in FY 2005 through FY 2008. He noted that utilizing a four-year average of non-labor costs resulted in normalized expense level of $287,932, representing a reduction of $252,504 in T&D mains maintenance expense. Mr. Catlin also excluded these costs from his calculation of an adjustment for general inflation.[30]

Addressing KCWA's general inflation adjustment to certain O&M costs not separately adjusted, Mr. Catlin rejected using the average increase in the Consumer Price Index ("CPI") Northeast for the years 2003 through 2007. He proposed using the Gross Domestic Product Price Index ("GDP-PI") because the categories used in the CPI-Northeast are largely either not applicable to KCWA or have already accounted for by separate adjustments at rates greater than the rate of inflation. According to Mr. Catlin, the GDP-PI is a broad based measure of inflation or price changes that is based on all of the goods and services that make up the U.S. gross domestic product. As such, he believed the GDP-PI is more representative of the types of costs to which a general price

[29] *Id.* at 12-14.
[30] *Id.* at 14-16.

escalator is being applied in this proceeding. The result of his analysis was a general inflation adjustment of $41,732 based on projected increase in the GDP-PI of 5.5 percent from the test year to the rate year, or $60,995 less than the general inflation increase of $102,727 proposed by KCWA.[31]

Mr. Catlin agreed that the use of test year purchased water volumes would be reasonable had KCWA not adjusted its test year sales volumes to reflect the 4.14 percent loss of sales to Clariant Corporation. Therefore, Mr. Catlin proposed to adjust purchased water costs to reflect this significant reduction in water sales volumes. His adjustment resulted in a reduction in purchased water costs of $172,742.[32]

Mr. Catlin adjusted the allowance for O&M Reserve funding to be included in rates to reflect the Division's recommended level of operating expenses to reflect the projected O&M Reserve balance as of the beginning of the rate year. He believed that it would be appropriate to expect that a $255,325 deposit will be made unless KCWA affirmatively demonstrates that it is financially not possible to do so. He noted that to assume otherwise would result in an additional $255,325 being included in rates until the completion of the Authority's next rate case, whether or not the funding is required.[33]

Mr. Catlin made an adjustment to KCWA's proposed R&R Reserve funding allowance to reflect a deposit made between KCWA's filing and Mr. Catlin's testimony in this docket. He also noted that the R&R Reserve funding allowance of $200,000 per year that he recommended is greater than the funding that KCWA is likely to require on an annual basis in the near future. He proposed that to the extent that this funding

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[31] *Id.* at 16-17.
[32] *Id.* at 18-19.
[33] *Id.* at 21-22.

allowance exceeds that required, KCWA should be required to set the funds aside so that the appropriate disposition can be determined in the Authority's next rate case.[34]

Addressing IFR funding, Mr. Catlin recommended that the IFR funding be increased to $5.4 million rather than to $6.0 million as requested by KCWA. He noted that given the current economic strains on consumers from high energy prices as well as general economic conditions, he believed it would be appropriate to moderate the increase in IFR funding. He pointed out that even at a level of $5.4 million for IFR funding, KCWA will have $18.1 million in IFR funds and $21 million in capital improvement funds available in FY 2009 and FY 2010, amounts that coincide with KCWA's spending plan.[35]

Addressing KCWA's requested 5 percent operating revenue allowance, Mr. Catlin recommended that the operating revenue allowance continue to be set at the historical level of 1.5 percent of rate revenues. He noted that in developing rate year expenses, KCWA made adjustments for known and measurable changes and applied an inflation factor to all other expenses for which known and measurable changes were not made. In addition, the amounts included as contributions to the O&M reserve and the R&R reserve include amounts in excess of the normal annual requirements in order to bring those reserves to the required levels. Finally, test year sales, which were already below those in any of the last five years, have been reduced to reflect the full annual revenue loss of a major customer even though that customer is not scheduled to discontinue service until after the first two months of the rate year. Therefore, Mr. Catlin

[34] *Id.* at 22-24.
[35] *Id.* at 24-25.

did not believe an increase in the operating revenue allowance is necessary in this proceeding.[36]

However, he stated that if the Commission elects to approve an operating revenue allowance for KCWA in excess of traditional 1.5 percent,he recommend that an operating revenue allowance of three percent of rate revenues be allowed. Of the total, he indicated that 1.5 percent of revenue be unrestricted and that the remaining 1.5 percent be restricted in the event revenues are more than 0.5 percent below the allowed level. Further, he recommended that the unrestricted allowance be set at 1.5 percent and for KCWA to utilize that allowance to address expense overruns and/or revenue shortfalls of up to 0.5 percent of rate revenue. Under his proposal, the restricted allowance would only be accessed if the revenue shortfall exceeded 0.5 percent of rate revenue.[37]

With regard to the accumulated level of funding in the restricted fund, he proposed a limit equal to six percent of rate revenues. In order to provide balance, he recommended that if revenues exceed the allowed level by more than 1.0 percent in the rate year, any revenues above that level should be added to the restricted operating revenue allowance. For years subsequent to the rate year, the allowed revenues used to calculate any revenue surplus should be adjusted by the change in the GDP-PI for the year.[38]

While concluding that the cost allocation methodology presented by Mr. Woodcock on behalf of KCWA is appropriate for use in determining cost responsibility and setting rates in this proceeding, Mr. Catlin noted that the cost study results for a 4-inch private fire service and the billing charge for public fire service resulted in nominal

[36] *Id.* at 25-26.
[37] *Id.* at 26-27.
[38] *Id.* at 28-29.

reductions in the proposed rates compared to the existing rates. To avoid some rates going down when there is an overall increase of over 16 percent, he recommended that those rates remain at the current level.[39]

Additionally, Mr. Catlin suggested that in future cost studies, KCWA consider allocating debt service and related costs on the basis of the per books investment because those costs are consistent with the investment that was financed with the bonds. Currently, KCWA utilizes asset replacement value to allocate both IFR costs and debt service costs. Allocating IFR costs based on the cost of replacing existing investment is reasonable, but he thought the other allocation would be more appropriate. He did not raise it for this docket because he did not believe that any change would have a significant effect on the cost study results in this proceeding. However, he stated that it could be important in the future if KCWA issues more debt.[40]

III. KCWA'S REBUTTAL

On August 26, 2008, KCWA submitted the pre-filed rebuttal testimony of Mr. Brown and Mr. Woodcock. Mr. Brown reiterated KCWA's position that if the Commission accepted Mr. Catlin's position on the operating revenue allowance, KCWA would not pursue seasonal rates, despite the fact that KCWA believed it is an important first step toward full seasonal rates.[41] Addressing the Division's concerns regarding the additional enforcement regulations, KCWA indicated that "it will not pursue the implementation of the "same event" enforcement charges proposed," but would rely on the current procedure.[42] Mr. Brown also provided additional information relative to the

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[39] *Id.* at 30.
[40] *Id.* at 29-31.
[41] KCWA Exhibit 2 (Rebuttal Testimony of Timothy Brown), pp. 1-2.
[42] *Id.* at 2-3.

projected increase in chemical prices, thus requesting the Commission to reject the Division's proposed downward adjustment of $29,980.[43]

Addressing the Division's position on health insurance cost, Mr. Brown argued that just because other entities are requiring health care premium employee copays does not mean that every company should. He indicated that KCWA's salaries are lower than those in private industry and that to modify employee benefits "will require a commensurate adjustment in payroll to attract an excellent workforce."[44] He stated that KCWA has acted aggressively to keep health care costs down through competitive bidding and the use of consultant. Additionally, employees are required to pay higher co-pays for services and prescriptions in order to keep premium costs down. Because of these efforts to control costs, Mr. Brown believed the Division's position was "without merit and [was] not reflective of marketplace reality."[45]

Finally, Mr. Brown discussed the extensive IFR programs KCWA has undertaken in the past in order to provide quality water. Mr. Brown noted that there are many plans included in its approved IFR plan and stated that KCWA is currently working on a new IFR plan for the next five years. He argued that reducing the funding request of $6 million to the $5.4 million proposed by the Division would be irresponsible because it would put KCWA in the position of catching up during the pendency of the next plan.[46]

Mr. Woodcock indicated there were six areas of full or partial disagreement with the Division: (1) IFR Funding; (2) operating revenue allowance; (3) sales volumes; (4)

[43] *Id.* at 4.
[44] *Id.* at 3.
[45] *Id.*
[46] *Id.* at 4-7.

health insurance costs; (5) chemical costs; and (6) O&M Reserve funding.[47] Addressing the Division's negative $600,000 adjustment to KCWA's claim for IFR funding, Mr. Woodcock stated that KCWA was asked through various data requests to justify the $6 million spending level that was sought for IFR and that it provided this information showing that the money was needed to continue with its capital improvement program and to fund the various infrastructure replacement projects that have been approved. He noted that the law relating to IFR states, that the "'Rhode Island Public Utilities Commission … shall permit for just and reasonable infrastructure replacement in the portion of the water supplier's rate structure to comply with this chapter and shall allow the water supplier to add this required funding to its rate base in accordance with this chapter.'"[48]

Addressing the Division's reluctance to support this request in order to "moderate the rate increase in this proceeding … given the current economic strains on consumers from high energy prices as well as general economic conditions", Mr. Woodcock stated that he did not believe that the current economic strains should play a role in this proceeding, and certainly not if they violate state law or are contrary to stated policy. He stated that the residents of Kent County have a lower percentage of population below the poverty level than the rest of the State of Rhode Island and the nation as a whole. He noted that the water bill for a typical resident will be under $600 per year (less than $50 per month) under the rates proposed. That is just over 1% of the medium household income in Kent County and less than half the level deemed affordable. He argued that the Division had performed no analysis to support the claim of "economic strains on

[47] KCWA Ex. 4 (Woodcock's rebuttal testimony), pp. 1-12.
[48] *Id.* at 2-3.

consumers", particularly as it may apply to consumer's water bills. Further, he claimed that the Division's adjustment would have a de minimus impact on bills which could be avoided by minimal conservation efforts by customers.[49]

With regard to the operating revenue allowance, Mr. Woodcock indicated that KCWA considered Mr. Catlin's position and his comments on the use of test year sales and reduced its request to an operating revenue allowance of 3.0% of rate revenues. He stated that with regard to Mr. Catlin's recommendations for the funding of the restricted account KCWA is in general agreement. With regard to the recommendation that if actual revenues in the rate year exceed the allowed revenues by more than 1%, any "excess" revenues be added to the restricted portion of the operating revenue allowance and that in years subsequent to the rate year, the allowed revenues be increased based on the GDP-PI index, Mr. Woodcock agreed in concept. However, he stated that the revenues should also reflect the pass-through rates of Providence Water Supply Board and the CPI-Northeast inflator should be used instead of the GDP-PI. Finally, he believed the excess should be 4 percent rather than 1 percent based on historical fluctuations in sales.[50]

Mr. Woodcock noted that Mr. Catlin recommended some adjustments as shown to proposed sales volumes including those related to changes in sales to Amgen. However, Mr. Woodcock stated that he was proposing no further adjustment for the reduced sales to Amgen. He indicated that updated sales volumes for FY 2008 sales already reflect that reduction.[51]

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[49] *Id.* at 3-4.
[50] *Id.* at 4-6.
[51] *Id.* at 6-7.

Addressing the Division's proposal to fund 90 percent of the health care costs through rates, Mr. Woodcock stated that KCWA disagreed because it would be unfair to employees without an adjustment to their salaries. He noted that KCWA had agreed to reduce its request for salary increases from 4 percent to 3.2 percent. He claimed that it is disingenuous to suggest that the Division's recommendation is not a requirement that KCWA increase the co-pay. He argued that suggesting it simply be taken out of the operating revenue allowance has the effect of reducing that allowance by 0.3 percent.[52]

With regard to Mr. Catlin's proposed adjustment to chemical costs, Mr. Woodcock used updated chemical costs and calculated a weighted average rather than the simple averaged used by Mr. Catlin based on older costs.[53] For the general inflationary index, Mr. Woodcock agreed to use the GPD-PI index for everything other than power and chemical related costs for which the CPI index would apply.[54]

Addressing cost allocations and rate design issues, Mr. Woodcock agreed that it would be reasonable in KCWA's next cost allocation study to consider using the book value of assets rather than asset replacement value to assign debt service and related costs. He also stated that KCWA still advocates for seasonal rates as long as the Commission allows at least a 3 percent operating revenue allowance. Conceding that this first step with a seasonal rate structure may not be the ideal, Mr. Woodcock indicated that KCWA believes that it is appropriate and should be approved by the Commission despite some limitations.[55]

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[52] *Id.* at 8.
[53] *Id.* at 9-10.
[54] *Id.* at 10.
[55] *Id.* at 12.

IV. DIVISION'S SURREBUTTAL

On September 10, 2008, the Division submitted the pre-filed surrebuttal testimony of Mr. Catlin. Mr. Catlin noted that in its rebuttal testimony, KCWA accepted several of the Division's adjustments or presented updated and/or revised positions that resolved other issues. As a result, Mr. Catlin stated that only IFR funding, the operating revenue allowance, employee contributions to health insurance and O&M reserve funding remained in dispute.[56] The result of Mr. Catlin's surrebuttal is an increase of $3,157,863. or $1,252,455 less than the increase of $4,410,318 sought by KCWA in its rebuttal filing.[57]

With regard to IFR funding, Mr. Catlin stated that KCWA disagreed that the allowed level of funding be increased to $5.4 million per year instead of the $6.0 million requested by KCWA. He indicated that KCWA has also disagreed with his recommendation that the employee health insurance premiums included in rates be reduced to reflect a ten percent employee contribution toward medical premiums. Mr. Catlin continued to support his initial adjustments with regard to these issues. With regard to the funding of the O&M Reserve, he noted that the annual funding of $199,691 that he recommended is consistent with the funding of $210,000 included in KCWA's FY 2009 budget.[58]

Addressing the Operating Revenue Allowance, Mr. Catlin indicated that Mr. Woodcock agreed that setting the operating revenue allowance at 1.5 percent of rate revenues is consistent with past Commission decisions. Mr. Catlin stated that while there have been some minor variations in the base to which the percentage allowance has been

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[56] Div. Ex. 2 (Surrebuttal Testimony of Thomas Catlin), p. 2.
[57] *Id.* at 6.
[58] *Id.* at 2-3.

applied, the only case of which he was aware of where the Commission approved an operating revenue allowance or operating reserve allowance of greater than 1.5 percent was for the Providence Water Supply Board in Docket No. 3832.[59]

However, if the Commission were to allow KCWA an Operating Revenue Allowance of 3 percent, Mr. Catlin noted that Mr. Woodcock accepted the Division's recommendation that a limit of six percent of rate revenues be placed on the balance of restricted funds with the clarification that rate revenues should include those that result from the pass-through of PWSB rate increases and from CPI adjustments, to which Mr. Catlin agreed. Catlin also found Mr. Woodcock's procedure for reporting revenues and the level of the restricted funds and addressing any excess acceptable.[60]

Mr. Catlin also recommended that the threshold for determining excess revenues be set at three percent above the allowed revenues. This is the low end of the range of variations in sales identified by Mr. Woodcock. In addition, to the extent rate year revenues are in excess of the allowed revenues, Mr. Catlin proposed that any rate year revenues from Clariant's pigment manufacturing facilities should be treated as excess and added to the restricted portion of the operating revenue allowance.[61]

Regarding KCWA's seasonal rate proposal, Mr. Catlin clarified that the Division does not oppose KCWA's seasonal rate proposal, but also did not advocate adopting seasonal rates because true seasonal rates cannot be properly administered with quarterly billing. However, given the small differential proposed by KCWA and the Authority's

[59] *Id.* at 3.
[60] *Id.* at 4.
[61] *Id.* at 4-5.

stated desire to make a first step toward seasonal rates, Mr. Catlin did not object to KCWA's proposal.[62]

V. HEARINGS

After duly published notice, on September 24, 2008, the Commission conducted evidentiary hearings at its offices at 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

FOR KCWA:	Joseph McGair, Esq.
FOR CITY OF WARWICK:	Peter Ruggerio, Esq. Lincoln Lennon, Esq.
FOR THE DIVISION:	Leo Wold, Esq. Special Assistant Attorney General
FOR THE COMMISSION:	Cynthia G. Wilson-Frias, Esq. Senior Legal Counsel

Following public comment, Mr. McGair noted that there were three major areas of continuing controversy between KCWA and the Division, namely, funding through rates of healthcare costs, IFR funding, and the level of operating revenue allowance. In addition, Mr. McGair indicated that KCWA is seeking to file certain reports on a semi-annual basis rather than a triennial basis.[63] Mr. Wold agreed that there were three areas of continuing disagreement, stating that the difference in IFR funding was a proposed \$600,000 adjustment, the difference in operating revenue allowance was a proposed \$316,841 adjustment, and the difference in the funding of healthcare costs through rates is based on a fundamental difference in principle.[64] Mr. Ruggerio stated that the City of

[62] *Id.* at 5-6.
[63] Tr. 9/24/08, pp.45-46.
[64] *Id.* at 46-47.

Warwick believed additional cost savings could be achieved through reductions in the IFR program.[65]

KCWA presented Mr. Brown for cross examination. With regard to funding of health care benefits, Mr. Brown indicated that he was aware that requiring employees to contribute to the costs of health insurance premiums has become more prevalent in recent years.[66] Mr. Brown conceded that he had not performed any studies or analyses comparing KCWA with other utilities in Rhode Island to support his claim that to modify health care benefits, KCWA would be required to make a commensurate adjustment to payroll to attract an excellent work force.[67] Mr. Brown stated that KCWA's employee health insurance requires considerably higher co-pays for services than the plan for the State of Rhode Island employees.[68]

Addressing funding of its IFR programs, Mr. Brown agreed that KCWA's current IFR plan filed with the Rhode Island Department of Health anticipated annual expenditures of $6 million per year, but testified that KCWA has not had $6 million included in rates and has not fully funded its IFR programs to the levels provided for in rates since 2002. He agreed that as a result of KCWA's failure to fully fund its IFR programs, the Department of Health has not taken adverse action against KCWA.[69] Mr. Brown stated that he did not believe KCWA had funded its IFR account in the full amount in fiscal year 2006-2007. He conceded that KCWA had provided a salary upgrade resulting in average salary increased of 6.4 percent and that this was in excess of

[65] *Id.* at 47-48.
[66] *Id.* at 53-54.
[67] *Id.* at 54.
[68] *Id.* at 45.
[69] *Id.* at 57-60.

the 4 percent increase in the funding level allowed in the prior rate case for usage on and after July 7, 2005.[70]

Further addressing IFR project funding, Mr. Brown confirmed that he will not go out to bid for a project unless one hundred percent of the expected cost has been collection and was already in the IFR account.[71] In response to questioning from the bench, Mr. Brown agreed that this could result in additional inflationary costs to a project.[72]

Addressing questions from the bench regarding funding of Capital Improvement Projects ("CIP") which are funded through long term bonds, Mr. Brown agreed that approximately $21 million had been in the CIP account since 2002, or approximately six years. He explained that the projects for which KCWA had issued the bonds had been delayed and therefore, the money was not expended. KCWA has begun using those funds for design services.[73] The CIP funds are invested and can earn interest, but Mr. Brown conceded that the bonds had recently been earning less than the carrying cost.[74] Mr. Brown also testified that he shared the Commission's concern regarding costs associated with the delay of commencing the project bonded in 2002.[75] In response to further questioning from the bench, Mr. Brown indicated that if KCWA were to issue bonds and a project was cancelled, he would make a filing with the Commission for approval of a different capital project and would have to notify bondholders of the change.[76]

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[70] *Id.* at 86-88.
[71] *Id.* at 79-80.
[72] *Id.* at 80-81.
[73] *Id.* at 106-108.
[74] *Id.* at 107, 109-10.
[75] *Id.* at 127-129.
[76] *Id.* at 145-46.

Mr. Brown confirmed that the proposed violation of moratorium/restrictions penalty provisions of KCWA's tariffs had been withdrawn. He also clarified that if the service is terminated for lack of payment, for violation of the usage moratorium, or if termination of service is requested for a period outside of normal business hours, the new turn-off charge will apply. However, if repairs will be done during normal business hours, the fees would not apply. He indicated that the turn-off charge is more than the turn-on charge because there tends to be more work involved in terminations, such as having to locate the shut-off valve.[77]

With regard to the request for funding for an additional employee position, Mr. Brown explained that the employee would have to possess specific training to operate and implement the GIS system through updating and tracking the results. The purpose of this is to keep current plans of the water system. The employee would be a field employee as well as an office employee.[78] Mr. Brown also indicated that all KCWA "employees are dual certified for distribution as well as treatment except the office staff" which would allow employees to be shifted to other duties. This was discussed in the context of a meter replacement program, which would allow for monthly metering and would be more automated than the current metering system and which is slated for a future rate case. Some of the current meter readers would be utilized to "key up the valve access program and the hydrant maintenance program."[79]

KCWA presented Mr. Woodcock for cross-examination. Addressing the Division's position regarding the Operating Revenue Allowance, Mr. Woodcock testified

[77] *Id.* at 73-74, 100.
[78] *Id.* at 89-91.
[79] *Id.* at 94-98, 200. While the meter replacement program is not a subject for Commission review in this docket, KCWA is proposing depositing any excess O&M reserve funds into a restricted account for future use in such a program. *Id.* at 97.

that a four percent threshold would be more appropriate than a three percent threshold for determining if KCWA had excess revenues which should be deposited into the restricted portion of the Operating Revenue Allowance along with those funds already being deposited to that account. He disagreed that Clariant revenues related to the pigment manufacturing operation should be singled out for deposit into the restricted Operating Revenue Account in the event Clariant does not cease operations on or before December 31, 2008. Finally, he believed in the event KCWA were to require a withdrawal from the restricted Operating Revenue Account it should be able to withdraw the entire shortfall rather than the shortfall minus a half percent as posited by the Division.[80]

With regard to seasonal rates, Mr. Woodcock indicated that although it would be ideal to treat all customers the same, he did not believe the proposed seasonal rate would be discriminatory. He stated that the periods of highest demand include May through September and out of those five months, KCWA was picking three to include in its seasonal rates. He stated that, "ideally everybody would be the same, but there are constraints with any utility billing that we have to deal with and this certainly falls within the realm of just and reasonable..."[81] He also noted that all customer classes peak in the summer, but did concede that there is less fluctuation seen in the industrial class than in the residential class. He confirmed that no revenue impact studies had been completed for the proposed seasonal rates.[82]

The Division presented Mr. Catlin for cross examination. With regard to healthcare costs, Mr. Catlin stated that he was advocating only that there should be an employee contribution to the premium, but that he only recognized it toward healthcare

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[80] *Id.* at 194-197.
[81] *Id.* at 198-99.
[82] *Id.* at 200-01.

and not vision or dental.[83] He testified that he "did a fairly extensive internet search and reviewed a number of papers that suggested that employee contributions had significantly increased over the last several years."[84]

With regard to KCWA's policy of not bidding an IFR project until the funds are in the account, Mr. Catlin stated that he believed this approach was more conservative than that which is followed by other utilities in Rhode Island. In referring to municipally owned water utilities, he noted that they tend to spend the money more currently than KCWA. Mr. Catlin agreed that in the past, the Commission has allowed utilities to issue bonds for IFR projects when completion of the project was to be over the long term and was of significant size.[85]

Mr. Catlin explained that the Division's position regarding the Operating Revenue Allowance was to allow a 1.5 percent operating revenue allowance, but if the Commission were to approve a 3.0 percent operating revenue allowance, the Commission should require 1.5 percent be set aside in a separate fund to cover revenue shortfalls in excess of a half a percent. In other words, if KCWA were to experience a shortfall in revenues less than half a percent, it would not be able to withdraw funds from the restricted operating revenue allowance account.[86] In addition, Mr. Catlin recommended that if revenues are more than three percent higher than allowed, with adjustments, the amount in excess of the three percent should be deposited into the restricted operating revenue allowance account. He noted that this would provide balance to the funding and

[83] *Id.* at 150-51.
[84] *Id.* at 151.
[85] *Id.* at 156-59.
[86] *Id.* at 161-64.

withdrawals of the restricted account.[87] Finally, in the event the restricted account balance grows to an amount in excess of six percent of revenues, KCWA should be required to make a filing with the Commission for a determination of whether continued funding of the restricted account should continue.[88]

Clarifying the Division's position regarding the seasonal rate, Mr. Catlin stated that if KCWA had proposed a seasonal differential that was substantially higher than the rate charged during the remainder of the year, Mr. Catlin would have opposed it because it would not have been fair without monthly billing. However, because of some apparent desire within the state to move toward seasonal rates, he would not oppose the differential as a first step.[89] He did not believe the differential would send appropriate price signals, but rather, could get customers used to the idea of a seasonal differential if properly publicized.[90] He continued to maintain, however, that "you can't really have effective seasonal rates with quarterly billing."[91] He explained, "[f]or anybody other than those customers who are billed at the end of September for July, August and September, part of their consumption will be what was the true seasonal period and part of it will be in a period that wasn't a seasonal period."[92] He agreed that, to some extent, the rate could be seen as discriminatory.[93] Mr. Catlin agreed that as part of his review of KCWA's filing, the Company had not undertaken any studies of the differences in costs

[87] *Id.* at 167-68.
[88] *Id.* at 169.
[89] *Id.* at 172.
[90] *Id.*
[91] *Id.* at 174.
[92] *Id.* at 174-75.
[93] *Id.* at 175.

during the summer versus during the winter and had not changed its revenue projections based upon implementation of the seasonal rate.[94]

VI. BRIEFS

On October 17, 2008, KCWA, Warwick and the Division filed their Post-Hearing Memoranda. KCWA provided a detailed summary of the proceedings before the Commission.[95] KCWA reiterated many of its arguments regarding the major issues in the case. With regard to the issues remaining in dispute between the parties, KCWA argued that the statutory language mandating IFR plans be submitted to and approved by the Department of Health required the Commission to allow IFR funding of $6 million. KCWA maintained that the economic conditions of the State should not be relevant to the analysis and that further, even if they are, the Division did not provide evidence of such adverse economic conditions.[96]

With regard to the Operating Revenue Allowance, KCWA noted that it had reduced its request from 5% to 3% of rate revenues with 1.5% restricted and 1.5% unrestricted and further, had agreed to many of the Division's conditions for funding and withdrawing from the restricted portion.[97] KCWA argued that it should benefit from a recent Commission decision allowing Providence Water Supply Board a 3.0% operating revenue allowance. KCWA also argued that 3.0% is appropriate because the Company could show a downward trend in sales.[98]

Addressing the Division's proposal regarding the funding of health care costs, KCWA argued that it has been aggressive in controlling health care costs, that it should

[94] *Id.* at 177-78.
[95] KCWA Post-Hearing Memorandum, pp. 4-34.
[96] *Id.* at 35-36, 42.
[97] *Id.* at 36-37, 43.
[98] *Id.* at 43.

not be penalized for having a non-unionized work force, and that it would be unfair to require an employee contribution to health care while only increasing salaries by 3.2%. KCWA argued that there was no claim made that its employees are overpaid.[99]

In its Post-Hearing Memorandum, Warwick summarized certain portions of the rate request and objected to the magnitude of the proposal on the basis that the State is in "unprecedented economic times." Warwick specifically objected to the hydrant increase. Further, Warwick proposed that funding of IFR be reduced and to allow KCWA to pay for IFR projects through bonds. Finally, Warwick expressed concern with KCWA's policy of waiting until all program expenses be fully funded prior to the initiation of work.[100]

In its Post-Hearing Memorandum, the Division noted that at its proposed IFR funding level of $5.4 million, KCWA will have in excess of $18 million available in FY 2009 and FY 2010 to undertake proposed projects. According to the Division's review of KCWA's IFR plan, $15.65 million will be required. The Division indicated that despite the fact that KCWA has not fully funded its IFR plan since FY 2006, it has experienced no adverse consequences from the Department of Health. Finally, the Division pointed out that based on Mr. Brown's testimony at the hearing, "it is highly improbable that the utility would expend the authorized funds within the rate year."[101] Therefore, according to the Division, its $600,000 downward adjustment to KCWA's request will allow KCWA to perform under its proposed IFR plan during the rate year.[102]

[99] *Id.* at 38, 42. KCWA also noted that the Division was not proposing to phase in the co-pay and that the cut would affect the O&M Reserve funding. *Id.* at 42-43.
[100] City of Warwick's Post-Hearing Memorandum, pp. 1-3.
[101] Division's Post-Hearing Memorandum, pp. 3-4.
[102] *Id.* at 4.

Addressing employee contributions to health insurance, the Division noted that currently, KCWA does not require a contribution toward the health care premiums by employees. According to the Division, this is contrary to the expressed expectation of the Commission as set forth in two prior Commission Orders.[103] The Division indicated that the uncontroverted testimony was that employee contributions toward health care premiums has become more prevalent and that based on this evidence, "it is not unreasonable for the Commission to recognize 90% of KCWA's health insurance expense for ratemaking, and adjust downwards KCWA's rate year health expense by $46,723,"[104]

With regard to KCWA's propose Operating Revenue Allowance, the Division continued to recommend a 1.5% allowance on rate revenues, which the Division indicated would be consistent with prior Commission decisions and in fact, would be in excess of what was allowed in several other matters before the Commission. In support of its position, the Division noted that KCWA has more control than other non-investor owned utilities over its personnel costs, has not only made adjustments to the test year for known and measurable expenses, but has "'applied an inflation factor to all other expenses for which known and measurable changes were not made'", and has utilized a consumption amount that is lower than the most recent five year average. According to the Division, these factors support a 1.5% operating revenue allowance. However, the Division stated that if the Commission were to allow a 3.0% operating revenue allowance, it should include several controls as set forth in Mr. Catlin's testimony.[105]

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[103] *Id.* at 4-6, *citing*, Commission Order No. 18719, Commission Order No. 19062.
[104] *Id.* at 6.
[105] *Id.* at 6-10. In its proposed findings, the Division also recommended the Commission deny KCWA's request for seasonal rates until such time as KCWA implements monthly billing. *Id.* at 2.

COMMISSION FINDINGS

At an open meeting on October 20, 2008, after reviewing the evidence and the arguments, the Commission allowed a revenue increase of $3,423,233, or 20.91% for a total revenue requirement of $19,798,220.[106] The impact on a typical residential customer using approximately 27 hcf per quarter is $24.57 from $111.67 to $136.24 or 22%. The annual impact would be an increase of $98.28 from $446.68 to $544.96.

The Commission accepted the Division's position that the allowance for IFR funding included in rates be increased from the current level of $4.805 million to $5.4 million effective November 1, 2008 and that the amount be deposited to the restricted IFR account. The Commission agrees with the Division's analysis that the $5.4 million funding level will allow KCWA to comply with its projected spending plan during the rate year. The Commission disagrees that R.I.G.L. §56-15.6-1 et seq. requires funding of the entire IFR plan through rates if KCWA will not be able to utilize the funds during the rate year. The Commission also notes that KCWA has not suffered any adverse consequences from the Department of Health resulting from its approved IFR funding levels.

KCWA is encouraged to meet with a financial advisor to create a formal investment policy. This relates to two areas of concern that were raised during the course of this proceeding. First, KCWA issued more than $20 million in bonds in 2002 for CIP projects, but because of delays, did not spend the money immediately and has only just begun to do so in 2008. It appears from Mr. Brown's testimony that KCWA could have sought authorization from the Commission and bondholders to use those funds for other CIP projects. Although those funds were in investment accounts, with the downturn in

[106] The approved cost of service is incorporated as Appendix A to this Report and Order.

the markets, KCWA has recently been losing money on those funds. In addition, because of inflation, projects undertaken now will be more costly to complete than if the projects had been started earlier. In the future, if KCWA faces a similar situation, it should reevaluate its CIP list to determine whether there are other more immediate projects for which the money could be used.

Likewise, while the Commission understands that KCWA differs from other regulated municipal water utilities in that it does not have a city or town to rely on for loans in the event of a revenue shortfall and must earn its credit rating on its own, the Commission is concerned about the policy of not issuing RFPs for IFR projects until 100 percent of the project cost is in the IFR account, even if the project will exceed a year in duration. Mr. Catlin described this policy as more conservative than other utilities. This policy, while assuring KCWA will be able to pay the bills as they come due, also runs the risk of inflationary cost increases. The Commission also notes that in some cases, it has approved requests by water utilities to bond long-term IFR projects. Therefore, this is another reason why KCWA should develop a formal investment policy.

A majority of the Commission accepted the Division's recommendation that KCWA's proposal to implement seasonal rates be denied in this proceeding and should be reconsidered at such time as KCWA implements monthly billing. The Commission notes that KCWA's witness agreed that seasonal rates would be more appropriate with monthly billing. The Division's witness even agreed that the rate could be seen as discriminatory within rate classes because of the quarterly billing issue. Furthermore, the Division's witness did not believe the proposed differential would send appropriate price signals to cause customers to modify their usage. KCWA testified that it will be upgrading its meters in the future, subject to Commission approval of funding. According to KCWA, these meters will allow for monthly billing. The Commission will revisit any proposals by KCWA to implement seasonal billing at such time as the meter technology is in place.

A majority of the Commission approved a 3.0% operating revenue allowance, and accepted the Division's recommendation that of the total Operating Revenue Allowance, 1.5% shall be unrestricted for use by KCWA in meeting expense overruns and revenues shortfalls of up to 0.5% of total rate revenue. The remaining 1.5% of total Operating Revenue Allowance shall be restricted and may only be used to cover shortfalls in total allowed rate revenue when the shortfall exceeds 0.5% of such revenue. If the shortfall exceeds 0.5% of total rate revenue, KCWA may seek recovery of the full shortfall. If revenues exceed the total allowed rate revenue by more than 3%, the full amount of the revenue in excess of the allowed rate revenue shall be deposited to the restricted operating revenue reserve. Total allowed rate revenues will initially be set at the rate revenues allowed in this proceeding. This amount shall be adjusted annually based on the annual change in the Consumer Price Index (CPI) for the Northeast. In addition, any increase in revenues approved for the pass-through of the Providence Water Supply Board rate increases shall also be recognized. The balance in the restricted Operating Revenue Allowance shall be limited to 6% of total rate revenues. KCWA shall file a report by November 1 of each year that presents the revenues for the prior fiscal year and the level of restricted operating revenue reserve. If the restricted Operating Revenue Allowance balance exceeds 6% of total revenues, the Commission will open a proceeding to address the appropriate adjustment to the KCWA's rates.

Pro forma revenues were determined based on historical data with a negative adjustment made for usage by Clariant's Pigment Operation based on Clariant's notice that it will cease operations by the end of calendar year 2008. For purposes of determining whether KCWA has exceeded allowed revenues, a majority of the Commission rejected the Division's proposal that any revenue from the Clariant Pigment Operation facility be deposited into a restricted account.

The Commission accepted the Division's recommendation that in determining KCWA's allowed cost of service, a 10% employee contribution toward Blue Cross health insurance premiums be recognized. To the extent that KCWA elects not to require such employee contributions, that amount shall be absorbed out of the Operating Revenue Allowance. This finding is consistent with ongoing Commission policy as set forth in several prior Commission orders. In its last KCWA rate order, the Commission stated, "...that reducing health care costs is becoming more prevalent throughout the public sector."[107] The Commission further stated that "KCWA should take heed of a recent Commission order relating to another non-investor owned utility in which the Commission expressed its expectation that the utility 'would require its employees to share in the expense of their health care premiums or implement other approaches that will clearly reduce the health care premiums paid' by the utility.'"[108] Additionally, in 2006, the Commission stated that "the policy of 'reducing health care costs is becoming more prevalent throughout the public sector' and that KCWA 'should take heed' of the Commission's expectation that employee co-sharing of health care premiums will

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[107] *Order No. 18316*, p. 26 (issued August 4, 2005)

[108] *Order No. 18316*, pp. 26-27 (issued August 4, 2005), *quoting*, *Order No. 18124*, p. 11 (issued January 21, 2005.

occur."[109] The Commission notes that this stated Commission policy has been made clear for almost four years and the time has come for all regulated utilities to implement the policy. Even KCWA's witness agreed that he was aware that employee co-sharing was becoming more prevalent. The Commission's role is to ensure rates are just and reasonable. The Commission has determined on numerous occasions that allowing funding in rates to reflect the policy of employees sharing in the costs of health care premiums result in just and reasonable rates. This policy has been implemented in the union contracts of each non-investor owned utility regulated by the Commission.[110]

KCWA has argued that only allowing funding of 90 percent of the pro forma health care premiums would be unfair to its employees because requiring an employee to pay a share of his or her premium would necessitate a salary increase. However, KCWA's employees have received salary increases in prior years without the implementation of an employee co-share. Therefore, KCWA's past performance has demonstrated that it has not linked salaries to co-shares. Furthermore, KCWA employees have been given a salary increase during the rate year and funding of salary increases was allowed in this case. Therefore, KCWA's argument is without merit. KCWA also argued that it would be unfair to penalize KCWA employees simply for not organizing in a union. However, every other regulated water utility in Rhode Island, union and non-

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[109] *Order No.* 18719 (issued September 14, 2006), *quoting*, *Order No. 18316*, pp. 25-27.

[110] The Commission notes that Providence Water Supply Board, Pawtucket Water Supply Board, Newport Water Division, and Woonsocket Water Department all require their employees to pay a portion of their health care premiums. *See* Docket No. 3684, Exhibit PUC-5 (DR PUC 1-16); Docket No. 3945, Exhibit PWSB 1 (Schedule RB-09); Docket No. 3818, Division Ex. 3 (DR Div 1-8); Docket No. 3800, (WWD response to Division DR 34). In addition, in Docket No. 3707, the Commission noted that after an open meeting where the Commission proposed modification of a Settlement Agreement to reflect funding of Narragansett Bay Commission's health care premiums to reflect a 10 percent employee co-share, NBC indicated that it had reached a tentative agreement with its unions to require a small employee co-share. The Commission noted that while it did not reach the level proposed by the Commission, it was "a step in the appropriate direction." *Order No.* 18719, pp. 18-19. United Water requires a co-share in excess of 10 percent. *See* United Water's Response to Commission Inquiry dated September 25, 2003.

union, require an employee health care premium co-share to the point where a utility reopened negotiations with its union to obtain a co-share.[111] Therefore, it would be reasonable for the Commission, in future rate cases, to fund less than the amount agreed to under a union contract if the Commission believed that such clauses did not result in just and reasonable rates since management has some ability to require co-shares through collective bargaining.

KCWA has argued that only allowing funding of 90 percent of its pro forma health care premiums would automatically reduce its operating revenue allowance below that which was requested. However, one of the reasons KCWA sought a higher operating revenue allowance than has been allowed by the Commission was the revenue uncertainty associated with its proposed seasonal rate. The Commission did not approve the proposed seasonal rate, but still approved an operating revenue allowance equal to $583,313 while the decision to approve funding of the healthcare premiums at a level of 90 percent of pro forma expenses resulted in a reduction to rate year expense of $46,723.[112]

Pursuant to R.I. Gen. Laws § 39-3-12, the utility has the burden of proof to justify its rate increase. A part of this proposed rate increase included a request for funding for a salary increase of 4 percent, later reduced to 3.2 percent. In justifying the salary increase, neither Mr. Brown nor Mr. Woodcock provided studies or analyses to compare KCWA to other Rhode Island water utilities, but simply provided testimony with no supporting documentation that it needed such a large increase to attract a good workforce. Both the

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[111] *See Order No.* 18719, p. 18, n.43.

[112] As the Commission has previously noted, "the level of the operating reserve and whether to grant one are solely matters of discretion for the Commission. Thus it is clear that '[a utility] is not entitled to an operating reserve and that the Commission can establish the funding level of such reserve.'" *Order No.* 18719, p. 20.

utility and the Division agreed to increases equal to the average provided by the utility in past years. Thus, KCWA did not provide substantial evidence to find that a 3.2 percent increase was reasonable.

In contrast, there is evidence that a 3.2 percent salary increase would not be reasonable under current economic conditions.[113] The record in this matter reflects that Rhode Island has high unemployment and under these conditions, the Commission finds it difficult to believe that KCWA would have difficulty retaining its employees, even with a raise less than 3.2 percent. The Commission notes that in setting just and reasonable rates, the Commission has previously stated that, "under Title 39 it would be unreasonable and inefficient for the employees of non-investor owned utilities to enjoy compensation that is more generous than what is received by a utility's ratepayers, a large majority of whom are in the private sector."[114] Thus, in the private sector, employees are more concerned about job retention than receiving salary increases. Furthermore, KCWA employees are employed by a non-investor owned company. Therefore, it is reasonable to compare KCWA's employees to other public sector employees, many of whom have realized no salary increase in FY 2009 while being required to pay larger health care co-shares.

A majority of the Commission allowed funding through rates equivalent to a 2% salary increase in the rate year for KCWA's employees, noting that this does not preclude

[113] While the Commission cannot set rates by using local economic conditions as a basis for determining the consumer's ability to pay, the Supreme Court has not found that local economic conditions do not have a bearing on the setting of just and reasonable rates. For example, in setting the appropriate return on equity, the Commission may review factors which make a company desirable to investors such as "local economic conditions, including employment, population and standard of living…." *Narragansett Electric Co. v. Harsch*, 117 R.I. 395, 429, 368 A.2d 1194, 1213 (1977). Therefore, by analogy, for purposes of determining whether rates are just and reasonable, the Commission can review local economic conditions in determining whether employee compensation is reasonable.
[114] *Order No.* 18124, p. 11.

KCWA from granting its employees an increase that is higher or lower than the 2% allowed in rates. In fact, KCWA implemented a 3.2 percent salary increase effective July 1, 2008, three months prior to the start of the rate year.[115] Furthermore, KCWA has previously found it reasonable to provide salary increases in excess of the funding level allowed by the Commission and has done so while not fully funding its restricted accounts. During the course of this rate case, KCWA agreed to funding of a 3.2 percent increase. In support of its request for funding for salary increases of 4 percent, KCWA noted that if the labor increase was reduced from 4 percent per year to 3 percent, it would result in a rate year reduction of less than $45,000, or 0.21 percent of the total rate year cost of service. If KCWA provides the full 3.2 percent increase, the money will come from the operating revenue allowance. The impact of the Commission's decision on KCWA's final position (3.2 percent increase) is a reduction to rates of approximately $25,000, including the related adjustment to the O&M Reserve, or 0.13 percent of the total rate year cost of service.

The Commission finds that to the extent the amounts approved for the O&M Reserve and the R&R Reserve are not required to meet increases in the reserve requirements established by its bond indenture, any excess shall be set aside in a separate restricted account to be used to meet future capital needs. The Commission grants KCWA's request to file compliance reports for its CIP, IFR and restricted accounts semi-annually instead of three times per year.

KCWA shall restrict the following amounts collected through rates: IFR - $5,400,000, O&M Reserve - $193,620 , R&R Reserve – $200,000, Debt Service -

[115] Division Ex. 3 (DR 1-25); Commission Ex. 1 (PUC 1-13); KCWA Ex. 5, p. 7.

$3,932,319, Capital Equipment - $100,000 and Operating Revenue Allowance Stabilization Fund - $291,657.

COMPLIANCE FILINGS

On November 5, 2008, KCWA submitted its first set of compliance tariffs for Commission review. On November 12, 2008, the Division submitted a Memorandum stating that "KCWA based its compliance filing on the assumption that the Commission's intent was to limit funding of the increase in wages to 2% for the period July 1, 2009 through October 31, 2009 rather than from the beginning of the rate year which is November 1, 2008."[116] On November 19, 2008, at an open meeting, the Commission rejected the November 5, 2008 compliance filing and clarified that the Commission's salary adjustment was to apply to the entire rate year. On November 20, 2008, KCWA submitted a second compliance filing reflecting the salary adjustment during the entire rate year. On November 21, 2008, the Division submitted a Memorandum recommending the Commission approve KCWA's November 20, 2008 compliance filing. At an open meeting on November 25, 2008, the Commission approved KCWA's November 20, 2008 compliance tariffs.

Accordingly, it is

(19545) ORDERED:

1. Kent County Water Authority's Abbreviated Rate Filing of March 31, 2008, is hereby denied and dismissed.

2. Kent Count Water Authority will receive a total cost of service of $19,798,031, which equates to a revenue increase of $3,423,233, effective for usage on and after November 1, 2008.

[116] Memorandum dated 11/12/08.

3. Kent County Water Authority KCWA shall restrict the following amounts collected through rates: IFR - $5,400,000, O&M Reserve - $193,620, R&R Reserve – $200,000, Debt Service - $3,932,319, Capital Equipment - $100,000 and Operating Revenue Allowance Stabilization Fund - $291,657.

4. Kent County Water Authority's compliance tariffs filed on November 5, 2008, are hereby rejected.

5. Kent County Water Authority's compliance tariffs filed on November 20, 2008, are hereby approved.

6. Kent County Water Authority shall comply with all findings and instructions contained in this Report and Order.

EFFECTIVE IN WARWICK, RHODE ISLAND, PURSUANT TO OPEN MEETING DECISIONS ON OCTOBER 30, 2008, NOVEMBER 19, 2008, AND NOVEMBER 25, 2008. WRITTEN ORDER ISSUED JANUARY 23, 2009.

PUBLIC UTILITIES COMMISSION

*Elia Germani, Chairman

Robert B. Holbrook, Commissioner

**Mary E. Bray, Commissioner

*Chairman Germanin dissented from the decision to fund 2 percent salary increases and the decision denying seasonal rates. A separate opinion is attached regarding the salary increase.

**Commissioner Bray dissented from the decision to allow a 3 percent operating revenue allowance.

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

I dissent from the decision of the majority to reduce the proposed salary increase of 3.2 % for KCWA's employees. The majority instead approved funding for 2% salary increase. It is clear the majority reduced the percent of the salary increase primarily because of the challenging economic conditions existing in Rhode Island.

The majority does recognize that under the decision of the Supreme Court in *Narragansett Electric Co v. Harsch,* 117 R.I. 395, 368 A.2d 1194, (1977), the Commission cannot establish rates by using local economic conditions as a basis for determining the consumer's ability to pay and therefore, use that as a basis for setting rates. The majority of the Commission indicates that the same decision of the Supreme Court permitted the Commission to review factors which make a company desirable to investors such as "local economic conditions including employment, population and standard of living". However, the Supreme Court indicated those factors can solely be recognized in setting a rate of return for a company. The Court held that economic conditions could not be used as a justification for setting rates. The majority decision seems to ignore the KCWA's reason for seeking a 3.2% salary increase requested. KCWA in this testimony states if the salary increase request were not granted, KCWA would probably face a desire on the part of its employees of the company to join a union. The KCWA is the only utility in RI that does not have a union. The Commission should acknowledge that if a union becomes the bargaining agent for KCWA's employees, this decision would impair the flexibility necessary for the efficient operations of the company. In my judgment, the end result would be to deny the KCWA an important method for achieving efficient operations of the company. It is well known that a company which is unionized is less efficient, and therefore, it costs the company more money to operate. Thus, the majority in my judgment, is being "penny wise and dollar foolish" if it fails to grant the utility the flexibility it needs to be efficient.

Elia Germani, Chairman

APPENDIX A

SUMMARY OF COST OF SERVICE

	Test Year	Adjustments	Rate Year
Revenues			
Service Charges	$960,059	$205,802	$1,165,861
Metered Rates	$13,784,776	$3,115,977	$16,900,753
Fire Protection	$1,282,239	$101,454	$1,383,693
Miscellaneous	$347,912	$0	$347,912
Total Revenue	$16,374,987	$3,423,233	$19,798,220
Expenses			
O&M			
Supply	$3,658,536	$614,382	$4,272,918
Pumping	$667,868	$111,111	$778,979
Treatment	$207,829	$132,547	$340,376
T&D	$1,409,859	($170,061)	$1,239,798
Customer	$286,602	$17,748	$304,350
Admin	$2,054,697	$223,763	$2,278,459
Total O&M	$8,285,390	$929,490	$9,214,881
Fixed Charges			
Debt Service	$3,901,944	$30,375	$3,932,319
Reserves and Coverage	$0	$393,620	$393,620
Renewal & Replacement	$100,000	$0	$100,000
Infrastructure Replacement	$4,004,478	$1,395,522	$5,400,000
Payroll Taxes	$138,876	$11,899	$150,775
PILOT	$23,123	$0	$23,123
Total Fixed	$8,168,421	$1,831,416	$9,999,837
Operating Revenue	$0	$583,313	$583,313
Total Expenses	$16,453,811	$3,344,219	$19,798,031