STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: CITY OF NEWPORT WATER DIVISION APPLICATION TO CHANGE RATE SCHEDULES	:	DOCKET NO. 4025

REPORT AND ORDER

I. Introduction

On December 9, 2008, the City of Newport, Utilities Department, Water Division ("Newport Water") a municipal utility, filed with the Public Utilities Commission ("Commission") a rate application pursuant to R.I.G.L. § 39-3-11. In its filing, Newport Water requested a total revenue increase of 28.8%, to collect an additional $3,353,023 for operating revenues, for a total revenue requirement of $12,754,756. The impact of this request on the typical residential customer's bill with annual consumption of 55,200 gallons annually, if granted, would result in an increase of $92.84 per year or 28.8%. On December 23, 2008, the Commission suspended the effective date of Newport Water's requested rate increase in order to conduct a full investigation and to hold public hearings. The parties to the docket were the Division of Public Utilities and Carriers ("Division") on behalf of the ratepayers, Portsmouth Water and Fire District ("PWFD"), a wholesale customer, and the United States Navy ("Navy"), the utility's largest single customer.

The instant general rate case filing represents Newport Water's fifth such filing in the last fifteen years. The following table provides a brief history:

Docket No.	Filing Date	Amount Requested	Amount Allowed	% Increase
2985	5/28/99	$1,893,179	$ 449,419	27.50%
3578	11/28/03	$ 606,662	$ 0	0.00%

3675	4/15/05	$1,852,451	$1,513,407	20.48%
3818	1/29/07	$1,580,896	$ 911,458	10.74%
4025	12/9/08	$3,353,023	$2,044,097	21.55%

II. Newport Water's Pre-Filed Testimony

Newport Water submitted the Direct Pre-Filed Testimony of Julia Forgue, Director of Utilities, Harold Smith of Raftelis, its consultant, and Laura Sitrin, the City of Newport's Finance Director. Noting that current revenues would not be sufficient to support expenses in the rate year, Ms. Forgue indicated that Newport Water used a test year of Fiscal Year 2008 (July 1, 2007 to June 30, 2008) and a rate year of Fiscal Year 2010 (July 1, 2009 to June 30, 2010). The application for increased rates is comprised of increases in Debt Service and Capital Spending ($1,197,822) and Operation and Maintenance ("O&M") Expenses ($1,949,530). The largest increases in O&M expenses are: Salaries and Wages ($282,777); Employee Benefits ($215,642); City Services ($389,955); Electricity ($169,637); and Chemicals ($249,335).[1]

Ms. Forgue asserted that Newport Water was in compliance with all prior Commission orders. She noted that Newport Water was seeking two changes to those orders. First, Ms. Forgue noted that the Water Pollution Control ("WPC") Division was ordered to pay one half of the cost associated with the move to quarterly billing, which has been paid. However, in this docket, Newport Water seeks two changes to the way it collects these funds. She stated that Newport Water has 14,442 water accounts as of 9/30/08, of which, 9,452 are also Newport Sewer Customers and 4,619 are Middletown customers whose usage information Newport Water provides to the Town of Middletown for their sewer bills. As such, she proposed that the Newport WPC Division pay one half of the costs attributable to sixty-two point forty-two percent (62.42%) of the water bills and that the Town of Middletown pay one half of the costs on thirty-one point nineteen percent (31.19%) of the water bills. She indicated that the WPC Division should only be required to pay for its proportional share of the Customer Services costs. She explained that by paying for half of the total costs associated with all of the Water Division's accounts, the WPC Division is absorbing costs in its rates that are associated with preparation of billings that are not part of the WPC system such as the water retail accounts in Portsmouth.[2]

In addition, Ms. Forgue indicated that Newport Water was seeking to directly bill both the WPC Division and the Town of Middletown for their proportional costs. Currently, Newport Water charges the WPC Division for one half of all the costs. The WPC then bills the Town of Middletown, which only reimburses the WPC for their proportional share of costs based on number of Middletown accounts. Thus, according to Ms. Forgue, the WPC is currently advancing funds to the Water Division on behalf of the Town of Middletown.[3]

Ms. Forgue noted that Newport Water had transitioned to quarterly billing from tertiary billing and had accrued the additional revenue that resulted from the extra customer charge in a restricted account. A portion of this account was earmarked to pay for a Commission-ordered management study and she requested the net amount be used to reduce Newport Water's outstanding payables.[4] Ms. Forgue summarized Newport

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[1] Newport Water Exhibit 1A (Pre-Filed Testimony of Julia Forgue), pp. 3-4.
[2] *Id.* at 4-5.
[3] *Id.* at 5.
[4] *Id.*

Water's cash flow and payables status, noting that Newport Water had recently received an A+ rating from Standard & Poor's.[5]

Addressing debt service, Ms. Forgue indicated that Newport Water was seeking an increase of $842,985 for two loans from RI Clean Water Finance Agency. The first loanapproximately $7.1 million (2010 SRF A), is for Phases 2 through 5 of the CDM contract and additional professional services associated with the implementation and procurement of capital improvements at Station 1 and Lawton Valley. The second loan for $3.6 million (2010 SRF B) is for Distribution Main Improvements to fund construction of the water main improvement project pursuant to the design work currently underway as part of the Series 2008 SRF A loan. It will also include engineering design costs for the next water main improvement project that is scheduled to start in FY12.[6]

Next, Ms. Forgue discussed each normalizing adjustment where the adjustment to the Test Year exceeded $5,000. She stated that "many of these adjustments were necessary due Newport's efforts to reduce it outstanding payables."[7] She also noted that there were differences between allowed costs and actual test year costs which are carried over into the normalized test year. Additionally, of the forty-five adjustments, nine were the result of costs "cut back in FY 08 to reduce our outstanding payables and does not reflect a normal year of expenses."[8]

Next, Ms. Forgue noted that the majority of the increase to operation and maintenance expense was the result of rate year adjustments. Addressing salaries and

[5] *Id.* at 6-7.
[6] *Id.* at 12-13.
[7] *Id.* at 13.
[8] *Id.* at 14-25.

wages, Ms. Forgue explained that these resulted primarily from contractual requirements under collective bargaining agreements, including the results of classification studies and new labor contracts. However, the projected increases under the AFSME contract were based on an assumption as the contract was to expire on June 30, 2009. Additionally, hourly wages for temporary employees were increased during the rate year because, according to Ms. Forgue, Newport Water desired to attract more qualified candidates. She explained that employee benefits were increasing as a result of increased taxes, pension contributions, and health insurance costs.[9]

Addressing increases in electricity costs, Ms. Forgue noted that this expense increased in several accounts for an overall increase of $169,637. She explained that Newport Water's cost for supply is obtained through a contract the City of Newport has with the Rhode Island Energy Aggregation Program of the RI League of Cities & Towns that expires in February 2009. The current base cost is expected to increase at that time from $0.0596 per kwh to $0.094 per kwh based on information received from the RI League of Cities & Towns. No change is projected for fixed charges or delivery cost per kwh.[10]

Discussing the increase in the Gasoline & Vehicle Allowance, she indicated that the fuel cost for FY 2010 is developed from the actual fuel usage in FY 08 priced at the highest cost per gallon in FY 08, increased by three percent (3.0%) to account for possible fuel cost increases. She stated that the insurance portion is based on information received from the Rhode Island Interlocal Trust. She explained that the parts and labor portion is allocated monthly from the City of Newport Equipment Operations Division on

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[9] *Id.* at 25-29.
[10] *Id.* at 29-31.

a per vehicle basis. To arrive at the FY 10 parts and labor cost, the actual cost allocated to Administration for FY 08 was increased by nine point five percent (9.5%) in FY 09 and three percent (3.0%) in FY 10 to reflect increases in the Equipment Operations Division's budget in those years removing the fuel and insurance costs.[11]

Next, Ms. Forgue explained that adjustments were made to Repairs, Replacement and Maintenance for different reasons. In some cases, routine repairs will be required, in others, security measures necessitate the repairs or replacement, in some, the cost of materials has increased, and in other cases, maintenance was deferred due to cash flow concerns.[12] She also explained Newport Water's calculation of projected increases for chemical expenses.[13] She then provided rationale for employee-related expenses and consulting expense.[14] Additionally, she discussed increases in property taxes.[15] Ms. Forgue also provided an outline of the new methodology for determining City Service expense.[16]

Finally, Ms. Forgue explained that Newport Water is proposing increases to miscellaneous charges for various items and new charges for additional items. She stated that since Docket 2029 (effective July 1, 1992), Newport Water has maintained the same fees for the Miscellaneous Charges. She indicated that the Deputy Utilities Director for Finance evaluated the fees to assure they were appropriately recovering Newport Water's costs for the services provided. Ms. Forgue noted that the revised fees in the Proposed Tariff include those for: Temporary Water Service; Meter Test; Seasonal Turn-on and

[11] *Id.* at 32.
[12] *Id.* at 32-33.
[13] *Id.* at 33-34.
[14] *Id.* at 34-35.
[15] *Id.* at 35.
[16] *Id.* at 36-36.

Turn-off; Non-Payment Turn–on; Meter Service; Interest on Delinquent Accounts; and Special Billings. The new fees proposed are for: Water Sample Testing; Flow Testing; Pressure Testing; Service Application Fees; Statement Charge; and photocopying. Newport Water also proposed to remove the Connection Charge and incorporate it into the Meter Service charge which will include new installations, repairs and replacements.[17]

Mr. Smith provided testimony explaining that the reasons for the rate increase included increases in personnel costs driven by salaries and insurance, increases in electricity and chemicals and additional funding needs for capital projects.[18] He also indicated that Newport Water is requesting an Operating Reserve Allowance of three percent (3.0%) of total O&M expenses with the same restrictions imposed on Kent County Water Authority in a recent rate case.[19] Addressing capital revenue requirements to fund projects contained in Newport Waters Capital Improvement Plan ("CIP"), Mr. Smith explained that the requested Rate Year capital revenue requirements will be sufficient to fund the capital costs in the rate year, but not for the following year. However, he indicated that Newport Water would have sufficient funds to meet rate funded capital needs in FY 2010 and FY 2011 as a result of planned transfers from the Capital Spending Restricted Account to the Debt Service Restricted Account.[20]

Addressing rate year water sales, Mr. Smith indicated that Newport Water was proposing to base pro forma revenues on the most recent three year historical usage by retail rate class. However, for the Navy and PWFD, Mr. Smith indicated that Newport

[17] *Id.* at 38-39.
[18] Newport Water Exhibit 2 (Pre-Filed Testimony of Harold Smith), pp. 15-16.
[19] *Id.* at 9.
[20] *Id.* at 11-12.

Water had adopted projections provided by the Navy and PWFD, subject to clarification of the Navy's projections.[21]

Finally, Mr. Smith indicated that Newport Water had used the cost allocations set forth in Docket No. 3818 subject to the completion of an agreed upon cost of service analysis. Mr. Smith explained that while Newport Water had prepared a preliminary full cost of service study that allocates costs to different customer classes based on class demands, Newport Water had not yet completed its required Demand Study and would continue collecting data through September 2009. Therefore, Mr. Smith also contemplated Newport Water would not meet a September 1, 2009 deadline for filing such a study. Based on the cost allocations used in this filing, Mr. Smith calculated a twenty-eight percent (28%) increase on all customers' bills.

Ms. Sitrin provided testimony regarding the Cost Allocation Manual ("CAM") that was submitted to the Commission by Newport Water on October 28, 2008. She explained that the CAM was created to address the allocation of services from the City of Newport to each of the five Enterprise Funds, of which, Newport Water is one. She indicated that if the City did not provide these services, Newport Water would have to obtain the services from an outside vendor or hire additional staff. Therefore, Ms. Sitrin noted, Newport Water has historically sought funding through rates from the Commission for City Services.[22]

Ms. Sitrin related that in the past, Newport Water's requests for City Service expenses were mainly based on the percentage of the Water Fund's budget as compared to the combined total budgets of all the City's enterprise funds and the General Fund.

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[21] *Id.* at 12-13.
[22] Newport Water Exhibit 3 (Pre-Filed Testimony of Laura Sitrin), p. 2.

However, Ms. Sitrin noted that in Docket 3818, the Commission ordered Newport Water to develop a Cost Accounting Manual that would set forth a more detailed methodology for reimbursing the City as opposed to an allocation based solely on budge percentages. Therefore, Ms. Sitrin noted that she had developed a Cost Allocation Manual, which details the allocation of costs to the Enterprise Funds and the rationale behind the allocations.[23]

Ms. Sitrin explained that in order to prepare the CAM, she reviewed the services provided by various City Departments to the Enterprise Funds. She indicated that in some cases, she was able to develop an actual calculation for the amount of time, money or number of tasks to be used in the calculation. However, in other instances, she continued to use the percentage of each enterprise fund's budget to the combined total budgets of all the enterprise funds and the General Fund. Finally, there were instances where she used different calculations. She stated that she provided an explanation for each methodology.[24]

First, Ms. Sitrin explained where it was possible to calculate the estimated amount of time, money or number of tasks that should be allocated. This category included Audits, Other Post-Employment Benefits ("OPEB"), City Council and City Clerk, Finance (Purchasing and Collections) and Finance (Communication Costs). She indicated that Audits are billed back based on the percentage of time spent on each Enterprise Fund. She indicated that the OPEB allocation is based on the Annual Required Contribution by the Enterprise Funds as determined by the City of Newport's actuaries. Ms. Sitrin indicated that this rate filing does not include a request for Newport

[23] *Id.* at 2-3.
[24] *Id.* at 3.

Water's share of the Annual Required Contribution because the City of Newport has not yet authorized retiree insurance payments from the Trust and all payments are currently funded from operations (pay-go). Newport Water currently pays retiree health insurance from its revenues. Ms. Sitrin indicated that a decision was made not to include Newport Water's share of the ARC until such time as the retiree benefits are paid out of the Trust.[25]

Addressing the City Council and City Clerk, Ms. Sitrin indicated that costs for the City Council's and City Clerk's salaries, benefits, dues and subscriptions and office supplies will be allocated to all funds on the basis of the fund's share of items addressed at Council meetings for a fiscal year. An additional cost allocation may be made for a Fund's number of hours spent in workshops as compared to the total number of hours in workshops. Ms. Sitrin also noted that the City Council has also budgeted funds for Citizen Surveys, which assess citizen satisfaction with the delivery of city services. She explained that if there is a specific question related to an Enterprise Fund, the costs will be allocated based on the number of Fund-specific questions to total questions.[26]

Next, Ms. Sitrin indicated that the Finance Purchasing Agent's salary and benefits will be allocated based on each Fund's share of purchase orders. All costs in the Collector's Division will be allocated based on the number of payments processed as compared to combined tax, water, sewer and tickets payments processed. She related that Finance (MIS - Communication Costs) will be allocated based on each Fund's number of

[25] *Id.* at 3-4.
[26] *Id.* at 4-5.

phones as a percentage of total phones. Phone system infrastructure, to the extent that it can be separated from computer infrastructure, will also be allocated in this manner.[27]

Addressing costs that Ms. Sitrin recommended be allocated based on the percentage of each Enterprise Fund's budget to the combined total budgets of all the Enterprise Funds and the General Fund, she maintained that it would be extremely difficult to determine the exact amount of time, money or number of tasks to be used in the calculation. Therefore, the CAM still used budget comparisons for several allocations including the City Manager on the basis of the extent of his or her duties including the fact that Department Directors report directly to the City Manager. Therefore, she asserted that it would be almost impossible to track the exact amount of time the City Manager spends on issues related to the Enterprise Funds in a given year. Therefore, she believed that it would be equitable to assign salaries, benefits and operating costs from the City Manager's Office based on budgets.[28]

With regard to other departments that would be allocated on the basis of budget comparisons, she indicated that costs for Human Resources will be allocated based on the percentage of full-time or permanent part-time employees in the Fund to total full-time and permanent part-time employees in the City. The City Solicitor was allocated on the basis of three positions whose work relates to the Enterprise Funds. The Finance Department costs were reviewed by Division within the Department to determine how costs should be allocated. Other than those Ms. Sitrin discussed earlier in her testimony, she noted that even where other costs were assigned based on budget, the City examined the amount of costs that would be allocated (i.e. 80% of Finance Administration to all

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[27] *Id.* at 5.
[28] *Id.*

enterprise funds). In some instances, a specific percentage of costs were allocated directly to Newport Water (10% of the Assessor's salary and benefits, 5% of the Controller's and Accounting Supervisor's salaries and benefits).[29]

Noting that the School Department and Library budgets were not included in the combined total budgets of all Enterprise Funds and the General Fund, Ms. Sitrin stated that the Newport School Department and the Newport Public Library, while combined with the City for financial reporting, are separate and distinct organizations with their own elected or appointed boards, administration and staffs. However, she noted that there are some instances in which allocations include the School (i.e. Audit, ERP system) and that these allocations were specifically noted in the Cost Allocation Manual.[30]

Finally, she explained that Facilities and Maintenance Costs will be allocated based on the square footage of each funds' buildings as a percentage of the total square footage of buildings served, and Public Safety Costs will be allocated based on each fund's percentage of assessed value to total assessed value less the value of Navy and federal property.[31]

III. PWFD's Pre-Filed Testimony

On April 2, 2009, Christopher P. N. Woodcock, a consultant working on behalf of Portsmouth Water and Fire District, filed direct testimony. Much of Mr. Woodcock's testimony focused on his concern with the level of City Services being requested by Newport Water. He asserted that the Cost Allocation Manual submitted by Newport Water did not conform to the Commission's ruling in Docket No. 3818. He pointed out that the allocation for many city offices was based on the water budget as a percentage of

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[29] *Id.* at 6.
[30] *Id.*

the total City budget, excluding the school and library budget, whereas in Docket No. 3818, the school and library budgets were included in the total City budget in the determination of city services.[32] Mr. Woodcock also took issue with the fact that the allocations were not based on the revenue requirement approved by the Commission.[33]

With regard to the City Manager and City Council, he argued that Newport Water was not in compliance with the prior Commission order because the City included more than base salary for the city manager and city councilors in its allocation calculations. He quoted language from the prior Docket relating to the allocation for the City Clerk office…" allocating one percent (1%) of the City Clerk's Office budget to Water is fair and reasonable". In the current case, Woodcock claims, "Newport Water has ignored those findings and simply assigned costs based on the City Council allocation" which "does not conform to the Commission's ruling in Docket 3818".[34] Further, Mr. Woodcock did not believe that basing the allocation on the number of agenda items was a reasonable methodology and served to overstate the amount of time the City Council dedicated to Newport Water issues. Based on a more detailed review of the role of the City Council, Mr. Woodcock proposed allocating five percent (5%) of the councilors' base stipends to Newport Water.[35]

With regard to City Finance allocations, he argued that Newport Water is non-compliant since the City used more than half of the Finance Budget in the allocation calculations, contrary to the Commission's ruling in Docket 3818.[36] Mr. Woodcock

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[31] *Id.* at 7.
[32] PWFD Exhibit 1 (Direct Testimony of Christopher P. N. Woodcock), p. 5, 8-9.
[33] *Id.* at 5, 7-8.
[34] *Id.* at 5-6.
[35] *Id.* at 13-15.
[36] *Id.* at 6.

maintained that the City support was overstated in light of the existence of full time finance personnel in Newport Water's payroll. He also compared the revenue requirement of the Water Fund and the Water Pollution fund and argued that the stated that the "disparity between the water fund and water pollution fund is particularly striking."[37] Mr. Woodcock also questioned the amount of time the Finance Department allocated to Newport Water (21%) compared to the amount of time spent by the Auditors reviewing Newport Water's books and records (6%).[38]

Mr. Woodcock recalculated the activities of the tax collector's office based on a listing of all activities undertaken by the department rather than water and sewer collections alone, resulting in a proposed allocation of sixteen point seventeen percent (16.17%) in place of the City's proposed twenty point five percent (20.5%). He included the number of tax payments, water and sewer collections, tax notices, MLCs, ticket collections, parking permits and fishing permits to come up with the total number of activities, or 194,176. Of this, 64,454 were related to water and sewer collections, and half of that was allocated to water.[39]

Noting that Newport proposed to allocate sixteen point nine percent (16.9%) of the Accounting Division cost to the Water Division based on the number of payroll and vendor checks, Mr. Woodcock maintained that this does not properly reflect all of the activities undertaken by the Accounting Division. He also expressed concern with the cost per check, noting that the methodology results in 10 checks being issued per day at a cost of $30 per check, particularly where the costs are based mostly on salary. He also noted that the total cost of the Accounting function does not match the amount in the

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[37] *Id.* at 11.
[38] *Id.* at 12.

City's budget. He also removed five percent (5%) for the portion separately allocated for water and used the remaining ninety-five percent (95%) as the basis for my proposed allocation. Mr. Woodcock did not propose an alternate method of calculating the allocation, instead proposing the Commission disallow any allocation of costs until another methodology is developed.[40] In the alternative, he suggested that "the percentage of budget value used in the last docket and updated in this one be used, but cut in half to reflect the City's failure to meaningfully comply with the Commission's Order in Docket 3818."[41]

Addressing the Solicitor's office, Mr. Woodcock believed that the allocation should be reduced further based on the outside legal services provided to Newport Water.[42] In the area of Public Safety costs being allocated as part of City Services, he identified this as a new cost that he identified as an unauthorized tax. He allocated no costs to Newport Water.[43] Mr. Woodcock also made adjustments to the allocation of costs from the Human Resources Division, arguing that the 150 seasonal employees represented by Newport Water should be included in the calculations. His adjustment resulted in a nine percent (9%) allocation rather than the twelve point nine percent (12.9%) proposed by the City.[44] Addressing Newport Water's proposal to allocate purchasing costs based on the number of purchase orders, Mr. Woodcock suggested that rather than using all purchases contained in each purchase order, the use of unique

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[39] *Id.* at 19.
[40] *Id.* at 19-21.
[41] *Id.* at 21.
[42] *Id.* at 10.
[43] *Id.* p 7, 21-22.
[44] *Id.* at 16.

purchase orders would be a better measure, increasing the allocation to eighteen point six percent (18.6%).[45]

Mr. Woodcock was dissatisfied with the use of the Assessor's "years of experience" as the basis for the allocation of that department and criticized the lack of objective measurement or means to verify this. In response to PWFD's request for a quantifiable basis, Newport Water suggested that the preparation of tangible property declarations cost about $1,250, based on 8 hours of time (rounded up to 10 hours) at $125/hour. Mr. Woodcock argued that after a review of the personnel costs for the department, the cost per hour should be between $37.50 and $55.00. He also expressed concern that the number of hours was overstated.[46] Furthermore, Mr. Woodcock argued that with regard to appraisals, he argued that there is no indication that the City does this for the Water Division parcels. Further, he maintained that the suggested outsourcing costs were overinflated. Including the preparation of the declarations, the revaluation reviews and meetings with the towns, Mr. Woodcock allocated approximately three point two percent (3.2%) of the Assessor's time to Newport Water.[47]

Mr. Woodcock then indicated that he had several concerns with the proposed allocations of MIS Division costs. First, Mr. Woodcock indicated that postage should not be allocable to Newport Water because Newport Water pays its own postage.[48] Second, Mr. Woodcock states that "the City's cost allocation manual indicates that "45% of the maintenance and hosting costs related to the ERP system should be specifically assigned to the School Department" – it is not clear where this reduction to the MIS budget is

[45] *Id.* at 16.
[46] *Id.* at 17.
[47] *Id.* at 18-19.
[48] *Id.* at 22.

made."[49] Third, Mr. Woodcock could not find an adjustment to reflect outsourcing of support.[50] Finally, Mr. Woodcock reiterated that Newport has excluded the school and library budgets from the twenty-two point fifty-five percent (22.55%) allocation factor it proposes. Mr. Woodcock argued that this exclusion is unjustifiable in light of statements contained in the City Budget that all municipal and school departments are supported by MIS Staff.[51]

Following his testimony regarding City Services, Mr. Woodcock quoted extensively from other Newport Water dockets. Arguing that Newport Water's request to use funds accrued from its transition from triennial billing to quarterly billing, Mr. Woodcock argued that prior Commission rulings precluded Newport Water from using any of the funds to pay the City for outstanding payables. In fact, Mr. Woodcock maintained that Newport Water should have a $315,614 debt to the City "wiped off the books" and that the City should credit the Water Fund another $357,807. The supporting fiscal information he relied on was a comparison of the payables owed to the City in February 2009 and those owed to the City on June 30, 3009. The basis for this argument was that the outstanding payables were all the result of amounts due prior to June 30, 2005. Therefore, PWFD was arguing that Newport Water was in violation of prior Commission Orders.[52] In the alternative, Mr. Woodcock argued that if the payables are considered new loans subsequent to June 30, 2005, Newport Water was in violation of prior Commission Orders because there was no accompanying loan documentation.[53]

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[49] *Id.*
[50] *Id.*
[51] *Id.* at 22-23.
[52] *Id.* at 23-27.
[53] *Id.* at 27-29.

Addressing the Operating Revenue Allowance, Mr. Woodcock supported a three (3.0%) operating revenue allowance with half restricted for use when revenues fall below specified levels. However, consistent with his argument regarding payables owed to the City, he maintained that the operating revenue allowance need not be included in rates, but would come from amounts he maintained the City owed to Newport Water.[54]

Addressing Revenue Requirements, Mr. Woodcock indicated that PWFD would be primarily relying on the Division's adjustments. However, he indicated that there was a minor adjustment to the regulatory assessment from the Rhode Island Water Works Association because the proposed rate year expense appeared overstated. Additionally, he questioned the proposed rate year expense for Fire Protection as it was almost two times the cost for FY 2008 which included the purchase of new hydrants. He proposed use of the most recent four year average to set the rate year expense, or $6,300.[55] Addressing capital costs, Mr. Woodcock recommended allowance in rates of $1,154,000 instead of the $1,652,019 proposed by Newport Water based on Ms. Forgue's response to a data request indicating that certain costs would not be included in the capital requirement. He made other adjustments to reflect updates provided by Newport Water during discovery.[56] He also made minor adjustments to miscellaneous revenues and revenue offsets to correct a calculation and to recognize reimbursement for meter replacements received from the sewer billings.[57]

Looking forward to the cost allocation study to be filed by Newport Water, Mr. Woodcock indicated that in order to properly allocate costs from the pumping facilities

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[54] *Id.* at 29-30.
[55] *Id.* at 31-32.
[56] *Id.* at 33-35.
[57] *Id.* at 36.

between supply (treatment), distribution and transmission, Newport Water should be tracking those costs separately. Mr. Woodcock asked that the Commission order Newport Water to track the pumping costs separately from treatment costs.[58]

IV. Navy's Pre-Filed Testimony

On April 1, 2009, the Navy submitted the Direct Pre-Filed Testimony of its consultant, Ernest G. Harwig. Mr. Harwig recommended Newport Water's request for a three percent (3.0%) operating revenue allowance be denied, arguing that continuation of one and a half percent (1.5%) is sufficient.[59] Mr. Harwig also proposed the Commission order a Phase II of the instant proceeding to adjust rates according to an approved cost of service study to be filed by Newport Water later in 2009.[60] Additionally, Mr. Harwig proposed that Newport Water's proposal to finance several projects through current revenues be moved to debt service funding due to the expected service lives of the projects extending ten years and beyond. He calculated a $517,241 decrease in Newport Water's revenue requirement as a result of his proposal.[61] Addressing City Services, Mr. Harwig proposed a $188,700 reduction to Newport Water's request.[62]

Mr. Harwig stated that Newport Water had overstated its total share of the City's operating budget and overestimated the amount of time devoted to Newport Water by the City Council and City Clerk. He maintained that Newport Water's share of the total budget should be calculated on the basis of its actual revenue request, or thirteen point seventy-two percent (13.72%). Mr. Harwig would apply this allocator to the City Manager, City Solicitor, 80% of Finance costs and non-telephone MIS costs. With

[58] *Id.* at 32-33.
[59] Navy Exhibit 1 (Pre-Filed Testimony of Ernest Harwig), pp. 3, 7-8.
[60] *Id.* at 3, 8-9.
[61] *Id.* at 3, 6-7

regard to the calculation of the City Council allocator based on the number of docketed items, Mr. Harwig argued that a simple tally of docketed items is an unreliable proxy for the time actually spent by the Council on Enterprise Fund issues because it does not reflect the actual amount of time spent by the Council on various issues. Therefore, he recommended an allocation factor of five percent (5.0%).[63]

V. Division's Pre-Filed Testimony

On March 31, 2009, the Division of Public Utilities and Carriers ("Division") submitted the Direct Pre-Filed Testimony of its consultant, Thomas Catlin of Exeter Associates. Using the same test year and rate year as Newport Water, Mr. Catlin recommended that Newport Water receive a revenue increase of $1,763,385 through a uniform percentage increase to existing rates and charges for metered water service and fire protection service.[64] Mr. Catlin indicated that he believed several Newport Water expenses may have been overstated, but only focused on the larger elements of costs for which he believed adjustments to the claimed rate year expenses were necessary.[65]

Mr. Catlin proposed downward adjustments to eight specific areas: (1) Employee Vacancies ($145,752 reflecting a number of employee vacancies based on prior year averages); (2) Overtime ($7,172 based on justifications provided in Newport Water's Data Responses); (3) Consultant Fees ($78,500 reflecting proposals to defer recovery of certain costs not associated with the rate year, proposed amortization of costs, and a reduction based on historical averages); (4) Chemicals ($82,500 subject to the receipt of updated rate year costs); (5) Motor Vehicle Fuel Expense ($25,469 resulting from his

[62] *Id.* at 3, 6.
[63] *Id.* at 3-6.
[64] Division Exhibit 1 (Pre-Filed Testimony of Thomas Catlin), pp. 4-5.
[65] *Id.* at 6.

calculation using different historical period than Newport Water); (6) City Services ($281,247 to be further discussed below); (7) Debt Service and Capital Spending ($92,985 resulting from updated projections); and (8) Meter Replacement Allocation.[66] Mr. Catlin's proposed adjustments to the Meter Replacement Allocation to the Water Pollution Control Division resulted in an adjustment to the Revenue Offsets amount, or an increase in rate year revenue offsets of $32,766 based on an allocation of meter replacements consistent with the treatment of other metering and customer accounting costs.[67] Finally, Mr. Catlin accepted Newport Water's proposed Operating Revenue Allowance of three percent (3.0%), but clarified that there should be conditions upon which Newport Water could access the restricted portion.[68]

Mr. Catlin proposed allowing $331,622 in rates for City Services – Legal and Administrative and $152,631 for City Services – MIS. Mr. Catlin accepted Newport Water's allocators and allocable budgets for the following: Human Resources, Purchasing, Accounting, Audit Fees, Citizen Survey, Public Safety, Facilities Maintenance, and MIS-Communication Costs. However, Mr. Catlin proposed a general allocator of eleven point seventeen percent (11.17%) for Legal and Administrative and fourteen point twenty-nine percent (14.29%) for MIS based on the inclusion of the School and Library budgets in the overall City budget used as the denominator in developing the percentage of costs that should be allocated to Newport Water.[69] This differs from Newport Water's general allocator of twenty-two point thirty percent

[66] *Id.* at 6-12.
[67] *Id.* at 22.
[68] *Id.* at 22-23.
[69] *Id.* at 13-15.

(22.30%). Mr. Catlin applied his respective general allocators to the following: City Manager, City Solicitor, Finance Administration, and MIS-Other Costs.

Mr. Catlin also adjusted the allocable budgets for certain of the departments. With regard to Finance Administration, Mr. Catlin applied his allocator to half of the total budget for the department.[70] He believed that the methodology used by the City of Newport to develop the allocable budget for the Finance Department gave "little or no recognition…to the fact that Newport Water shares a Director of Finance with the WPC Division and pays sixty percent (60%) of the associated salary and benefits" in addition to having its own full-time financial analyst.[71] Mr. Catlin also expressed concern that the number of water-related bank and investment accounts used by the City was overstated by the inclusion of a separate Water Billing Charges Account and a Water Repayment Account, both of which are being eliminated in Newport Water's filing. In addition, Mr. Catlin did not believe it was necessary to include two water debt service accounts, two water debt service reserve accounts, and a water sinking fund account because such duplicate accounts are unnecessary. Finally he noted that a separate account is included for each restricted fund which he thought was unreasonable because these accounts should not be given the same weight as the City's General Fund Account and Imprest Account that are used for all City departments other than water.[72] Finally, because Ms. Forgue testified that Newport Water is directly charged for its advertising relating to purchasing, its costs should not be based on the purchasing agent's total budget.[73]

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[70] *Id.* at 16-17.
[71] *Id.* at 16.
[72] *Id.*
[73] *Id.*

Mr. Catlin also made separate recommendations regarding the allocation of City Council and City Clerk costs, Assessment Division costs, Collections Division costs and Accounting Division costs. He recommended allocating only five percent (5%) of the City Council's costs to Newport Water. He maintained that Newport Water's reliance on water-related agenda items compared to the total number of City Council agenda items significantly overstated the percentage of time devoted to water issues because it ignores items taken up in Executive Session or addressed by the Council serving as the Licensing Commission. Furthermore, he indicated that the calculation also does not consider the time Council members spend at meetings and workshops and special events, serving on the School's Ad Hoc Building Committee or any other activities in which council members participate. Finally, he took issue with the manner in which Newport Water counted the agenda items with regard to the consent agenda.[74]

With regard to the City Clerk, Mr. Catlin argued that Newport Water had not demonstrated that the allocation should differ from the one percent (1%) approved by the Commission in Docket No. 3818.[75] Addressing City Assessor, Mr. Catlin proposed that rather than using the Assessor's own estimate of his time, the allocation should be based on Newport Water's analysis that indicated that the average cost of the services performed by the assessor would be approximately $12,400 per year if they were outsourced at a cost of $125 per hour. ($12,400 divided by $125 per hour equals 99 hours.) Mr. Catlin recommended, therefore, that Newport Water be allocated five percent (5%) of the Assessor's salary rather than the ten percent (10%) proposed by the City.[76]

[74] *Id.* at 17-18.
[75] *Id.* at 18.
[76] *Id.* at 19.

Mr. Catlin argued that the methodology used to allocate cost of the Collections Division of the Finance Department fails to give any weight to the Collection Division's other activities outside of processing water payments compared to the total tax, water, sewer and ticket payments. Therefore, Mr. Catlin included those other activities in the denominator and reduced the percentage allocated from twenty percent (20%) to seventeen point one percent (17.1%), noting that he believed it was still overstating Newport Water's responsibility to this Division.[77]

Finally, with regard to City Service, Mr. Catlin maintained that there was no justification for directly assigning five percent (5%) of the Controller's and Accounting Supervisor's salary and benefits to Newport Water while the remainder of the Accounting Division's costs were allocated to Newport Water based on the relative payroll and vendor checks. Therefore, arguing that the separate allocation is arbitrary and unsupported, he allocated all Accounting Division costs on the basis of the relative number of checks.[78]

VI. Newport Water's Rebuttal Testimony

On April 29, 2009, Newport Water submitted the Rebuttal Testimony of Julia Forgue, Laura Sitrin and Harold Smith in order to respond to the pre-filed testimony of PWFD, the Navy and the Division. Ms. Forgue disagreed with Mr. Catlin's adjustments to Salaries & Wages, Gasoline, Meter Replacement Allocation, and Consultant Fees. She also disgreed with Mr. Woodcock's position on the use of the Extra Billing Charge Restricted Fund, and his adjustment to Fire Protection. She also disagreed with Mr. Harwig's suggestion that several projects should be financed by debt rather than through

[77] *Id.* at 19-20.
[78] *Id.* at 20.

the restricted Capital Account. She did agree with Mr. Catlin's adjustment to overtime for Source of Supply Mainland and substantially agreed with his adjustment to Customer Service, differing by eleven and a half hours.[79] She also agreed with Mr. Woodcock's adjustment to reduce the request for Regulatory Assessment.[80]

Addressing Salaries and Wages, Ms. Forgue stated that Mr. Catlin's adjustment is overstated because he included a position in his calculation that is vacant because it is a position for which Newport Water is seeking funding in this docket. She also argued that Mr. Catlin's proposed reduction would have a negative impact on Newport's operations. She conceded that turnover does occur, but argued that typically, when a single position becomes vacant it is filled by a promotion, which in turn creates a series of promotions "up the ladder" until a position at the "bottom of the ladder" is filled. While it may seem logical to cut salary expense based on an "average vacancies," a reduction of this type has unintended negative effects. She argued that if salaries and wages are eliminated based on two positions because of temporary vacancies, then Newport will not have sufficient funds to fill all its current employee positions and would have to eliminate permanent positions. She maintained that this may actually lead to an increase in salary and wage expense as operating with vacancies results in increased overtime costs to cover the duties of a vacant position.[81]

Addressing Mr. Catlin's adjustment to Gasoline expenses, Ms. Forgue agreed to use a fuel price based on the average period January 2008 through January 2009 which

[79] Newport Water Exhibit 2 (Rebuttal Testimony of Julia Forgue), pp. 2-3.
[80] *Id.* at 8-9.
[81] *Id.* at 1-2.

would result in a decrease of $10,528 from Newport Water's original filing and an increase of $14,941 over the Division's proposal.[82]

With regard to Consultant Fees, Ms. Forgue agreed to reduce the line item "other consultant fees" to $50,000 in the rate year, but disagreed with the proposal to defer recovery of costs associated with the cost of service study because work had already commenced on the project. She also disagreed with the proposal to amortize the cost of the Risk Management Study which is performed every five years, but is paid for in one year.[83]

Responding to Mr. Woodcock's testimony that the payables owed in this docket result from pre-June 2005 amounts, Ms. Forgue argued that the Commission should reject the argument since this issue was litigated and decided in Docket 3818. Referencing exhibits from Docket No. 3818, Ms. Forgue noted that Newport Water had a cash deficit of $919,761 as of June 30, 3005. She further noted that this cash deficit was reduced to $54,069 in October 2005 and in July 2006, Newport Water had a cash surplus of $439,939. Thus, she maintained, there was no longer a cash deficit as of the beginning of FY07. She explained that during FY07, Newport went from a cash surplus in July 2006 to a deficit in June 2007 and that it was this deficit that the Commission allowed Newport to reduce through efficiencies in the Docket 3818 Order.[84]

Ms. Forgue also disagreed with Mr. Woodcock's opinion that the money owed to the City of Newport in February 2009 were loans. She stressed that Newport's monthly cash flow reports are snapshots in time. Thus, at any one time, the reports may show money to be reimbursed to the City of Newport. This is particularly true of payroll

[82] *Id.* at 4.
[83] *Id.* at 4-5.

reimbursements. She noted that although Newport Water is a regulated utility, it is still a department of the City of Newport and therefore, municipal employees. She indicated that the City pays all of its municipal employees bi-weekly, including those employed in the Water Division and then seeks reimbursement from Newport Water. The priority each month is to fund the restricted accounts. Therefore, when funds are available, they are deposited into the restricted accounts. Thereafter, when funds are available, the City Controller arranges for the reimbursement of payroll and the payment of vendor invoices.[85]

Ms. Forgue disagreed with Mr. Woodcock's adjustment to fire protection on the basis that Mr. Woodcock was incorrect that Newport Water was seeking funding for past expenses. However, she agreed to reduce the rate year request to $14,500 based on the average of historical fire protection expenses plus the cost of five new fire hydrants.[86]

With regard to Mr. Woodcock's concerns regarding a lack of separate allocation of pumping costs at the treatment plants, Ms. Forgue noted that Newport Water will address pumping costs with the demand study and cost allocation study that will be completed and submitted in the Fall of 2009.[87]

Addressing Mr. Harwig's proposal to fund more projects through debt, Ms. Forgue stated that while it may seem logical to finance these projects with debt due to the length of their service life, it is not always practical or economical to do so. She opined that not all of the projects would qualify for subsidized borrowing through the Rhode Island Clean Water Finance Agency. However, even if they would qualify, she noted

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[84] *Id.* at 7-8.
[85] *Id.* at 8-9.
[86] *Id.* at 9-10.
[87] *Id.* at 10-11.

that one of the projects listed by Mr. Harwig was already underway. Additionally, some projects are funded by sources other than Newport Water and requiring Newport Water to fund its portion through debt could delay the project and adversely impact the other funding sources. Finally, she expressed reservations about adding borrowing costs to some projects which require fairly low annual funding.[88]

Ms. Sitrin did concede to some of the points and recommended changes to the methodology in calculating the City Service expense. However, there remained several areas of disagreement. Responding to areas of disagreement with the parties' proposed adjustments to the City Services allocation, Ms. Sitrin first stated that the Water Fund is the second biggest fund in the City of Newport without an independent management board. She maintained that the capital and debt needs together with the various regulations under which Newport Water operate require a greater degree of attention and extra effort to understand the applicable regulations and ensure compliance. She indicated that the rate filing process alone requires increased effort on the part of the City Manager, Water personnel and Finance personnel as well as from the City Solicitor and City Council. Also, she stated that the Water Fund's financial activities and payroll are intertwined to a large degree with other City operating funds. She noted that while vendor checks are issued from the Water Fund's own checking account, all other financial activity is handled through wire transfers and journal entries. Therefore, she argued that all of these factors create an environment where more support is needed for the Water Fund than for other funds.[89]

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[88] *Id.* at 11-13.
[89] Newport Water Exhibit 3 (Rebuttal Testimony of Laura Sitrin), p. 2.

With regard to the critique that when comparing the Water Fund to the City budget, Ms. Sitrin should have excluded the operating reserve, the Repayment to City account, depreciation, debt service and capical expenditures, Ms. Sitrin agreed to remove the operating reserve and the Repayment to City accounts but did not agree to remove the other expenditures because administration of those items requires City resources. She also agreed to utilize the approved revenue requirement rather than the total expenditure budget for City Manager, City Solicitor, 80% of Finance Administration costs and non-telephone MIS costs assuming the School and Library budgets are excluded from the City budget for developing the allocator. Ms. Sitrin argued that the City support is so minimal that the entire School and Library budgets should not be included in the City General Fund budget when calculating the allocations or City Services.[90] She noted that the school bank and investment accounts should have been removed when calculating the allocator for Finance Administration and did so in Rebuttal.[91]

Addressing the parties' critiques of the allocation to the Finance Department, Finance Administration – 80%, Ms. Sitrin maintained that Newport Water requires an inordinate amount of support from the Finance Department because of the number of activities it must perform, including that in the last six years, the Water Fund is the only fund to have borrowed money through debt issuances. Ms. Sitrin did concede that the financial staff at the Water Fund perform many vital functions including, but not limited to: preparation for and assistance with rate filings; maintenance of the billing system; monitoring capital projects; answering and addressing billing issues and customer needs; supervising the Customer Accounts division; tracking billing charges and preparing

[90] *Id.* at 3-6.
[91] *Id.* at 7.

journal entries for billings. However, she maintained that because the Water Fund is so intertwined with the City, the Finance Administration must also devote a great deal of effort to the Water Fund. [92] Addressing Mr. Catlin's concerns that the number of water-related bank and investment accounts was overstated in the allocation of ten percent (10%) of the Finance Administration costs, Ms. Sitrin stated that she removed all investment accounts, most school accounts, and water accounts soon to be closed, resulting in a revised bank account allocation applied to five percent (5%) of the Finance Administration budget.[93]

With regard to the parties' concerns that using the number of items on the City Council agenda to allocate City Council and City Clerk support to Newport Water, Ms. Sitrin defended her approach as a useful proxy in light of the fact that there is no way to accurately measure the time spent by the Council outside of regular meetings. She believed that use of the same allocation for the City Clerk was appropriate based on the Clerk's responsibility to prepare, disseminate, and post the agenda and minutes and to maintain legal documents related to Newport Water. However, she performed a new count for the allocation that included executive sessions in addition to regularly scheduled meetings if the reason for the executive session could be determined. The count also included several other agenda items not originally included in the count. Ms. Sitrin did not, however, include workshops in the calculation because she believed the results would be too heavily skewed toward Newport Water.[94]

With regard to the Assessor's Department, Ms. Sitrin agreed to Mr. Catlin's revision of the cost resulting in an allocation of five percent (5%) of the City Assessor's

[92] *Id.* at 8-9.
[93] *Id.* at 9-10.

salary and benefits. Addressing Mr. Woodcock's argument that relying on the Assessor's best estimate of his time was not objective and that Newport Water overstated the costs of outsourcing the work, Ms. Sitrin stated that while "the only true way to make this determination is to outsource all services provided by the City," given the relationship of the City and Newport Water, it would be inefficient to do so.[95]

Addressing Mr. Catlin's objection to allocating five percent (5%) of the Controller and Accounting Supervisor salary and benefits directly to Newport Water, Ms. Sitrin stated, that all activity of Newport Water, with the exception of vendor checks, is processed through wires, transfers and journal entries by the Controller and Accounting Supervisor with approval of the City Finance Director. According to Ms. Sitrin's calculations, thirty-three point two percent (33.2%) of all wires and/or transfers were for Newport Water and twenty-seven point four percent (27.4%) of all journal entries were for the Newport Water. Although this would reflect a normal year, she did not want to weigh the results too heavily toward Newport Water, instead assigning the five percent (5%) of salaries.[96]

Responding to Mr. Woodcock's concerns regarding the description of services of the Accounting Division and the use of payroll and vendor checks as the basis for the allocator, Ms. Sitrin stated that this methodology was used as an objective proxy to calculate the Accounting Division's time. She indicated that in addition to the processing of payroll and vendor checks, three other functions are employee related: W-2 preparation, quarterly and annual tax requirements, and administration of the deferred compensation and Section 125 Plan programs. Therefore, she maintained that the count

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[94] *Id.* at 11-15.
[95] *Id.* at 16-17.

of payroll checks resulted in an objective number to use in allocating time spent on all of these employee related functions. In addition, Accounting pays the water vendors from the water fund checking account. Thus, the number of these checks also served as an objective proxy for the Accounting department's time.[97]

With regard to Police and Fire Services, Ms. Sitrin argued that, contrary to Mr. Woodcock's position, it is appropriate to charge these services to Newport Water because Newport Water is not charged taxes and does not make a payment in lieu of taxes like other tax-exempt properties. Therefore, it should be allocated General Fund supported costs through a cost allocation process.[98]

With regard to Newport's decision not to include the School budget in the City budget for purposes of developing an allocator for MIS services, Ms. Sitrin argued that the School is not a department of the City. She indicated that the schools have their own computer system and training support. She noted that while the School and City do share financial and payroll software, the support for that software is outsourced and forty-five percent (45%) of that cost is allocated to the schools and was removed from the City budget when the allocator was developed.[99]

Mr. Smith addressed the parties' proposed adjustments in the following categories: (1) capital spending; (2) City Service expense; (3) allocation of certain costs to water pollution control and the Town of Middletown; (4) operating revenue allowance; and (5) allocation of the rate increase across customer classes. Following his discussion of the areas in which there was now agreement of the all or some of the parties, Mr.

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[96] *Id.* at 17.
[97] *Id.* at 18.
[98] *Id.* at 19.
[99] *Id.* at 20-21.

Smith made several adjustments, reducing Newport Water's requested Net Revenue Requirements by $919,996. He indicated that this reduction in Net Revenue Requirements results in Newport Water's requested percent increase in rate revenues dropping from twenty-eight point seventy-five percent (28.75%) to nineteen point twelve percent (19.12%).[100]

Addressing capital spending, Mr. Smith agreed that Newport Water's request for debt service should be adjusted to reflect the latest information regarding the anticipated interest rates on Newport's future borrowings. He adopted PWFD's methodology of determining the actual amount allowed for debt service in the rate year because it recognizes that Newport Water's debt service requirements will increase over the coming years.[101] With regard to the contributions to capital spending, based on Mr. Catlin's suggestion, Mr. Smith recommended that the contribution to the Capital Spending restricted account be reduced by $505,101 from $1,652,019 to $1,146,918 which is the average of Newport's annual cash capital requirements for fiscal years 2010 and 2011.[102] Finally, addressing Mr. Harwig's recommendations to fund more projects through debt service rather than cash, Mr. Smith expressed concern that such changes would adversely affect Newport Water's ability to meet the provisions of its Trust Indentures regarding debt service coverage ratios.[103]

Addressing City Service expense, Mr. Smith noted that the Cost Allocation Manual was developed in response to the Commission's prior Order in Docket No. 3818 and that, based on his review of other municipally owned water utilities, contrary to the

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[100] Newport Water Exhibit 4 (Rebuttal Testimony of Harold Smith), p. 22. The adjustments included updating water consumption figures as a result of discovery responses from the Navy and PWFD. *Id.*
[101] *Id.* at 4.
[102] *Id.* at 4-5.

sentiments expressed in the testimony of the witnesses for the Division, PWFD and the Navy, the magnitude of the charges the City is assessing based on the Cost Allocation Manual, are not out of line with the charges assessed to other utilities by their parent city or county.[104] With regard to the methodology chosen by Newport Water in developing its Cost Allocation Manual, Mr. Smith conceded that there may be methodologies that would be more accurate, but maintained that the costs of such studies would outweigh the benefits to Newport Water's ratepayers. He further testified that in his opinion, the methodologies utilized by Newport Water resulted in a fair approximation of the City Service costs.[105]

Regarding the allocation of meter replacement costs to Water Pollution Control and the Town of Middletown, Mr. Smith agreed with PWFD's recommendation that fifty percent (50%) of the meter replacement costs be split between Water Pollution Control and the Town of Middletown similar to the way Newport proposes to allocate O&M and debt service costs between the two entities because it more accurately reflects the benefit that these two entities will receive from the new meters. However, he utilized updated costs to allocate from those used by Mr. Woodcock in his recommended adjustment.[106]

Addressing Mr. Harwig's testimony recommending the operating revenue allowance remain at one and a half percent (1.5%) rather than the requested three percent (3.0%), Mr. Smith noted that Newport Water's request, if approved, would be consistent with the Commission's recent decision regarding Kent County Water Authority. He also maintained that the requested operating revenue allowance would allow Newport Water

[103] *Id.* at 5-6.
[104] *Id.* at 7.
[105] *Id.* at 7-11.
[106] *Id.* at 12-13.

to build up a reserve equal to forty-five days of operating expenses in approximately eight years. Additionally, he claimed that the Navy's proposal would adversely affect Newport Water's credit worthiness compared to Newport Water's request which was not objected to by either the Division or PWFD.[107]

Finally, Mr. Smith addressed the Navy's concerns regarding Newport Water's proposal to increase the rates of all rate classes by a uniform amount. He noted that the Commission previously ordered Newport Water to perform a full cost of service study by September 1, 2009. He explained that Newport Water will be collecting additional data for the Demand Study from a daily meter reading program that will be implemented. This program involves the daily reading of water meters for a randomly selected sample of approximately 160 of Newport Water's customers during the months of May 2009 through September 2009. Therefore, he noted the Cost of Service Study would be filed in the Fall of 2009. However, because of the need for a rate increase, Newport Water filed for an increase, agreeing that once the Commission rules on the Cost of Service Study, the rates could be adjusted accordingly.[108]

VII. PWFD's Surrebuttal Testimony

On May 13, 2009, PWFD filed the Surrebuttal testimony of Christopher P.N. Woodcock. Mr. Woodcock primarily agreed with the Division's revenue adjustments, but indicated that chemical costs should be adjusted to reflect current costs and use, that PWFD was still recommending the adjustments to Debt Service and Capital Spending that were contained in Mr. Woodcock's Direct Testimony, and that there were additional

[107] *Id.* at 13-16. Mr. Smith recognized that Mr. Woodcock had recommended the operating revenue allowance be funded through existing funds rather than through increased revenues, but did not address the substance of PWFD's position. *Id.* at 14.
[108] *Id.* at 16-17.

adjustments that should be made to City Services.[109] Addressing the Navy's adjustments, Mr. Woodcock did not believe Mr. Harwig's adjustments to City Services were sufficient. Mr. Woodcock also disagreed with Mr. Harwig's proposal to increase debt financed projects on the basis that Newport Water may have difficulty maintaining the required debt service coverage. Finally, Mr. Woodcock reiterated that a one and a half percent (1.5%) operating revenue allowance is insufficient and continued to support the requested three percent (3.0%), albeit funded from the extra billing account rather than future rates.[110]

Addressing City Services, Mr. Woodcock maintained that the City's claims for administrative functions were not in line with other utilities. In response to Mr. Smith's assertion that Newport Water's request for City Services represents seven percent (7%) of Newport Water's O&M budget, Mr. Woodcock determined that seven percent (7%) is higher than the five point seven percent (5.7%) median cost of City Services of the survey group cited by Mr. Smith. Further, he faulted Mr. Smith for not comparing Newport's City Services to Pawtucket Water Supply Board or Providence Water Supply Board, each of which is less than two and a half percent (2.5%) of their respective operating budgets.[111]

Mr. Woodcock attacked a statement by Laura Sitrin that says Newport Water "requires a greater degree of attention and extra effort to understand the applicable regulations and ensure compliance".[112] He argued that there is no evidence to suggest that Newport Water is different in this regard to other regulated Rhode Island water utilities.

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[109] PWFD Ex. 2, (Surrebuttal Testimony of Christopher P.N. Woodcock), pp 2-3.
[110] *Id.* at 3-4.
[111] *Id.* at 4-6.
[112] *Id.* at 6.

While conceding that the existence of a separate board may remove some political considerations, "it does not significantly impact the amount of administrative oversight needed."[113] He summarized his position by arguing that the management of Newport Water is to blame for its reliance on the City of Newport.[114]

With regard to the city's allocation of Finance Department costs to the water department, Mr. Woodcock argued that Newport Water has been provided considerable ratepayer funds to pay for water department positions intended to reduce the water department's reliance on the City's finance department. He referred to Docket No. 3675 wherein Ms. Forgue testified that the Deputy Utility Director of Finance would be taking most of the responsibilities that fell onto the City's finance director. He also noted that Kent County Water and Pawtucket Water do not rely on an outside finance department.[115]

Mr. Woodcock took issue with Ms. Sitrin's claim that his recommendation with regard to the allocation of City Council costs is "without any basis or experience." Mr. Woodcock conceded that no methodology is perfect and proposed that the cost base for allocation for City Council expense should be the Council's salaries and stipends, as approved by the Commission in Docket No. 3818, rather than the entire City Council budget as the allocation cost base. He also maintained that the City Clerk's allocation should not be based on the number of agenda items in the City Council minutes, opining that $20,000 overstates the value of the City Clerk's services.[116]

Mr. Woodcock also revised his recommendation of Assessor's office costs to $4,200, equivalent to 77 hours per year, which falls between Newport Water's request of

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[113] *Id.*
[114] *Id.* at 7.
[115] *Id.* at 9.
[116] *Id.* at 11-12.

$5,673 and his original position of $3,600. In the area of public safety costs (police and fire), Mr. Woodcock reasserted his position that this allocation is nothing more than a thinly veiled tax and should not be allocated to the utility at all.[117]

In addressing the issue of pumping costs, Mr. Woodcock indicated that pumping costs should be tracked separately from treatment costs. He referenced the response to PWFD 4-4, in which Richard Esten indicated that Newport will track the costs separately. Woodcock indicated that he is not convinced that Ms. Forgue agrees with Mr. Esten. He urged the Commission to clearly indicate in its Order that Newport Water is to track these costs separately.[118]

With regard to Newport Water's repayments to the City, he contended that Newport Water did not have funds on hand on June 30, 2005 to meet its expenses. As a result, he asserted that the City paid employees salaries in June 2005 despite the fact that the water department did not have the funds in its accounts, thereby arguing that the City exceeded the $2.5 million limit on reimbursements to the City. Therefore, he continued to advocate for the disallowance of repayments to the City. In response to Ms. Forgue's argument that Newport had a surplus as of July 2006, he pointed out that the only reason that Newport Water had a surplus at that time is that the City prepaid a full year of fire protection charges.[119]

Mr. Woodcock also continued to support an operating revenue allowance of three percent (3.0%) but urged the Commission to put a limit on the account of six percent (6.0%) of total revenues. He proposed one adjustment to miscellaneous expense to account for Newport Water's share of a surplus distribution of medical insurance

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[117] *Id.* at 13-14.
[118] *Id.* at 14-15.

premiums which would be made to the City in FY 2010. Finally, he proposed that Newport Water bill the City for fire protection charges monthly, in conformance with its tariff, rather than less often as it appeared was occurring.[120]

VIII. Navy's Surrebuttal Testimony

On May 13, 2009, the Navy submitted the Surrebuttal Testimony of Ernest G. Harwig in which he did not address adjustments to Newport Water's revenue requirement, but focused on debt service coverage ratios ("DSCR") and Newport Water's cost of service study.[121] Addressing Newport Water's concerns that Mr. Smith's proposals to include more projects in debt service rather than pay-as-you-go, Mr. Harwig stated that his adjusted revenue requirement for Newport Water did factor in its proposed borrowings for FY 2010. He also argued that Mr. Smith did not provide a calculation of Newport's DSCR for FY 2010 under Mr. Harwig's recommendations to support his assertion that they would result in Newport Water being unable to meet DSCR requirements. Third, he noted that the cumulative adjustments made by Mr. Smith to Newport Water's original revenue request in his rebuttal exhibits ($919,996) are greater than the total adjustment that Mr. Harwig had recommended ($840,890). Mr. Harwig also claimed that he and Mr. Smith had achieved roughly similar results regarding the amount of debt service to be included in Newport Water's revenue requirement and therefore, he did not believe his recommendations were more detrimental to Newport Water's DSCR, than Mr. Smith's Rebuttal position.[122]

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[119] *Id.* at 15-18.
[120] Id. pp. 19
[121] Navy Exhibit 2 (Direct Testimony of Ernest Harwig), pp. 1-2.
[122] *Id.* at 2-3.

Addressing Newport Water's proposed cost of service study, Mr. Harwig welcomed it as a way to address Newport Water's difficulty in accurately reflecting the cost of serving its various customers in rates. Therefore, he reiterated his proposal that the Commission should order a Phase II to this proceeding to implement a revenue-neutral adjustment to Newport Water's rates. He indicated that Phase II implementation would result in equitable movement toward cost of services rates without delay, as opposed to waiting until Newport Water's next rate case to implement cost-based rates.[123]

IX. Division's Surrebuttal Testimony

On May 13, 2009, the Division submitted the Surrebuttal Testimony of Thomas Catlin in which he recommended Newport Water receive a revenue increase of $1,547,419, or sixteen point fifty-seven percent (16.57%).[124] Mr. Catlin continued to propose downward adjustments to four specific areas, accepting Newport Water's Rebuttal positions on Overtime Wages, Chemical Costs, Updated Debt and Capital Spending, and Meter Replacement Allocation with clarification. Mr. Catlin still proposed adjustments to the following: (1) Employee Vacancies ($142,250 reflecting a number of employee vacancies based on prior year averages, adjusted for the exclusion of a vacant position in the calculation); (2) Consultant Fees ($25,000 reflecting his proposal to amortize the cost of service study over two years rather than treating it as an annual expense); (3) Motor Vehicle Fuel Expense ($12,174 resulting from his calculation using different historical period than Newport Water in its Rebuttal); and (4) City Services

[123] *Id.* at 3.
[124] Division Exhibit 2 (Surrebuttal Testimony of Thomas Catlin), p. 11, TSC-1.

($52,489 to be further discussed below).[125] The Operating Revenue Allowance was also adjusted as a result of Mr. Catlin's other adjustments.

Mr. Catlin proposed allowing $352,909 in rates for City Services – Legal and Administrative and $144,402 for City Services – MIS.[126] Mr. Catlin noted that Ms. Sitrin's rebuttal testimony provided a more detailed explanation and justification for several of the allocation procedures than was provided in her direct testimony and therefore, Mr. Catlin had fewer allocations with which he disagreed.[127] Mr. Catlin proposed a general allocator of ten point seventy-seven percent (10.77%) for Legal and Administrative and fourteen point zero eight percent (14.08%) for MIS based on the inclusion of the School and Library budgets in the overall City budget used as the denominator in developing the percentage of costs that should be allocated to Newport Water.[128]

Mr. Catlin continued to disagree with Newport Water's exclusion of the School and Library budgets from the calculation of the budget percentage applied to the City Manager, City Solicitor and Finance Administration costs. He argued that the fact that Newport Water concedes there is some involvement of these departments with the Schools and Library demonstrates that it is not appropriate to exclude the School and Library budgets from the calculations. He noted that he was including only the General Fund contributions to the School and Library budgets rather than the entire School and Library budgets. According to Mr. Catlin, the City's General Fund contribution

[125] *Id.* at 2-6, 9-11.
[126] *Id.* at TSC-8, p. 1.
[127] *Id.* at 6.
[128] *Id.* at TSC-8, p. 2.

represents only sixty-one percent (61%) of the total School Department budget and seventy-eight percent (78%) of the total Library budget.[129]

Mr. Catlin continued to disagree with the five point seventy five percent (5.75%) allocation of the City Clerk's office to Newport Water based on the percentage of City Council agenda items associated with water issues because it failed to take into account the other duties of the City Clerk's office, thereby overstating the costs allocable to Newport Water. Therefore, he continued to recommend a one percent (1%) allocator.[130] Additionally, Mr. Catlin argued that the Finance Department costs that were assigned to Newport Water were overstated because it fails to give adequate consideration to the fact that Newport Water has its own Director of Finance and its own financial analyst. However, he stated that he would accept Newport's allocations to the Water Division if the School and Library budgets are included in calculating Newport Water's share of the total City budget used to allocate eighty percent (80%) of Finance Administration costs.[131]

X. Pre-Hearing Briefs

On May 18, 2009, the Commission issued a pre-briefing question to be addressed by the parties as follows: Whether the issue of repayment to the City of Newport in the amount $1,584,171 has been decided by Order No. 19240. If so, can and should the Commission revisit this issue in the instant docket." This question arose from a review of the Order in Docket No. 3818 and related testimony and briefs which showed that PWFD

[129] *Id.* at 8.
[130] *Id.* at 8-9.
[131] *Id.* at 9.

had made similar, and at times identical, arguments as had been made in the instant docket regarding repayment of funds to the City of Newport.[132]

On May 26, 2009, Newport Water filed its Pre-Hearing Brief, stating "the issue of repayment *was* addressed by Order No. 19240, and the Commission should not revisit this issue even if it can do so. Newport Water urges the Commission to make a definitive ruling on this topic so that this issue does not become a perennial part of Newport Water's future rate filings."[133] Thus, Newport Water argued that while the Rhode Island Supreme Court has held that the Commission is not absolutely barred from addressing certain issues raised in prior cases, it should not hear the issue again pursuant to the Doctrine of Administrative Finality.[134]

Citing decisions from the Rhode Island Supreme Court, Newport Water argued that under the doctrine of Administrative Finality, decision-makers are required to "articulate the changed circumstances that support a different decision on a subsequent application."[135] Newport Water maintained that the Commission already addressed the issue of repayment, that it was a central issue to Newport Water's rate case in Docket No. 3818, and that the Commission decided it clearly and unequivocally. Further, Newport Water noted that PWFD did not appeal the Commission's decision in that prior case. Finally, Newport Water argued that the Commission's decision in Docket No. 3818 was consistent with its approval of a Settlement in Docket No. 3578, Newport Water's earlier rate case where repayment issues were addressed.[136]

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[132] *See* Commission Exhibit 6.
[133] Newport Water's Pre-Hearing Brief, p. 1.
[134] *Id.* at 2-3.
[135] *Id.* at 3, *quoting, Johnston Ambulatory Surgical Associates Ltd. V. Nolan,* 775 A.2d 799, 810 (R.I. 2000).
[136] *Id.* at 4-7.

On May 26, 2009, the Division submitted a letter with a copy of its brief from Docket No. 3818 supporting its position that in the pending matter, PWFD has made the a request for the very same relief that it sought in Docket No. 3818, but which was denied.[137] The Division notes that PWFD's basis that it was "'not certain all the information was clear when the Commission reported its findings in Docket 3818…,' that there was 'an impression that the $1,584,171 deficit all happened in FY 2007", does not meet "the requisite change in material circumstances" required by the Court to reconsider the issue.[138] Therefore, the Division posited that reconsideration of PWFD's request for the same relief is barred by the doctrine of Administrative Finality.[139]

On May 26, 2009, PWFD filed its Pre-Hearing Brief, noting that that the Commission's Order in Docket No. 3578 allowed Newport Water to repay the City of Newport $2.5 million, accrued through June 30, 2005. In Docket No. 3818, the Commission did not include further repayment in Newport Water's revenue requirement, but authorized further repayment "if Newport Water realizes savings from efficiencies, and such funds are not required for expenses included in the revenue requirement."[140]

PWFD argued that of the funds Newport Water is seeking to repay through use of the extra billing account funds, $709,421 was borrowed from the City and can be traced back to a point in time prior to June 30, 2005 and was not part of the $2.5 million. As such, PWFD argued that the $709,421 should be treated as another loan despite the absence of documentation. Furthermore, PWFD argued that the absence of such

[137] Letter from Leo Wold, Special Assistant Attorney General to Luly Massaro, Clerk, 5/26/09, p. 1..
[138] *Id.* at 2.
[139] *Id.*
[140] PWFD Pre-Hearing Brief, pp. 1-2 (citations omitted). PWFD proposed the Commission consider amending Order No. 19240. The Commission notes that PWFD never appealed the Order and further, that the time allowed for such types of proposals has passed. *See* Commission Rule of Practice and Procedure 1.26, 1.28.

documentation further violates the Commission's Order in Docket No. 3578. PWFD argues that Newport Water was never out of debt to the City because it kept "roll[ing] the debt forward."[141]

Finally, PWFD argued that Newport Water had not complied with the Commission's Order in Docket No. 3818 because it did not find real efficiencies, but rather deferred expenses in order to repay the City of Newport without first applying to the Commission. PWFD argued that Newport Water was "robbing Peter to pay Paul" and "did not spend $230,000 in FY 2008 that had been approved by the Commission as part of the revenue requirement in Docket 3818. According to PWFD, Newport Water identified no efficiencies but deferred expenses for maintenance that would need to be included in future revenue requirements in order to avoid decline in service. Finally, PWFD argued that Newport Water should not be permitted to use revenues accrued in the extra billing account to satisfy outstanding payables at the conclusion of the instant rate case because the change from tertiary billing to quarterly billing is not an efficiency. Therefore, PWFD stated that the Commission should reject Newport Water's request to repay monies owed to the City.[142]

XI. Hearing

Following notice, public hearings for the purposes of taking public comment were conducted at Newport City Hall and at the Commission. Public hearings were also conducted on May 27, 2009 for the purpose of hearing oral argument concerning the Pre-Hearing Briefs and to take evidence on the propriety of Newport Water's filing at the

[141] *Id.* at 3-6, n. 5.
[142] *Id.* at 7-12.

Commission's Offices, 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

The following appearances were entered:

FOR NEWPORT WATER:	Joseph Keough, Jr., Esq.
FOR NAVY:	Audrey Van Dyke, Esq.
FOR PWFD:	Gerald R. Petros, Esq. David Marquez, Esq.
FOR DIVISION:	Leo Wold, Esq. Special Assistant Attorney General
FOR COMMISSION:	Cynthia G. Wilson-Frias, Esq. Senior Legal Counsel

A. Oral Argument

Mr. Petros conceded that the Commission did rule that Newport Water may repay the $1,584,171 owed to the City of Newport at the time the Commission ruled at its Open Meeting. Additionally, Mr. Petros stated that PWFD did not take issue with Newport Water or the Division regarding their analyses of the Doctrine of Administrative Finality.[143] However, Mr. Petros raised "the issue of whether or not Newport Water has complied with the Commission's order in the method of repayment it has implemented thus far and proposes to implement going forward."[144] Specifically, Mr. Petros indicated that PWFD does not believe that Newport Water paid the City back with funds realized from efficiencies, but through deferrals for items that were needed and built into the revenue requirement.[145]

[143] Tr. 5/27/09, pp. 10-11.
[144] *Id.* at 11.
[145] *Id.* at 23.

Mr. Keough argued that PWFD was simply "coming under a different theory this time to get the exact same relief they as [for] in the last case" which is what the Doctrine of Administrative Finality is meant to prevent.[146]

B. Evidentiary Hearing

Newport Water presented Julia Forgue, Laura Sitrin, and Harold Smith for cross-examination. PWFD presented Christopher Woodcock. The Navy did not present any witnesses. The Division presented Thomas Catlin.

On cross-examination, Ms. Forgue explained that when referring to the cost allocation between supply and distribution associated with pumping, she agreed Newport Water would use its best efforts rather than simply indicating that all pumping costs would be separately allocated was because there are certain costs associated with pumping that are associated with both supply and distribution. Therefore, she agreed that where the activities are associated with both, Newport Water would have to develop a reasonable methodology to separate them.[147]

On further cross-examination, Ms. Forgue reviewed an exhibit from Docket No. 3818, Newport Water's most recent rate matter before the Commission. She agreed that the exhibit included items for which the utility was seeking funding approval during the rate year. She characterized specific line items in the repairs and maintenance account as examples of items for which repairs and maintenance would be needed. She indicated that within the category, there were some projects that the utility still needs to address, despite having the items in the prior revenue requirement because the utility made a decision to prioritize expenses and these particular expenses were placed lower in the

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[146] *Id.* at 24-25.
[147] *Id.* at 48-50.

priority list.[148] For example, with the roof, after the close of the rate case, there was a conscious decision made in prioritization and the state of the roof was reviewed again and a decision was made to repair leaks rather than replacing the entire roof at that time.[149]

Ms. Forgue denied redirecting the funds included in the revenue requirement for repairs and maintenance to the City of Newport.[150] She also further denied that Newport Water would have had enough money to undertake all repair and maintenance projects if the City had not been repaid because she did not see payroll as "giving money to the City," but paying expenses due.[151] She did agree that Newport Water needed to make large normalizing adjustments in the instant matter because of its decision to reduce outstanding payables. Ms. Forgue agreed that at the beginning of FY 2008, Newport Water's largest creditor was the City of Newport. She also agreed that as of April 30, 2009, the City was owed four payrolls and certain overhead charges.[152] On redirect, Ms. Forgue clarified that there was no point in time between the FY 2007 and April 30, 2009 that Newport Water did not owe payroll to the City of Newport.[153] She indicated that unlike other expenses for which Newport Water receives invoices, payroll and City Service expense are not invoiced. She also agreed that there was no time in FY 2008 when there were no outstanding payables to vendors. With regard to payroll and City Service expense, Ms. Forgue stated that as funds are transferred to the City for payroll, the oldest are satisfied before the most recent.[154]

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[148] *Id.* at 74-76.
[149] *Id.* at 142-43.
[150] *Id.* at 77-78.
[151] *Id.* at 83-84.
[152] *Id.* at 87-89.
[153] *Id.* at 152-53.
[154] *Id.* at 151-56.

With regard to Newport Water's radio read project, Ms. Forgue explained that the utility's goal is to complete the installations in customers' homes by December 2010. According to Ms. Forgue, this project will allow Newport Water to eventually move to monthly billing. Expanding on a response to a Division data request, Ms. Forgue assured the Commission that the current meter readers are involved in additional training and that the current meter readers would be qualified to undertake additional duties once there is a reduction in the meter reading duties resulting from the radio read project.[155]

On cross examination regarding the calculation of proposed changes to the turn-off and turn-on charges, Ms. Forgue agreed that the proposed $40 charge was higher than the $35 cost incurred by Newport Water for a turn-on/turn-off charge. She indicated that the charge applies when the service is reconnected after disconnection for non-payment. She stated that the $40 would be charged during normal business hours of 7:00 a.m. and 3:30 p.m. She maintained that Newport Water could not calculate the cost during non-business hours because the cost incurred is different depending on the personnel on duty at the time. Customers who seek reconnection outside of the 7:00 a.m. to 3:00 p.m. timeframe are advised that if they can wait until those hours, they will be turned on for $40, but otherwise the charge will be significantly more based on three hours at time and a half for the personnel on duty. However, they are not provided with the actual charge.[156]

With regard to Newport Water's request to include anticipated in labor contracts not yet finalized, Ms. Forgue disagreed with the Commission's suggestion to restrict the revenue related to that request until such time as the contracts were finalized. She

[155] *Id.* at 100-01.
[156] *Id.* at 123-28.

expressed concern with the expense of setting up the restricted account, but agreed to do it if ordered.[157] Ms. Sitrin later testified that Newport Water could restrict and track funds for different purposes within one account without having to set up a separate account for each purpose.[158]

On cross-examination, Ms. Sitrin testified that since the creation of the Deputy Utility Director of Finance within Newport Water, Ms. Sitrin has been able to focus less on rate filings which take an extensive amount of time. She also indicated that the Deputy Utility Director of Finance oversees the tracking of billing and receivables on the detailed ledger side. Newport Water also now tracks their capital projects more extensively than in the past. She testified that these were the types of activities that she had to undertake as the City's Finance Director prior to the creation of the new position within Newport Water.[159]

The Division presented Mr. Catlin for cross-examination. With regard to the issue of moneys owed to the City, Mr. Catlin characterized the City's support of Newport Water as the provider of working capital to cover fluctuations that are present in the accounts receivable.[160] He testified that when one reviews the expenses and revenues at any point in time, the expenses owed to the City reflect "the amount that Newport Water has been advanced by the City to meet its receivables, payables in advance of collecting its receivables."[161] Further, he continued to advocate for the ability of Newport Water to utilize funds accrued in the restricted "Extra Billing Account" to pay down payables.[162]

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[157] *Id.* at 173-74.
[158] *Id.* at 195-96.
[159] *Id.* at 193-94.
[160] *Id.* at 182.
[161] *Id.* at 183.
[162] *Id.* at 181-82, 185-86.

PWFD presented Mr. Woodcock for cross-examination. Mr. Woodcock stated that he had not calculated the figure referenced in PWFD's brief regarding the total PWFD claimed was included in the Docket No. 3818 revenue requirement and not spent.[163]

XII. Post-Hearing Briefs

A. Newport Water

Newport Water summarized its filing and discussed its position regarding remaining disputes with the other parties over Motor Vehicle[164] and Consultant fees[165], Debt Service[166], and the expenses owed to the City of Newport for payroll[167], city services[168] and sludge removal[169]. For most of the issues, the brief summarized the final positions of the parties and addressed what Newport Water believed were the weaknesses in the other parties' positions.

Addressing expenses owed to the City of Newport, Newport Water noted that it had shown in Docket No. 3818 a steady decline in consumption over a six year period, resulting in the utility collecting lower revenues than had been approved by the Commission in setting Newport Water's revenue requirements. According to Newport Water, it had been unable to collect $5,329,576 between FY 2004 and FY 2007. Newport Water noted that it is required to fully fund its restricted accounts regardless of the level of revenues received, leaving Newport Water in the position of choosing which

[163] *Id.* at 231.
[164] Newport Water's Post-Hearing Brief, p. 33.
[165] *Id.* at 34.
[166] *Id.*
[167] See *infra* notes 149-169 and accompanying text.
[168] Newport Water's Post-Hearing Brief, pp. 27-32.
[169] *Id* at 34-35.

O&M expenses to pay.[170] Therefore, according to Newport Water, it was unable to pay all of its approved expenses, forcing it to rely on the City's willingness to accept late reimbursement of payroll and city services.[171]

In response to PWFD's argument that even if Newport Water was able to identify efficiencies, it still needed to apply for approval by the Commission to repay the City of Newport, Newport Water argued that if the Commission wanted to include such specific requirements, it could have done so. In fact, Newport Water argued, the Commission has previously included such specificity in its Orders. For example, in Order No. 17992 the Commission required Newport Water to segregate a specific repayment amount to be repaid to the City upon meeting certain conditions and receiving Commission approval. Such precautions were not included in Order No. 19240.[172] Furthermore, Newport Water maintained that the $1,584,171 was not a loan from the City of Newport, but were "for legitimate Commission expenses that were unpaid at the end of FY 2007 due to a lack of revenue caused by under-consumption."[173] This lack of revenue had previously been defined as a "structural deficit" by PWFD's attorney. Because the $1,584,171 of expenses was not segregated by the Commission subject to repayment from a restricted account, it was Newport Water's position that it had not violated any Commission Order.[174]

Newport Water argued that because of the nature of the payables owed to the City of Newport, one cannot look at amounts due at particular points in time. Newport Water explained that the expenses owed to the City are paid on a rolling basis because the City

[170] Newport Water's Brief, p. 2.
[171] *Id.*
[172] *Id.* at 6.
[173] *Id.* at 7.

of Newport pays its employees (including water department employees) on a biweekly basis and expects reimbursement from Newport Water. Therefore, the level of payroll expenses owed to the City fluctuate based on the revenues Newport Water has available to pay to the City. Newport Water contrasted this with the $2.5 million loan which was recognized in Docket No. 3578. That loan was a fixed amount with a repayment schedule.[175] According to Newport Water, "with ongoing expenses owed to the City, it is difficult to segregate a specific dollar amount that can be reduced until the balance reaches zero because Newport Water incurs these expenses on a continual basis."[176]

Further, Newport Water noted that amounts owed to every vendor differ at varying times during the year based on the expenses at any point in time and the collections at any point in time. Quoting from the Division's witness, Mr. Catlin, Newport Water noted that the City of Newport is effectively acting as the source of working capital for the utility and "you really can't look at it as a snapshot at any one point in time and say this is some 'back to' amount."[177] Finally, Newport Water argued, if it had deferred all expenses to pay the City of Newport exclusively, the utility would be current on those expenses and in arrears to outside vendors rather than being behind to all vendors, including the City. Newport Water maintained that "the only difference is at the end of FY08 the ratios of expenses owed to the City and outside vendors was more proportionate than in prior years."[178]

Addressing efficiencies, Newport Water stated that the dictionary defines efficiency as "effective operation as measured by a comparison of production with cost

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[174] *Id.*
[175] *Id.* at 8.
[176] *Id.* at 9.
[177] *Id.* (citations omitted).

(as in energy, time, and money)." According to Newport Water, this is what they did by providing safe water and collecting more revenue than anticipated at lower expense than forecasted in FY 2008.[179] On a procedural level, Newport Water noted that PWFD did not raise the issue of efficiencies in its direct or surrebuttal testimony, but rather in its pre-hearing brief submitted the day before the evidentiary hearings commenced. Further, Newport Water stated that "PWFD still did not fully identify the exact dollar amount it wanted disallowed in this rate filing" in its pre-filed testimony, brief, or live testimony, but rather provided a schedule in response to a Commission Record Request made at the hearing.[180]

Notwithstanding its procedural argument, Newport Water stated that its ability to reduce payables resulted from deferred expenses, increased revenue and a reduction in outstanding receivables. Newport Water maintained that the deferred expenses focused on at the hearing were a small part of the overall savings. Newport Water referred the Commission to Exhibit E of its Post-Hearing Brief wherein the utility restated its witnesses' testimony regarding savings realized from the approved revenue requirement in the prior docket, reductions in costs realized from the approved revenue requirement, deferrals of expenses from the approved revenue requirement and increased expenses from the approved revenue requirement.[181] According to Newport Water, the savings resulted in $709,891, the reductions in costs resulted in $108,756, the deferrals resulted in $101,123 for a total available to reduce outstanding payables to all vendors of $658,622

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[178] *Id.* at 9-10.
[179] *Id.* at 10.
[180] *Id.* at 11-12.
[181] *Id.* at 13-16, Exhibit E.

after covering increased costs of $261,148.[182] In addition, Newport Water's revenues were higher than forecasted in FY 2008, providing an additional $191,997 available to the utility.[183] Newport Water argued that each instance of cost savings and deferrals should be considered an efficiency under the Commission's Order.[184]

Newport Water argued that it did not make a decision to implement conservative spending policies for the sole reason to reduce outstanding payables, but rather, to avoid increasing outstanding payables. The utility referred to a historical decline in consumption which led to Newport Water collecting lower revenues than had been allowed by the Commission.[185] In fact, Newport Water noted that even with its conservative approach to financial management, the utility owes money to vendors at the end of each month, both inside and outside of the City as a result of the timing of revenues and expenses. Newport Water also noted that PWFD has not argued that money owed to outside vendors should not be repaid, but focuses on the fact that Newport Water reduced the payables to the City after Docket No. 3818. According to Newport Water, its strategy after Docket No. 3818 was to repay all vendors more equitably than it had in the past, showing a larger reduction to the City payables than in the past.[186]

Newport Water reiterated its position regarding Administrative Finality on this issue as set forth in it Pre-Hearing Brief, and further noted that PWFD was simply attempting to state the issue in a different way to obtain the same relief that had already been ruled on by the Commission in the prior docket.[187] Newport Water stated that the

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[182] *Id.* at Exhibit C and Exhibit E.
[183] *Id.* at 21, Exhibit A.
[184] *Id.* at 17-20.
[185] *Id.* at 14.
[186] *Id.* at 25-26.
[187] *Id.* at 22.

Supreme Court of Rhode Island has concluded that the Rule of Administrative Finality applies "as long as the outcome sought in each application is substantially similar, even if the two applications each rely on different legal theories."[188]

Newport Water then argued that the Commission's approval of the repayment of expenses to the City of Newport does not constitute retroactive ratemaking because R.I.G.L. § 39-3-11.1 allows a utility such as Newport Water to reimburse its host municipality for loans or advances. Newport Water noted that the Supreme Court has found that this provides an exception to the doctrine against retroactive ratemaking.[189] Newport Water noted that the City provides a source of working capital to Newport Water, particularly with regard to payroll. Because Newport Water's employees are City employees, they are paid every two weeks by the City, regardless of whether the funds are immediately available from Newport Water. Payroll is then transferred to the City when Newport Water collects its receivables.[190]

B. PWFD

On June 19, 2009, PWFD submitted its brief, focusing on the repayment of payables to the City of Newport, City Service expense, cost allocation[191] and availability of information.[192] PWFD reiterated its arguments regarding the appropriate allocation of expenses to Newport Water, maintaining that Newport's understatement of the overall City budget results in an over-allocation of costs to the utility. Additionally, PWFD

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[188] *Id.* at 22-23, *quoting Johnston Ambulatory Surgical Associates Ltd. v. Nolan*, 755 A.2d 799, 810 (R.I. 2000).
[189] *Id.* at 23 (citations omitted).
[190] *Id.* at 26.
[191] Portsmouth Water and Fire District Brief, pp. 20-21 (noting that while having no bearing on this docket, separate identification of pumping costs for supply and distribution and pumping costs for treatment is important to proper cost allocation and requesting the Commission require records identifying the costs separately).
[192] *Id.* at 21.

expressed concern at the overall percentage allocated to Newport Water by the City of Newport compared to the overall percentage allocated by other regulated water utilities in Rhode Island by their respective host municipalities.[193] PWFD also requested the Commission "order Newport Water [to] reasonably share, as it is developed, information related to the planning, design, and construction of the replacement [treatment] facility."[194]

Addressing the repayment of payables to the City of Newport, PWFD stated that Newport Water has the burden in the instant matter to demonstrate that it complied with Commission Order No. 19240 prior to repaying amounts owed to the City of Newport.[195] PWFD argued that Newport Water failed to meet its burden because rather than identifying specific efficiencies, the utility deferred expenses and diverted funds allocated to expense items from the revenue requirement to the City of Newport.[196]

Acknowledging that Newport Water spent less money in 2008 than allowed because certain expenses were lower than expected, PWFD nevertheless argued that the primary reason was the result of cutting "back on expenses for the express purpose of reducing payables."[197] In support of its assertion, PWFD noted that sales were higher than projected in 2008 and Newport Water still deferred expenses that had been contained in the revenue requirement in the prior docket and were now proposed in this docket.[198] PWFD quoted from Ms. Forgue's testimony where she stated that Newport Water prioritized expenses in the most efficient manner to treat and distribute water and

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[193] *Id.* at 15-20.
[194] *Id.* at 21.
[195] *Id.* at 4.
[196] *Id.* at 5-8.
[197] *Id.* at 8.
[198] *Id.*

to operate the facility, and that if it had spent everything in its revenue requirement in the previous case, its deficit and payables to the City would be even larger than they were. According to PWFD, this means that Newport Water deferred expenses specifically to repay the City of Newport and further that the cash-flow problems were caused by Newport Water as a direct result of its decision to repay the City of Newport.[199] Therefore, PWFD argued that Newport Water had not realized efficiencies and should not have repaid the City of Newport. Accordingly, PWFD requested the Commission order the repayment of funds to Newport Water through various rate design mechanisms.[200]

C. Navy

The Navy submitted its brief, noting that it is the second-largest customer of Newport Water. The Navy argued that the proposed CAM over-allocated various costs to Newport Water.[201] The Navy supported the inclusion of the School and Library budgets in the calculating the total General Fund budgets.[202] Next, the Navy urged the Commission to encourage Newport Water to finance its future capital improvement to reduce the burden on ratepayers, including considering financing through debt.[203] Next, the Navy continued to support the continuation of a one and a half percent (1.5%) operating revenue allowance.[204] Finally, the Navy recommended the Commission order a

[199] *Id.* at 11.
[200] *Id.* at 12-13. PWFD proposed ways that Newport Water could have achieved efficiencies, but without citations, it appears none of those proposals were part of the record or subject to cross examination.
[201] Department of the Navy Brief, pp. 1-2.
[202] *Id.* at 2-3.
[203] *Id.* at 3.
[204] *Id.*

phase two proceeding in this case to reallocate Newport Water's rates upon the submission of a cost allocation study.[205]

D. Division

In its Brief, the Division noted that the only areas of disagreement between itself and Newport Water related to motor vehicle fuel expense, amortization of the cost of service study expense, and city services. The Division continued to advocate for its surrebuttal adjustments.[206] The Division indicated that it would provide additional comment on Newport Water's agreement to allocate twenty percent (20%) for the schools and four percent (4%) of the libraries in determining the percentage of the City Manager, City Solicitor and Finance Administration costs allocable to Newport Water and PWFD's request to reject repayment of funds to the City of Newport.[207]

The Division argued that the City Council, City Manager and City Finance Director's activities related to the Schools and Library cannot be characterized as minimal. Therefore, the Division did not support the inclusion of only twenty percent (20%) of the schools and four percent (4%) of the library budgets in calculating the City's budget. The Division indicated that it would accept Newport Water's allocation of the Finance Department if the schools and libraries were included in the City budget. Otherwise, the Division supported Mr. Catlin's allocation as stated in his direct testimony.[208]

Addressing PWFD's request to bar repayment to the City of Newport, the Division noted that the Commission's Order in Docket No. 3818 stated that Newport

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[205] *Id.* at 4.
[206] Division of Public Utilities and Carriers Brief, p. 1.
[207] *Id.* at 1-2.
[208] *Id.* at 2-3.

Water's revenue requirement did not include funds to accomplish the repayment of $1,584,171 which should be paid back to the City.[209] Rather, the Commission allowed repayment if Newport Water could achieve efficiencies. The Division argued that, contrary to PWFD's assertion, "the transition to quarterly billing was expressly termed by the parties as one – in fact the principal – of several 'efficiencies' that [Newport Water] was in the process of implementing."[210] According to the Division, further reading of the Commission's Order in Docket No. 3818 suggests that "the production of 'efficiencies' was *not* a condition precedent to repayment of the City but rather merely a means to commence the required repayment at the time of the Order without increasing rates."[211] The Division noted that in its Order, the Commission specifically accepted the fact that there had been unforeseen expenses that resulted in a decline in revenues in FY 2006 and/or FY 2007. Additionally, the Division maintained that by accepting the monthly cash flow statements that show payables to the City, the Commission accepted such documentation as evidence that the City had advanced funds to Newport Water.[212] Therefore, the Division maintained that "none of the $1,584,171 can be attributed to a [Newport Water] violation of a prior Commission Order…or fiscal imprudence on the part of the utility."[213]

XIII. Commission Findings

At an Open Meeting on June 25, 2009, the considered the evidence presented in the record and made adjustments to Newport Water's final request, allowing a revenue increase of $2,044,097 for a total cost of service of $11,528,666. The impact of this

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209 *Id.* at 3 (citations omitted).
210 *Id.* at 4.
211 *Id.* at 4-5 (emphasis in original).
212 *Id.* at 5-6.

decision on the typical residential customer's bill with annual consumption 59,200 gallons annually will be an increase of $50.28 per year or 15.6%. The Commission made adjustments to Newport Water's claims to Motor Vehicle Fuel ($2,925 reflecting the use of a more recent twelve-month average), Consultant Fees ($25,000 reflecting a two-year amortization) and City Services.

A. Other Revenue Requirements

1. City Services

In Docket No. 3818, the Commission encouraged Newport Water to develop a Cost Allocation Manual Furthermore, explaining how costs are allocated to the City's various department in order to ensure that ratepayers are not paying for services they are not receiving. Newport Water did file such a manual and provided testimony in support of the allocations. During the course of this proceeding, Newport Water made adjustments to the allocations in accordance with suggestions made by the parties. However, there remained disagreement between the parties regarding the appropriate calculation of the allocation of services provided by various City departments to Newport Water.

One main area of contention was the factors to be included in the total City budget used to develop a general allocator. The Division and PWFD argued that the City budget should include 100% of the appropriation made to the Schools and the Library while Newport Water originally argued that none of those two appropriations should be included. Newport Water's final position included twenty percent (20%) of the appropriation to the Schools and four percent (4%) of the appropriation to the Library. The Commission accepted Newport Water's calculation, finding persuasive the argument

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[213] *Id.* at 6.

that while there is some support provided to these two departments, it does not rise to the level of support provided to other City departments, particularly where there is a separate School Committee and administration.

The allocator developed according to Newport Water's methodology will apply to City Service – MIS and to the City Manager's budget. The only dispute between Newport Water and the Division on this Department was the allocator to be applied as addressed above. With regard to PWFD's argument that the Commission should continue to base the City Service allocation on the City Manager's salary only, the Commission notes that such a methodology was determined prior to the filing of the Cost Allocation Manual which provides a better analysis than that which existed in Docket No. 3818 when the Commission made that decision. Additionally, the Commission notes that the Division accepted Newport Water's proposal to apply the general allocator to the City Manager's budget.

The Commission accepted Newport Water's proposal, supported by the Division, to apply a five point seventy-five percent (5.75%) factor to the City Council's budget. The Commission found that PWFD's proposal to apply a smaller factor was not supported by the record. Furthermore, the Commission notes that the use of just the City Councilors' stipends rather than the budget was ordered prior to the filing of the Cost Allocation Manual which provides a better analysis than that which existed in Docket No. 3818 when the Commission made that decision.

The Commission accepted the Division and PWFD's proposal to allocate only one percent (1.0%) of the City Clerk's budget rather than the five point seventy-five percent (5.75%) proposed by Newport Water. The Commission agrees with Mr. Catlin that the methodology Newport Water used to develop the five point seventy-five percent (5.75%) allocator overstates the costs allocable to water issues. However, the Commission accepted Newport Water's proposal to use a City Clerk budget of $319,706. PWFD proposed a smaller budget, but the Commission found that PWFD's adjustment was not clearly supported by the record.

The Commission accepted PWFD's proposal to allocate ten point zero nine percent (10.09%) rather than twelve point nine percent (12.9%) to the Human Resources budget of $303,388, finding PWFD's allocator, which was developed based on the inclusion of temporary employees in the budgets, to be reasonable. The Commission was not convinced by Newport Water's argument that temporary employees need such minimal attention by the Human Resources Department that they should not be included in the calculation.

The Commission accepted the general allocator proposed by Newport Water to be applied to City Solicitor costs. However, the Commission did not accept Newport Water's proposal to apply the allocator to the City Solicitor's entire budget, but rather, accepted PWFD's proposal to apply the allocator to half of that budget, or $144,589 on the basis that Newport Water uses outside legal counsel for many of its legal needs.

Similarly, the Commission accepted the general allocator proposed by Newport Water to be applied to Finance Administration (80%), but only applied it to half of the allocable budget, or $149,585 as proposed by PWFD. The Commission agreed with PWFD that Newport Water has requested funding for and has received such funding for a Deputy Director of Finance and a Financial Analyst position on the basis that it would reduce Newport Water's reliance on the City. Furthermore, Ms. Sitrin testified that since those positions were filled, she has had to provide less support in regulatory matters.

The Commission accepted an allocation of five percent (5%) to an allocable budget of the Assessor's salary. The assessment was based on Mr. Catlin's calculation of 99 hours per year to support Newport Water. PWFD's proposed allocator was based on Mr. Woodcock's calculation of 77 hours per year as necessary support to Newport Water. The Commission found the Division's calculation was more reasonable.

With regard to the Accounting Department, the Commission accepted an allocator of sixteen point ninety percent (16.90%) to an allocable budget of $383,951. This percentage is based on the number of payroll and vendor checks which Ms. Sitrin argued was an objective number to use in allocating department time. Three other accounting department functions, according to Ms. Sitrin, are employee related and therefore, the payroll checks provide an objective number. The Commission finds that Newport Water's allocator is based on objective criteria and notes that it was supported by the Division. The Commission rejected PWFD's proposal for this department based on Mr. Woodcock's own concession that he used an allocator similar to that which was approved in Docket No. 3818 because he did not have a better methodology to suggest than that proposed by Newport Water, but that he did not believe the costs should be allocated entirely based on the number of checks cut because the accounting department has other responsibilities.

Finally, the Commission accepted PWFD's proposal to allocate none of the Public Safety budget to Newport Water on the basis that this is really a tax by the City on a City Department which is, by its nature, tax exempt.

2. Miscellaneous Charges

The Commission also accepted Newport Water's proposal to change the Turn-On/Turn-Off Charges and Seasonal Turn On Charges for those particular services provided after normal business hours, but required Newport Water to maintain its current tariff for those particular services performed during normal business hours. However, at the time it receives a call from a customer requesting those particular services outside of normal business hours, Newport Water must provide that customer with a range of the total charge that will be assessed to the customer.

3. Use of Extra Billing Charge Revenues

In Docket No. 3818, the Commission ordered Newport Water to establish a restricted account in which to accrue the revenues from the extra billing revenue received as a result of the transition from tertiary to quarterly billing. Approximately $64,333 from the account will be required to pay for the Commission-ordered review of Newport Water's Operations. Newport Water requests the remaining funds (estimated to be $235,000 at the end of the FY) be used to reduce payables. The Division supports this proposal. At the hearing, Newport Water's witness, Ms. Forgue, indicated there was no objection to using the entire amount in the restricted account to pay outside vendors.

PWFD did not support this position, recommending that the extra billing charge revenue be utilized to fund the Operating Revenue Allowance. It was PWFD's position that Newport Water would not have the level of outstanding payables if it had not repaid the City of Newport for vendor payroll and services that was outstanding at the end of Fiscal Year 2007. PWFD argued that Newport Water violated the Commission's prior

Orders and therefore, should not be entitled to recovery of those costs. For reasons explained below, the Commission rejects this proposal.

The Commission finds that Newport Water may utilize funds remaining in the Extra Billing Charge Restricted Account to reduce its payables to outside vendors, satisfying the oldest bills first. The Commission notes that this was the Division's recommendation in Docket No. 3818, and is one which the Division still supports.

4. Operating Revenue Allowance

The Commission accepted Newport Water's request for a three percent (3.0%) Operating Revenue Allowance ("ORA") which was supported by PWFD and the Division. These parties agreed that Newport Water should be allowed a three percent (3.0%) ORA with half restricted and half unrestricted with the same conditions set forth by the Commission in KCWA's recent rate order (Docket No. 3942).[214] The Navy advocated retaining the one and a half percent (1.5%) Newport Water currently has in rates. The Commission finds that with the exception of 2008, Newport Water has consistently experienced declining sales volume which has led to an exacerbation of its ageing payables and continued dependence on the host City in excess of other water

[214] In accordance with the Commission's Order in Docket No. 3942, 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. *See Order No.* 19545 (issued January 23, 2009).

utilities regulated by the Commission. Therefore, the Commission finds that a three percent (3.0%) ORA is reasonable and should be funded through rates.

PWFD advocated using the funds projected to have accrued in the Extra Billing Restricted Account" to fund the ORA while Newport Water and the Division build that portion into rates. Because the Commission determined that revenues collected in the Extra Billing Restricted Account should be used to reduce Newport Water's payables to outside vendors, PWFD's proposal is moot.

5. Salaries and Wages

Newport Water's labor contracts all expire on or before June 30, 2009. Newport Water included three percent (3.0%) increases for executive, administrative, and professional employees in the rate year and three and a half percent (3.5%) for the others. Newport Water indicated that the total increase would be $91,213.88.[215] In the past, the Commission has addressed an issue like this by ordering the projected increase to be restricted until such time as the labor agreements were finalized in the event the projected funding was excessive. Newport Water objects to the treatment of such funds because of the cost of setting up the restricted account and because another fund would exacerbate Newport Water's cash flow issues. Ms. Sitrin testified that the funds could be maintained in another restricted account but tracked separately. The Commission finds that the cash flow issue is a red herring because if the raises were approved, the salaries would need to be paid on a whole dollar basis as well. Therefore, the Commission finds that Newport Water shall restrict the projected salary increases until such time as the labor contracts are finalized. The Commission finds that Newport Water could utilize the Extra Billing Restricted Account which will no longer be needed and may simply rename it to

Restricted Salaries and Wages. Any amounts in excess of the increases projected in this rate case shall remain restricted until further order of the Commission.

B. Non-Revenue Requirements Issues

There were several issues raised by the parties that did not relate to the revenue requirements in this case. The Navy requested the Commission encourage Newport Water to investigate issuing debt service for larger projects currently labeled IFR rather than including the projects in current rates. Newport Water expressed concern that in this case, this proposal would adversely affect the Company's debt coverage ratios. The Commission has approved proposals by water utilities in the past to fund larger IFR projects through debt and would consider such proposals again in the future. However, the Commission declines to order Newport Water to make any changes to its IFR funding at this time and leaves it to Newport Water's discretion to request changes to funding IFR projects in future cases.

In Docket No. 3818, the Commission ordered Newport Water to complete and file with the Commission a Cost of Service Study by September 1, 2009.[216] Newport Water has indicated that it believes the study will not be completed by then, but has not requested an extension of time. Therefore, Newport Water is still under the Order in Docket No. 3818 and shall simultaneously file a Revenue-Neutral Petition to Change Rates pursuant to the cost allocations developed in the Cost of Service Study. The parties acknowledged that it is important to a Cost of Service study to be able to track pumping and treatment costs separately. Newport Water committed on the record to tracking these

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[215] See Exhibit L to Newport Water's Post-Hearing Brief.
[216] On September 2, 2009, Newport Water filed a Petition for Relief from Order seeking an extension of time to file its Cost of Service Study from September 1, 2009 until November 1, 2009. At its September

costs to the best of their ability. PWFD stated that "the Commission should order Newport Water or any private operator hired by [Newport Water], maintain records identifying pumping costs for supply and distribution separately from pumping costs for treatment." The Commission declines to make this order, finding that it would not be reasonable for the Commission to order Newport Water to track the costs separately beyond their "best efforts." However, the Commission expects Newport Water to separately identify and track the costs in a reasonable manner and explain where it was unable to separately track such costs.

PWFD also requested the Commission order Newport Water "to reasonably share, as it is developed, information related to the planning, design, and construction of the" new Lawton Valley Treatment Plant. The Commission expects Newport Water to provide any requestor with any public records during the planning, design, and construction of the new treatment plant. The Commission will not become involved in the planning, design and construction of this treatment plant outside of a proceeding under R.I. Gen. Laws § 39-4-2, which is not warranted at this time. The Commission believes PWFD should approach the Department of Health to determine what role it may or may not have in Newport Water's approval process before that Agency.

Finally, throughout this docket, PWFD made several allegations that Newport Water had not complied with prior Commission Orders and that the Commission should therefore disallow repayments to the City. However, until the day of the hearing, PWFD's assertions were almost identical to those made in Docket No. 3818, prompting the Commission to request Pre-Hearing Briefs on the Doctrine of Administrative Finality.

30, 2009 Open Meeting, after receiving no objections from the parties, Commissioner Bray moved to grant the petition. Commissioner Roberti seconded the motion and the motion was unanimously passed.

PWFD's Pre-Hearing Brief restated, almost exclusively, the arguments made in Docket No. 3818 and in testimony in this case.

However, in its Pre-Hearing Brief, PWFD also raised new arguments for the first time. PWFD alleged in its Pre-Hearing Brief that Newport Water had violated Order No. 19240 because (1) it had not identified efficiencies and (2) it had not spent certain funds requested for specific repair and maintenance items which were included in the revenue requirement approved in that Order, but was seeking funding again in the instant docket. According to PWFD, these expense items were required and were included in the revenue requirement. Thus, PWFD requested the Commission disallow some amount to the City. But, PWFD did not provide through a witness to this docket a recommendation of the appropriate amount to disallow.[217]

PWFD's allegation requires the Commission to interpret at least one prior Order, specifically, Order No. 19240 issued in Docket 3818. As the Commission has previously noted, in Rhode Island, the Supreme Court has indicated that it will defer to an administrative agency's interpretation of its own statutory authority when the agency is entrusted with the "administration and enforcement" of the statute.[218] This "deference is accorded even when the agency's interpretation is not the only permissible interpretation."[219] Furthermore, it appears to be well settled among several other jurisdictions that "'an agency's interpretation of the intended effect of its own orders is

[217] In its Post-Hearing Brief, PWFD states that based on Mr. Smith's Direct Testimony and the Division's Revenue Requirement, "Newport Water deferred spending at least $228,816 in FY 08 – all of which had been approved by the Commission as part of the revenue requirement in Docket 3818 – for the express purpose of reducing its payables." PWFD Post-Hearing Brief, p. 6.
[218] *Order No. 17524,* p.p. 73-74 (issued August 1, 2003) *quoting Pawtucket Power Associates v. City of Pawtucket*, 622 A.2d 452, 456 (R.I. 1993).
[219] *Id.* Certainly if the agency is accorded deference in interpreting its enabling legislation, the Commission believes Rhode Island Supreme Court will agree with other jurisdictions, both state and federal, that administrative agencies be afforded deference in interpreting their own orders.

controlling unless clearly erroneous.'"[220] In addition, the reviewing court will determine if the "Commission's interpretation of its prior...order is supported by the record and is consistent with the language of that order."[221] The Commonwealth of Pennsylvania has stated that "'The Commission, as an administrative agency, is peculiarly fitted to interpret its own orders...In recognition of this principle a court will not set aside a construction placed upon its own orders by an administrative agency unless the result is clearly erroneous, arbitrary, and unsupported by the evidence.'"[222] However, courts have held that "[a]gencies are entitled to interpret their own orders, for administrative purposes so long as the agency does not use the occasion to interpret as a means to amend the prior order."[223] Finally, The United State Court of Appeals for the Sixth Circuit has stated that while an agency's interpretation of its own orders is highly deferential, the court is "not required to accept an agency's representation that an order says 'day' when it seems to us that the order says 'night.'"[224] Therefore, in reaching its decision that Newport Water did not violate Commission Order No. 19240, the Commission must show that it relied on evidence presented at the hearing and that in reviewing the totality of the circumstances surrounding the issue of Repayment to the City, the Commission's current interpretation is not arbitrary or capricious.

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[220] *Kansas Industrial Consumers Group, Inc. v. State Corporation Commission of Kansas*, 138 P.3d 338, 346 (Kan. 2006) (citations omitted).
[221] *Id.*
[222] *Burgit v. Pennsylvania Public Utility Commission*, 475 A.2d 1339, 1344. (Pa. 1984) (citations omitted).
[223] *Cities of Abilene, et al. v. Public Utility Commission of Texas*, 146 S.W.3d 742, 747 n.7 (Tex. 2004) (citation omitted) (*stating* that administrative findings that are purely factual, even if the evidence "preponderates against the agency's finding, the court must still uphold it if enough evidence suggest the agency's determination was within the bounds of reasonableness" *Id.* at 748.).
[224] *Consumers Energy Company v. Federal Energy Regulatory Commission*, 226 F.3d 777 (6th Cir. 2000) (finding that FERC's interpretation of its order requiring Appellant to submit a rate filing was not consistent with its argument that its order simply required periodic informational filings by Appellant as allowed by federal statute).

In addressing this issue at the open meeting, the Commission found that PWFD's interpretation of Order No. 19240 was incorrect. First, the Commission found that its Order No. 19240 did not clearly require Newport Water to segregate a specific dollar amount owed to the City and to repay it after all other expenses and vendors were repaid. The amount set forth by the Commission was simply the amount which was to be repaid to the City at the time of the hearing in Docket No. 3818, but not included in Newport Water's Revenue Requirement. In Order No. 19240, the Commission found specifically that amounts due to the City should be paid back to the City.[225]

In support of this interpretation, the Commission notes that its decision in Docket No. 3818 differs significantly from its Order No. 17922 (Docket No. 3578) approving a Settlement which included the creation of a separate "Repayment to City" line item designed to segregate a specific amount of money to be held aside and owed to the City. In that case, neither the City of Newport nor Newport Water could account for the amounts loaned to the utility nor the reasons for these loans. Thus, the parties settled upon what they believed to be a reasonable amount to be repaid over time. As a result, although expressing serious reservations regarding the management of the utility and the oversight by the City, the Commission allowed repayment if various conditions were met by Newport Water. This differs from the circumstances in Docket No. 3818 where the outstanding payables to outside vendors and the City were not found to be the result of poor financial management, but were found to be related to reduced consumption. In fact, in setting the rate year consumption below that which was proposed by the parties,

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[225] The Commission's decision in Docket No. 3818 avoided any issue of retroactive ratemaking, i.e., including recovery of prior costs in the rate year to be recovered through future rates. Furthermore, even if someone were to argue that the decision in this docket could be considered retroactive ratemaking, an

the Commission specifically noted that Newport Water had experienced a continual decline in consumption over several years.[226]

Second, the Commission found that Newport Water reasonably interpreted the Commission's language allowing repayment to the City based on efficiencies. Newport Water has argued that it realized efficiencies through the delivery of safe potable water to its customers at a lower expense at a time when it was collecting higher revenues. In her testimony, Ms. Forgue's testimony discussing normalizing adjustments sets forth further areas of cost savings and increased expenses in the area of salaries and wages. These net cost savings resulted primarily from employee turn-over and the lack of a new labor contract.[227] Additional cost savings resulted from a City policy change regarding the payment of landline telecommunications costs.[228] In another area, Ms. Forgue noted that heavy equipment was not required to be rented during the test year due to a lack of any large main breaks, but needed to be included in the rate year in case such rentals were needed in the future.[229] Another area of savings resulted from a change in Dam Safety Regulations and a decision to limit raw material purchases for dam repairs and tree removals.[230] Other budgeted costs included in the revenue requirement were lower and resulted in savings to Newport Water.[231] Furthermore, management decisions were made regarding the hiring of temporary employees, the reduction of spending on conferences

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argument not made to the Commission in this case, it would most likely fall under the exception set forth in R.I.G.L. § 39-3-11.1 (allowing municipalities to collect funds advanced to its utility).

[226] *Order No. 19240*, p. 38.

[227] Newport Water's Post-Hearing Brief, Exhibit E, *citing* Newport Water Exhibit 1A (Pre-Filed Testimony of Julia Forgue, pp. 16-22.

[228] Newport Water's Post-Hearing Brief, Exhibit E, *citing* Newport Water Exhibit 1A (Pre-Filed Testimony of Julia Forgue, p. 15.

[229] Newport Water's Post-Hearing Brief, Exhibit E, *citing* Newport Water Exhibit 1A (Pre-Filed Testimony of Julia Forgue, p. 23.

[230] Newport Water's Post-Hearing Brief, Exhibit E, *citing* Newport Water Exhibit 1A (Pre-Filed Testimony of Julia Forgue, p. 18.

and training, and the reduction of inventory and office supply purchases.[232] The Commission finds that these management decisions resulted in funds being made available to the utility to reduce its payables to all vendors, including the City.

In addition, we note, as did the Division, that Newport Water did realize the specific types of efficiencies discussed at the evidentiary hearing in Docket No. 3818. At that hearing, the transition to quarterly billing was set forth as a specific efficiency that Newport Water was implementing. Another efficiency discussed in Docket No. 3818 was the implementation of radio reads.[233] The Division argued that in light of the projected efficiencies, it was unnecessary to include the $1.5 million in future rates. The Commission agrees with the Division's interpretation of the Commission's Order that, "...as used in Order No. 19240, the production of 'efficiencies' was not a condition precedent to repayment of the City but rather merely a means to commence the required repayment at the time of the Order without increasing rates."[234]

While PWFD may define efficiency differently through different examples, the Commission finds that its interpretation of Order No. 19240 is consistent with both the dictionary definition provided by PWFD and with prior Commission decisions. In Docket No. 2108, the Commission addressed Providence Water Supply Board's Petition under R.I.G.L. § 39-3-11.1 to repay the City of Providence. The Commission approved a Settlement Agreement which, similar to the Settlement Agreement in Docket No. 3578, allowed the utility to repay a specific amount of money to the City over a five-year

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[231] Newport Water's Post-Hearing Brief, Exhibit E, *citing* Newport Water Exhibit 1A (Pre-Filed Testimony of Julia Forgue, pp. 21-22.
[232] Newport Water's Post-Hearing Brief, Exhibit E, *citing* Newport Water Exhibit 1A (Pre-Filed Testimony of Julia Forgue, pp. 14, 16, 23-25.
[233] Tr. 7/25/2007, pp. 11, 19-20.
[234] Division's Post-Hearing Brief at 5.

period, if the utility met certain conditions. The Settlement required Providence Water to make a showing that as a result of sound fiscal management during the previous year, cost savings measures resulted in funds being available to repay the City of Providence. Examples of one-time savings of funds were shortening the billing cycle, more aggressive collection of accounts receivable, higher than anticipated revenues in a given year due to unanticipated consumption increases, and implementation of automated meter reading.[235] In the first year of repayment, the Commission accepted as source of funds for repayment, a credit for an overpayment to the Water Quality Protection Surcharge, the purchase of boring equipment at less than the outside contract price, and the acquisition of surplus equipment from Fort Devens. In Docket No. 2108, the Commission, after considering Providence Water's testimony that sound fiscal management should look at "...expenditure reductions, revenue enhancement and overall operating efficiencies..." the Commission specifically found that in the future, "the Commission will consider the totality of the PWSB's operations, instead of specific cost items, in determining whether the PWSB is displaying sound fiscal management and consequently permitted to repay the city of Providence any additional funds under the Plan."[236] In the following year, Providence Water was allowed to repay the City after showing savings in "salaries and benefits, equipment and supplies, property taxes, and by reducing its write-off expense."[237]

Relying on Webster's Dictionary, PWFD states that Newport Water had the burden to show that it had "[a]cheived the Commission-approved service, safety and quality goals with a minimum of effort and expense." The Commission finds that this is

[235] *Order No. 14683* (issued April 7, 1995).
[236] *Order No. 14927* (issued February 23, 1996).

what Newport Water did. The reality is that Newport Water began the Rate Year with a negative balance which the Commission found needed to be repaid. Newport Water managed to provide safe and potable water and reduce its vendor payables. This was the result of a combination of management decisions to cut expenses, expenses that were lower than forecasted, and increased consumption. This is how a budget works and how ratemaking works. With the exception of restricted accounts, when the Commission sets rates for a utility, it does not set line item expenses from which the utility may not depart. Rather, the Commission sets what it finds, based on all of the evidence, is a reasonable revenue requirement within which the utility must operate.

The Commission specifically found that Newport Water had managed its payables prudently and none of the disputed repayments should be disallowed. PWFD argued that Newport Water deferred expenses rather than realizing permanent efficiencies because the deferred items again appear in the requested revenue requirement after Newport Water experienced an increase in revenues in the rate year. However, the appearance of the same line item several years in a row is not unusual, particularly when a utility needs to defer expenses for one valid reason or another, such as prioritization of expenses or in response to decreased consumption. Furthermore, the Commission finds that the deferred expenses, such as patching instead of replacing a roof or repairing rather than replacing overhead doors to be reasonable management decisions that do not affect the quality of the water delivered or the utility's ability to deliver water. Therefore, Newport Water did not defer expenses at the detriment of its customers, but rather, in an effort to make the utility more fiscally sound.

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[237] *Order No. 15333* (issued June 20, 1997).

In this case, PWFD argued that because Newport Water realized higher than anticipated revenues in the rate year, it should have undertaken all of its proposed rate year expenses and only repaid the City for outstanding O&M after all of that was complete.[238] The problem with PWFD's argument is that PWFD is looking at Newport Water's management decision with 20/20 hindsight rather than with the standard the Commission would use for a prudence review which can be better summed up as whether the decisions made were reasonable based on the information available at the time of the decision.

Ms. Forgue explained that in light of the fact that Newport Water had consistently realized lower revenues than those upon which rates had been set, she reviewed expenses more closely based on the assumption that declining revenues could continue. She denied deferring expenses with the sole intent of reducing payables to the City. As she pointed out, based on several years of historical consumption data, she could not anticipate higher than expected revenues in FY 2008.

The underlying problem arises from the fact that Newport Water is unique as to other regulated non-investor owned water utilities in Rhode Island in that when consumption is reduced, the funds that end up short are the O&M accounts. Other water utilities fund O&M first and then fund their restricted accounts on a whole dollar basis in a certain priority order until there are no more revenues left with which to fund. Therefore, most of the other water utilities are under-funded in their IFR accounts, but have not had to rely on their respective host city for cash flow.[239] Conversely, Newport

[238] PWFD apparently has taken no issue with Newport Water's management decisions regarding the repayment of outstanding payables to outside vendors during the same periods of time.
[239] *See In re: City of Newport Water Division Application to Change Rate Schedules*, Docket No. 3818, Tr. 7/24/07, pp. 41-42, 85-86, 121-22 (discussing the fact that Newport Water fully funds restricted accounts

Water has been funding their restricted accounts first on a whole dollar basis and O&M last.[240] Had Newport Water applied their revenues in the same manner as the other water utilities, there would most likely not have been an issue of outstanding payables to the City in either this docket or Docket No. 3818. Because Newport Water fully funded its restricted accounts, it received an A+ bond rating, so the Commission cannot say this was a bad management decision. However, because of this decision, as Mr. Catlin aptly stated, the City has had to act as Newport Water's source of working capital.[241] The City has been paying its employees biweekly and patiently awaiting reimbursement from Newport Water.[242]

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on a whole dollar basis before funding O&M expenses). *See In re: Providence Water Supply Board Application to Change Rate Schedules*, Docket No. 3832, Tr. 9/12/07, pp. 188-193 (Ms. Bondarevskis explaining that the IFR is only funded when the cash is available from the operating account and that it has consistently been behind in its funding levels.). *See In re: Kent County Water Authority Application to Change Rates,* Docket No. 3942, PUC Exhibit 1 (KCWA's Response to Commission Data Request 1-10) (explaining how KCWA funds its restricted accounts); Tr. 9/24/08pp. 134-35 (Mr. Brown explaining that when receivables were down at the time of the hearing, IFR funding was four payments behind). *See In re: Providence Water Supply Board Application to Change Rate* Schedule, Docket No. 4061, Tr. 9/29/09, pp. 22-33. (Ms. Bondarevskis explaining that Providence Water Supply Board funds O&M expenses first and then restricted accounts on a whole dollar basis in a certain priority, *Id.* at 22-23; Mr. Woodcock explaining that Kent County Water Authority uses essentially the same methodology as Providence Water Supply Board. *Id.* at 23-24. Mr. Smith explaining that Newport Water funds the restructed accounts first and then the operating expenses. He also noted that some of Newport Water's restricted accounts are for operating expenses such as chemicals and electricity." *Id.* at 24-25.)

[240] *See Order No. 19240*, p. 37. The Commission notes that Newport Water's method of funding restricted accounts was in strict compliance with the Commission's Order and in fact, the Commission recognized that there may be shortfalls in revenues available for O&M expenses. Payroll needs to be met and the Commission cannot find that its prior Orders would suggest Newport Water and its customers may avoid payroll expenses through compliance with restricted funding requirements if it means the utility cannot reimburse the City simultaneously with the payment of payroll. Furthermore, the Commission does not intend its Order regarding whole dollar funding of restricted accounts to supersede any funding requirements set forth in Newport Water's Trust Indentures in any way.

[241] As the Rhode Island Supreme Court has noted, "Cash working capital is the amount of cash required by the company to continue operations during the interim between the rendition of services to its retail customers and receipt of payment therefor." *Narragansett Electric Company v. Harsch,* 368 A.2d 1194, 1202 (R.I. 1977).

[242] The Commission also determined that Newport Water acted reasonably in interpreting Order No. 19240 and found that all outstanding payables as of May 31, 2009 were for valid expenses which must be repaid by all customers. The Commission found that the payment of payroll by the City to all of its employees, including Newport Water, is not a loan to Newport Water every two weeks which requires separate documentation. However, even if the Commission were to treat these bi-weekly payrolls as loans from the City, the Commission agrees with the Division's position that the monthly cash flow reports documenting

The Commission does remain concerned with the level of outstanding payables, particularly when caused by lower than expected consumption. Therefore, the Commission ordered Newport Water to contact the Commission immediately if more than six payrolls are owed to the City or if outside vendor payables are in arrears 120 days or more. At the time of such contact, Newport Water is required to provide a proposed resolution to the Commission to bring the past due balances current.

According, it is hereby

(19940) ORDERED

1. The City of Newport, Utilities Department, Water Division's Application for a General Rate Increase, filed on December 9, 2008, is hereby denied and dismissed.

2. The City of Newport, Utilities Department, Water Division will receive a total cost of service of $11,528,666, which equates to a revenue increase of $2,044,097, effective for usage on and after July 1, 2009.

3. City of Newport, Utilities Department, Water Division shall restrict the following accounts in the following amounts collected through rates: Debt Service - $2,010,823; Capital - $1,146,918; Chemicals - $669,000; Electricity - $582,400; Retiree Insurance – $347,200; Accrued Benefits Buyout - $175,000; and Restricted Salary Increases $91,214.

4. City of Newport, Utilities Department, Water Division shall fund its Restricted Accounts monthly on a whole dollar basis and not on a percentage of collections basis.

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the payrolls owed and repaid constitute "documentary evidence." Therefore, the Commission finds no violation of its Order in Docket No. 3578.

5. City of Newport, Utilities Department, Water Division shall comply with the following periodic reporting requirements:

(a) City of Newport, Utilities Department, Water Division shall continue providing a reconciliation of each restricted account on a quarterly basis within 30 days of the end of the quarter.

(b) City of Newport, Utilities Department, Water Division shall continue providing a balance sheet, income statement and cash flow statement on a quarterly basis within 30 days of the end of the quarter.

(c) Newport shall provide updates on its Conference and Training Costs in its quarterly reports within 30 days of the end of the quarter.

(d) On a monthly basis, City of Newport, Utilities Department, Water Division shall continue providing a monthly cash reconciliation to include cash inflow and cash outflows within 15 days of the end of the month. Inflows and outflows should be compared to budget with an explanation of any deviation from the budget by more than 10%, on a quarterly basis within 15 days of the end of the quarter.

(e) City of Newport, Utilities Department, Water Division shall continue providing monthly statements on an accrual basis consistent with a format and due date previously approved by the Public Utilities Commission.

6. City of Newport, Utilities Department, Water Division shall contact the Public Utilities Commission if its payables to outside vendors are 120 plus in arrears and/or it owes more than six payrolls to the City of Newport.

Said report shall contain a proposal to resolve the arrears as soon as possible.

7. City of Newport, Utilities Department, Water Division shall provide the parties to the docket with a copy of all reports made to the Commission in compliance with this Order.

8. City of Newport, Utilities Department, Water Division shall file reports regarding Capital Improvement Projects on a semi-annual basis, within 30 days of the end of the previous six-month period.

9. City of Newport, Utilities Department, Water Division shall file a Revenue Neutral Cost of Service Study by November 1, 2009.

10. City of Newport, Utilities Department, Water Division's Tariffs, filed on July 17, 2009, are hereby approved.

11. City of Newport, Utilities Department, Water Division shall comply with all other findings and instructions as contained in this Report and Order and with all terms of the Settlement Agreement incorporated herein.

EFFECTIVE AT WARWICK, RHODE ISLAND PURSUANT TO OPEN MEETING DECISIONS ON JUNE 25, 2009, JULY 24, 2009 and SEPTEMBER 30, 2009. WRITTEN ORDER ISSUED MARCH 29, 2010.

PUBLIC UTILTIES COMMISSION

Elia Germani, Chairman

Mary E. Bray, Commissioner

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.