

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION**

**IN RE: NARRAGANSETT BAY COMMISSION :
 GENERAL RATE FILING : DOCKET NO. 4026**

ORDER

On December 22, 2008, the Narragansett Bay Commission ("NBC") filed an application for a General Rate Change with the Public Utilities Commission ("Commission") seeking new residential and non-residential rates designed to collect revenues equal to \$78,751,850. This represents a revenue increase of \$8,990,368 or 12.89%. Rates would increase 13.45% as not all revenue accounts will be impacted by the proposed increase. The proposed effective date of the tariff change was July 1, 2009. At open meeting, on January 15, 2009, the Commission suspended the effective date pending its investigation pursuant to its authority under R.I. Gen. Laws §39-1-11.¹

The instant rate case filing represents NBC's tenth rate filing in the last nine years. This rate case filing does not relate to debt service for the Combined Sewer Overflow Abatement Program ("CSO"). The following provides a history of recent rate increases:

DOCKET NO.	FILING DATE	INCREASE REQUESTED	INCREASE ALLOWED	AUTHORIZED REVENUE
3592	3/1/04	\$ 4,967,683	\$2,883,974	\$54,380,549
3639*	10/4/04	\$ 6,551,225	\$6,551,225	\$60,931,773
3707	11/1/05	\$ 3,108,471	\$2,348,622	\$63,284,139
3775*	10/4/06	\$ 6,010,883	\$6,010,833	\$69,295,022
3797	12/1/06	\$ 4,798,797	\$2,621,492	\$71,503,022
3905	12/3/07	\$10,924,164	\$7,236,917	\$75,031,159
4026	12/22/08	\$8,990,368		

*Debt service related to Combined Sewer Overflow project.

¹ R.I. Gen. Laws §39-3-11 authorizes the Commission to suspend the taking effect of proposed rate(s) for a period not to exceed six (6) months in order that it may investigate and hold public hearings on the propriety of the proposed change(s).

I. NBC PRE-FILED DIRECT TESTIMONY

A. Testimony of Walter E. Edge, Jr.

Walter Edge, a certified public accountant, who has provided expert testimony for NBC on numerous occasions, provided pre-filed testimony in support of the requested rate increase. Mr. Edge developed a normalized test year of FYE June 30, 2008 and a rate year of FYE June 30, 2010. Mr. Edge summarized the adjustments made in the previous docket, Docket No. 3905, filed on December 1, 2007. Mr. Edge identified NBC's continued revenue shortfall in the rate year as one of the most important issues in Docket No. 3905. He noted that the over-estimation of consumption has resulted in consumption rates being calculated too low. This has caused significant revenue shortfalls adversely affecting NBC's ability to meet debt service coverage requirements.²

Mr. Edge also discussed the establishment and funding of a Revenue Stability Fund approved by the Commission to address unforeseen revenue shortfalls that result from factors beyond the control of NBC. He pointed out that this fund is not intended to deal with on-going revenue shortfalls. He discussed the Commission's approval of NBC's request to continue its debt service compliance filing mechanism and noted that since NBC had not yet filed for an increase in debt service costs, there is no adjustment in this filing. Mr. Edge also noted that since there were no costs associated with the CSO Phase I Facilities for the test year, NBC would project the entire annual cost in this filing. Finally, Mr. Edge discussed the Operating Reserve Allowance being reduced by the Commission to 1% of operating expenses and excluding debt service and personnel expenses from its calculation.³

² NBC Exhibit 1a, Testimony of Walter E. Edge, Jr., December 22, 2008 at 1-2.

³ *Id.* at 2-3.

Mr. Edge identified the six items driving NBC's request for an increase in rates: 1) rate year revenue which represents approximately 56% of the increase requested, 2) monthly billing which will make bills more affordable to ratepayers, alleviate revenue lag issues and smooth out cash-flows, 3) increases in salaries and wages, changes in benefits and funding of four new positions, 4) increases in the cost of electricity and natural gas, 5) costs associated with the operation of the CSO Phase I Facilities including utility costs and treatment costs, and 6) miscellaneous adjustments reflecting projected increases in the rate year.⁴

Although Mr. Edge did not audit the test year, he reviewed the year end audit results, the audited trial balance and the detail posting to many of the general ledger accounts to prepare the test year. Even though Mr. Edge calculated the increased user fee revenues expected in FY 2009 from the rate increase in Docket No. 3905, he did not make an adjustment to reflect this increase, because he made a net adjustment with the lower projected consumption units for FYE 2010.⁵

Mr. Edge made the following adjustments to eliminate 1) \$1,840,913 of investment income earned, 2) Environmental Enforcement revenue of \$75,500, 3) related expenses of \$10,588, 4) Operating Supplies and Expense of \$2,658, 5) Other Services of \$714 and 6) grant revenue of \$27,653. He removed \$7,124,163 of depreciation expense and all but \$9,690 of the \$339,482 annual amortization expenses in the test year. He made a test year adjustment to show the \$1,746,443 amount reflecting capital outlays purchased in the test year that he will reverse in the rate year. He added the \$16,800,970 cost of debt service and the \$8,138,699 debt coverage allowance, and removed the \$2,670,346 test year interest expense. Mr. Edge also calculated a Net Operating Reserve of \$146,866 in accordance with the Commission approved method in

⁴ *Id.* at 4-6.

⁵ *Id.* at 7.

Docket No. 3905. He eliminated a \$12,484 one-time gain on the disposal of assets and increased Workers Compensation Insurance by \$66,873 to reflect accounting adjustments.⁶

Mr. Edge grouped NBC's revenue and expense accounts into four categories: (1) revenues, (2) personnel services, (3) capital outlays, and (4) accounts with balances of less than \$200,000. With regard to revenues, Mr. Edge noted that, with the exception of a minor increase in residential consumption in FYE 2008, the downward trend he predicted in Docket No. 3905 continued, with billed consumption for the first two quarters of FY 2009 being more than 10% lower than the consumption estimate for FY 2009. He also noted that one of NBC's largest industrial customers ceased operations in October of 2008 and that this customers was billed \$122,000 in the test year.⁷

Although NBC agreed with the Division to use the test year consumption units from 2007 for the rate year consumption for 2009, Mr. Edge pointed out that this results in approximately \$3 million in lower revenue than projected in Docket No. 3905. Mr. Edge also discussed how calculating rate year consumption revenues assuming all consumption would be billed at new rates, as recommended by the Division in Docket No. 3905, and eliminating the "composite rates" concept contributed to the approximate \$3.6 million revenue shortfall experienced in FYE 2008. Mr. Edge identified the billing lag as preventing NBC from collecting revenue recognized in the rate year, because it is not collected. He estimated the increase in the billing lag in the rate year to be \$1,772,439.⁸

In addition to the reasons discussed above, Mr. Edge noted that the issue of collections also added to the rate year revenue problem. In FY 2008, NBC collected more than \$1.1 million less than the amount billed. NBC has been able to sustain these revenue shortages over time,

⁶ *Id.* at 8-9.

⁷ *Id.* at 12-13.

⁸ *Id.* at 14-17.

because its rates are designed to generate 125% of annual principal and interest to ensure an operating surplus at the end of every year. This shortfall has resulted in restricted carry-forwards lower than authorized amounts, reduced liquidity and increased difficulty in making monthly transfers required by the Trust Indenture. The restricted cash carry-forward prevents NBC from funding its operating capital expenses, the Operating Reserve for Revenue Stability Fund and the other funds that used as pay-as-you-go financing for capital projects.⁹

Mr. Edge also warned that if revenue shortfalls continue, NBC will not be able to meet its debt service coverage requirements thereby jeopardizing its credit rating. While the annual coverage allowance is required to be at a level of 1.25, this has declined from 1.60 in 2006 to 1.27 in 2008. Mr. Edge noted that but for the fact that 2008 was a dry year, and NBC's operating and maintenance expenses had not exceeded Commission approved levels, NBC would not have met the coverage requirement.¹⁰

Mr. Edge noted that the revenue and cash shortfall concerns can be addressed by the Commission adopting NBC's projected rate year revenue calculation that reflects declining consumption levels over the past three years and in FY 2009. He warned that using the test year consumption levels (FY 2008) will result in a projected revenue shortfall of at least \$5 million. He also noted that conversion to monthly billing will help with revenue and cash flow problems that are caused by billing lags and composite rates. He again pointed out that monthly billing will allow NBC to collect consumption revenue in the same fiscal year it is recognized for accounting purposes, as well as allow for billing and collection at current rates as opposed to collecting accounts receivables billed at old rates. Mr. Edge identified two benefits NBC will receive from monthly billing: 1) the cash flow produced by the monthly billing will bring the

⁹ *Id.* at 17-22.

¹⁰ *Id.* at 23-24.

carry-forward balance closer to approved levels in NBC's restricted accounts used for capital outlays, the Operating Reserve for Revenue Stability Fund and pay-as-you-go capital and 2) additional operating cash flow will shore up the revenue fund cash balance.¹¹

Mr. Edge projected rate year consumption revenue and fixed revenue using rates approved in Docket No. 3905 times rate year (FY 2010) projected units. He left miscellaneous revenues at test year levels minus \$330,000 for the Special Master, which ends prior to the rate year, and \$73,000 for the reduction to the DOB/TSS Surcharge revenue loss resulting from the closing of the large industrial customer in the interim year. Mr. Edge noted that the objective of the Operating Reserve for Revenue Stability Fund, which is not funded through rates but through a restricted carry-forward, was to insure NBC could make its debt service payments in the event of revenue shortfall. He pointed out that while this fund can be used to address one-time revenue shortfalls, it is not appropriate to use it to fund operations on an on-going basis that should be funded through rates.¹²

Regarding expenses, Mr. Edge adjusted test year salaries for union and non-union employees by 4.00% for 2009 and 4.25% for 2010. He increased the FICA expense and adjusted the pension accounts expense for union employees based on the rate provided to NBC by the State Retirement Board. He calculated the non-union pension expense at 10% of non-union compensation and limited rate year salaries as he had in NBC's prior dockets. He identified the large increase between the test year and the rate year in Retirement Health as a result of the State's retiree health insurance percentage increasing to 6.01% in the rate year from 5.46% in FY

¹¹ *Id.* at 24-27.

¹² *Id.* at 28-29.

2008. Mr. Edge calculated the rate year health and dental insurance expense by increasing the interim year premium by 10% based on NBC's current utilization experience.¹³

Mr. Edge adjusted the biosolids disposal account by \$623,976 to reflect an increase in the rate year due to the impact of the CSO Phase I Facilities and two CPI adjustments. He increased screening and grit by \$96,509 to reflect a projected 8.23% increase in the contracted rate per ton. In response to an expected increase resulting from CSO Phase I Facilities, he adjusted the Maintenance/Service Agreements Account by \$66,700. An increase of \$129,932 was also made to Insurance Expense and Workers' Compensation Insurance in response to expected increases in the rate year. Likewise, Mr. Edge adjusted the Fuel, Gas and Electric Costs Accounts by \$162,438 for gas and \$1,398,574 for electric to reflect (1) increases in the costs of those commodities and (2) the CSO Phase I Facilities pump station. This included the increased operating costs for the treatment of increased flow at the Field's Point Wastewater Treatment plant resulting from the CSO Phase I Facilities being put in service.¹⁴

Mr. Edge assumed a 3% increase in the cost of chemicals as the current contracted rate is due to expire on April 1, 2010. He increased lab supplies by the average of the increase in the annual percentage for FY2005 through FY 2008. The adjustment of \$329,057 to the Management/Audit Services Account reflected soda ash costs and a 3.26% CPI adjustment. He increased operating costs for treatment of the captured flows directed to the Field's Point Wastewater Treatment Facility by a projected 5.13%. Mr. Edge added the projected cost of \$387,000 to implement the monthly billing proposal. Mr. Edge eliminated Capital Outlay

¹³ *Id.* at 30-32.

¹⁴ *Id.* at 32-33.

Accounts the from rate year revenue requirement, because these are expected to be covered from the restricted carry-forward debt service coverage allowance.¹⁵

Mr. Edge explained that NBC is seeking four new positions, two Laboratory Technicians, a Customer Service Representative and a Field Investigator, due to increasing regulatory complexity and revenue issues. Mr. Edge explained that because of changes in NBC's RIPDES permit, it must take and analyze approximately 65% more samples than it did in previous years. The Customer Service Representative and Field Investigator positions are needed to respond to increased workloads and collection efforts and to support monthly billing and the conversion to monthly billing. Customer service calls and field investigations have increased by 140% and 256% respectively since FY 2006. Additionally, Mr. Edge noted how NBC is working diligently to put customers with past due payments on budget payment plans before those customers balances become too large to manage.¹⁶

Lastly, Mr. Edge requested that rate case expense be left at the test year level and that the current rate case expense be charged to the interim year and not amortized over any future period, since NBC will continue to file annually in order to address significant borrowing needed in the future. He also requested that the operating reserve be recalculated using 1.5% of operating costs, as opposed to the 1% used in Docket No. 3905, and that personnel services be included in the calculation. Finally, Mr. Edge noted that NBC did not propose any rate design issues in this Docket.¹⁷

B. Testimony of Maureen Gurghigian

Maureen E. Gurghigian, Managing Director with First Southwest Company and financial advisor to NBC, provided pre-filed testimony to discuss NBC's credit rating and how critical it is

¹⁵ *Id.* at 33-35.

¹⁶ *Id.* at 35-41.

¹⁷ *Id.* at 41-43.

for NBC to maintain the highest credit rating possible. She noted that NBC's credit rating was recently upgraded from A+ to AA- as a result of the establishment and funding of the Operating Reserve for Revenue Stability Fund and the continuation of the multi-year debt service compliance filing mechanism. She noted that the interest rate spreads between the A and AA rated issues was 100 basis points as of December 5, 2008, double of the spread in September 2008. With the deterioration of the Municipal Bond Insurance Agency's ("MBIA") credit rating, which provided bank and municipal bond insurance of NBC's Variable Rate Demand Bonds ("VRDBs"), NBC's VRDB's were refunded and Citizen's Bank issued a stand-alone direct-pay Letter of Credit, which requires no bond insurance to replace the liquidity facility/insurance combination. The Citizens Bank letter of credit allowed NBC to weather the turmoil the financial markets faced again in September of 2008.¹⁸

Ms. Gurghigian noted that NBC's credit rating increases the marketability of its VRDB's and may afford NBC ability to enter the VRDB market with an uninsured standby bond purchase agreement which is less costly than a direct pay Letter of Credit. She pointed out that the high credit rating will also provide a benefit to NBC's future fixed rate debt issuance in the form of lower interest rates. Ms. Gurghigian stated that failure to achieve debt service coverage of 125% will affect NBC's credit rating. She noted that as a general rule a higher coverage ratio will result in a higher credit rating. Ms. Gurghigian also noted that debt service coverage usually correlates with liquidity which is an indication of financial flexibility and the ability of an issuer to meet ongoing operating needs in addition to debt service payment.¹⁹

Finally, Ms Gurghigian explained that rating agencies look at other factors such as the rate setting environment, rate flexibility, financial performance and budget practices. She

¹⁸ NBC Exhibit 1b, Testimony of Maureen Gurghigian, December 22, 2008 at 1-5.

¹⁹ *Id.* at 5-7.

pointed out that Standard and Poor's has considered the ability of NBC to obtain rate relief, its positive relationship with the Commission and its sound financial performance in rating NBC. In addition to the above noted factors, Ms. Gurghigian identified other factors beyond the control of NBC that are considered by rating agencies such as economic factors and diversification of the rate base.²⁰

II. DIVISION PRE-FILED DIRECT TESTIMONY

Thomas A. Catlin, a principal with Exeter Associates, Inc. provided pre-filed testimony on behalf of the Division of Public Utilities and Carriers ("Division"). Mr. Catlin's testimony presented findings and recommendations with regard to NBC's proposal for monthly billing and the design of its rates to recover additional revenue. Lafayette K. Morgan, his associate, provided prefiled testimony discussing NBC's revenue requirements.

A. Testimony of Thomas A. Catlin

Mr. Catlin noted that currently NBC bills customers on a quarterly basis using consumption data provided by the customers' water suppliers. Some water suppliers provide consumption data quarterly, one provides the data semi-annually and three provide the data annually. NBC's proposal to convert to monthly billing will allow it to bill for estimated usage on a monthly basis beginning in the month after NBC receives the actual usage for the prior quarter. Mr. Catlin recommended accepting NBC's proposal to convert to monthly billing conditioned on NBC not recovering conversion costs associated with the change, the insignificant amount of incremental expense of approximately \$0.25 per customer per bill and NBC's not increasing the customer charge but dividing the current quarterly charge by three to determine the monthly customer charge. Mr. Catlin identified two benefits of the conversion to

²⁰ *Id.* at 7-8.

monthly billing as the reduction in the amount of NBC's unbilled receivables and the reduction in the NBC bill for customers making it easier for those customers to budget and pay their bills.²¹

Mr. Catlin also provided testimony on NBC's proposed rate design. He disagreed with NBC's proposal to increase both the service charge and the consumption charge in order to recover the allowed increase. He instead suggested an increase in the dwelling unit charge for residential customers and an increase in meter service charges for non-residential customers to recover the portion of the allowed revenue increase proportioned to those customers. The amount proportioned to residential customers would equal 56.06 percent resulting in an annual increase to residential customers of \$42.88 based on NBC's requested \$8,990,368 of additional revenue. The 44.94 percent increase in the meter service charge would allow NBC to recover 43.94 percent of additional revenues. Mr. Catlin noted that he suggested his methodology to recover the allowed revenue increase because the majority of NBC's revenue requirement is based on CSO costs and the treatment of stormwater as opposed to wastewater volumes. Additionally, he noted that more than 50 percent of NBC's costs are debt service related and a stable revenue stream provided by the increase in service charges. Finally, he pointed out that recovery of additional revenue through fixed service charges will maintain or improve NBC's credit rating.²²

B. Testimony of Lafayette K. Morgan, Jr.

Mr. Morgan provided testimony regarding NBC's requested revenue increase. Mr. Morgan recommended an increase of \$6,692,683 over current rates or a total revenue requirement of \$76,454,165. This amount is \$2,297,685 less than what NBC requested. Mr. Morgan used a test year ending June 30, 2008 and a rate year ending June 30, 2010. The first

²¹ Division Exhibit 1a, Testimony of Thomas A. Catlin, April 15, 2009 at 4-6.

²² *Id.* at 6-8, Schedules TSC-1, TSC-2, TSC-3.

adjustment he made was to reduce salaries and other personnel costs by \$141,869. He recommended accepting the 4.25 percent increase for union employees noting that NBC is under a current contractual obligation to provide such increase. However, he recommended a 2 percent increase for non-union employees noting current weak economic conditions, less than 2 percent projected inflation during the rate year, and the high unemployment level among NBC's customers. He also eliminated one of the laboratory technician positions requested by NBC noting that the increase in number of parameters, which was used by NBC to justify the new positions, has leveled off. He pointed out that he did not reduce overtime costs and that if another position became necessary, it could be added at a later date.²³

Mr. Morgan also made four adjustments to health insurance costs resulting in a reduction of \$111,138. His first adjustment was to the premium costs. He adjusted NBC's 10 percent increase in medical premiums and 6 percent increase in dental premiums to the average annual increase over the last three years. His second adjustment was to employee co-payments to reflect the average rate year wage increase in the salary and wage increases he proposed. His third adjustment was made to reflect healthcare costs for only two new positions as opposed to the three proposed by NBC. Lastly, he updated the number of employees enrolled in the healthcare plans to reflect the most recent data provided by NBC.²⁴

Mr. Morgan adjusted NBC's projected biosolids disposal costs by \$466,398 by using a 24 month average as opposed to NBC's three year average noting that the 24 month average was consistent with the number of months used by NBC and the Division to develop biosolid quantity in Docket No. 3905. Mr. Morgan calculated screening and grit costs based on the

²³ Division Exhibit 1b, Testimony of Lafayette K. Morgan, Jr., April 15, 2009 at 2-7, Schedules LKM-1, LKM-2 and LKM-3.

²⁴ *Id.* at 7-9, Schedule LKM-4.

current rate of \$65.00 per ton because recently obtained information establishes that this rate is likely to remain the same for 2010. He therefore reduced NBC's request by \$51,760.²⁵

Workers' compensation expense was projected by Mr. Morgan to be \$159,658 less than NBC's projection. He utilized a 2 year average annual increase noting that NBC's calculation included 2006 data that reflected an abnormally high growth rate which in turn distorts the average increase. Mr. Morgan reduced NBC's laboratory expenses by \$39,609 noting that Mr. Edge's testimony indicates that the number of tests NBC is required to perform is leveling off. To apply the three year average escalation rate of 15.32 percent would overstate the level of increase in light of the fact that the tests are leveling off.²⁶

NBC's projected electricity costs were reduced by Mr. Morgan by \$735,281 to reflect the a rate of 7.195 cents per kWh for the entire rate year as opposed to NBC's projections of 7.195 cents per kWh for July 1, 2009 through January 31, 2010 and 12.4 cents per kWh for February 1, 2010 through June 30, 2010. Mr. Morgan noted that National Grid's Last Resort Service for the period ending May 2009 through December 2009 shows a range of 6.04 cents to 7.765 cents per kWh shows that NBC can get a rate lower than the 12.4 cents per kWh it has projected. Additionally, he adjusted the manner in which NBC calculated the electricity for the Tunnel Pump Station from the maximum usage of each piece of equipment (which he described as unrealistic and yielding a continual over-recovery) to the average of the maximum and minimum expected electricity costs.²⁷

When calculating its projected level of management and audit services, NBC used the historical average annual rate of 3.26 percent. Mr. Morgan adjusted this by using the forecasted inflation rate of 1.7 percent as released in the March 2009 edition of Blue Chip Economic

²⁵ *Id.* at 9-11, Schedules LKM-5, LKM-6.

²⁶ *Id.* at 11-14, Schedules LKM-7, LKM-8.

²⁷ *Id.* at 14-15, Schedule LKM-9.

Indicators. This resulted in a \$195,990 decrease in NBC's forecasted expense for management and audit services. He also reduced NBC's Net Operating Reserve, which it calculated at 1.5 percent of operating expenses including personnel services cost but excluding debt service costs, by \$396,074. His adjustment was calculated using the Commission's previously approved 1 percent of operating expenses excluding personnel and debt service costs.²⁸

III. NBC REBUTTAL TESTIMONY

In response to Mr. Catlin's and Mr. Morgan's testimonies, NBC filed the rebuttal testimony of Mr. Edge. Mr. Edge indicated in his rebuttal that he was in agreement with Mr. Catlin's recommendation that monthly billing be accepted based on the conditions that NBC did not request the funding of the conversions costs and the dividing up of the current service charge so that there will be no adverse impact on customers. He noted that the one-time cash flow will only occur during the conversion period because unbilled revenue will decrease as consumption billings become more timely. Mr. Edge pointed out that should this one-time cash flow of approximately \$10 million materialize, NBC will be able to replenish its Revenue Fund which has decreased as a result of declining consumption billings.²⁹

Mr. Edge also provided testimony supporting Mr. Catlin's proposed rate design and methodology. Specifically Mr. Edge agreed with allocating cost recovery between residential customers through a uniform increase in the per dwelling unit charge and non-residential customers through a uniform percentage increase in the meter size based service charge. He also agreed with Mr. Catlin that recovering costs through fixed fees will provide a more stable revenue stream for NBC to meet its debt service obligations. Finally, Mr. Edge noted that this

²⁸ *Id.* at 16, LKM-1, LKM-10.

²⁹ NBC Exhibit 2a, Rebuttal Testimony of Walter E. Edge, Jr. filed May 7, 2009 at 1-3.

could result in a higher credit rating for NBC which would result in lower borrowing costs ultimately mitigating the impact of debt service on customers.³⁰

Mr. Edge provided rebuttal testimony in response to Mr. Morgan's testimony. Regarding salaries and personnel expenses, Mr. Edge noted that the 2% increase Mr. Morgan recommended for non-union employees was less than the 3% cost of living adjustment NBC proposed for union employees and is inequitable. He noted that the union wage increase includes a step increase in addition to the cost of living increase. Mr. Edge also pointed out that NBC's management, budgeting and financial practices resulted in its upgrade to its credit rating and that all employees, union and non-union helped to accomplish this. Additionally, Mr. Edge noted that non-union employees do not receive retiree health insurance benefits and receive less than the amount of contribution for their pension from NBC that the union employees receive.³¹

Mr. Edge disagreed with Mr. Morgan's elimination of one of the two proposed laboratory technician positions justifying it by the increase in sampling requirements. He accepted Mr. Morgan's adjustment for retiree healthcare. Mr. Edge disagreed with Mr. Morgan's adjustments to his rate year increase in health care insurance premiums. He noted that actual renewal rates will be known prior to the conclusion of the docket and that they be used to calculate the dental insurance costs.³²

Mr. Edge agreed with Mr. Morgan's adjustment to the biosolids disposal cost conditioned on the Commission agreeing to use other recent information on large expense items such as electricity. He disagreed with the adjustment to screening and grit costs noting that it omitted the \$33,414 cost of netting in the rate year that he also failed to include in his schedule. With regard to Mr. Morgan's adjustments to insurance premiums, Mr. Edge accepted Mr. Morgan's use of

³⁰ *Id.* at 4.

³¹ *Id.* at 6-8.

³² *Id.* at 10-11.

the two year average that excluded an increase in year one because he identified it as an abnormality. He did not accept Mr. Morgan's adjustment regarding old worker's compensation claims but changed his original position because settlement of an old claim may not occur.³³

Mr. Edge maintained his position for lab supply expense noting that Mr. Morgan's position was inconsistent with his methods used for other accounts in the docket. He also disagreed with Mr. Morgan's adjustment to electric costs. First he noted that NBC contracted for a three year rate of \$0.08125 per kWh beginning January 2010 which is higher than the amount projected by Mr. Morgan. Second, he noted that Mr. Morgan's adjustment to the Tunnel Pump Station ("TPS") usage did not take into account and is not alone on a single meter. Mr. Edge noted that the updated Bucklin Point electricity usage is 24% higher than Mr. Edge originally projected. Mr. Edge pointed out that in light of the amount of electricity already used and the higher kWh rate Mr. Morgan's adjustment falls short of the amount needed which totals nearly \$4 million.³⁴

Mr. Edge also accepted Mr. Morgan's adjustment to \$33,793 for management audit services after correcting a mathematical error. He objected to his adjustment to the net operating reserve calling it unrealistic to believe a \$170,000 net operating reserve was prudent for a utility the size of NBC. He also questioned the Commission's reduction of the operating reserve to an amount far less than any other regulated water utility regulated by the Commission. He noted that the rate year chemical expense will likely be higher than what he originally filed and that the biosolids expense could likely rise because of changes in rainfall and the operation of the CSO Phase I Facilities for a complete year, both of which could cause the operating reserve to be depleted very quickly. He again stressed that NBC's operating reserve should be 1.5% of

³³ *Id.* at 11-13.

³⁴ *Id.* at 13-17.

operating expenses less only debt service. Finally, Mr. Edge pointed out that the Operating Reserve for Revenue Stability Fund will not help address these unexpected expenses during the rate year because that fund is intended only to address shortfalls in revenue that result from variability in consumption revenue.³⁵

Maureen Gurghigian also provided additional testimony in support of NBC's proposal to convert to monthly billing. Ms. Gurghigian stated that rating agencies would view favorably a greater portion of NBC's revenue being recovered from fixed fees because revenue will not be as dependent upon consumption. She noted the importance of NBC's maintaining a AA- or higher credit rating as a financial benefit to NBC's ratepayers, because bondholders and investors consider a utilities' ability to service its debt.³⁶

IV. DIVISION SURREBUTTAL TESTIMONY

The Division filed the Surrebuttal Testimony of Lafayette Morgan on June 1, 2009. Mr. Morgan addressed a number of issues in Mr. Edge's rebuttal testimony. The first issue Mr. Morgan discussed was salaries and personnel costs. He rebutted the arguments made by Mr. Edge noting his adjustment to allow recovery of a 2% increase for non-union employees allows for merit-based compensation to be paid from NBC's strategic plan goals. He also asserted that Mr. Edge's claim that the 2% increase for non-union employees was inequitable was erroneous, because Mr. Edge should not have assumed that union employees would continue to receive the same increase as in the past. He cited the Providence Water Supply Board rate filing where the negotiated contract provided for a 2% increase for 2008, no increase for 2009 and a 2% increase for 2010. Lastly, Mr. Morgan rebutted Mr. Edge's claim that the 2% increase will cause that a five year employee to earn the same than a newly hired union employee noting that the five year

³⁵ *Id.* at 17-19.

³⁶ NBC Exhibit 2b, Rebuttal Testimony of Maureen Gurghigian filed May 7, 2009 at 2-5.

employee who performs well will not be limited to a 2% increase. Mr. Morgan also corrected two issues in his calculation.³⁷

Mr. Morgan asserted that he had no objection to reviewing the actual rates of healthcare costs which NBC claimed would be available by the end of this proceeding. He also indicated that he would use the actual dental premiums if they became available. Mr. Morgan accepted Mr. Edge's additional \$50,000 to workers' compensation expense conditioned upon the fact that if the \$50,000 per year for the new claim is not spent, those unspent amounts be recorded in a reserve account to either refund ratepayers or to offset future claims. Mr. Morgan accepted Mr. Edge's regarding lab supply expense and withdrew his adjustment.³⁸

Mr. Morgan partially agreed with Mr. Edge's revised adjustment to electricity costs. He agreed with Mr. Edge's newly contracted supply rate but disagreed with the updated electricity usage amounts he proposed. He noted that because of the annual variability in electricity usage, he did not agree with Mr. Edge's basing normalized electric use on data from only one year. Additionally, Mr. Morgan asserted that Mr. Edge's projection was not based on a full 12-month period of data. Finally, Mr. Edge was not consistent with the partial year data he used which varied depending on facility. Mr. Morgan asserted that he was opposed to using data that moved away from the 3-year average by annualizing electricity usage based on less than one year's activity and recommended an adjustment to reduce NBC's proposed electricity expense by \$151,271. Mr. Morgan corrected an error to his adjustment to management services and concluded that he agreed with Mr. Edge on this issue. Finally, Mr. Morgan asserted that he

³⁷ Division Exhibit 2, Surrebuttal Testimony of Lafayette K. Morgan, Jr., June 1, 2009 at 1-5, Schedule LKM-3S.

³⁸ *Id.* at 5-7, Schedules LKM-4S, LKM-7S, LKM-8S.

calculated the net operating reserve consistently with the Commission's order in Docket No. 3905.³⁹

V. HEARING

After published notice, the Commission conducted a public hearing on June 9, 2009 at the Commission offices located at 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

FOR NBC	:	Joseph Keough, Esq.
FOR THE DIVISION	:	Leo Wold, Esq. Special Assistant Attorney General
FOR THE COMMISSION	:	Patricia S. Lucarelli, Esq. Chief of Legal Services

Mr. Edge testified on behalf of NBC and noted that after reviewing Mr. Morgan's surrebuttal, NBC was in agreement with the Division's position on personnel expense, health benefits and electricity costs. He also testified that he was in agreement with Mr. Catlin's rate design charging the increase to fixed charges. Mr. Edge noted that with regard to operating reserve, Providence Water's operating reserve was increased from one-and-a-half percent to three percent. When questioned about the negotiation of NBC's union contract which expires in 2010, Mr. Edge deferred to Karen Giebink who indicated that negotiations for a new contract had not yet begun.⁴⁰

Mr. Edge testified that NBC's working capital has decreased and its coverage allowance calculation is more difficult to meet. Because of this, he asked the Commission to increase the operating reserve and allow for personnel expense to be included in that calculation. Mr. Edge

³⁹ *Id.* at 8-11, Schedules LKM-9S, LKM-10S.

⁴⁰ Transcript of Hearing ("T."), June 9, 2009 at 17-25.

also discussed how the monthly billing would occur, pointing out that the estimated bills would be trued-up as soon as NBC received actual data from the water utilities. Should the Commission approve the request for monthly billing, NBC agreed to send out notice immediately following the open meeting authorizing the change.⁴¹

Mr. Catlin and Mr. Morgan testified as a panel on behalf of the Division. Regarding the monthly billing, Mr. Catlin testified that it was his understanding that the soonest any customer could be billed after their last bill would be three months later. He noted that NBC informed him that if monthly billing was approved by the Commission for effect July 1, 2009, NBC would not implement it until October, thus preventing the jamming together of the monthly bill with the quarterly bill. Mr. Catlin also addressed NBC's request for an increase in its operating reserve. He noted that the Division's agreement with NBC to establish a Revenue Stability Fund was based on NBC's agreement that its operating reserve be 1%.⁴²

VI. COMMISSION FINDINGS

At an open meeting on July 1, 2009, the Commission considered NBC's application for a General Rate Change and rejected the December 22, 2008 filing. The Commission discussed and deliberated on the other issues that arose during the course of the investigation and hearing.

The Commission is not convinced that NBC needs the field investigator position it requested. Particularly in this economic climate, businesses are not choosing to increase employees but employees are assuming more responsibilities so that savings can be attained. Therefore, the Commission will adjust the agreed to operating expense by (\$57,238) for a total of \$18,968,508 being allowed for personnel services. Additionally, the Commission will no longer

⁴¹ *Id.* at 25-34.

⁴² *Id.* at 41-47.

approve credit card fees being financed by the ratepayers. This is a direct and deliberate violation of the Commission's rules prohibiting credit card costs from being borne by ratepayers.⁴³ Operating Supplies and Expenses will be adjusted by (\$58,388) for a total of \$14,073,616 being approved for Operating Supplies and Expenses.

The Commission is also concerned with the salary increases afforded to NBC employees. These salary increases exceed other comparable utilities. For example, Providence Water's recent filing noted negotiated salary increases of 2% for 2008, 0% for 2009 and 2% for 2010.⁴⁴ This is more reflective of the current condition of the economy than the increases proposed by NBC. The Commission understands that the union contracts dictating the proposed increases for union members expire in 2010 and urges NBC to negotiate terms that are comparable to other utilities and are reflective of the economy. The Commission stresses that it will only approve costs to be passed on to ratepayers that it deems to be prudent and reasonable, and NBC, like any other utility seeking to recover its costs from ratepayers, has the burden of establishing such costs are prudent costs.

With regard to the amount that NBC is authorized for an operating reserve, the Commission is satisfied that the 1% allowed in Docket No. 3905 excluding debt service and personnel costs is sufficient. NBC did not provide compelling evidence that this amount is insufficient and noted that in Docket 3905, NBC agreed to the 1% operating reserve in light of the fact that the Division supported its request for a \$4.5 million revenue stability fund. In Order No. 19062 in Docket No. 3797, the Commission discussed the reasons for an Operating

⁴³ The Commission has previously decided not to disallow this expense at a time when the Commission was undertaking a review of the Credit Card Rules. However, since that time, the Commission has made the determination that there should be no changes made to the Credit Card Rules.

⁴⁴ See Docket No. 4061, Testimony of Harold Smith at p.7.

Reserve.⁴⁵ One of those reasons was to address unexpected increases in expenses that are beyond the control of the utility. Both Debt Service and Personnel Expense costs are deemed to be within the control of NBC. Although NBC requested that personnel expenses be included in the calculation of the operating reserve, there was no evidence presented by NBC that it cannot control these expenses. The Commission has previously omitted Personnel Costs in the Operating Reserve calculation and indicated that because Personnel Costs are controllable by NBC, they can be controlled by such measures as co-sharing healthcare premiums, salary freezes or layoffs.⁴⁶ Thus, the total operating reserve being approved by the Commission in light of the other adjustments it has made is \$171,046.

The Commission is cognizant of the fact that often times, ratepayers are not aware of when public hearings are held even though notice of such is published in *The Providence Journal*. This issue was raised at one of the public comment hearings. In the future, NBC's notice of filing included in its next customer billing, pursuant to Rule 2.4 of the Commission's Rules of Practice and Procedure, shall occur subsequent to the Commission's pre-hearing conference and shall include the dates, times and places of the public comment hearings scheduled by the Commission.

The Commission is satisfied that NBC will provide proper notice to customers of its conversion to monthly billing and there will not be a "jamming" of bills. It is the hope of the Commission in approving NBC's request for monthly billing, with no conversion costs and no additional customer charge for this conversion that customers will be better able to manage smaller bills as opposed to the quarterly bills they currently receive. Additionally, the

⁴⁵ Factors considered by the Commission in setting an Operating Reserve include: significant revenue fluctuations, unanticipated increases in fuel costs, unexpected increases in expenses which are beyond the control of the utility and necessary to meet expenses approved in the cost of service. See Docket No. 3797, Order No. 19062 (citations omitted).

⁴⁶ See Docket No. 3739, Order No. 19062 (citations omitted).

Commission believes that monthly billing will assist NBC with its admitted cash flow problems. Finally, the Commission accepted NBC's rate design to increase existing rates as an incremental increase through the fixed fee component.

Accordingly, it is hereby

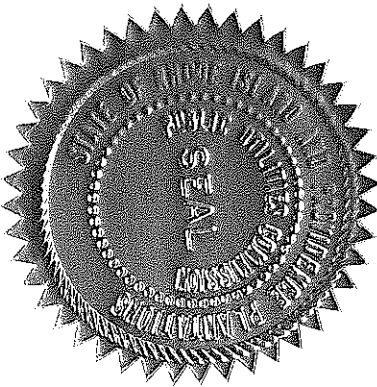
(19693) ORDERED:

1. Narragansett Bay Commission's General Rate Filing filed on December 22, 2008 is denied.
2. A revenue increase of \$7,176,197 resulting in a cost of service of \$76,937,679 is hereby approved for usage on and after July 1, 2009. Said revenue increase shall be an incremental increase through the fixed fee component.
3. The Commission will continue to restrict those accounts previously restricted, namely Debt Service--\$32,554,796 and Debt Service Coverage--\$8,138,699. Debt Service Coverage funding may be used for: (1) the payment of Capital Improvement Program projects; (2) capital outlays; and (3) funding the Revenue Stability Fund.
4. Funding of an Operating Reserve at 1% of operating expenses, excluding Debt Service related costs and Personnel Expense in the calculation, is approved.
5. Narragansett Bay Commission's notice of filing to its customers pursuant to Commission Rule or Practice and Procedure 2.4 shall occur after the pre-hearing conference and shall include the dates of the public comment hearings.
6. Narragansett Bay Commission's request to convert to monthly billing beginning October 1, 2009 is approved. Customers shall be notified of such change immediately of such change and that there shall be no increase in the customer charge as a result of this conversion.

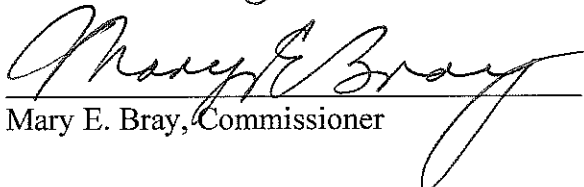
7. The Parties shall act in accordance with all other findings and instructions contained in this Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND JULY 1, 2009, PURSUANT TO
OPEN MEETING DECISION ON JULY 1, 2009. WRITTEN ORDER ISSUED JULY 8, 2009.

PUBLIC UTILITIES COMMISSION




Elia Germani, Chairman


Mary E. Bray, Commissioner

Appendix A

Cost of Service

	NBC Position	Commission Adjustments	Proforma Cost of Service
REVENUES			
User Fee Revenues	\$ 66,857,660		\$ 66,857,660
Other Service Revenues	1,712,626		1,712,626
Miscellaneous	<u>1,191,196</u>		<u>1,191,196</u>
Total Revenues	<u>\$ 69,761,482</u>		<u>\$ 69,761,482</u>
EXPENSES			
Personnel Services	\$ 19,025,746	(\$57,238)	\$18,968,508
Operating Supplies & Expenses	14,132,004	(\$58,388)	14,073,616
Professional Services	2,983,341		2,983,341
Amortization	9,690		9,690
Debt Related Costs	37,983		37,983
Debt Service	32,554,796		32,554,796
Debt Coverage	<u>8,138,699</u>		<u>8,138,699</u>
Total Expenses	\$ 76,882,259		\$76,766,633
Operating Reserve	\$ 549,406*	\$171,046**	\$171,046
COST OF SERVICE	<u>\$ 77,431,665</u>	<u>\$</u>	<u>\$ 76,937,679</u>
RATE YEAR REVENUES AT PRESENT RATES			
REVENUE INCREASE	\$ 7,670,183	\$	\$ 7,176,197

* Constitutes 1.5% of operating expenses excluding debt costs.

** Constitutes 1.0% of operating expenses excluding debt and personnel costs.