STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: NARRAGANSETT BAY COMMISSION :
ABBREVIATED APPLICATION FOR RATE RELIEF : DOCKET NO. 3592

REPORT AND ORDER

On March 1, 2004, the Narragansett Bay Commission ("NBC") filed with the Rhode Island Public Utilities Commission ("Commission") an abbreviated application for rate relief seeking an increase of its existing schedule to become effective on April 1, 2004. The proposed rates were designed to generate total revenues of $56,466,859, and if approved as filed, would increase NBC's present revenues by $4,967,683 or 9.65%. The Commission suspended the effective date of the proposed rate increase.

The instant abbreviated rate case filing represents NBC's fourth rate filing the last four years. Although the last three rate filings were necessitated primarily by the costs of the Combined Sewer Overflow Abatement Program ("CSO"), this abbreviated rate case filing does not relate to debt service for the CSO. The following provides a brief history:

DOCKET NO.	FILING DATE	INCREASE REQUESTED	INCREASE ALLOWED	AUTHORIZED REVENUE
3162	6/29/00	$10,089,441	$ 6,669,489	$36,632,209
3409	12/21/01	$ 8,834,420	$ 8,834,420	$45,467,359
3483	11/29/02	$13,826,248	$ 7,047,965	$51,499,178
3592	3/1/04	$ 4,967,683		

I. NBC

On March 1, 2004, NBC submitted pre-filed testimony by Walter Edge, an outside consultant. In his prefiled testimony, Mr. Edge indicated that the abbreviated rate filing encompasses personnel expenses and operating costs, but does not include debt service. Mr. Edge utilized the rate year approved in Docket No. 3483 as the test year.[1] Mr. Edge made no adjustments to the test year. For the rate year, Mr. Edge reviewed NBC's projected expenditure levels for fiscal year 2005 and identified salary and fringe adjustments of $1,564,692. This adjustment resulted from the addition of 12 employee positions and a 5 percent increase in total salaries for the rate year to cover steps, COLAs, longevity, merit increases and incentive raises. Mr. Edge argued that in Docket No. 3483 NBC had requested 254 positions but that the Commission approved 250 positions with a turnover allowance of 7 positions. After discussions with the state of Rhode Island budget office, Mr. Edge represented that the State's average turnover allowance last year was about 3 percent. He applied this turnover allowance of 3 percent to 262 positions, which resulted in a turnover allowance of 7.86 positions. The 12 new positions requested by NBC were: technical advisor, paralegal, customer service statistical analyst, fields point assistant inventory control clerk, technical database coordinator, two environmental monitoring assistants, Assistant Manager EMDA, Laboratory Tech position, Environmental Compliance Tech Assistant, Fields Point operator and Bucklin Point operator. Also, Mr. Edge also adjusted the health and dental insurance to reflect the increase in Blue Cross rates. In addition, Mr. Edge increased the allowance for old claims for workers' compensation by $100,000. Furthermore, NBC will no longer use its employees to incinerate sludge at Fields Point, but will outsource sludge incineration, resulting in payroll savings of $338,724.[2]

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[1] On August 13, 2003, NBC filed a motion with the Commission requesting authorization to use the rate year in the next abbreviated rate filing. With two conditions, the Division concurred with the request on August 21, 2003. On August 22, 2003, the Commission approved NBC's request with the Division's two conditions.

[2] NBC Ex. 1 (Edge's direct testimony), pp. 1-19.

In operating expenses, Mr. Edge indicated that there will be a $2,805,522 increase in the sludge loading/disposal account. Mr. Edge argued that sludge disposal needs to be outsourced because NBC's solids waste handling facilities are obsolete and in need of significant capital investment. Mr. Edge noted that replacing the incinerator would cost approximately $21 million plus interest, thus increasing NBC's debt service requirement. NBC looked at two other solids handling scenarios. The first scenario was for Bucklin Point to have a contract rate with the Rhode Island Resource Recovery Corporation ("RIRRC") for one-half of a year and market rates for one-half of a year and that Fields Point would operate the incinerator for a full year. This would reduce the revenue requested in this docket by $659,061. The second scenario was for Bucklin Point to have a contract rate with RIRRC for one-half of the year and market rates for one-half of the year and that Fields Point would go on the RIRRC rate for the entire year. Mr. Edge indicated that NBC will adopt one of the lesser cost approaches if it should become available, but for now NBC will include $380 per dry ton for the full year so as to protect NBC from the possibility of the worst case scenario.[3]

As for other operating expenses, Mr. Edge indicated there will be a net increase of $464,147 in the cost of electricity. Mr. Edge also projected a yearly cost for soda ash of $243,541 and a net increase of $37,625 for sodium hypochlorite. Also, Mr. Edge stated that natural gas will increase by $187,353. In addition, Mr. Edge asserted that insurance will increase by $170,439, while sodium bisulfate will increase by $55,287, and regulatory expense will increase by $40,928. However, Mr. Edge noted that computer supplies will decrease by $92,636. Lastly, NBC requested that its operating reserve be

[3] Id., pp. 20-22.

increased from 1% to 1.5% or $197,889. NBC argued that its operations have been exemplary and the CSO project is progressing well.[4]

Mr. Edge proposed that the revenue increase be implemented on an across-the board basis except for Pretreatment fees, BOD/TSS charges, and Septage Income charges. This resulted in increases of 10.25% on flat fees, measured service fees, and connection permit fees.

II. DIVISION

On June 2, 2004, the Division of Public Utilities and Carriers ("Division") submitted the pre-filed testimony of Thomas Catlin, an outside consultant. Mr. Catlin recommended a revenue increase of $2,533,394 or 4.9%. Based on data responses, NBC reduced its revenue request by $185,597 based on: a reduction in wage increases from 5% to 4%; an elimination of the salary and benefits associated with Juan Mariscal, who is on loan to the Water Resources Board; and an increase in electricity costs for Bucklin Point. Regarding the operating reserve, Mr. Catlin was satisfied with a one percent operating reserve but noted it is a matter of Commission discretion. As for employee positions, Mr. Catlin noted that NBC was not actively recruiting four employee positions and therefore, eliminated the salaries and benefits for these positions causing a reduction of $240,184. For workers' compensation, Mr. Catlin noted that in Docket No. 3483, an allowance of $50,000 was established for ongoing weekly payments for these old claims. Thus, Mr. Catlin rejected NBC's request for an additional $100,000 for workers' compensation claims because it was not clear the claim would be paid in fiscal year 2005,

[4] Id., pp. 23-27.

and even if it was paid that fiscal year, then it would be reasonable to amortize the cost over several years.[5]

In the area of sludge handling expense, Mr. Catlin noted that on April 30, 2004, NBC entered into an agreement with RIRRC. As a result, Mr. Catlin recommended sludge disposal costs at Bucklin Point be based on one-half year of operations under the current contract and one-half year under the new RIRRC contract while for Fields Point, the costs should be based on NBC continuing to operate its incinerator during the rate year. This represents a reduction of $1,407,295 in NBC's proposed rate year cost of service. As for the $200,000 reduction in overtime savings related to the outsourcing of sludge handling, Mr. Catlin adjusted to the cost of service by $129,180 based on the ability of NBC to reduce overtime through its new employees. Mr. Catlin noted that NBC employees hired after July 1, 2004 will be required to pay up to 10 percent of the cost of their health insurance if they elect a PPO option rather than the HMO option. In regards to insurance expense, Mr. Catlin reduced NBC's request by $81,375 to reflect current known premiums and NBC's projected increase in worker's compensation insurance premiums. Lastly, Mr. Catlin reduced the cost of equipment maintenance agreements by $123,571 to recognize the actual level of costs based on recent experience.[6] Mr. Catlin agreed with NBC's proposal for changing rates on an across-the-board basis.

III. NBC's REBUTTAL

On June 28, 2004, NBC submitted the pre-filed rebuttal testimony of Walter Edge. Mr. Edge agreed with most of Mr. Catlin's recommendations. In regards to Mr.

[5] Div. 1 (Catlin's direct testimony), pp. 1-9.
[6] Id., pp. 10-16.

Catlin's "NBC Updates and Revisions", Mr. Edge indicated that the contracted electricity rate for Bucklin Point is slightly higher and results in an additional increase in electrical costs of $34,286, and therefore, the revised net adjustment is $151,311 instead of $185,597. As for the worker's compensation claim, Mr. Edge did not agree to Mr. Catlin's adjustment but will accept it at this time, indicating NBC could raise this issue again in the next filing. As for sludge disposal costs, Mr. Edge indicated that the adjustment should be $1,423,712 or $16,417 higher than Mr. Catlin's recommendation to reflect the costs of polymer, lime and fuel oil #2.

Mr. Edge disagreed with Mr. Catlin's estimated overtime savings, and Mr. Catlin's reduction of four employee positions. Mr. Edge indicated that NBC did not pursue these four positions because NBC did not have sufficient funding available. Also, Mr. Edge did not agree with Mr. Catlin's approach to determining the level of expenditures for equipment maintenance agreements. Lastly, Mr. Edge renewed his request for a 1.5 percent operating reserve. Accordingly, Mr. Edge determined that NBC needed a revenue increase of $3,158,415.[7]

IV. DIVISION SURREBUTTAL

On July 26, 2004, the Division submitted the surrebuttal testimony of Thomas Catlin. At the outset, Mr. Catlin agreed with Mr. Edge's recommendation in his rebuttal testimony regarding overtime and equipment maintenance contracts expense. Mr. Catlin noted that in Mr. Edge's rebuttal testimony NBC adjusted the claim for sludge disposal costs consistent with Mr. Catlin's direct testimony except for minor refinements to certain costs. However, after further discovery, Mr. Catlin identified and disagreed with NBC's five percent contingency of $30,201 for the natural gas costs. He indicated that

[7] NBC Ex. 2 (Edge's rebuttal testimony), pp. 1-5.

all of the costs of sludge disposal were estimates, and it is inappropriate to single out natural gas costs to add a five percent contingency. As for the unfilled employee positions, Mr. Catlin maintained his direct testimony position. He noted that as of the end of June 2004 NBC still had 15 employee vacancies which exceeded the employee turnover adjustment recognized by NBC. Furthermore, Mr. Catlin maintained his position that NBC have only a one percent operating reserve in accordance with the Commission's prior order. In conclusion, Mr. Catlin recommended an overall revenue requirement for NBC of $54,240,634, which is an increase of $2,744,059 and is $414,356 less than requested in Mr. Edge's rebuttal testimony.[8]

V. HEARINGS

After published notice, the Commission conducted public hearings on August 16 and 18, 2004 at the Commission's offices at 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

FOR NBC:	Peter McGinn, Esq.
FOR THE DIVISION:	Leo Wold, Esq. Special Assistant Attorney General
FOR THE COMMISSION:	Steven Frias, Esq. Executive Counsel

On August 16, 2004, NBC presented as its witness, Mr. Walter Edge. Under cross-examination, Mr. Edge admitted that the $143,970 difference between the parties' position regarding the operating reserve is a small number. Also, Mr. Edge acknowledged that some of the positions requested by NBC are not based on federal mandates for the CSO project. He indicated that there were currently 252 filled positions at NBC. In response to a question as to whether NBC could require its non-union

[8] Div. Ex. 2 (Catlin's surrebuttal testimony), pp. 1-6.

employees to share in the cost of their health care premiums, Mr. Edge stated "in fairness to the non-union employees," NBC "deal with them in a similar fashion as their union employees." Also, Mr. Edge concurred with Mr. Catlin's recommendation to deny NBC's request for a natural gas cost contingency of 5 percent. In addition, Mr. Edge admitted that a 1.5 percent operating reserve would not assist NBC in performing any task with which it currently has difficulty.[9]

The Division presented Mr. Catlin as its witness. Under cross-examination, Mr. Catlin indicated that the CPI for the last several years has been approximately 2 percent a year. Also, Mr. Catlin asserted that "it is out of step with the employment world as it exists where there are non-union contracts" for employees not to pay a portion of their health care premiums. He also stated it would be reasonable for non-union employees to have a 10 percent co-share for their health care premiums. Mr. Catlin concurred that the level of NBC's operating reserve is the prerogative of the Commission.[10]

NBC also presented Mr. Raymond Marshall, Deputy Director of the NBC, as a witness. Mr. Marshall indicated that the three NBC positions related to public affairs are necessary to improve the public image of NBC, and the government affairs manager lobbies the General Assembly regarding legislation that may impact NBC's ratepayers.

On August 18, 2004, NBC presented Thomas Brueckner and Joseph Pratt as witnesses. Mr. Brueckner answered questions regarding the current status of NBC's CIP while Mr. Pratt answered questions regarding the CSO project.[11]

After the hearing, NBC provided a record response indicating that NBC has 124 non-union employees and there would be $92,354.17 in savings for the remainder of

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[9] Tr. 8/16/04, pp. 19, 29, 39-40, 53-55.
[10] Id., pp. 74-75, 80.
[11] See Tr. 8/16/04.

fiscal year 2005 if these employees paid 10 percent of their health care premium.[12] Also in response to a Commission data request, the Division clarified its position by indicating that the "Division's revenue requirements include funding for approximately 250 positions."[13]

COMMISSION FINDINGS

The two primary issues for the Commission to decide are the level of NBC's operating reserve, and the appropriate amount of NBC's personnel expenses. In regards to the operating reserve, the issue is whether it should be set at 1 percent of NBC's operating expenses, not including debt service/coverage, or 1.5 percent of NBC's operating expenses. The difference between these two approaches is approximately $140,000. In the last docket, the Commission approved a one percent operating reserve. However, since the last docket it has become apparent to the Commission that energy costs are increasing steadily. From June 30, 2003, the date of the open meeting decision in Docket No. 3483, to September 23, 2004, there have been two increases in electric and natural gas rates with more on the horizon.

In Docket No. 3483, the projected cost of electricity was an issue of contention. In this docket, the projected cost of natural gas was an issue until NBC withdrew its request for a 5 percent contingency for gas costs. In light of volatile and steadily rising energy costs, the Commission finds that a 1.5 percent operating reserve for NBC is appropriate at this time. This larger operating reserve should give NBC the flexibility to cope with higher energy costs for the future.

[12] NBC Record Response 8/19/04.
[13] Division's Data Response 8/30/04.

In regards to personnel expenses, NBC should be aware that the utility has the burden of proof for increasing its personnel expenses if it causes an increase in its rates.[14] In fact, the Commission's role in reviewing NBC's rates arising from personnel expenses "exceeds mere regulation" because "Section 39-1-1 vests the Commission with the power to regulate and *supervise* the conduct of the utility "for purposes of controlling its efficiency and protecting the public against improper and unreasonable rates."[15] In other words, this Commission may at times supervise the conduct of a utility to ensure it is efficient and that ratepayers are protected from improper and unreasonable rates.

Once again, NBC is seeking more FTE positions. NBC erroneously maintained that in Order No. 17558 this Commission approved 250 FTE positions and on that basis was now requesting 262 FTE positions. In fact, the Commission clearly asserted "NBC's revenue requirement will be based on 243 positions".[16] In the filing, the Division has reduced the number of FTE positions through a turnover adjustment. As a result, the Division proposed fully funding 250 positions. Although the Division's methodology is complicated, the Commission recognizes that NBC has more responsibilities and duties due to the CSO Project. Before the CSO Project commenced, NBC had 241 positions funded by the Commission.[17] An increase to 250 positions appears, on its face, to be reasonable in light of the undertaking by NBC of the CSO project. For the sake of simplicity, the Commission will accept the Division's revenue requirement for personnel expenses, but to make it abundantly clear to NBC; the Commission is only approving 250 FTE positions.

[14] R.I.G.L. Section 39-3-12.
[15] Prov. Water Supply Board v. Malachowski 624 A.2d 305, 309 (R.I. 1993).
[16] Order No. 17558, p. 30.
[17] Order No. 16751, p. 4.

A utility has an obligation to run an efficient operation. When a utility seeks to increase its personnel expenses, it must provide reasonable and sufficient evidence that the personnel expenses are reasonable and beneficial to ratepayers. There are questionable personnel positions at NBC such as four positions related to public relations or lobbying. Even if NBC is a non-investor owned utility, this Commission could disallow from rates those personnel costs related to these activities.[18]

In addition, NBC has provided little or no evidence that it is being pro-active in limiting personnel expenses. One example of such an initiative taking place in the public sector is recent policy initiatives by Governor Carcieri. For instance, Governor Carcieri has required all non-union classified state employees to share in the cost of their health premiums. In the private sector, it is common for employees to share in a portion of their health care premiums. The Commission expects that in future rate cases involving personnel expenses, NBC would require its employees to share in the expense of their health care premiums or implement other approaches that will clearly reduce the health care premium paid by NBC. The Commission is aware of NBC's concern regarding fairness to non-union employees. However, in ratemaking, fairness requires the Commission to balance the interests of the utility versus the ratepayers. Accordingly, under Title 39 it would be unreasonable and inefficient for the employees of non-investor owned utilities to enjoy compensation that is more generous than what is received by a utility's ratepayers, a large majority of whom are in the private sector.

[18] Order No. 17971 pp. 18-19, 22. In this Order, the Commission disallowed a portion of NEGas' public relations expenditures and all of its lobbying expenses.

Performance based ratemaking ("PBR") has successfully kept distribution rates at stable levels in the energy sector in Rhode Island.[19] The time may have come to implement a similar approach to non-investor utilities. On behalf of the ratepayers the Division should examine and propose some new forms of regulation, which will require non-investor utilities to limit their personnel costs.

At an open meeting on September 23, 2004, the Commission reviewed the evidence. The Commission approved the Division's surrebuttal position for NBC's revenue requirement except for a 1.5 percent operating reserve and made it clear that the Commission is approving only 250 positions for NBC. Thus, NBC received a revenue increase of $2,883,974 and a revenue requirement of $54,380,549.[20] At the open meeting of October 7, 2004, the Commission approved NBC's compliance tariff filed on September 29, 2004, which reflected the Commission's September 23, 2004 open meeting decision.

(18124) ORDERED;

1. Narragansett Bay Commission's abbreviated rate application of March 1, 2004, is hereby denied and dismissed.

2. A revenue requirement of $2,883,974 resulting in a cost of service of $54,380,549, which includes only 250 full time equivalent positions, is hereby approved for effect October 1, 2004.

3. The Commission will continue to restrict those accounts previously restricted in Docket 3483 (Report and Order No. 17558). These accounts and their allotments were not changed in this filing and will continue to be funded in these amounts: Debt Service-

[19] Order Nos. 18037 and 17381.
[20] The approved cost of service is incorporated as Appendix A to this Report and Order.

-$21,909,888; Debt Service Coverage--$6,094,071; and funding for Commission oversight of the Combined Sewer Overflow ("CSO") project--$150,000. The CSO oversight funds shall continue to accrue from the carry forward of funds otherwise not used for Debt Service Coverage. Additionally, Debt Service Coverage funding may be used for payment of Capital Improvement Program projects and for capital outlays. The restricted funds shall only be used for their designated purposes and excess/available funds shall be invested in an interest bearing account.

4. Narragansett Bay Commission shall comply with all other findings and instructions in the Report and Order.

EFFECTIVE AT WARWICK, RHODE ISLAND, PURSUANT TO AN OPEN MEETING DECISIN ON SEPTEMBER 23, 2004 AND OCTOBER 7, 2004. WRITTEN ORDER ISSUED JANUARY 21, 2005.

PUBLIC UTILITIES COMMISSION

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Elia Germani, Chairman

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*Kate F. Racine, Commissioner

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Robert B. Holbrook, Commissioner

*Commissioner Kate Racine concurs but is unavailable for signature.

Appendix A

Narragansett Bay Commission
Docket 3592
Cost of Service

	NBC Rebuttal Position	Commission Adjustments	Proforma
REVENUES			
User Fee Revenues	$ 48,388,711	$ --	$ 48,388,711
Other Service Revenues	2,367,664		2,367,664
Miscellaneous	740,200		740,200
Total Revenues	$ 51,496,575	$ --	$ 51,496,575
EXPENSES			
Personnel Services	15,649,050	(240,184)	15,408,866
Operating Supplies &Exp	10,565,364	(30,201)	10,535,163
Special Services	2,029,039		2,029,039
Amortization	9,690		9,690
Debt Service	21,909,888		21,909,888
Carry Forward from 2003	(2,025,910)		(2,025,910)
Debt Coverage	6,094,071	-	6,094,071
Total Expenses	$ 54,231,192	($ 270,385)	$ 53,960,807
OPERATING RESERVE	423,797	(4,055)	419,742
COST OF SERVICE	$ 54,654,989	($ 274,440)	$ 54,380,549
REVENUE INCREASE	$ 3,158,414	($ 274,440)	$ 2,883,974