

SURREBUTTAL TESTIMONY
of
DAVID RUSSELL
before the
PUBLIC UTILITIES COMMISSION
DOCKET No. 3674

for
THE TOWN OF CUMBERLAND

September 2005

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**SURREBUTTAL TESTIMONY
OF
DAVID F. RUSSELL
FOR
THE TOWN OF CUMBERLAND**

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is David F. Russell, and my business address is **RUSSELL CONSULTING**, 15 Titcomb Street, Suite 100, Newburyport, Massachusetts 01950.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS CASE?

A. I am testifying on behalf of the Town of Cumberland, RI.

Q. MR. RUSSELL, WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?

A. I am providing surrebuttal testimony on one issue; namely, the ratemaking treatment of a portion of the property tax expense incurred by the Pawtucket Water Supply Board (PWSB) for some of its assets located in the Town of Cumberland.

Q. DOES YOUR SURREBUTTAL TESTIMONY ADDRESS THE PREFILED TESTIMONY OF ONE OR MORE OTHER WITNESSES IN THIS CASE?

A. Yes it does. Specifically, the rebuttal testimony of Mr. Christopher Woodcock, who has testified on behalf of the PWSB; and the pre-filed testimony of Mr. Thomas Catlin (he did not submit surrebuttal testimony), who has testified on behalf of the Division.

1

2 **Q. WHAT IS YOUR PRESENT OCCUPATION?**

3 A. I am a professional consultant specializing in utility management, economics and
4 rates. I am the owner and founder of my own consulting business - **RUSSELL**
5 **CONSULTING**. We specialize in providing the following professional services to
6 cities and towns, municipal utilities, regulatory agencies and consumer advocacy
7 groups: management reviews and audits, needs assessment and facilities
8 planning, utility economics and rate studies, determination of component and
9 total revenue requirements, cost-of-service studies, demand management and
10 conservation programs, expert witness services, utility contracts and
11 negotiations, feasibility studies, system appraisals and related
12 regulatory/institutional studies.

13

14 **Q. PLEASE SUMMARIZE YOUR TRAINING AND EXPERIENCE.**

15 A. I have over 30 years of experience as a professional engineer, management
16 consultant, and economist. My formal education consists of a B.S. Degree in
17 Electrical Engineering from Rutgers College, an M.S. Degree in Engineering
18 Management from Northeastern University and an M.A. Degree in Economics
19 from Rutgers University. I have also taken numerous professional development
20 courses throughout my career, including the American Management
21 Association's Strategic Planning Program, Competitive Cost and Quality
22 Management - an executive conference sponsored by the American Water
23 Works Association Research Foundation and the Electric Power Research
24 Institute, and the Edison Electric Institute's Rate and Cost-of-Service Seminar at
25 Indiana University. I am a Registered Professional Engineer in the States of

1 Massachusetts (Registration Number 28342) and New Jersey (Registration
2 Number 26512).

3
4 For nearly all my career I have been actively involved in the management and
5 control of utility businesses, from small public water companies to large multi-
6 state, fully integrated, private electric companies. Within the private sector, I
7 have worked directly for three electric utility holding companies in the northeast.
8 For these utilities, I have held the positions of Strategic Planner, Senior Engineer,
9 Rate Supervisor, and Director of Regulatory Services. I was also a Principal
10 Management Consultant for a large engineering company (Camp Dresser &
11 McKee, Inc.), where for several years I provided management and financial
12 consulting services to many municipalities, state agencies and both public and
13 private utilities. As a lead consultant I was actively involved in all phases of the
14 management consulting practice, including marketing, writing proposals,
15 interviewing, negotiating contracts with clients, and both participation in and
16 management of contracted services.

17
18 Within the public sector, I was an Engineer for the Massachusetts Department of
19 Public Utilities, the predecessor agency to the Massachusetts Department of
20 Telecommunications and Energy (MADTE) for four years, being promoted to the
21 position of Chief Engineer for two years prior to leaving state service.
22 Additionally, while pursuing a Master of Arts Degree in Economics from Rutgers
23 University (with concentrations in Regulatory and Resource Economics), I
24 provided technical and economic consulting services to the New Jersey Board of
25 Public Utilities. I am a member of, and actively participate in, several

1 professional societies, including the American Water Works Association (AWWA)
2 (I am a member of the Rates and Charges Committee) and the New England
3 Chapter (I am the Chairman of NEWWA's Conservation Committee and Co-
4 Chairman of the Financial Management Committee), the Water Environment
5 Federation (WEF) and the New England Chapter, The International Water
6 Resources Association, the National Society of Professional Engineers, the
7 Institute of Electrical and Electronics Engineers, the Rutgers Engineering
8 Society, and was for several years a member of the American Public Power
9 Association ("APPA").

10
11 I have provided expert witness testimony on many occasions before several state
12 public utility commissions (including The Rhode Island Public Utilities
13 Commission) and legislative committees, including testimony on matters directly
14 related to utility planning, forecasting and needs assessment, least cost planning,
15 capital improvements, revenue requirements, cost of service studies and rate
16 design, and demand management/conservation programs.

17
18 I have written several papers and articles that have been published in
19 professional journals and/or presented at utility industry conferences. Topics
20 have included rate design and cost of service studies, appraisals of utility
21 systems, energy conservation and other measures to reduce total energy costs,
22 and cost/benefit analysis of alternative ownership options for utilities. Most of
23 these papers have been published in Professional Journals and/or presented at
24 industry conferences

1 I have prepared and presented courses on cost of service and rate design
2 studies at industry conferences and seminars. This has included the Cost of
3 Service Study portion of the Annual Rate Seminar sponsored by the New
4 England Water Works Association (NEWWA), and the Revenue Requirement
5 and Rate Design portions of a two-week International Seminar sponsored by the
6 Institute for Public-Private Partnerships in Washington, DC. For the NEWWA I
7 have prepared a two-day training course (“Accounting for the Non-financial
8 Manager”) for water utility managers, focusing on the accounting of utility
9 operating costs, and both expansion capital costs and pay-as-you-go capital
10 costs. On a part-time basis, I also teach undergraduate and graduate courses in
11 economics and management science, as an adjunct professor at Boston
12 University. My resume is attached as Exhibit No. DFR-1.

13
14 **Q. WITH RESPECT TO THE ISSUE YOU WISH TO ADDRESS, WHAT IS YOUR**
15 **UNDERSTANDING OF MR. WOODCOCK’S AND MR. CATLIN’S POSITION**
16 **THERE TO?**

17 A. I have reviewed the entire testimony of these two experts in this Docket, as well
18 as other documents in this Docket, including responses to data requests, that
19 address this issue. From this review, it is clear that both Mr. Woodcock and Mr.
20 Catlin have taken the position that a special surcharge or rate differential should
21 be established to recover one expense – tangible property taxes - from a limited
22 group of customers, comprised of all of the retail customers of the PWSB located
23 in the Valley Falls section of Cumberland, and one wholesale customer – the
24 Cumberland Water Department (CWD).

1 **Q. HOW WOULD YOU LIKE TO PROCEED WITH YOUR TESTIMONY?**

2 A. First, I would like to provide some background as to my understanding of this
3 issue. This will be followed by my responses to specific points raised by Mr.
4 Woodcock and Mr. Catlin in their testimonies. Lastly, I will provide a summary of
5 my findings, conclusions, and recommendations relative to this issue.

6
7 **Q. TO BEGIN THEN, WHAT IS YOUR UNDERSTANDING OF THIS ISSUE?**

8 A. The issue I have focused on addresses the question - what is the best way to
9 recover a specific expense incurred by the PWSB (tangible property tax)?
10 Should it be recovered from all of PWSB's customers, or from a selected
11 subgroup of customers? All of the parties seem to have agreed that the tangible
12 tax expense is legally incurred and should be paid in some manner by the
13 PWSB, in an amount that will ultimately be determined by pending court litigation.
14 The expense in question is a portion of the property tax which Cumberland
15 charges PWSB for certain assets owned by this utility located in Cumberland. As
16 with most municipalities, the Cumberland property tax consists of two
17 components. One is for "real" property, which is billed at a lower tax rate. The
18 recovery of that portion of the property tax and the method of recovery (from all
19 PWSB ratepayers) is not in dispute by any of the parties. The other portion of
20 the tax is for tangible property, which includes all other PWSB property located in
21 Cumberland not classified as real property. The method of recovering this later
22 portion of the property tax from PWSB's ratepayers is the disputed issue.

1 **Q. WHAT HAS BEEN YOUR EXPERIENCE WITH RESPECT TO PROPERTY TAX**
2 **EXPENSES AND THEIR METHOD OF RECOVERY?**

3 A. In the many cases I've been involved with, all property taxes (real and tangible)
4 have always been considered a cost of doing business and hence a legitimate
5 expense just like any other expense incurred by a utility in the normal course of
6 providing service. Thus, all property taxes (and indeed all other taxes) are
7 considered revenue requirements to be recovered from all utility customers in the
8 same way as most other operating and maintenance (O&M) expenses. I am not
9 aware of a single case where any portion of the property taxes was completely
10 separated from all other expenses and charged through a special surcharge or
11 rate differential to a subgroup of the entire customer base. Yet, this is exactly
12 what the PWSB's and the Division's witnesses have recommended in this case.

13
14 **Q. IS THE FACT THAT SUCH TREATMENT IS UNPRECEDENTED IN YOUR**
15 **EXPERIENCE, ENOUGH REASON IN ITSELF FOR THE COMMISSION TO**
16 **REJECT IT?**

17 A. No, not by itself. But I believe it should raise a big red flag and cause the
18 Commission to set a very high threshold relative to its reasonableness,
19 necessity, equitability, and preference in this specific case, as it considers such
20 an unprecedented ratemaking proposal.

21

22

23

1 Q. DO YOU BELIEVE THAT THE PWSB AND THE DIVISION HAVE SATISFIED
2 THEIR BURDEN OF PROOF FOR SUCH AN UNPRECEDENTED
3 TREATMENT IN THIS CASE?

4 A. No, I do not, for several reasons. First, I will provide some background
5 information and areas of agreement; outline the basis for some of my main
6 arguments; and then proceed to specific issues/statements made by the two
7 witnesses with whom I disagree on this particular issue.

8
9 Based on my review and evaluation of the pertinent documents in this case and
10 my professional experience, I submit that the following are fair and accurate
11 statements:

- 12
- 13 ➤ All parties agree that tangible property taxes on water utility assets in Rhode
14 Island are lawful and need to be recovered through water rates in some
15 manner.
 - 16
 - 17 ➤ Property taxes are levied on all types of utility assets regionally and
18 nationally, and their recovery is universally (or nearly universally) through the
19 traditional method of spreading/sharing the costs among all customers of the
20 utility involved.
 - 21
 - 22 ➤ The record in this case demonstrates that the taxing of tangible assets owned
23 by water utilities in Rhode Island is not unique. In fact, several communities
24 currently have such taxes in effect and have for many years, and the cost of

1 these taxes have been spread to all customers of the utility, not a small
2 subgroup.

3
4 ➤ It is my understanding that all of the parties have agreed that the tangible
5 property tax levied by Cumberland is a lawful tax, and has left the
6 determination of the reasonableness of its magnitude and its application to
7 the State Courts.

8
9 ➤ It is the very rare exception rather than the rule to segregate a particular cost
10 of providing service from all others and to target its recovery from a particular
11 subgroup of customers. I am, of course, referring to intraclass segregation of
12 costs, and not interclass allocation of costs. To my knowledge, the PWSB
13 does not treat any other cost it incurs in this manner, and it appears that it has
14 not done so in the past.

15
16 The purpose of a property tax is to fairly recover from all the owners of property
17 in a municipality an annual amount which collectively can be used to pay a large
18 portion of the annual costs incurred by the municipality in providing the services
19 to all residences and businesses. To the extent that the benefits provided by
20 municipal services are related to the value of property owned, such taxes are fair
21 and equitable. Under the PWSB's surcharge proposal, the property tax would
22 not be paid by the property owner (PWSB in this case). Instead, it would be paid
23 partly by a small portion of the users of the facilities being taxed and partly by a
24 wholesale customer that does not directly benefit at all from the taxed distribution
25 pipes - even though both groups do not own any portion of the property being

1 taxed. The property owner in this case is the PWSB (and ultimately the City of
2 Pawtucket and its citizenry).

3
4 PWSB's claim that the taxpayers in Cumberland are the only group to benefit
5 from Cumberland's taxing of PWSB's tangible property is somewhat like saying
6 that the only group to benefit from the expenditure of funds to pay for chemicals
7 used at a treatment plant is the owner of the company supplying the chemicals.
8 Surely most, if not all, customers of the water system, who receive high quality
9 potable water partly because of the use of those chemicals, benefit from the
10 purchase of those chemicals. Similarly, through the payment of property taxes in
11 Cumberland, PWSB fulfills one of its legal obligations that allows it to locate and
12 continue to operate its utility facilities in Cumberland (including underground
13 pipes). As a direct result of that ongoing privilege, PWSB is able to supply a
14 much larger customer base, which in turn spreads all fixed costs over a much
15 larger customer base, resulting in a lower average fixed cost for all customers
16 served by PWSB. This includes all customers in Pawtucket and Central Falls, as
17 well as those in Cumberland served by the PWSB.

18
19 From Mr. Bruce's testimony, it is clear that PWSB has for many years paid its
20 total bill for all property taxes in Cumberland (real and tangible) without appeals,
21 and spread this expense to all of its customer base, not just its customers in
22 Cumberland. This is the normal or traditional ratemaking treatment of property
23 taxes and most other costs of providing service. It would appear that had there
24 not been an increase in the assessed value of the tangible property, the PWSB
25 would have continued with the status quo.

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Assuming that Cumberland’s taxing of tangible utility property in Cumberland is legal and will be based on a fair and reasonable computation of tax rates and assessments as determined by the pending litigation, I see no reason for treating it any differently for ratemaking purposes than any other legitimate expense incurred by the PWSB.

Q. TURNING TO MR. WOODCOCK’S REBUTTAL TESTIMONY, DO YOU AGREE THAT IT IS IRRELEVANT WHAT OTHER COMMUNITIES IN RHODE ISLAND ARE DOING WITH RESPECT TO THIS ISSUE?

A. No, I do not. It is always useful to know what other communities are doing with respect to an issue that is in dispute in a pending case. The fact that several other municipalities charge PUC regulated water utilities tangible property taxes for water pipes in their communities means that this is not a unique situation, and in fact may be characterized as a fairly typical (although not universal) practice in Rhode Island. If this was totally unique to Cumberland, then the argument for special treatment in this case because of its uniqueness may, but not necessarily, have some validity. However, the record (developed by the Commission in PWSB’s last full rate case) clearly indicates that several other communities do charge tangible property taxes on water pipes. Moreover, Mr. Bruce’s testimony, based on the survey done by Cumberland’s Tax Assessor, shows that almost every community with gas distribution pipes charges their local gas utility property taxes for such assets. It has also been my personal experience that the distribution facilities owned by electric utilities are taxed by each community in which they have such facilities.

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Q. DO YOU AGREE WITH MR. WOODCOCK’S BELIEF THAT PAWTUCKET’S ATTEMPT TO OBTAIN STATUTORY EXEMPTION FROM SUCH TAXATION IS IRRELEVANT IN THIS CASE?

A. No, I do not. It is relevant because PWSB is trying to accomplish the same end result through its proposed ratemaking treatment of this expense. If PWSB, and in turn the City of Pawtucket, truly believed that this was a legitimate tax that should be recovered in some manner, and simply wanted to change the ratemaking treatment of this expense and make it more “equitable”, they would not be trying to prohibit the tax at the same time. The ratemaking treatment they are seeking in this case has the exact same financial effect on them as the legislation they have unsuccessfully sought. Thus, it appears that their only real objective in making this unusual proposal is to avoid a tax they are legally responsible for.

Q. DO YOU BELIEVE THAT A SURCHARGE THAT IS DESIGNED TO SEGREGATE A LEGITIMATE COST AND RECOVER IT FROM A TARGETED GROUP OF CUSTOMERS COULD OPEN A “PANDORA’S BOX?”

A. Yes, I do. Targeting particular costs to particular customers would set a precedent that would support acceptance of rate differentials for any customer or group of customers of any regulated utility that could demonstrate that they do not cause the utility to incur one or more costs, and therefore those costs should only be recovered from those causing the costs to be incurred. In the extreme, every customer would have their own rate. Several examples have been cited in this case and others, including customers in high-gradient zones that require

1 pump stations, proximity to sources of supply and/or treatment facilities,
2 customers whose water needs little or no treatment versus those that need
3 expensive treatment, etc. In Docket 2048 involving Providence Water, Mr. Catlin
4 used the same argument I am making to oppose such a surcharge (i.e.,
5 geographic rate differential) at that time. In this case, however, he has reversed
6 his position on the ratemaking treatment of the tangible tax. However, he may
7 still agree with his earlier position relative to its leading to a dramatic increase in
8 the number and frequency of rate differential proposals. This Commission clearly
9 expressed its concern about opening a Pandora's Box in relation to the similar
10 surcharge proposal (high service area geographic differential) by Providence
11 Water. To wit, in its Order in Docket 2048, the Commission made the following
12 ruling.

13 "The Commission finds for the Division on this issue. In reaching
14 this finding, the Commission considered the potential consequences that
15 such a precedential decision could generate. For example, if we approved
16 a pumping zone charge [i.e., a geographic rate surcharge/differential],
17 would ratepayers at the far end of the distribution system be the next
18 target for a special cost surcharge? What about ratepayers who live
19 closest to the treatment plant, would they be entitled to a rate discount?
20 Furthermore, what about the existing customers being served water above
21 the system's gradient, such as the Fruit Hill residents? Will they too have
22 to pay a surcharge, or will they be exempted (perhaps unjustly) from the
23 special pumping zone surcharges?"

1 Q. ON PAGE 22, LINES 9 TO 11, MR. WOODCOCK STATES, "IN THE CASE OF
2 CUMBERLAND'S TANGIBLE TAXES, THE MONEY LEAVES THE SYSTEM
3 TO THE DETRIMENT OF ALL RATE PAYERS AND ONLY BENEFITS THE
4 TAX PAYERS OF CUMBERLAND." DO YOU AGREE WITH THIS
5 STATEMENT?

6 A. For reasons outlined below, I disagree with this statement. While it is true that
7 payments for this tax do leave the system, it means nothing because this is true
8 for all taxes, and indeed for all other expenses (e.g., for chemical expenses), with
9 the possible limited exception of payments for internal water use. Furthermore, I
10 would not characterize the use of funds to pay for legitimate expenses as a
11 "detriment" to any ratepayer; and as explained above, the PWSB does "benefit,"
12 and in turn all of its customers benefit, by paying a legitimate tax that allows them
13 to have the ongoing privilege of locating some of its assets in Cumberland and
14 being able to recover revenues (and spread out costs) through the use of those
15 assets from its customers located in Cumberland year after year.

16
17 Q. DO YOU HAVE SIMILAR CONCERNS AND RESPONSE TO MR.
18 WOODCOCK'S RESPONSE TO THE NEXT QUESTION ON PAGE 22, LINES
19 13 THROUGH 15, WHERE HE SAYS, "THEREFORE, WHILE ALL OF PWSB'S
20 RATEPAYERS BEAR THE BURDEN OF INCREASED RATES TO PAY THIS
21 TAX, ONLY THOSE RATEPAYERS IN CUMBERLAND REAP THE BENEFITS
22 OF PAYING LOWER TAXES."?

23 A. Yes, I do. In my view, Mr. Woodcock continues to mis-characterize the purpose
24 of property taxes, the benefits derived from payment of any legitimate tax, and
25 the established preference of spreading these costs to all customers. The

1 parties in interest or "sides" with respect to this issue are the party that levies the
2 property tax - Town of Cumberland, and the party responsible for paying the tax -
3 the PWSB (the owner of the pipes).

4
5 **Q. IN HIS RESPONSE TO THE NEXT QUESTION (LINES 1 TO 19, PAGE 23),**
6 **MR. WOODCOCK MAKES A DISTINCTION BETWEEN REAL PROPERTY**
7 **AND TANGIBLE PROPERTY AND INDICATES HIS WILLINGNESS TO**
8 **ALLOW THE STATUS QUO FOR REAL PROPERTY. DO YOU AGREE WITH**
9 **THIS?**

10 A. No, the Courts will decide which portion of the tangible tax are properly taxed at
11 the tangible rate and which may be taxed at the real estate rate, and the proper
12 valuation for each. Depending on the decision in the pending court case, there
13 could be significant transfers of property taxes from those taxed at the tangible
14 tax rate to those taxed at the lower real estate tax rate. There could also be a
15 significant reduction in valuation, followed by refunds. But, ultimately the
16 remaining tangible property tax allowed by the Courts should be recovered in the
17 traditional manner that was supported for many years by the PWSB before the
18 valuation increase triggered the dispute.

19
20 **Q. PLEASE CONTINUE WITH MR. CATLIN'S TESTIMONY WITH RESPECT TO**
21 **THIS ISSUE.**

22 A. Mr. Catlin's testimony is generally in agreement with Mr. Woodcock's. Having
23 read Mr. Catlin's testimony in the prior PWSB case concerning the proposed
24 surcharge, and in testimony as summarized by the Commission in Docket 2048
25 for Providence Water, it is apparent that Mr. Catlin has reversed his position on

1 this issue. In PWSB's last full case he testified that, "property subject to taxation
2 is normally used for the benefit of all customers. Under such circumstances, it
3 would be inappropriate to recover the property taxes assessed by a given
4 municipality. Instead, it is normally appropriate that all property taxes be
5 recovered from all customers as part of base rates." In the Providence Water
6 case (Docket 2048), Mr. Catlin rejected Providence Water's proposal to
7 implement a surcharge (i.e., geographic rate differential) that would have allowed
8 it to charge an additional amount to only customers served in the special
9 pumping zones. He pointed out that "other customers are not charged different
10 rates depending on their location, elevation, or other similar factors which may
11 affect the cost of serving them." He also testified that "the surcharges proposed
12 for these so-called pumping zone customers are unwarranted in view of the
13 nominal impact spreading the costs would have on all ratepayers." The only
14 difference between this case and the prior Providence Water case is the type of
15 expense involved. It is not clear at all why he decided to completely change his
16 position on this important issue in the present case.

17
18 **Q. ON PAGE 10, LINES 6 AND 7, MR. CATLIN STATES, "THE TANGIBLE**
19 **PROPERTY UPON WHICH THE TOWN OF CUMBERLAND ASSESSES**
20 **PROPERTY TAXES CONSISTS ALMOST EXCLUSIVELY OF DISTRIBUTION**
21 **PIPES LOCATED IN THE TOWN." DO YOU AGREE WITH THAT**
22 **STATEMENT?**

23 **A.** No. From the valuation study performed by Mr. O'Leary, which has been
24 introduced by Mr. Bruce, it is clear that the tangible property upon which the tax
25 has been assessed includes many general benefit facilities in addition to

1 distribution pipes. These general benefit facilities include such items as: a 23
2 million gallon aeration basin, a 500,000 gallon clearwell, a 17 million gallon
3 settling basin, flocculators, a dam, two large below surface pumps, 6 and 12
4 million gallon capacity pumping stations, a 1.5 mile – 4 foot diameter
5 transmission pipeline that carries water from PWSB’s treatment plant to
6 Cumberland, lab equipment, and various miscellaneous tangible assets such as
7 furniture, computers, and other machinery and equipment.

8
9 **Q. FURTHER DOWN IN THAT LINE OF QUESTIONING MR. CATLIN STATES,**
10 **“IN CONTRAST, THE TANGIBLE PROPERTY SUBJECT TO TAXATION IN**
11 **CUMBERLAND IS NOT PROPERTY UTILIZED FOR THE GENERAL BENEFIT**
12 **OF ALL RATEPAYERS.” DO YOU AGREE WITH THAT STATEMENT?**

13 **A.** No, I do not, for several reasons. First, as just explained, the tangible property
14 taxed in Cumberland includes a very substantial portion of general benefit
15 facilities. Second, a significant portion of the “pipe” assets in the tangible
16 property classification are used for the general benefit of PWSB’s system.
17 Principal among these are:

18
19 ➤ The raw water and/or distribution pipes that allow the surface water
20 sources (located in Cumberland) and several well water sources
21 (located in Cumberland) to flow from these sources to the treatment
22 plant and/or directly into the entire PWSB distribution system.

23
24 ➤ The pipes including 1.5 miles of transmission pipe on the output side of
25 the treatment plant that feed into the PWSB distribution system and

1 through which all treated water must flow to reach any customer on the
2 system, whether they are located in Pawtucket, Central Falls, or
3 Cumberland.

- 4
- 5 ➤ A substantial portion of Cumberland Water Department's distribution
6 system (pump stations, storage tank, pipes, etc.) in CWD's service
7 area is utilized daily to bring water and fire protection service to nearly
8 350 PWSB customers in the Terrace Heights section of Cumberland.
9 CWD provides this significant benefit to the PWSB on an ongoing
10 basis without any charges to PWSB.

11

12 And third, as I explained above (page 10, lines 13 - 17), all of PWSB's customers
13 benefit from paying the property tax on all PWSB pipes in Cumberland because
14 PWSB maintains the privilege of having a larger customer base which allows all
15 customers to share in having lower average fixed costs.

16

17 **Q. ON PAGE 10, LINES 22 TO 24, MR. CATLIN STATES, "NEITHER THE CITY**
18 **OF CENTRAL FALLS NOR THE CITY OF PAWTUCKET ASSESS PROPERTY**
19 **TAXES ON THE DISTRIBUTION PIPES (OR ANY OTHER TANGIBLE**
20 **PROPERTY) LOCATED IN THEIR JURISDICTION." DO YOU AGREE WITH**
21 **THAT STATEMENT?**

22 **A.** Yes, I believe it is true that the other two communities served by PWSB do not
23 charge property taxes on the distribution system pipes located in these towns.
24 However, in both cases the community that would charge the tax is the owner of
25 the pipes. They could try to institute PILOT (Payment-In-Lieu-Of-Tax) taxes, but

1 the only property owners that would benefit would be those that are not
2 customers of PWSB. All others would lose the deductibility (for income tax
3 purposes) of any lessening of their property tax due to the shift to a utility
4 surcharge. Thus, while the statement may be true, its relevance is unclear at
5 best, and the conclusions he draws from it are not valid.

6
7 **Q. YOU HAVE PROVIDED SEVERAL REASONS WHY YOU BELIEVE THAT THE**
8 **SURCHARGE PROPOSAL IN THIS CASE SHOULD BE REJECTED BY THE**
9 **COMMISSION. PLEASE PROVIDE A SUMMARY OF YOUR FINDINGS AND**
10 **CONCLUSIONS WITH RESPECT TO THE TANGIBLE TAX ISSUE.**

11
12 **A.** Certainly, I would be glad to. The following is a list of my major findings and
13 conclusions relative to the proposed tangible tax surcharge. Where appropriate,
14 each point listed is followed by a brief description of why the item supports the
15 arguments favoring continued use of the traditional ratemaking recovery of this
16 legitimate expense.

- 17
18 ➤ All parties agree that tangible property taxes on water utility assets in Rhode
19 Island are lawful and must be recovered through water rates in some manner.
20
21 ➤ Property taxes on all types of utility assets are very common in Rhode Island
22 and nationally, and their recovery is universally (or nearly universally) through
23 the traditional method of spreading/sharing the costs among all customers of
24 the utility involved.
25

- 1 ➤ The record in this case demonstrates that the taxing of tangible assets owned
2 by water utilities in Rhode Island is not unique. In fact, several communities
3 currently have such taxes in effect and have for many years, and the cost of
4 these taxes have been spread to all customers of the utility, not a small
5 subgroup.
- 6
- 7 ➤ Imposition of the surcharge proposed in this case completely defeats the
8 purpose of the tangible property tax levied by Cumberland in that the burden
9 of paying the tax would be taken away from the owner of the assets (PWSB)
10 and shifted to others that do not own the property. "Others" here includes a
11 selected group of PWSB's ratepayers and other citizens in Cumberland who
12 are not even customers of PWSB, but are customers of the CWD. This
13 strikes me as being patently inappropriate, and could be an illegal shifting of
14 tax burden to others that have no ownership interest in the assets being
15 taxed.
- 16
- 17 ➤ It is the very rare exception rather than the rule to segregate a particular cost
18 of providing service from all others and to target its recovery from a particular
19 subgroup of customers. To my knowledge, the PWSB does not treat any
20 other cost it incurs in this manner, and it appears that it has not done so in the
21 past.
- 22
- 23 ➤ Property taxes allow communities to recover a large part of the costs they
24 incur in providing municipal services in an equitable manner that
25 proportionately shares those costs between property owners with assets

1 located in their community, based on the relative values of those assets
2 owned by each property owner. In exchange for these tax payments,
3 businesses and utilities earn the right and privilege of having those assets in
4 the community with the continuing ability to do their business or provide their
5 service in that community and earn a return or collect revenues through the
6 use of those assets. This is not a "tangible" benefit like the purchase of fuel
7 or chemicals, but it is a critical benefit/privilege received by those
8 businesses/utilities that pay this cost of doing business. To claim that the
9 utility that owns those assets and hence all of their ratepayers receive no
10 benefit from payment of such taxes ignores this traditional and mutually
11 beneficial transaction.

12
13 ➤ A significant portion of the tangible assets owned by the PWSB in
14 Cumberland are facilities that benefit all customers of the PWSB. All parties
15 agree that these general benefit facilities and their associated property taxes
16 should continue to be recovered in the traditional manner. Unless a
17 settlement can be reached, the determination of dollar amounts assigned to
18 each classification of real property and tangible property can only be decided
19 by the state Courts.

20
21 ➤ To some degree, even so-called special benefit facilities such as distribution
22 pipes or pumping facilities provide some benefit to all customers served by
23 the same utility. The benefit for distribution pipes results from the fact that the
24 greater the length of pipes installed, and hence their assessed value, the
25 greater the number of customers that can be served by the utility (for example

1 through line extensions to serve new streets and/or developments). The
2 larger the customer base, the greater the number of customers there are to
3 spread fixed costs over, lowering average fixed costs per customer. All
4 customers benefit from lower average costs through lower average charges.

5
6 ➤ Establishing a new ratemaking paradigm as suggested by PWSB would open
7 a Pandora's Box for any customer or group of customers looking to reduce
8 their utility rates (water, sewer, gas, electric, etc.) by shifting costs to other
9 groups. This would also increase the level of rate case complexity and in turn
10 increase the level of rate case expenses that would be passed on to all
11 customers, in all rate cases involving special surcharges designed to shift one
12 or more costs of doing business to one or more sub-groups of customers.

13
14 ➤ In theory, the type of surcharge proposed here could be appropriate, but only
15 in extraordinary situations, and only after satisfying three strict criteria. First,
16 the surcharge must be significantly more equitable than the traditional cost
17 recovery approach. Second the expense must be extraordinary in nature.
18 For example, it could be an expense that is significantly greater than normal
19 levels experienced by the utility or most utilities. And third, the impact to
20 individual customers (from spreading it to all customers) must be greater than
21 nominal or minimal. In my opinion, none of these criteria are satisfied in this
22 case.

23
24 ➤ All parties agree that at least the portion of the property tax associated with
25 real property should continue to be paid by PWSB and recovered from all

1 customers in the traditional manner. It appears that a significant portion of
2 the assets currently classified as tangible may be reclassified in the pending
3 litigation as real property. To the extent this happens, the assessed value of
4 tangible property will decrease and in turn decrease the associated tax
5 proportionately. Refunds will be given for overpayments, if any. And, future
6 taxes may be reduced.

7
8 ➤ Notwithstanding the many objections provided herein, the level of the
9 proposed surcharge in this case is significantly overestimated. This is due to
10 two factors. First, as explained by Mr. Bruce, the rate year estimate of the
11 Cumberland tangible property tax itself is high by as much as \$86,000.
12 Secondly, if the total sales to Cumberland (both wholesale and retail) is the
13 appropriate level of sales to spread the cost over, in the last three years it has
14 averaged about 100,000 cubic feet more than the number used, and Chris
15 Collins estimates that Cumberland Water's 2006 wholesale consumption will
16 be much greater than what PWSB has used in its projections. Furthermore,
17 to the extent a settlement or a decision by the State Courts lowers the amount
18 and/or value of tangible assets, the rate year tangible tax estimate would
19 somehow have to be lowered by a corresponding amount (either before or
20 after this rate case is decided). Refunds would be paid and would need to be
21 applied to the benefit of those ratepayers who paid the tangible taxes. All of
22 these potentially thorny problems are eliminated (or significantly reduced) if
23 the traditional method of collecting the tax is continued.

1 ➤ The impact of spreading this cost to all customers has a minimal or nominal
2 effect on each customer. Mr. Catlin has used this argument in prior cases
3 where the same surcharge strategy was proposed for the additional cost of
4 pumping water to customers in high elevation zones. For example, in the
5 Providence Water Case (Docket 2048) he testified that “other customers are
6 not charged different rates depending on their location, elevation or other
7 similar factors which may effect the cost of serving them.” (Order at 30) Mr.
8 Catlin also testified that the proposed surcharge for the pumping zone
9 customers was unwarranted “in view of the nominal impact spreading the cost
10 would have on all ratepayers.” (Order at 30) Even at the proposed level of
11 tangible tax, which represents the high end of the possible range, this tax is
12 only about 2% of PWSB’s total revenue requirement. If the so-called general
13 benefit facilities are somehow separated from the tangible assets and the rate
14 year estimate of the tangible tax is reduced to the level suggested by Mr.
15 Bruce in his testimony, the tangible tax would be in the order of 1% to 1.5% of
16 PWSB’s total revenue requirements. At the high end of the range these
17 levels are close to levels experienced in the past; and at the low end of the
18 range, the tangible tax would be below historic levels, which the PWSB paid
19 for many years without any appeal and recovered the associated expense
20 from all customers in the traditional manner.

21
22 Using Mr. Woodcock’s numbers, a typical (10,000 cubic feet or about 75,000
23 gallons per year) residential non-Cumberland customer would only save
24 about \$3.17 per quarter (\$12.68 per year) if the surcharge was denied, while
25 a customer in Cumberland using the same amount of water would have to

1 pay an additional \$14.48 per quarter (\$57.92 per year) if the surcharge were
2 approved as proposed. Therefore, the difference in these two scenarios
3 means that for every \$1 saved by a non-Cumberland typical residential
4 customer if the surcharge were implemented, a similar Cumberland customer
5 would have to pay an additional \$5.

- 6
- 7 ➤ The proposed surcharge would allocate a significant portion of the expense to
8 PWSB's wholesale customer – the Cumberland Water Department (CWD).
9 The CWD and its retail customers receive absolutely no benefit from the
10 distribution pipes in the section of Cumberland served by PWSB. If one
11 assumes, solely for the sake of argument, that PWSB's argument that their
12 customers (in Pawtucket and Central Falls) that do not receive any benefit
13 (physical) from Cumberland's pipes should not have to pay any portion of the
14 of the tax on those pipes is valid, then why shouldn't PWSB apply the same
15 principle to its customer the CWD? To be logically consistent, the simple
16 answer is they should. However, if they were consistent they would have to
17 compute and apply the surcharge based only on the sales to retail customers
18 in the Valley Falls section of Cumberland. This would result in a huge
19 increase to those customers. Had Mr. Woodcock only included the retail
20 sales in Cumberland in calculating his proposed surcharge, it would have
21 resulted in a surcharge of \$1.44 per HCF, which is two and a half times larger
22 than his proposed surcharge which includes the wholesale sales to CWD.
23 This would add even greater weight to the argument that a nominal or
24 minimal increase to all PWSB customers is preferred to a rate design that
25 results in a very large increase to a small group of targeted customers.

1 Again, this is the reason for the widespread use of the traditional approach of
2 averaging such costs over all customers.

3
4 ➤ This situation is somewhat different in that only one of three communities
5 served by the same utility has a property tax on tangible assets owned by that
6 utility. In many cases where one utility serves neighboring communities, all or
7 most of those communities tax all assets of that utility for those facilities
8 located in their city/town. In this case, if either Central Falls and/or Pawtucket
9 taxed (through property taxes or PILOT assessments) PWSB's assets in their
10 communities, this issue would probably not have been raised. Is it fair or
11 equitable to penalize one town, or the customers located therein, because
12 one or more other communities served by the same utility either decide not to
13 tax those assets or are unable to do so. In my opinion, it would not be.

14
15 ➤ If the assets in Cumberland currently classified as tangible property include a
16 sizable portion of real property assets, then both Mr. Woodcock and Mr.
17 Catlin have testified that the tax on those assets should be deducted from the
18 tax on tangible assets and that amount should not be included in the
19 computation of the proposed surcharge. If a settlement or a Court decision
20 results in such a reduction in the tangible tax in Cumberland, then the
21 surcharge calculation should be reduced by the same amount. For example,
22 if it is decided that 25% of the currently classified tangible asset value in
23 Cumberland should be taxed at the lower real property rate, then all else
24 being equal, the computation of the surcharge should be reduced by 25%.
25 Similarly, if it is decided that 50% of the currently classified tangible asset

1 value in Cumberland should be taxed at the lower real property rate, then all
2 else being equal, the computation of the surcharge should be reduced by
3 50%. Similar reductions could be realized by reducing the assessed value of
4 the assets by comparable percentages. To the extent either or both of these
5 factors (tax rate and assessed value) results in a significantly lower tax on
6 tangible assets in Cumberland, the proposed surcharge would be significantly
7 higher than it should be.

8
9 **Q. WHAT IS YOUR RECOMMENDATION WITH RESPECT TO THIS ISSUE?**

10 A. Based on all of the foregoing, it is my recommendation that the Commission
11 reject the surcharge proposed by the PWSB in this Docket. Additionally,
12 Cumberland should continue to maintain a contingency reserve fund in case a
13 settlement of the contested property tax or a Court decision results in
14 refunds of previously collected property taxes from the PWSB.

15
16 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

17 A. Yes, it does.

DAVID F. RUSSELL, P.E.**CAREER SUMMARY:**

Since the early 1970s Mr. Russell has been professionally involved in the management, control and regulation of public utilities in the Northeast. He has worked for two regulatory agencies; in MA. – the Department of Telecommunications and Energy – as its Chief Engineer; and in NJ. – the Board of Public Utilities – as a special consultant to the Chief Economist. He has held senior engineering and management positions for two New England electric utilities (Eastern Utilities Associates and Unitil Service Corp.), and one in NJ./PA. (General Public Utilities). He has also been a principal management consultant for a major engineering company (Camp, Dresser & McKee, Inc.) at its headquarters in Boston/Cambridge, MA. for several years. Over the past 10 years he founded and developed a successful consulting business with offices centrally located in New England, about 30 minutes north of Boston, in Newburyport, MA.

He is an Engineer and Economist by training (BSEE from Rutgers College), and has advanced degrees in Engineering Management (MS. from Northeastern Univ.) and Economics (MA. from Rutgers Univ.) specializing in resource and regulatory economics. He has testified before three of the six Public Utility Commissions in New England (and several others nationally) on many occasions as an expert on utility management, finance, rate design and cost of service studies, and related customer service issues. He is a Registered Professional Engineer in MA. (License No. 28324) and NJ. (License No. 26512). He has authored several papers published in professional journals, and has presented his work at many professional seminars and industry conferences.

Mr. Russell has been a lead technical negotiator for several municipal clients in negotiating multi-million dollar contracts with private utilities and energy customers. He has prepared numerous reports and technical presentations for utility CEO's; and municipal, regional and state governments. He has been responsible for the planning, review and feasibility analysis of numerous utility capital improvement projects, totaling many billions of dollars. This included a broad spectrum of utility facilities (electric, gas, water, sewer and solid waste facilities) - production plants, transmission facilities, and distribution systems. He has also led teams of consultants in the appraisal of utility system components and entire systems (all assets). He has considerable international experience having worked for many other countries, including Mexico, Columbia, Egypt, Sri Lanka and the Bahamas. For the Government of Egypt he has worked on several projects each of which involved the feasibility and implementation of public-private partnerships in both the water and wastewater sectors.

PROFESSIONAL EXPERIENCE:**RUSSELL CONSULTING****Public and Private Utility Consultant, 1995-Present**

Provides management and financial consulting services to public and private utilities, municipalities, governmental agencies and private companies. Areas of expertise include

management consulting, management reviews and audits, rate design and cost of service studies, appraisals of utility plant and equipment (including GASB-34 Compliance), utility contracts and negotiations, performance enhancement and benchmarking, utility economics, power markets and deregulation, and the feasibility and implementation of public-private partnerships. *RUSSELL CONSULTING* has teamed with other consulting firms to successfully complete several multi-disciplinary projects for International clients.

Unitil Service Corp.

Director of Regulatory Services, 1993-1994

Managed the staff and resources of the Regulatory Services Department for this regional utility holding company. Areas of functional responsibility included sales and load forecasting, customer and load research, rate research and analysis, rate design, rate and tariff administration, revenue requirements and cost of service studies, economic analysis, demand side management (DSM) planning, program design and evaluation, and related analytical services. Responsible for insuring that rates and cost recovery for the retail companies contributed positively to the continued financial strength of the corporation and that positive regulatory relations were maintained. Successfully developed and maintained expanded DSM programs in Massachusetts and New Hampshire. Also responsible for preparing and filing each retail company's Least Cost Integrated Resource Plans, covering the next 10 years, including the first Integrated Gas Resource Plan. Successfully managed and coordinated an external (PUC) audit of the accounting and control of all DSM expenditures by the affiliated retail companies in New Hampshire.

Camp, Dresser and McKee, Inc.

Principal Management Consultant, 1985-1993

Took a lead role in many projects including management audits, financial feasibility reports, privatization studies and rate/cost of service studies for a wide range of municipal and private utilities. Gained international experience as a financial advisor to the World Bank, the Governments of Egypt and Mexico, and the Water and Sewerage Authority of the Bahamas. Served as project manager for management audits.

Eastern Utilities Associates

Section Manager, 1982-1985

Responsible in the Rate Department for the development and implementation of several pass-through rate clauses designed to recover specific capital and operating costs based on customer demands and/or total use. These cost recovery mechanisms included fuel, purchased power and oil-conservation adjustment clauses. Was lead engineer for cost of service and rate design studies prepared for rate cases involving affiliated retail electric companies. Also played a key role in rate filings before the Federal Energy Regulatory Commission for the Company's wholesale affiliate. Responsible for all PURPA-related programs for the Company's retail affiliates in Massachusetts and Rhode Island.

New Jersey Board of Public Utilities

Consultant, 1981-1982

Participated in the development of standard purchase and sale rates for cogeneration facilities and small powerplants, as required by PURPA. Presented the staff's case on rate-of-return issues involving proposed rate increases by major electric and gas utilities.

General Public Utilities

Senior Engineer, 1978-1980

Provided in-house consulting services to the Corporate Planning Division. Instrumental in implementing the system-wide strategic planning process. Also assisted the Forecasting, Load Research and Supply Planning Groups in determining the need for new power plants and least-cost alternatives. This work included the development of the firm's conservation and load-management programs (the first in the industry).

Commonwealth of Massachusetts, Department of Public Utilities

Chief Engineer, 1971-1978

Reviewed, conducted public hearings and reported on the need for and costs of major construction projects proposed by electric and gas utilities including powerplants, substations, transmission lines and gas storage facilities (LNG, SNG and Propane) and gas pipelines. Was instrumental in developing the State's gas-pipeline safety code and was responsible for the gas-pipeline safety program funded by the U.S. Department of Transportation. Also helped to design and implement the Cost of Gas Adjustment clause for all retail gas utilities. Managed the environmental review process, which included writing internal procedures, the Scope of Work for major facilities, and Statewide rules and regulations. Was appointed by the Governor to the Cogeneration Commission and the Public Power Commission.

RELATED PROFESSIONAL EXPERIENCE:

- Registered Professional Engineer in Massachusetts (28342) and New Jersey (26512).
- Author of several papers published in professional journals.
- Numerous presentations at regional and national meetings of professional organizations.
- Provided expert testimony in numerous quasi-judicial proceedings before several state public utility commissions and legislative committees.
- Part-time instructor at Boston University teaching undergraduate and graduate courses in Economics, Management Science and Finance.

PROFESSIONAL MEMBERSHIPS:

- American Public Power Association
- American Water Works Association, Member of the Rate and Charges Committee [Also a member of the Financial Management (Co-Chairman) and Conservation (Chairman) Committees of the New England Chapter]
- International Water Resources Association (Peer Review Editor)
- Institute of Electrical and Electronics Engineers (Power Engineering and Engineering Management Sections)
- National Society of Professional Engineers
- Rutgers Engineering Society
- Water Environment Federation (Member of the Management & Admin. Committee)

EDUCATION:

- Rutgers University, MA in Economics (Resource and Regulatory Economics), Research Assistantship with Full Scholarship, 1984
- Northeastern University, MS in Engineering Management (Operations Research and Finance), 1977
- Rutgers College, BS in Electrical Engineering, Alumni Scholarship (full tuition and expenses), 1971

PUBLICATIONS/PRESENTATIONS: Author of several papers published in professional journals and presentations given at regional and national conventions.

EXPERT WITNESS SERVICES: Provided expert testimony in numerous quasi-judicial proceedings before several state Public Utility Commissions and Legislative Committees. Areas of expertise include many of the issues and topics outlined above.

COMMUNITY SERVICE: Chairman of the Planning Board, City of Newburyport, Ma.; Chairman of the Mayor's Special Task Force on Police Facilities; Member of the Merrimack Valley Planning Commission; I.C. Parish Council; Treasurer for the City Committee (Major Political Party); and Treasurer for the region's State Representative.

ADJUNCT PROFESSOR: Part-time instructor at Boston University teaching Undergraduate and Graduate courses in Economics, Management Science and Finance.

WHO'S WHO IN AMERICA: His biography was included in the Millennium and all subsequent Editions of Marquis' Who's Who in the America, and will be in the 2005 Edition.

PERSONAL: U.S. Citizen Married, three children.
FED. ID#: 04-3568177 1st Lt., U.S Army NG (Inactive Res.)