STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: NARRAGANSETT BAY COMMISSION :
APPLICATION FOR GENERAL RATE RELIEF : DOCKET NO. 3797

REPORT AND ORDER

On December 1, 2006, the Narragansett Bay Commission ("NBC") filed with the Rhode Island Public Utilities Commission ("Commission") an application for rate relief seeking an increase of its existing rate schedule to become effective on January 1, 2007. The proposed rates were designed to generate total revenues of $72,492,877 and if approved, as filed, would increase NBC's present revenues by $4,798,797 or an across-the-board rate increase of 7.44%. For a typical residential customer, using 97 hcf of water per year, NBC's annual bill would increase from $324.96 to $349.10. At an open meeting on December 19, 2006, the Commission suspended the proposed rate increase.

The instant rate case filing represents NBC's eighth rate filing in the last seven years. This rate case filing does not relate to debt service for the Combined Sewer Overflow Abatement Program ("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	$ 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	$6,010,883	$69,295,022
3797	12/1/06	$ 4,798,797		

I. NBC

On December 1, 2006 NBC submitted pre-filed testimony by Walter Edge, and Ms. Maureen Gurghigian, who are outside consultants. In his prefiled testimony, Mr. Edge indicated that the general rate filing encompasses increases in personnel expenses and operating costs, but does not include any increase for debt service costs. Mr. Edge utilized the fiscal year ending June 30, 2006 as the test year, and the fiscal year ending June 30 2008 as the rate year.

Mr. Edge made various adjustments to test year revenue accounts. First, Mr. Edge adjusted test year revenues to reflect the additional revenue increases granted to NBC in Docket Nos. 3707 and 3775. Next, he eliminated $2,032,812 of interest income earned during the test year period on project and debt service funds because this interest income is not available for operations. As in previous cases, he eliminated Environmental Enforcement revenues totaling $81,398 and related expenses in the accounts for public outreach totaling $6,991, and other services totaling $42,738. Mr. Edge explained that this revenue account and related expenses are legislatively mandated. In addition, Mr. Edge removed all grant revenues, which totaled $20,695, and an identical amount of grant expenses charged to non-union salaries because the revenue is not available to pay for normal operations. Also, Mr. Edge eliminated capital contributions received from an EPA grant for capital project costs reimbursement totaling $1,165,958 because these funds may only be used for certain capital items and are not available for operations. Lastly, in miscellaneous income, Mr. Edge eliminated the $27,997 Workers' Compensation check received by NBC because NBC does not expect to receive any further dividends.

Next, Mr. Edge made adjustments to test year expense accounts. First, he brought various expense accounts in line with expense adjustments made in Docket No. 3707 in the following areas: union pension, biosolids disposal, bad debt expense, solids handling repairs, oil for solids handling, fuel-gas, fuel-gas for solids handling, electricity, chemicals-polymer, supplies for solids handling, and the net operating reserve, Also, he made a small normalizing adjustment to Workers' Compensation Insurance account in the amount of $26,697 as a result of a Workers' Compensation audit for the test year, which was paid in a subsequent year. In addition, Mr. Edge eliminated a one-time loss in the equipment losses account in the amount of $734,185, which was the result of NBC selling Plat 56, Lots 341 and 342 on Field's Point Drive. Furthermore, Mr. Edge removed depreciation and all but $9,690 of the annual amortization expense related to Bucklin Point because NBC is regulated on a cash basis and not on a GAAP basis. Lastly, he added the cost of debt service principal payments and interest, as approved in Docket No. 3775.[1]

In making adjustments to the rate year, Mr. Edge explained that he left 63 expense accounts and 5 revenue accounts with test year balances of less than $200,000 at test year levels. For the 13 capital outlay accounts, Mr. Edge made no adjustment since NBC pays for capital outlays utilizing carry-forward funds from NBC's prior year debt coverage allowance. In the revenue accounts, Mr. Edge used the actual test year revenues for the five major revenue accounts, which are flat fees – residential, measured fees – residential, flat fees – commercial and industrial, measured fees – commercial, and measured fees – industrial. He also indicated that NBC's consumption levels have been declining over the past few years. As for pretreatment fees, connection permits fees, BOD/TSS Surcharge

[1] NBC Ex. 1 (Edge's direct testimony), pp. 8-10.

and septage fees, Mr. Edge left these accounts at test year levels. Although individually these accounts move in different directions, Mr. Edge noted that in total these four accounts have remained stable over the last four years, ranging from $1,998,070 to $2,062,436 in revenues. Various accounts such as miscellaneous operating income, environmental enforcement, reimbursed collection costs, grant revenue and capital contributions were left at their adjusted test year level of having a zero balance. The abatement fee and miscellaneous income accounts were left at the adjusted test year levels because the amount in these accounts was less than $200,000. For interest income, Mr. Edge increased the adjusted test year amount from $450,576 to $600,000 to reflect higher short-term interest rates. Mr. Edge maintained late charge revenues at the test year level of $447,672 and indicated these revenues have remained steady over the last four years.[2]

Mr. Edge reviewed the expense accounts for the rate year. In the areas of personnel expense, he indicated that NBC's approved rates have not reflected a salary increase since fiscal year 2005. He started his calculation by using the test year level for salary expense for non-union and union employees. The only adjustment to the test year Mr. Edge made was to eliminate one union position and replace it with a non-union position, and he noted the value of the two positions is about the same. Next, he increased the adjusted test year salaries by 3.75% for fiscal year 2007 and 4.5% for fiscal year 2008, which represents COLAs of 2.75% and 3.5% for fiscal years 2007 and 2008, respectively, and a 1 percent step increase. Also, Mr. Edge removed the grant related salaries from non-union payroll. As a result, Mr. Edge increased non-union salaries by $619,819 and union salaries by $343,445. Furthermore, he calculated the salary and

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[2] Id., pp. 12-15.

fringe reimbursement for capital projects and it resulted in a salary reimbursement adjustment of $83,493 and a fringed reimbursement adjustment of $45,888. In addition, since salaries are increasing, Mr. Edge made corresponding rate year adjustments to the overtime expense and FICA. Also, Mr. Edge projected a union pension increase of $77,955. Mr. Edge explained that NBC's union employees are participants in the State of Rhode Island pension plan and that the State of Rhode Island has increased the employer contribution to 20.77% for fiscal year 2008. As for non-union pensions, Mr. Edge asserted that the "non-union pension is calculated in the same manner as NBC's prior dockets at 10% of non-union salaries." In addition, Mr. Edge did not make an allowance for turnover in this docket because he indicated that the turnover allowance is already built into the actual test year payroll. In the test year, Mr. Edge stated that there was an average number of 244 employees.[3]

Specifically, in the area of health insurance, Mr. Edge explained that NBC's union employees receive retiree health insurance. He noted that the State of Rhode Island is implementing and funding GASB 45, Other Post Employment Benefits ("OPEB"), in fiscal year 2008. As a result, the employer's retiree health care percentage of salaries will increase from 2.74% to 8.57%, which is an increase of $324,610. For employee health insurance costs, Mr. Edge calculated the rate year expense by multiplying the number of employees in each type of coverage by the rate that will be paid in the rate year. Mr. Edge determined the rate year health insurance rate by using the average of the prior two years' percentage increases, less future savings from design

[3] Id., pp. 15-17.

changes negotiated in the union contract as well as premium co-pays by union and non-union employees as set forth in the union contract.[4]

As for other operating expenses, Mr. Edge focused on a few accounts. First, Mr. Edge indicated that biosolids disposal will increase significantly from $4,252,945 to $4,880,394, an increase of $627,449. Pursuant to the contract related to Field's Point and Bucklin Point, there is a true-up CPI adjustment of approximately 17 percent for fiscal year 2007 and a modest CPI adjustment for fiscal year 2008. Second, Mr. Edge stated that the maintenance/service agreement account will be $627,758 for the rate year, which is an increase of $210,891. Third, Mr. Edge increased the insurance expense and worker's compensation accounts from the total adjusted test year amount of $648,779 to $818,159. He calculated the actual costs of the insurance and worker's compensation for the interim year, fiscal year 2007, and then increased worker's compensation by the average percentage increase over the past three years. Fourth, Mr. Edge estimated the regulatory rate year expense at $266,741. Fifth, Mr. Edge increased the management/audit services account. The largest item in this account is the Management Contract for Bucklin Point treatment facility. This contract is adjusted annually using a 3.55% CPI adjustment factor for two years. Also, due to increased usage of chemical soda ash, the soda ash paid through the management contract will increase from $228,308 in the test year to $440,000 in the rate year.[5]

Regarding the operating reserve, Mr. Edge requested that the Commission depart from its position in the last docket when it excluded debt service as well as salaries and wages from the calculation of NBC's operating reserve. Mr. Edge argued that an

[4] Id., p. 17.
[5] Id., pp. 18-19, Schedule WEE-9.

operating reserve should cover adverse variances in revenue projections, and indicated NBC has suffered shortfalls in revenue in excess of the old calculation of the operating reserve. He emphasized that approximately 66% of NBC's total revenue is generated from billings related to water usage. He also noted that a 1.5% reserve on operating expenses less debt service and payroll is closer to 0.5% on combined revenues and operating expenses. However, if the Commission approved the establishment of an Operation and Maintenance ("O & M") Reserve Fund then NBC would be willing to recalculate net operating reserve in the same manner as it was calculated by the Commission in the last docket. Mr. Edge indicated that NBC is requesting to be allowed to use a portion of the carry-forward restricted funds from the prior year debt coverage allowance to fund the O & M Reserve Fund over a period of 7-10 years at an amount equal to approximately 25% of NBC's annual operating and maintenance costs. He noted that the O & M Reserve Fund was established under the Trust Indenture and is currently unfunded. He stated that funding the O & M Reserve Fund will improve NBC's financial position in the eyes of bond rating agencies. Mr. Edge asserted that funding the O & M Reserve Fund will be "at no cost to the ratepayers" nor will the revenue requirement be increased. Also, he maintained that the carry-forward not available for projects will be offset by lower future borrowing costs and in fact, if NBC can get its bond rating increased, future borrowing costs could be reduced. After calculating his proposed revenue increase, Mr. Edge indicated that NBC is requesting that the increase be implemented on an across the board basis.[6]

In her pre-filed testimony, Ms. Gurghigian discussed in greater detail the request to fund the O & M Reserve Fund. Ms. Gurghigian noted that as of October 30, 2007,

[6] Id., pp. 20-23.

NBC had outstanding debt of $363.7 million, and was projected to borrow $214.7 million from fiscal year 2007 through fiscal year 2012. To reduce the rate impact of its debt needs, NBC will continue to secure the maximum funding available through the low-interest loan program offered by Rhode Island Clean Water Finance Agency ("RICWFA") and for NBC to obtain the highest possible credit rating to lower the overall cost of borrowing. To enhance NBC's credit rating, NBC has implemented financial management initiatives such as defeasance of the State debt, wrapping longer term open market debt around the loans from the RICWFA, the issuance of variable rate debt, and closing each of the past 15 years under budget. Also, Ms. Gurghigian noted that the Commission strengthened NBC's credit rating by approving rates that generate 125% of principal and interest with the carry-forward used for pay-as-you-go capital. In addition, she indicated that the credit rating agencies viewed favorably the Commission's approval of multi-year rates for debt service, which enabled NBC to initiate the Variable Rate Debt Obligation ("VRDO") program. As a result, NBC's credit rating has been upgraded by Standard and Poor's from the initial A- to A in November 1998 and to A+ in September 2002.[7]

Ms. Gurghigian explained that prior to the issuance of the VRDO in April 2004, NBC executed a Trust Indenture, which is a contract between NBC and a bond trustee for the benefit of bondholders. The Trust Indenture sets forth the flow of funds, reserve requirements, and other such matters. These requirements assure bondholders and credit rating agencies that NBC can properly operate and meet its debt service obligations. Since the execution of the Trust Indenture, NBC has issued $115 million in open market revenue bonds, borrowed $70 million in loans from RICWFA, and in this fiscal year,

[7] NBC Ex. 2 (Gurghigian's direct testimony), pp. 3-4.

NBC will issue an additional $72.5 million in long-term debt. Although the O & M Reserve fund has not previously been funded, given NBC's outstanding debt and borrowing plans, Ms. Gurghigian asserted that an O & M Reserve Fund would be viewed favorably by credit rating agencies, and the O & M Reserve Fund may be used to meet unexpected costs associated with the operations of NBC's facilities. She recommended that NBC fund its O & M Reserve Fund at 25% of annual operation and maintenance costs over a time period of 7 to 10 years beginning in fiscal year 2008. Based on the 2007 NBC operating budget, this would result in a reserve level of approximately $8 million. Furthermore, she recommended that the O & M Reserve Fund be funded through the restricted carry-forward, which will reduce the funds available for pay-as-you-go-capital but would not require additional revenues to be raised through sewer user charges to fund the O & M Reserve. Although NBC's Board of Commissioners approved funding the O & M Reserve Fund, Commission approval is required because the Commission has restricted the use of these funds for debt service and pay-as-you-go capital.[8]

II. DIVISION

On March 21, 2007, 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 $3,005,858 or 4.4%. In the area of revenues, Mr. Catlin noted that Mr. Edge calculated revenues at present rates based on current units of service, which are referred to as "Prior Docket Weighted Rates". He disagreed with Mr. Edge's method of calculating rates because they reflect composite rates as calculated by NBC intended to account for the fact that NBC bills for consumption in arrears. Instead,

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[8] Id., pp. 4-6.

Mr. Catlin recommended that revenues should reflect the full annual effect of the rates that will be in effect during the rate year and the rates should be calculated utilizing the rates authorized in Docket No. 3775. Mr. Catlin's adjustment would represent an increase in revenue of $857,374.[9]

The next area Mr. Catlin discussed was health insurance costs. Because NBC incorrectly calculated the most recent two-year average percentage increase, Mr. Catlin revised the calculation using the accurate data. Also, Mr. Catlin disagreed with calculating NBC's dental premiums based on the maximum level allowed under NBC's contract with Blue Cross Dental, and instead calculated the dental premiums based on fiscal year 2007 rates adjusted to reflect the two-year average percentage increase. In addition, Mr. Catlin disagreed with NBC's level of employee health insurance co-payments. He stated that although there is a 6 percent cap on the percentage of total health insurance premiums for unionized employees in their contract, there is no such limitation for NBC's management employees. Furthermore, Mr. Catlin asserted that "it is not unusual for employers to require employees to bear much more than 6 percent of their health insurance premiums in today's environment of rapidly rising medical insurance premiums." As a result, Mr. Catlin recognized a level of rate year employee co-payment that does not reflect a 6 percent cap for non-unionized employees, which increases the rate year level for co-payments from $76,786 to $123,303. Also, Mr. Catlin updated the vision insurance expense to reflect the reduction in premiums which occurred since the 2006 test year. In total, Mr. Catlin calculated a total net health insurance expense of $2,889,371, a reduction of $94,557 in NBC's filed request. As for retiree health insurance, Mr. Catlin noted that the recently proposed budget for the State of

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[9] Div. Ex. 1 (Catlin's direct testimony), pp. 5-8.

Rhode Island for fiscal year 2008 has an employer contribution rate of 3.63 percent rather than 8.57 percent as indicated by NBC. Thus, Mr. Catlin reduced the retiree health insurance expense by $239,205.[10]

Mr. Catlin discussed other operating expenses. For biosolids disposal costs, Mr. Catlin adjusted the rate year level to reflect the actual contract disposal rate for July through December 2007 and the updated projection of the contract rate provided by NBC in a data response. This adjustment reduced the expense by $46,495. For bad debt expense, Mr. Catlin noted that NBC's claim of $160,000 is based on the amount of bad debt for fiscal year 2002. He indicated the net bad debt write-offs were $77,014 for fiscal year 2005 and $29,663 for fiscal year 2006 and the audited levels of uncollectible expense for those same two years were $110,701 and ($3,771), respectively. Accordingly, Mr. Catlin proposed setting the bad debt expense at $60,000, which is somewhat above the two-year average but represents a reduction of $100,000 in NBC's claimed rate year expense.

Regarding maintenance and service agreement costs, Mr. Catlin made several adjustments such as: adjusting fiscal year 2007 contract costs to exclude $15,202 for contract with Mythics, Inc.; reducing the fiscal year 2007 cost for a new contract with JSB-Surf Control because it is a three-year contract; increasing the Oracle system related costs to reflect the actual contract prices for fiscal year 2008; and adjusting the remaining contract costs to fiscal year 2008 levels by increasing the adjusted fiscal year 2007 costs by 14.15 percent. Mr. Catlin's adjustment reduced the maintenance and service agreement cost by $53,427 to $574,331. As to regulatory expense, Mr. Catlin excluded a $6,000 payment of RIPDES permit fees for Bucklin Point because the test year included

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[10] Id., pp. 8-11.

the permit fees paid for both 2004 and 2005. Also, Mr. Catlin reduced the annual PUC assessment by $30,673 by utilizing the actual fiscal year 2007 PUC assessment, which was increased to reflect the average annual increase over the last two years. In regards to the Bucklin Point management contract, which is indexed to the CPI, Mr. Catlin utilized a CPI escalation factor of 2 percent, which is based on the CPI increasing by 2 percent from January 2006 through January 2007. This reduced the rate year expense by $21,306.[11]

Mr. Catlin discussed a few other issues. Mr. Catlin recommended that $660,154 of funds, which are no longer required in the special master account in the event the Commission retained a CSO overseer, be used to offset NBC's operating costs over a two-year period. As for the O & M Reserve Fund, the Division does not object to allowing NBC to fund its O & M Reserve in the manner NBC proposed, but indicated that all interest earned on the invested funds should be treated as available income for setting rates. Mr. Catlin noted an O & M Reserve would result in an additional $8 to $9 million being set aside in a restricted account in addition to the substantial amounts of money set aside in other funds required by the bond indenture. In conclusion, Mr. Catlin recommended a 4.6 percent across-the-board rate increase for both flat fees and measured usage fees for residential, commercial and industrial customers.[12]

III. NBC'S REBUTTAL

On April 4, 2007, NBC submitted the rebuttal testimony of Mr. Edge. Mr. Edge agreed with many of Mr. Catlin's adjustments such as: residential measured use fees, biosolids disposal costs, bad debt expense, maintenance and service agreements, and

[11] Id., pp. 11-16.
[12] Id., pp. 16-18.

regulatory expense. He also agreed with the method used by Mr. Catlin in calculating the adjustment to the operating reserve of 1.5 percent of all of NBC's non-debt related operation expenses. Mr. Edge agreed with Mr. Catlin's adjustment to retiree health insurance but stated that if the State changed the funding percentage, NBC expected any shortfall to be addressed expeditiously by the Commission. Also, Mr. Edge agreed to the use of $660,154 in the special master account to be used to offset operations, but NBC wanted specific authorization in a Commission order and that this adjustment be treated as miscellaneous revenue for NBC. However, Mr. Edge disagreed with Mr. Catlin's use of a 2 percent CPI factor because the Bucklin Point management contract specifically uses the April CPI, which has not dropped below 3 percent in 2005 and 2006. Thus, Mr. Edge stated a 3.5 percent CPI factor is appropriate. Also, Mr. Edge stated NBC provided the wrong current rates for Vision Insurance and thus, the costs should be increased by $9,275.[13]

IV. DIVISION'S SURREBUTTAL

On April 18, 2007, the Division submitted the surrebuttal testimony of Mr. Catlin. He agreed with Mr. Edge that if the final State budget included a different percentage for retiree health insurance than what is currently in the proposed State budget, NBC should receive expedited treatment of any difference. He also agreed with Mr. Edge that the use of $660,154 of previously restricted special master funds should be treated as miscellaneous revenue in order to facilitate compliance with the bond indenture. In addition, Mr. Catlin agreed to use the correct Vision Insurance rates provided by Mr. Edge. However, Mr. Catlin did not agree with Mr. Edge's CPI factor for the Bucklin Point management contract. Although the inflation factor for the contract is set based on

[13] NBC Ex. 3 (Edge's rebuttal testimony), pp. 1-3, Schedule WEER-2.

the 12 month period ending April 2007, he noted that the 12 month period ending February 2007 had a CPI increase of 2.42 percent. Utilizing a 2.5 percent inflation rate, Mr. Catlin reduced NBC's claim by $14,204. As for the investment income of the O & M Reserve, NBC indicated that the Trust Indenture precludes NBC from using the investment income for operations. Mr. Catlin indicated that NBC should explain why steps cannot and should not be taken to allow interest on the O & M Reserve to be flowed back to ratepayers. In conclusion, Mr. Catlin recommended an increase of $3,027,432 for an overall revenue requirement of $71,908,962.[14]

V. HEARINGS

After published notice, the Commission conducted a public hearing on May 15, 2007 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

NBC presented its witnesses: Walter Edge, Maureen Gurghigian, Karen Giebink, NBC's Director of Administration and Finance, and Jeffrey Nemecek, NBC's bond counsel. Under cross-examination, Mr. Edge stated that the O & M Reserve would be for unexpected costs in operating expenses of NBC. Mr. Nemecek stated that if there is a deficiency in revenues to pay operations, NBC could utilize the O & M Reserve. Ms. Giebink acknowledged that NBC's budget differs from the NBC budget approved in rates by the Commission, and Mr. Edge concurred that NBC's budget is usually higher

[14] Div. Ex. 2 (Catlin's rebuttal testimony), pp. 1-5, Schedule TSC-10.

than the NBC budget approved by the Commission. In addition, Ms. Giebink indicated that NBC does not officially amend its budget to bring it into compliance with the Commission's decision regarding rate relief.[15] Ms. Giebink clarified that the O & M Reserve would not be "some sort of slush fund to circumvent the PUC regulatory process" and "to use funds from the O & M Reserve Fund … would be an extreme, dire situation." Ms. Giebink agreed that dipping into the O & M Reserve in order to pay the difference between how much is set in NBC rates for personnel expenses and how much NBC budgets for personnel expenses would not be an appropriate use of the O & M Reserve Fund.[16]

Ms. Gurghigian acknowledged that the reserve level is one factor in determining the bond rating of an entity. She concurred that based on current interest rates an upgrade of 13 basis points in interest rates would equate to only $1,300 per $1 million a year in savings. Mr. Edge concurred that for ratemaking purposes, interest on the $8 million O & M Reserve would not be used to offset NBC's operation costs, and agreed that if NBC had $70 million in debt, there would be approximately $100,000 in savings a year. Mr. Edge admitted that if NBC puts $8 million to $9 million in an O & M Reserve, NBC would have to borrow $8 million to $9 million to pay for capital projects since the money to fund the O & M Reserve would not be available for capital projects. Mr. Edge calculated that debt payments on $8 million to $9 million would be $800,000 for the fist year.[17]

Mr. Catlin testified on behalf of the Division. On the topic of the O & M Reserve, he testified that it would be reasonable for NBC to modify or amend the Bond Trust

[15] Tr. 5/15/07, p. 21-27.
[16] Id., pp. 40-45.
[17] Id., pp. 54, 60, 63-66.

Indenture, which would allow interest to offset NBC's operations for ratemaking purposes. Mr. Catlin stated that if $8 million to $9 million is set aside in an O & M Reserve rather than used for capital improvements, "there would be a significant additional cost to the ratepayers." He estimated the additional cost to ratepayers as "probably at least three quarters of a million dollars a year." Under cross-examination, Mr. Catlin testified that NBC has not shown that the savings to ratepayers is greater than the cost of creating an O & M Reserve.[18]

Mr. Edge was asked questions regarding NBC's operating expenses. Under cross-examination by the Commission, Mr. Edge acknowledged that the calculation of the operating reserve has changed over time, and the Commission has changed how it has calculated the operating reserve for NBC and other utilities. He agreed it is up to the Commission to determine what a reasonable amount is for an operating reserve. Mr. Edge concurred that due to the existence of Commission regulations prohibiting the cost of credit card fees from being charged to all ratepayers, the Commission could eliminate approximately $26,000 in credit card fees from NBC's rate request. Mr. Edge indicated that NBC is seeking funding for 244 positions but on average the number of employees at NBC is lower than 243. He asserted that NBC is having difficulty in hiring professionals due to a reduction in benefits for non-union employees. As an example of the erosion of benefits, he cited the co-pay for health insurance although he admitted that co-pays are becoming common in the public sector. Mr. Edge indicated that employees in other environments can receive golf club memberships or a car, but NBC cannot give those types of benefits. Chairman Germani requested that NBC provide a response indicating how NBC's salaries were out of sync with the marketplace. Mr. Edge

[18] Id., pp. 88-91.

indicated that there was a very small possibility that NBC's non-union pension would become underfunded if salaries rise at a percentage higher than 3.5 percent when the salary assumption for funding the non-union pension is 3.5 percent. Mr. Edge concurred that non-union salaries are not contractual. He admitted that it is possible that in fiscal year 2005, NBC's non-union employees received a larger salary increase than NBC's union employees.[19]

Mr. Edge indicated the aquarium and fish tanks, specifically in NBC's lobby, benefits ratepayers who enter NBC's building because it is calm and comforting. However, Mr. Edge did agree that the Commission could disallow this expense related to the aquarium and fish tanks. Regarding the water expense account, Mr. Edge concurred that the current expense for this fiscal year of approximately $48,000 is clearly below the $86,000 he projected for the rate year. He explained that clerical expenses were high for the test year because someone had taken maternity leave. Regarding approximately a $500,000 difference for electricity expense between fiscal year 2007 and the rate year, Mr. Edge stated that a defective electric meter at one of NBC's buildings is reading only one-third of the electricity being provided at that location, and the electric company would eventually bill NBC for this consumption. As for gas expense, Mr. Edge stated that NBC expected a substantial increase in the rate year.[20]

Mr. Catlin answered questions regarding NBC's operating expenses. Mr. Catlin indicated that in projecting expenses for the rate year, one factor is to review expenses for the most recent 12 months. However, he indicated that it is better to look at more than one year of experience. He stated that NBC has accepted his CPI of 2.5% for Bucklin

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[19] Id., pp. 106-107, 110-115, 119-123.
[20] Id., pp. 126-127, 135-137, 142-145.

Point. Mr. Catlin agreed that if actual salary increases exceed the 3.5% salary assumption for the pension fund, then there is a possibility that the pension fund could become underfunded. Also, Mr. Catlin agreed that for the past four fiscal years, NBC's non-union employees have not received 4.5% salary increases and that the four year average is approximately a 3.6% salary raise. Mr. Catlin indicated that if a utility makes a representation that their pay scale is out of sync with the market, a utility performs a compensation study to compare the salaries of a particular utility with what is offered by the utility's competitors.[21]

After the hearing, the Commission received record responses from NBC. In one response, NBC indicated that the electric meter originally believed by NBC to be defective was, in fact, working properly. Instead, NBC provided a response indicating that fiscal year 2007 electric consumption was lower than expected, but noted the existence of a new capacity charge, which began in December 2006, would offset any reduction in electric consumption. As a result of NBC's record responses, the Commission issued additional data requests and conducted an additional hearing to review NBC's energy expenses.

After notice, a public hearing was conducted on June 13, 2007 at the Commission's offices at 89 Jefferson Boulevard, Warwick, Rhode Island. Mr. Thomas Brueckner, NBC's Engineering Manager, and Mr. Edge were presented as witnesses for NBC. Under questioning, in reference to electric and gas costs, Mr. Edge concurred that utilizing a two year average is appropriate and noted that the NBC and the Division utilized a two year average in the present rate case. He indicated that NBC had spent $2,564,947 for electricity for the most recent 11 months ending May 31, 2007. He

[21] Id., pp. 163-166, 171-172.

explained that the capacity charge has been in existence for only 5.5 months and that the amount as of the end of May 2007 does not take into account accruals. Mr. Edge concurred that the most recent two year average utilizing actual consumption would include a time period when the incinerator was operational and a period of time when not all the new equipment at Bucklin Point would be operational. Mr. Edge admitted that the budget approved by NBC differs from the amount approved in rates by the Commission. Mr. Edge indicated that NBC's budget in the past year had over $60 million revenues and NBC had a revenue shortfall of $3 million. Mr. Edge stated that NBC was able to offset this loss of revenue and come under budget. Mr. Edge admitted that if NBC had not had a $3 million loss in revenue consumption, NBC's expenses would have been $3 million higher, and specifically cited the example of purchasing a new truck. Under direct examination, Mr. Edge indicated that the variance between the ten accounts presented in our prior set of data responses is close to zero. Also, Mr. Edge indicated that NBC is not seeking an additional $158,000 in rates for soda ash.[22]

COMMISSION FINDINGS

I. INTRODUCTION

At an open meeting on June 22, 2007, the Commission adopted the Division's surrebuttal position, including the denial of authorization for NBC to fund its O & M Reserve Fund, with various modifications. First, the Commission disallowed in rates the aquarium and related expenses totaling $1,695. Second, the Commission reduced the proposed rate increase by $40,458 to reflect lower natural gas costs. Third, the Commission reduced the proposed rate increase by $15,839 to reflect lower health insurance expenses. A majority of the Commission reduced NBC's proposed rate

[22] Tr. 6/13/07, pp. 22-25, 30, 37-39, 54-58, 69.

increase by $87,706 for salary increases to non-union employees and reduced NBC's operating reserve by $260,242 to reflect the exclusion of personnel costs from the calculations of 1.5 percent for the operating reserve. In total, a majority of the Commission approved a revenue increase for NBC of $2,621,492 or a 4 percent rate increase for a total cost of service of $71,503,022.[23] On June 27, 2007, NBC made a compliance filing to have new rates for effect July 1, 2007. On July 3, 2007, the Division indicated that the compliance filing was consistent with the Commission's recent open meeting decision. At an open meeting on July 13, 2007, the Commission approved NBC's compliance filing for effect July 1, 2007.

Overall, the Division surrebuttal position seems reasonable. However, there are specific areas the Commission determined needed an adjustment in order to create just and reasonable rates in the public interest. Also, the Commission must decide an issue of disagreement between the parties regarding the funding of an O & M Reserve. Once again, the Commission must note that in setting rates, the Commission reviews the evidence and, when necessary, explores issues on its own initiative. As the parties in any rate proceeding are well aware, the Commission can reject the expert opinion of witnesses and utilize its own expertise.[24] Justice Brennan once declared that a rate making agency like this Commission "is not intended to be a passive arbiter but the guardian of the public interest" and is "not a prisoner of the parties' submission" but must "make full use of the expert knowledge of Commissioners and staff".[25]

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[23] The approved cost of service is incorporated as Appendix A to this Report and Order.
[24] See Wakefield Water Co. v. PUC 457 A.2d. 251, 253 (R.I. 1983), and Valley Gas Co. v. Burke 446 A.2d 1024, 1033 (R.I. 1982). In both cases, the Commission decision was upheld although the position it adopted was not advocated by a party in the proceeding.
[25] Baltimore Ohio Co. v. United States, 386 U.S. 372, 427-430 (1967) (J.Brennan, concurring).

II. <u>O & M RESERVE</u>

The parties disagreed as to whether to authorize NBC to fund an O & M Reserve with carry-over debt coverage funds, which otherwise pay for Capital Projects. This O & M Reserve would be eventually equal to 25 percent of NBC's operating expenses or approximately $8 million based on NBC's current operating expenses. The Division indicated that it would agree to NBC's request to fund an O & M Reserve if interest from the O & M Reserve account flowed back to ratepayers. However, NBC asserted that its Trust Indenture for bonds does not allow interest to flow back to ratepayers. Specifically, a witness for NBC stated that interest income from the O & M Reserve cannot be utilized for ratemaking purposes.[26] The Division noted that there would be a "significant additional cost to the ratepayers" if an O & M Reserve was established because an O & M Reserve would necessitate additional borrowing by NBC since funds would be set aside in an O & M Reserve rather than used for Capital Projects. Mr. Catlin estimated that $8 million to $9 million in debt would cost at least three quarters of a million dollars a year.[27] In contrast, NBC only indicated that the funding of an O & M Reserve could potentially increase NBC's bond rating from A to AA which would result in an interest rate decrease of 5 to 13 basis points. Also, NBC indicated that reserve levels are one of the many factors reviewed by bond rating agencies.[28] NBC's witnesses acknowledged that 13 basis points would amount to only $1,300 per $1 million of debt per year, and that based on current interest rates and $70 million of debt, this would only result in approximately $100,000 of savings a year.[29] Thus, the funding of an O & M Reserve

[26] Tr. 5/15/07, pp. 43-44.
[27] <u>Id.</u>, pp. 88-90.
[28] PUC Ex. 1 (NBC Data Resp. 1-20).
[29] Tr. 5/15/07, pp. 60, 63-64.

could cost ratepayers approximately $750,000 in debt costs a year but only save ratepayers approximately $100,000 in interest costs a year.

NBC has failed in carrying its burden of proof. Based on current interest rates, NBC's current debt levels, and the current restrictions NBC has placed in its Bond Trust Indenture, the costs associated with funding an O & M Reserve from the carry-over for debt coverage would outweigh the benefits to ratepayers. If interest rates, bond ratings or the terms of the Trust Indenture were to change, the Commission will revisit the issue and once again determine if the benefits from the creation of an O & M Reserve exceed the costs for ratepayers.

III. GENERAL OPERATING EXPENSES

As stated previously by this Commission, public utilities are required to manage their operating expenses, for the "efficient and economical management" of the utility.[30] Operating expenses can be disallowed if the utility's decision results in "inefficiency" or "unnecessary costs".[31] The Rhode Island Supreme Court has been ever more explicit by declaring that the Commission's role in regulating a utility "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."[32] A utility has an obligation to run an

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[30] See e.g. Chicago G. T. Ry Co. v. Wellman 143 U.S. 339, 345-346 (1892); Missouri ex. rel. Southwestern Bell Tel. Co. v. Missouri Pub. Serv. Comm. 262 U.S. 276, 289 (1923) and Bluefield Water Works v. Pub. Ser. Com. 262 U.S. 679, 693 (1923).
[31] See e.g. Missouri ex. Rel. Southwestern Bell Tel. Co. v. Missouri Pub. Serv. Commission 262 U.S. 276, 289 (1923); West Ohio Gas Co. v. PUC 294 U.S. 63, 72 (1935) and Acker v. United States 298 U.S. 426, 430-431 (1936).
[32] Prov. Water Supply Bd. v. Malachowski 624 A.2d 305, 309 (R.I. 1993).

efficient operation. In addition, the utility has the burden of proof to demonstrate the rates it proposes and the expenses it incurs are reasonable.[33]

NBC has 63 expense accounts, each of which is less than $200,000. NBC left these accounts at test year levels for setting the rate year. In general, the Commission reviewed these accounts to determine if there was a significant increase in any account from fiscal year 2005 to the test year, fiscal year 2006. Also, the Commission reviewed these accounts to determine if the test year level was clearly higher than the interim rate year level, fiscal year 2007. Lastly, the Commission analyzed whether any expenses included in these accounts were inappropriate.

A number of accounts were reviewed. NBC noted a few accounts where either the test year amount was below fiscal year 2005 or that the test year level in an account appeared too low when compared to the amount incurred for fiscal year 2007. Some of the accounts noted by NBC such as the bond and notes account or the medical services account appear unusually high when compared to prior fiscal years and could be non-recurring in nature. Other accounts noted by NBC such as the other services account appear to be trending downward over the last few years.[34] Furthermore, NBC acknowledged that the variance between the accounts noted by NBC and the accounts subject to greater scrutiny from the Commission was approaching zero.[35] As for the accounts subject to greater scrutiny by the Commission, the variance in four of these six accounts was less than $10,000 through the end of May 2007.[36] Thus, the Commission decided not to make adjustments for such a small variance. As for the remaining two

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[33] See R.I.G.L. 39-3-12.
[34] Compare NBC Record Responses No. 4 with Schedule WEE-3 of NBC Ex. 1.
[35] Tr. 6/13/07, p. 58.
[36] PUC Ex. 1 (NBC Data Resp. 1 for 6/6/07 data requests).

accounts, the variance in the clerical services account is due to temporary help because of an employee taking maternity leave. Although the test year level for this account is higher than necessary for the rate year, no adjustment will be made because the amount in this account has fluctuated over the past few years and NBC should not be deterred from hiring temporary staff in lieu of full time staff. The second account is water, which is set at $85,503 for the rate year. However, based on the most recent 12 months of data or utilizing a two or three year average, NBC incurs approximately $67,000 in this account.[37] Furthermore, it should be noted that the other utility service accounts such as electricity and natural gas use a two year average for setting the rate year amount. However, the Commission will not make an adjustment in the account because Providence Water has recently filed for a rate increase of approximately 20 percent, which, if granted, would significantly reduce the potential variance in this account.

Next, the Commission reviewed various accounts to determine if there were any expenses that would be inappropriate for ratepayers to absorb. In the account entitled, "other expenses", NBC incurred $1,695 in expense from an entity named "Something Fishy, Inc." This expense was for aquarium maintenance at NBC's offices. NBC could not demonstrate that this expense is necessary to provide utility service or clearly benefit ratepayers. A vague assertion that fish tanks at NBC's office may provide comfort to ratepayers who visit NBC provides no comfort to NBC's ratepayers who are paying for this small indulgence while NBC's rates have been rising dramatically since 2000. The aquarium expense of $1,695 is disallowed. Lastly, the Commission could have reduced NBC's rate increase by $26,114 because NBC has accepted credit card fees instead of requiring individual ratepayers to pay the credit card fee, which is in violation of the

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[37] NBC Rec. Resp. No. 4 and see Schedule WEE-3 of NBC Ex. 1.

Commission's current regulations. However, the Commission has recently indicated at an open meeting that it will likely repeal these regulations during the rate year. Under these circumstances, making an adjustment related to credit card fees will be unnecessary.

IV. ENERGY COSTS

Energy costs are an important aspect of NBC's operating expenses. In Docket No. 3707, the Commission established rates for fiscal year 2007 based on approximately \$3.26 million for electricity costs and approximately \$500,000 for gas. NBC requested the same amount for the upcoming rate year, fiscal year 2008. However, through April 2007, NBC had only incurred approximately \$2.3 million in electric costs and approximately \$300,000 in gas costs.[38] At the first hearing, NBC inaccurately testified that its lower electricity costs were due to a faulty meter rather than less consumption.[39] Subsequently, NBC represented that although electric consumption was lower, the institution of a new capacity charge on December 2006 would cause NBC to incur approximately \$3.2 million in electric costs for the rate year, which is just \$56,779 less than NBC requested in this filing.[40]

The electric consumption estimate adopted in Docket No. 3707 on the recommendation of parties was erroneous. It appears for fiscal year 2007 that electric consumption is 4 million kWh below the estimate, of which 3 million kWh of this variance is due to the inaccurate estimate for Bucklin Point. However, the Commission will not make an adjustment to electricity costs. An adjustment would have to be based on the most recent 12 months of actual consumption rather than a two year average,

[38] PUC. Ex. 1 (NBC Data Resp. 4-1).
[39] Tr. 5/15/07, p. 143.
[40] NBC Rec. Resp. 8

which is the approach usually followed for NBC regarding energy costs. This is because a two year consumption average for electric costs would not include a time period when not all the new equipment at Bucklin Point was operational, but would include electric consumption by an incinerator no longer in use. Although the $3.26 million estimate for electricity costs could prove too high, it is the best estimate the Commission has based on the data in its possession.[41]

For gas costs, the picture is clearer. The amount proposed in the rate year is $503,412, which is based on the consumption of 329,744 therms. This estimation of gas consumption is too high. For the most recent 12 months, gas consumption was 251,120 therms and utilizing the most recent two year average, gas consumption was 268,572 therms. Based on current gas costs, and utilizing the most recent two year consumption average, the cost would be $462,954.[42] Also, NBC has locked in its gas supply costs through March 2008, and since National Grid's current gas supply rates are below NBC's current gas costs, NBC should not have a dramatic increase in gas supply costs for the last three months of the rate year. By utilizing the most recent data to develop a two year consumption average as well as actual charges, the Commission reduced NBC's gas costs from $503,412 to $462,854, a reduction of $40,458.[43]

V. PERSONNEL COSTS

Personnel costs are a significant portion of NBC's operating expenses. Personnel costs include a variety of expenses such as health care insurance, pensions, and salary. As for health care insurance, subsequent to the first hearing, NBC provided information

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[41] In future filings, the parties should make a diligent effort to as accurately as possible calculate NBC's electricity costs.

[42] PUC Ex. 1 (Data Resp. 3 for 6/6/07 data request).

[43] Also, it should be noted that NBC, in its draft operating budget for fiscal year 2008, indicated that these would be a reduction in its energy costs. NBC Rec. Resp. 2, p. 20.

that its health insurance renewal rates for the rate year were below its rebuttal position in the docket. The Division calculated that if the Commission adopted these health insurance renewal rates in setting rates, it would lower health insurance costs by $15,839. The Commission adjusted NBC's health insurance costs to better reflect actual health insurance renewal rates for the rate year.[44]

Regarding pensions costs, union personnel are required by state law to be in the State of Rhode Island's employees' retirement system. Thus, the Commission complied with state law and adopted NBC's request for additional funds for union pension costs. In this filing, the pension cost for non-union personnel was calculated utilizing the same method performed in prior NBC rate cases, which is 10 percent of forecasted non-union salaries. Although the non-union pension costs included the cost of an unfunded pension liability for prior service, the overall non-union pension cost was calculated, for purposes of setting rates, in the same manner as when NBC only had a defined contribution plan for its non-union employees.[45] Although a state utility commission could disallow in rates unfunded pension liability costs due to past service, this Commission will not do so at this time because NBC has not deviated from the prior rate setting method for calculating non-union pensions.[46]

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[44] PUC Ex. 1 (Division's Data Resp. for 6/1/07 data request). The employee health insurance costs would be lower if NBC's employees paid a higher co-share. As noted by the Division's witness, it is not unusual for employees to pay a co-share for health insurance which is higher than 6 percent of the premium.

[45] PUC Ex. 1 (NBC Data Resp. 2-17).

[46] See In re: Chesapeake & Potomac Tel. Co. 57 PUR 3rd 1 (D.C. 1964) and In re: Peoples Gas System, Inc. 1 PUR 4th (FL 1973). Furthermore, the R.I. Supreme Court has ruled on at least two occasions that the pension expenses of a utility may be disallowed in rates. On one occasion, the Court upheld the Commission when it disallowed an increase in rates for a supplemental executive retirement plan which was designed to "enhance the pension benefits" of certain executives for prior years of service. Providence Gas Co. v. Malachowski 656 A.2d 949, 951-952 (R.I. 1995). On another occasion, the Court reversed this Commission for failing to disallow a rate increase due in part to a utility pension expense because the court determined that the pension payment to management constituted a "gift". Town of New Shoreham v. PUC 464 A.2d 730, 737 (R.I. 1983).

The next issue is salaries. At the outset, it is clear that "expenses, including wage and salary increases that affect post-test year finances, are facts which are subject to the Commission's scrutiny."[47] In that case, the R.I. Supreme Court upheld this Commission when it "disallowed all but 29.3 percent" of New England Telephone's salary increase.[48] Likewise, courts have recognized the authority of state utility commissions to reduce a utility's proposed wage and salary increases, and have upheld the adjustments.[49] Thus, the Commission has the authority to review and, if justified, to disallow salary increases in rates.

NBC is seeking in rates 244 positions, and for non-union positions, salary raises of 3.75 percent in the interim rate year and 4.5 percent for the rate year. Mr. Edge stated NBC has an average of less than 243 positions and as of March 2007 it had only 237 positions filled.[50] Mr. Edge stated that an erosion of benefits such as co-share for health care and the inability to offer golf club memberships or cars has made it difficult to fill engineering positions.[51] Although the Commission requested information from NBC demonstrating that its salaries are out of sync with the market, NBC provided no such information. Instead, it merely provided data regarding its turnover, which also indicated a comparable amount of turnover for union personnel over the last two years.[52]

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[47] New Eng. Tel. v. PUC 116 R.I. 356, 381 (1976).
[48] Id. at 383.
[49] C & P Telephone Co. of W.Va. v. PSC, 301 S.E.2d 798 (WV 1983), Pacific Tel. v. PUC 401 P.2d 353, 377 (CA 1965). New England Telephone Co. v. PUC, 470 A.2d 772 (ME 1984), Southwestern Bell Tel. Co. v. Ark. PSC, 824 F2d 672 (8th Cir., Ark., 1987), See Mississippi PSC v. Home Tel. Co. 110 So.2d 618, 622-623 (MS 1964) (stating, "a regulatory commission has the power to disallow excessive salaries for ratemaking purposes."), See also Application of Northwestern PSC, 297 N.W. 2d 462 (SD 1980) (recognizing the authority of the PSC to reduce salaries).
[50] Tr. 5/15/07, p. 114.
[51] Id., pp. 114-115.
[52] NBC. Rec. Resp. No. 3

There are a number of factors that can be utilized to determine the reasonableness of an increase in salaries and wages. First, there is the rate of inflation. The rate of inflation to which NBC agreed for the Bucklin Point management contract for the rate year is 2.5 percent.[53] Salary increases of 3.75 percent and then 4.5 percent are clearly above the rate of inflation.

Second, a utility's salary increases for prior years can be an indicator of future salary increases. For example, the Division's witness stated that actuals from prior years is a factor in projecting costs for the future. Also, he indicated that for fiscal years 2002 through 2006, the NBC non-union salary increase was approximately 3.6 percent.[54] Thus, 3.75 percent and 4.5 percent increases are above historical actuals. As for the NBC's argument that non-union and union personnel receive the same salary increase, in at least one prior year non-union personnel received a larger increase than union personnel.[55] Also, non-union salaries are not contractual.[56] Furthermore, NBC's non-union salary increases are not COLAs but merit pay increases.[57] Even NBC's Draft Operating Budget for fiscal year 2008 indicates that non-union personnel will receive 3.5 percent to 4 percent increases.[58]

Third, salary increases should be consistent with long term pension calculations. NBC bases its actuarial non-union pension calculations on a 3.5 percent annual salary

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[53] Tr. 5/15/07, p. 164.
[54] Tr. 5/15/07, pp. 165-166, Div. Ex. 3 (Div 1-20).
[55] It should be noted that in this Docket, NBC agreed that the level of co-share for non-union employees will not be capped at 6 percent. This demonstrates that NBC recognizes there is no requirement that non-union and union personnel must receive identical compensation or benefits. Also, it should be noted that on average, non-union employees receive higher salaries than union employees (PUC Ex. 1, NBC Response to Commission Data Request 1-16). This, to some degree, offsets any alleged superior benefits union employees receive in comparison to non-union employees.
[56] Tr. 5/15/07, pp. 165-166.
[57] See Docket No. 3483 PUC Data Resp. 12, and in this Docket PUC Ex. 1 (NBC Data Resp. 1-3 and 2-3).
[58] NBC Rec. Resp. No. 2, p. 14.

increase.[59] Mr. Catlin agreed that in the long run salary increases which are higher than the pension assumption could cause an underfunding of the pension.[60] NBC strangely stated "there is no relationship between the actuarial assumption of 3.5 percent salary scale adjustment … and the annual salary increases."[61] Not basing pension calculations on actual salary increases is financially imprudent. Furthermore, this 3.5 percent salary increase is close to the 3.6 percent over the last four fiscal years.

Fourth, salaries at a utility can be compared with salaries at comparable businesses.[62] For NBC, other water utilities can be used for comparative purposes. Providence Water is the second largest non-investor owned utility in RI. It is only seeking a 3 percent increase for 2008.[63] Also, Woonsocket Water when it reviewed its salaries stated in a study that "data from Narragansett Bay Commission was not included since the wage scales are considerably higher than the water utilities."[64] It must be noted again that NBC failed to provide any evidence that its salaries were out of sync with the market even after it was asked to demonstrate that its wages were too low.

It must also be pointed out that NBC has not incorporated a specific turnover allowance in this rate filing. Instead, it indicated that a turnover allowance is already built in to its request of 244 positions. However, NBC may not have 244 filled positions for the rate year. As of March 2007, it had 237 positions. NBC's proposed salary increases of 3.75 percent and 4.5 percent for the rate year is premised on all non-union

[59] PUC Ex. 1 (NBC Data Resp. 3-4).
[60] Tr. 5/15/07, p. 164.
[61] PUC Ex. 1 (NBC Data Resp. 3-4).
[62] This analysis is limited to cost comparisons among utilities and does not extend to an evaluation of the management performance of any utility. An evaluation of the performance of a utility's management would require a significant amount of evidence to ensure an objective evaluation.
[63] See Docket No. 3832, the pre-filed testimony of Mr. Edge, p. 7.
[64] Div Data Resp. 1-3 in Docket No. 3626, the study was cited in Order No. 18027, pp. 2, 30.

positions receiving this increase. The amount of the salary increase is not justified since not all non-union positions will be filled for the rate year.[65]

As a result, NBC will not receive the 3.75 percent and 4.5 percent salary increases in rates. It is higher than inflation, exceeds salary increases for recent years, exceeds the pension assumption for salary increases, exceeds what other non-investor owned utilities paid and, furthermore, NBC will have turnover in the rate year. Basing rates on 3.5 percent salary increases is more reasonable because it is very similar to historical actuals, the pension assumption, and would capture some of the reduction in costs due to NBC's employee turnover. Also, setting rates on 3.5 percent still gives NBC the flexibility to give some non-union employees 4.5 percent salary increases because of turnover. Even if it had a full complement of non-union employees, NBC could give 4.5 percent salary increases to all its employees if NBC achieved savings in other accounts. This reduction will give an incentive to NBC to be efficient. Thus, the Commission adjusted rates to reflect 3.5 percent non-union salary increases, which reduces rates by $87,706.[66]

VI. OPERATING RESERVE

As has been stated in prior Orders, a non-investor owned utility's rates are set based on projected expenses for the rate year. To assist a non-investor owned utility with uncontrollable and unanticipated expenses or fluctuations in revenue, the Commission has granted an operating reserve to a utility.[67] However, the amount of the operating reserve and whether to grant one is solely a matter of discretion for the Commission. Thus, "NBC is not entitled to an operating reserve and that the Commission can establish

[65] An adjustment to reduce salary increases to 3.5 percent, which is $87,706, would equate to a turnover allowance of less than 1.5 positions based on 244 positions. These savings are less than $100,000 in rates, but the ratemaking principles followed are of significant importance to ratepayers.
[66] PUC Ex. 1 (Div. Data Resp. 4-1).
[67] Order No. 17588, p. 31.

the funding level of such a reserve."[68] In this current filing, NBC calculated its operating reserve by applying the 1.5 percent rate to its projected total rate year expenses ($71,416,496) less amounts provided for debt service ($30,832,125), debt service coverage ($7,708,031), and debt related costs ($45,270). This amounted to a requested operating reserve of $492,466.

In a prior rate proceeding, NBC's witness indicated that he had "no objection to whatever percentage this Commission decides is an appropriate percentage" for setting the operating reserve and agreed NBC is not entitled to an operating reserve.[69] In this proceeding, he further agreed that an operating reserve is a discretionary decision by the Commission.[70]

In fact, the Commission routinely adjusted and reduced NBC's operating reserve. For instance, in Docket No. 3483 the Commission reduced NBC's operating reserve by $132,216 to $252,685. This was done in order to avoid giving NBC excessive funds with which to increase personnel costs.[71] Also, the Commission has reduced NBC's operating reserve by $150,000 in order to allow the Commission to use these funds to finance an auditor/overseer of the CSO Project. Although NBC challenged this Commission's authority to adjust and reduce NBC's operating reserve for this purpose, the Rhode Island Supreme Court found NBC's argument "wholly without merit".[72] In Docket No. 3707, the Commission reduced NBC's operating reserve from $458,934 to $219,663 by exclusion of personnel costs from the calculation of the operating reserve.[73]

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[68] Id.
[69] Order No. 18719, p. 20.
[70] Tr. 5/15/07, pp. 106-107.
[71] Order No. 17588, pp. 31-32 , and Appendix A.
[72] In Re: NBC Rate Filing 808 A.2d 631, 637 (R.I. 2002).
[73] Order No. 18719, p. 24.

As stated in a prior Order, in setting an operating reserve, the Commission reviews a number of factors. Since these factors vary and are weighed differently, the operating reserve of utilities may differ and the level of an operating reserve may change from time to time for the same utility. The Commission will, once again, discuss some of the factors that were considered in setting NBC's operating reserve in this docket.

First, an operating reserve can be helpful if a utility experiences significant revenue fluctuations. For instance, some non-investor owned water utilities experience large revenue fluctuations due to changing weather patterns and a corresponding decline in water consumption.[74] According to NBC, only 66 percent of NBC's total revenue is generated from billings related to water usage, which is lower than other non-investor owned water utilities. In this docket, NBC represents that it experienced a $3 million revenue shortfall in fiscal year 2007. However, it should be noted that NBC's budget exceeds what this Commission approves in rates.[75] In addition, a $3 million revenue shortfall for NBC in fiscal year 2007 would have constituted less than 5 percent of NBC's budget. An efficient utility should be able to manage a revenue decrease of this level. Furthermore, NBC admitted that even with this $3 million revenue shortfall, NBC was able to avoid a deficit.[76] Ironically, NBC's witness admitted that if NBC had this additional $3 million in revenue, it would have spent it.[77] This demonstrates the risk of granting utilities excessively large operating reserves. Since NBC has shown it can find

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[74] See e.g. Order Nos. 18598 (Pawtucket Water), 19580 (Newport Water), an nd 18307 (Woonsocket Water).
[75] Tr. 5/15/07, p. 25.
[76] NBC was able to avoid a deficit although it had projected revenues in excess of $60 million with an operating reserve of $219,663.
[77] Tr. 6/13/07, pp. 54-56.

savings even when there is a revenue shortfall, NBC has less of a need of an operating reserve than other utilities.

Second, an operating reserve can be helpful in addressing unanticipated increases in fuel costs especially in a time when energy cost are rising rapidly. For instance, in Docket No. 3592, the Commission recognized that rising energy costs for NBC could justify the need of a higher operating reserve.[78] However, in another docket, NBC has indicated that it has locked into long-term contracts for gas supply rates as well as electric rates including a cap on electric usage at Bucklin Point.[79] In fact, NBC's energy costs will be lower in the rate year than they were projected to be for fiscal year 2007. Once again, NBC can be complimented for being pro-active in sheltering itself from volatile energy costs, but under these circumstances, there appears to be little need for NBC to have an operating reserve to address large potential increases in energy costs.

Third, an operating reserve can be useful in addressing "unexpected increases in expenses, which are truly beyond the control of the utility."[80] The Commission must emphasize that personnel costs are not uncontrollable by a utility. As noted previously by the Commission, "personnel costs, in contrast, can be controlled by an employee co-sharing health insurance premiums, salary freezes or lay-offs."[81] This is particularly applicable to NBC since it is a utility managed by an independent board, which has significant control over its personnel costs. The Commission has indicated that "NBC has many options in relation to its personnel costs".[82] It is not a non-investor owned utility who is managed, controlled or is considered a part of a municipality. Since NBC

[78] Order No. 18124 p. 9.
[79] Order No. 18719, pp. 21-22.
[80] Order No. 18316, p. 27.
[81] Id.
[82] Order No. 17558, p. 32.

can control increases in its personnel costs, especially for its non-union employees which compose approximately half of its workforce, there is little need for NBC to have an operating reserve to address personnel costs. In fact, a large operating reserve may allow a utility to be less efficient and more lax with personnel costs. The Commission has previously indicated that "performance based ratemaking ("PBR") has successfully kept distribution rates at stable levels in the energy sector" and stated that "a similar approach to non-investor utilities to limit their personnel costs" should be considered.[83] Exclusion of personnel costs from the calculation of an operating reserve will incent NBC to manage it personnel costs.

Fourth, an operating reserve can be in the public interest if the utility treats the funds received from the Commission as an operating reserve to be used when it is necessary to meet expenses approved in the utility's cost of service. In this docket, once again, NBC has intimated that it budgets more than this Commission allocates in rates. In a prior docket, NBC acknowledged that the operating reserve approved by the Commission "is not included as a separate line item in the budget."[84] Thus, NBC still appears not to treat the operating reserve as a reserve but as merely more money to spend for its own Board approved budget although it exceeds what the Commission approves in rates. Thus, NBC's management is still not treating the operating reserve as a "rainy day fund" or using it for "cash flow" but as more revenues to pay for expenses, not necessarily approved by the Commission. Accordingly, the Commission will not approve a large operating reserve since there are no assurances it will only be used for necessary and unanticipated expenses.

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[83] Order No. 18124, p. 12.
[84] Order No. 18719, p. 23.

It is apparent that a large operating reserve for NBC is unnecessary and in the past NBC has admitted it could avoid "unnecessary risk" with a reserve of $250,000.[85] In this case, the Commission is setting the operating reserve at $232,224 by exclusion of personnel costs from the calculation of the operating reserve.

Over time the Commission has eliminated all debt service/capital costs from the operating reserve calculation for many non-investor utilities.[86] To bring more accountability and incent utilities to manage personnel costs, personnel costs should likewise be excluded from the operating reserve calculation because a utility such as NBC can control these costs. Although a smaller operating reserve may be more challenging to NBC, a challenge for this Commission is to protect ratepayers from unnecessarily high utility rates caused by a larger than justified operating reserve. So far, NBC has met this challenge.

(19062) ORDERED;

1. Narragansett Bay Commission's abbreviated rate application of December 1, 2006, is hereby denied and dismissed.

2. A revenue requirement increase of $2,621,492 resulting in a cost of service of $71,503,022 is hereby approved for usage on and after July 1, 2007.

3. The Commission will continue to restrict those accounts previously restricted: Debt Service--$30,832,125; Debt Service Coverage--$7,708,031. The Commission Oversight funds for the Combined Sewer Overflow project are set at the level of $150,000. Excess Oversight funds of approximately $660,000 will be used to offset operating expenses over a two-year period. Additionally, Debt Service Coverage funding

[85] Order No. 17588, p. 31.
[86] Order No. 18719, p. 24.

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's Tariffs, filed on June 27, 2007, are hereby approved.

5. Narragansett Bay Commission shall comply with all other findings and instructions in this Report and Order.

EFFECTIVE JULY 1, 2007 AT WARWICK, RHODE ISLAND, PURSUANT TO OPEN MEETING DECISIONS ON JUNE 22, 2007 AND JULY 13, 2007. WRITTEN ORDER ISSUED SEPTEMBER 10, 2007.

PUBLIC UTILITIES COMMISSION

Elia Germani, Chairman*

Robert B. Holbrook, Commissioner

Mary E. Bray, Commissioner

*Chairman Elia Germani dissented from Section V, as it pertains to salary increases, and Section VI of the Commission findings.

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

DISSENT OF CHAIRMAN ELIA GERMANI

This is the fourth time I have dissented in a rate proceeding relating to the Narragansett Bay Commission (NBC). There are two issues in which I differ from the majority. The first of these issues is the denial by the majority of the request for rate relief for an adjustment in the test year salaries of non-union personnel of 3.75% for FY'07 and 4.5% for FY'08, which represents COLAs of 2.75% and 3.5% for FY'07 and FY'08, respectively (and a 1% step increase).

The majority indicated that one way of determining the validity of a rate increase request for salaries is to compare those salaries to a comparable business. They utilized as a comparable utility the Providence Water Supply Board (PWSB), which is only seeking a 3% increase for 2008. However, it is my view, based upon my observation of all the water utilities doing business in Rhode Island, and my observations of NBC, that NBC's performance as a regulated utility is far superior to any of the water utilities in Rhode Island. The performance of the PWSB in the past seven years has been mediocre. I also believe that there should be a distinction between the salaries of non-union and union employees because the benefits for union employees are superior to that of non-union employees.

The Defined Benefit Plan for union employees provides a benefit of 80% after 35 years of service, based upon the average of the three highest salary years. I think any non-union employee would be happy to exchange the pension program for non-union employees with that of union employees. It is interesting to note that the adjustment to the salary increases ordered by the Commission was $87,706. This is a rather miniscule amount of savings to the ratepayers when one considers the overall expenditures of operating NBC. Although I recognize that the Commission is free to establish levels for ratemaking purposes only, I think the Commission majority did not take into account a special situation which is faced by NBC's non-union employees.

The second area in which I differ with the majority was the operating reserve amount. First, the Commission majority is using an operating reserve calculation to be related to unexpected expense increases borne by a utility. However, an operating reserve also acts as somewhat of a buffer if the revenue projections of a utility are not exact and it is a matter of reality that revevue projections are rarely on target.

Also, I differ with the majority because once again the Commission majority has treated NBC differently than other regulated utilities. It has reduced the operating reserve amount by deleting personnel costs from the calculation. No other regulated utility in Rhode Island has been treated in a similar manner. I can only speculate why this is so. The operating reserve of $232,224, which was established by the majority, in my judgment is not sufficient, particularly when one considers a utility which has revenues which are projected to be $70 million. Thus, the operating reserve is less than 1/3 of 1% of operating expense. I, therefore, dissent with respect to the amount granted to NBC for salary increases for non-union personnel and with respect to an operating reserve which was authorized by the majority of the Commission.

Elia Germani

Elia Germani, Chairman

Appendix A

Narragansett Bay Commission
Docket 3797
Cost of Service

	NBC Position*	Commission Adjustments	Proforma Cost of Service
REVENUES			
User Fee Revenues	$ 65,396,772	$ - 0 -	$ 65,396,772
Other Service Revenues	2,510,108		2,510,108
Miscellaneous	974,650	-	974,650
Total Revenues	$ 68,881,530	$ - 0- -	$ 68,881,530
EXPENSES			
Personnel Services	$ 17,307,332	$ 103,545	$ 17,203,787
Operating Supplies & Expenses	12,904,293	42,153	12,862,140
Special Services	2,609,755		2,609,755
Amortization	9,690		9,690
Debt Related Costs	45,270		45,270
Debt Service	30,832,125		30,832,125
Debt Coverage	7,708,031	-	7,708,031
Total Expenses	$ 71,416,496	$ 145,698	$ 71,270,798
OPERATING RESERVE	492,466	260,242	232,224
COST OF SERVICE	$ 71,908,962	$ 405,940	$ 71,503,022
RATE YEAR REVENUES AT PRESENT RATES			68,881,530
REVENUE INCREASE	$ 3,027,432	$ (405,940)	$ 2,621,492

* NBC agreed with the surrebuttal cost of service filed by the Division.

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Cost of Service Adjustments

Personnel Services	
Health Care	$ 15,839
Salaries / Fringes to reflect 3.5% increases	87,706
Total Personnel Services Adjustment	$ 103,545
Operating Supplies & Expenses	
Aquarium	$ 1,695
Natural Gas costs	40,458
Total Operating Supplies & Expenses Adjustment	$ 42,153
Net Operating Reserve	
Adjustment to remove personnel costs and other Commission expense adjustments from calculation	$ 260,242