

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

**IN RE: CITY OF NEWPORT, UTILITIES,)
 DEPARTMENT WATER DIVISION) DOCKET NO. 3818
 APPLICATION TO CHANGE RATES)**

**POST-HEARING BRIEF OF THE DIVISION
OF PUBLIC UTILITIES AND CARRIERS**

The Division of Public Utilities and Carriers (“Division”) submits the following as its post-hearing brief in Docket No. 3818. Through testimony adduced at hearing, the Division and the City of Newport, Utilities Department, Water Division (“Newport” or “Newport Water”)¹ are in accord as to Newport’s revenue requirements with the exception of one account, the Operating Revenue Allowance (“ORA”).

Q. Mr. Catlin, you just talked about the operating reserve. This really represents the only difference between the Division’s position and Newport’s, is that correct?

A. That’s correct. That’s my understanding that at this point, the final adjustments that Newport proposed with regard to debt service and the increased costs associated with more frequent billing were acceptable to the Division, and so the only—there is a small effect on city services based on budget, but other than that, the only difference is how the operating reserve should be funded.

Transcript dated July 25, 2007 at 8.

With respect to the ORA, the testimony adduced at hearing overwhelmingly supports the position of the Division set forth in the Surrebuttal Testimony of Thomas S. Catlin. See Division Exhibit 2. As proposed by the Division, the ORA consists of:

¹ As distinguished from the City of Newport, which is referred to as the “City.”

Us[ing] an operating revenue allowance of one-and-one half percent of operating expenses. The Division has recommended that the additional monies that would be generated from the increased number of billing charges moving from every – billing every four months to billing every two months, those additional revenues could be and should be used to fund an operating reserve fund . . . the monies would be put aside and would be available to be used to meet revenue shortfalls or unanticipated expenses, but that they would not be used to pay for expenses not authorized by the Commission.

Transcript dated July 25, 2007 at 6-7. The fund would be capped at 1/8 of overall operating and maintenance (“O & M”) expenses (roughly \$800,000), which is approximately 8-9% of O & M expenses. Transcript dated July 25, 2007 at 12-13.

At hearing, through its expert Christopher Woodcock, Portsmouth agreed with the Division’s position with respect to the ORA:

Q. And Mr. Catlin has suggested that this fund [the ORA] be funded from the increase in billing charges, correct?

A. He has, yes.

Q. And he has suggested that the increase in billing charges which would fund it eliminates the need for the six percent of expenses.

A. Correct.

Q. You don’t agree with that.

A. I agree with what Mr. Catlin said. I agree that should be used in place of, in lieu of the six percent allowance that Newport has proposed. That the additional money, some 300 some odd thousand in the rate year, 560,000 in the subsequent year be used for that operating revenue with a portion of it restricted. I do not agree with what Mr. Smith said yesterday that that money be used to pay down payables ...

Transcript dated July 25, 2007 at 96-97.

The overwhelming evidence presented at hearing supports a finding that Newport’s ORA should be set at 1.5% of total operating expenses. See TSC-1 (Updated

as of 6/19/2007). All of the additional monies generated from the increased number of billing charges, net of any incremental expenses, should be directed to the ORA and restricted. Transcript dated July 25, 2007 at 6-7. The ORA should be funded in this manner up to a cap of 8-9% of total operating expenses. Transcript dated July 25, 2007 at 12-13. The money generated by the reduction of Newport's unbilled accounts receivable (by billing more frequently) can be used to reduce the utility's accounts payable. Division Exhibit 2 at 8-9.

Having addressed Newport's revenue requirements, only two other issues require discussion: (i) Portsmouth's request to require Newport to undertake a capital improvement project to improve the utility's water age², and (ii) Portsmouth's request to bar Newport's recovery of \$709,420.54 in rates.

In the Commission approved settlement to Docket No. 3578, Newport agreed that "it will not seek to recover in rates any additional monies that it may borrow from the City of Newport up through and including June 30, 2005. Newport Water agrees that should the City of Newport loan money to Newport Water after June 30, 2005, said loan shall be reflected by appropriate documentation and Newport Water shall have the duty to monitor and track its costs and properly account for how the loan proceeds are applied." In Re: City of Newport Water Division Application to Change Rate Schedule Docket No. 3578, Order No. 17992, Settlement Agreement, Para. 17. At hearing, Portsmouth introduced in evidence the Annual Report of Newport for the fiscal year

² The Division did not offer expert testimony with respect to this issue. Newport is willing to commit to the design necessary to commence the ultimate implementation of this proposed project. Transcript dated July 24, 2007 at 200. Rather than compelling Newport to implement a water age solution by a particular deadline, the Division believes that the Commission should recommend that Newport commence the design work as offered, and then reassess the progress of Newport's efforts in the next rate case.

ending June 30, 2005. Portsmouth Exhibit 15. Exhibit 15 shows \$356,081 in payrolls \$353,340 in other funds due the City of Newport as of June 30, 2005.

Newport's monthly cash flow statements show outstanding payables as of June 30, 2005 of \$1,003,085. Outstanding payables as of July 31, 2007 and August 31, 2005, are \$649,572 and \$780,612, respectively. Newport's cash position increases from \$83,324 as of June 30, 2005 to \$272,622 as July 31, 2007 and \$726,543 as of August 31, 2005. Cash less total outstanding payables for the periods ending June 30, July 31 and August 31, 2005 was -\$919,761, -\$376,950 and -\$54,069, respectively. See Newport Exhibit 13.

The settlement in Docket No. 3578 was concluded in May of 2004. For several years prior to the date of the settlement, unbeknownst to the Commission and Division, Newport had been "borrowing"³ money from the City to pay for the utility's operational deficits: \$2.5 million for an unknown period through June 30, 2003, and another \$911,085 for FY 2004. In Re: City of Newport Water Division Application to Change Rate Schedule Docket No. 3578, Order 17992 at 7.

The settlement in Docket No. 3578 was intended to effect a repayment to the City for monies "loaned" to Newport on the condition that the utility effected certain procedural safeguards including reporting requirements, the aim of which was to inform the Commission that Newport was being managed in a financially sound manner.⁴ See

³ In Docket No. 3578, the "borrowing" occurred because the water utility and the City paid expenses from a single checking account. Order No. 17792 at 65. In the instant matter, Ms Forgue testified that all bills incurred by the Water Division, including payroll, ". . . are paid from the Water Fund checking account." However, the City pays the employees when the checking account does not have sufficient funds to do so. When this "loan" occurs, the Water Department is obligated to reimburse the City for these wages. Newport Exhibit 2(a) at 18.

⁴ Portsmouth also contends that loans Newport received from the City in the pending docket were "undocumented" in violation of the "appropriate documentation" language contained in the Docket No.

Order No 17992 at 64-66. In addition to implementing the aforementioned procedural safeguards, Newport represented, through the above-quoted settlement provision, that Docket No. 3578's rates would sustain the utility's operations through June 30, 2005 without the need to "borrow" "additional monies" from the City. Docket No. 3578, Settlement Agreement, Para. 17.

The evidence presented at hearing shows that Newport essentially satisfied Docket No. 3578's settlement terms. Although \$356,081 in payroll and \$353,340⁵ in due to other City funds were accrued as of June 30, 2005, Newport was capable of paying these payroll and other obligations in July and August of 2006, while reducing the utility's total obligation from \$919,761 as June 30, 2005 to a balance -\$54,069 as of

3578 settlement, and therefore, should be denied. The Rhode Island Supreme Court has upheld the Commission's decision to deny a surcharge to repay a city loan when its review of the record confirms the that the Commission's rulings are based primarily on substantial violations of a Commission decision in a prior docket, *i.e.*, when the municipal utility applied funds earmarked for restricted accounts toward unauthorized expense increases and borrows long-term debt without the permission of the Division to pay for the increases. Providence Water Supply Bd. v. Malachowski, 624 A.2d 305, 308 (R.I. 1993). Without violations of such an Order, the Court has upheld a Commission ruling allowing the water supply board to repay the city for various management and other expenses. Audobon Society of Rhode Island v. Malachowski, 569 A.2d 1 (R.I. 1990). This is true even if utility expenses have been growing disproportionately to the City's budget, and a 2-page letter breaking down claimed costs into seven categories is the only documentation that reflects the "loan." Id. See also In Re: Woonsocket Water Department, 538 A.2d 1011, 1015 (R.I. 1988) (where Court affirmed decision of Commission to allow water department to institute a retroactive rate to repay its loan from city "regardless of water department's reason for allowing the debt to accumulate for four years").

The instant case is more closely analogous to Audobon and Woonsocket Water than to Providence Water. Like the 2-page letter in Audobon, the monthly cash flow statements, although not constituting formal loan documentation, do reflect the loans in question. See *e.g.*, Narrative to Cash Flow Statements for May and June 2006 (documenting that the City was financing water utility payrolls). Moreover, unlike Providence Water, nowhere does any party claim that Newport diverted funds earmarked for restricted accounts to pay for unauthorized expenses or borrowed money without the permission of the Division. Indeed, even Portsmouth concedes Newport is in compliance with all of the Commission's reporting requirements. Portsmouth Exhibit 6 at 11. At most, Portsmouth contends that Newport should have filed its rate case six months to a year earlier, and that Newport's failure in this regard increased the magnitude of the utility's borrowings from the City. Portsmouth Exhibit 6 at 25. This contention is no different from (and is in fact far less than) the four years of water department neglect permitted by the Court in Woonsocket Water.

⁵ \$146,864 of these "other funds" reflects a receipt of the Water Fund from the Navy for a sewer payment due to the Water Pollution Control Department, *i.e.*, a pass-through and not a true obligation of the Water Fund. See Revised Response to Hearing Request 07-25-07.

August 5, 2005. Newport Exhibit 13. The absence of a significant deficit between Newport's cash position and payables due to the City during this time-period shows that the rates given to Newport in Docket No. 3578 were able to sustain the utility's operations through the end of FY 2005.

Just as importantly, Newport Exhibit 13 shows that the deficit between Newport's cash and total payables as of June 30, 2007 of \$1,485,606 came about in the post June 30, 2005 time-period, particularly between June of 2006 and June of 2007. See Newport Exhibit 13. All of the parties concede that the summer of 2006 was "wetter" than normal, Transcript dated July 25, 2007 at 189, and that Newport sustained a decrease in consumption across virtually all classes in FY 2007, RFC Schedule F Comm. 2-1, equal to roughly an \$800,000 decrease in revenues. Transcript dated July 24, 2007 at 72. Moreover, it is undisputed that Newport incurred roughly \$531,000 in unexpected, non-recurring expenses in FY 2006 and FY 2007. Newport Exhibit 1(a).

Lastly, even if one were to accept the assertion that "much of the current deficit was there at the end of FY 2005"⁶ and that the FY 2005 deficit was "paid (some or all of it) from revenues the next year which created an ongoing deficit..." nothing in the settlement prohibited Newport from paying these alleged "loans" with revenues that the utility received after June 30, 2005 and that were derived from then existing rates.⁷ The settlement only bars Newport from "seek[ing] to recover in rates" monies to pay these loans—*i.e.*, the Docket No. 3675 rate increase or any other post-Docket No. 3578 awarded rate increase. Nor does the settlement bar Newport from financing the

⁶ Portsmouth Exhibit 6 at 24.

⁷ The rate increase from Docket No. 3675 did not start to produce additional revenues until the end of 2005. See Newport Exhibit 11.

“ongoing deficit” with additional loans that the utility obtained *after* June 30, 2005 and then requesting or using subsequent rate increases to pay for these loans.

While the Division does not oppose allowing Newport Water to pay down its accounts payable to the City, it does oppose increasing rates in this proceeding or using the additional billing charge revenues from more frequent billing to do so. As Mr. Catlin explained in his direct testimony, moving to more frequent billing “will result in a significant improvement in cash flow by both reducing the balance of unbilled revenues and by reducing the time that it takes for Newport to begin to realize the full annual effect of the rate increases it receives in this and future rate cases.” Division Direct Testimony at 16. It is the Division’s recommendation that Newport Water utilize the one-time bump in cash flow resulting from the reduction in unbilled revenues to reduce its accounts payable to the City. In Newport’s next case, a determination can then be made as to what, if any, measures are appropriate to reduce the accounts payable to the City.

Conclusion

For the foregoing reasons, the Commission should approve the revenue requirements agreed to by Newport and the Division with the exception of the ORA. With respect to the ORA, the Commission should approve funding level and manner of funding of this account as set forth in the Surrebuttal Testimony of Thomas S. Catlin and as testified to at hearing.

DIVISION OF PUBLIC UTILITIES
AND CARRIERS

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CERTIFICATE OF SERVICE

I certify that a copy of the within document was forwarded, by e-mail and by regular mail, postage prepaid, to the Service List in Docket No. 3818 on the ____ day of _____, 2007.
