

**BEFORE THE
PUBLIC UTILITIES COMMISSION
OF RHODE ISLAND**

**CITY OF NEWPORT)
UTILITIES DEPARTMENT,)
WATER DIVISION)** **DOCKET NO. 3818**

**DIRECT TESTIMONY
OF
THOMAS S. CATLIN**

**ON BEHALF OF THE
DIVISION OF PUBLIC UTILITIES AND CARRIERS**

MAY 2007

EXETER
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Direct Testimony of Thomas S. Catlin

Introduction

1

2 Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

3 A. My name is Thomas S. Catlin. I am a principal with Exeter Associates, Inc. Our offices
4 are located at 5565 Sterrett Place, Suite 310, Columbia, Maryland 21044. Exeter is a
5 firm of consulting economists specializing in issues pertaining to public utilities.

6 Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

7 A. I hold a Master of Science Degree in Water Resources Engineering and Management
8 from Arizona State University (1976). Major areas of study for this degree included
9 pricing policy, economics, and management. I received my Bachelor of Science Degree
10 in Physics and Math from the State University of New York at Stony Brook in 1974. I
11 have also completed graduate courses in financial and management accounting.

12 Q. WOULD YOU PLEASE DESCRIBE YOUR PROFESSIONAL
13 EXPERIENCE?

14 A. From August 1976 until June 1977, I was employed by Arthur Beard Engineers in
15 Phoenix, Arizona, where, among other responsibilities, I conducted economic feasibility,
16 financial and implementation analyses in conjunction with utility construction projects. I
17 also served as project engineer for two utility valuation studies.

1 From June 1977 until September 1981, I was employed by Camp Dresser &
2 McKee, Inc. Prior to transferring to the Management Consulting Division of CDM in
3 April 1978, I was involved in both project administration and design. My project
4 administration responsibilities included budget preparation and labor and cost monitoring
5 and forecasting. As a member of CDM's Management Consulting Division, I performed
6 cost of service, rate, and financial studies on approximately 15 municipal and private
7 water, wastewater and storm drainage utilities. These projects included: determining
8 total costs of service; developing capital asset and depreciation bases; preparing cost
9 allocation studies; evaluating alternative rate structures and designing rates; preparing bill
10 analyses; developing cost and revenue projections; and preparing rate filings and expert
11 testimony.

12 In September 1981, I accepted a position as a utility rates analyst with Exeter
13 Associates, Inc. I became a principal and vice-president of the firm in 1984. Since
14 joining Exeter, I have continued to be involved in the analysis of the operations of public
15 utilities, with particular emphasis on utility rate regulation. I have been extensively
16 involved in the review and analysis of utility rate filings, as well as other types of
17 proceedings before state and federal regulatory authorities. My work in utility rate filings
18 has focused on revenue requirements issues, but has also addressed service cost and rate
19 design matters. I have also been involved in analyzing affiliate relations, alternative
20 regulatory mechanisms, and regulatory restructuring issues. This experience has
21 involved electric, natural gas transmission and distribution, and telephone utilities, as
22 well as water and wastewater companies.

23 Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY
24 PROCEEDINGS ON UTILITY RATES?

1 A. Yes. I have previously presented testimony on more than 200 occasions before the
2 Federal Energy Regulatory Commission and the public utility commissions of Arizona,
3 California, Colorado, Delaware, the District of Columbia, Florida, Idaho, Illinois,
4 Indiana, Kentucky, Louisiana, Maine, Maryland, Montana, Nevada, New Jersey, Ohio,
5 Oklahoma, Pennsylvania, Utah, Virginia and West Virginia, as well as before this
6 Commission. I have also filed rate case evidence by affidavit with the Connecticut
7 Department of Public Utility Control.

8 Q. ARE YOU A MEMBER OF ANY PROFESSIONAL SOCIETIES?

9 A. Yes. I am a member of the American Water Works Association (AWWA) and the
10 Chesapeake Section of the AWWA. I serve on the AWWA's Rates and Charges
11 Committee and on the AWWA Water Utility Council's Technical Advisory Group on
12 Economics.

13 Q. ON WHOSE BEHALF ARE YOU APPEARING?

14 A. I am presenting testimony on behalf of the Division of Public Utilities and Carriers (the
15 Division).

16 Q. HAVE YOU PREVIOUSLY TESTIFIED ON WATER UTILITY ISSUES
17 BEFORE THIS COMMISSION?

18 A. Yes, I have been asked by the Division to address water utility issues on several
19 occasions. I testified on revenue requirement, cost of service and/or rate design issues in
20 Newport Water Division, Docket Nos. 2029, 2985, 3457, 3578 and 3675; Providence
21 Water Supply Board, Docket Nos. 2022, 2048, 2304, 2961, and 3163 and 3446; Kent
22 County Water Authority, Docket No. 2098, Woonsocket Water Department, Docket Nos.
23 2099 and 2904; United Water Rhode Island, Inc., (formerly Wakefield Water Company),

1 Docket Nos. 2006 and 2873; and Pawtucket Water Supply Board, Docket Nos. 3193,
2 3378, 3497 and 3674.

3 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

4 A. Exeter Associates was retained by the Division to assist it in the evaluation of the rate
5 filing submitted by the City of Newport Utilities Department, Water Division (Newport
6 Water or the Water Division) on January 29, 2007. This testimony presents my findings
7 and recommendations with regard to the overall revenue increase to which Newport is
8 entitled and with regard to the design of rates to recover those revenues.

9 Q. HAVE YOU PREPARED SCHEDULES TO ACCOMPANY YOUR
10 TESTIMONY?

11 A. Yes. I have prepared Schedules TSC-1 through TSC-10. Schedule TSC-1 provides a
12 summary of revenues and expenses under present and proposed rates. Schedules TSC-2
13 through TSC-9 present my adjustments to Newport Water's claimed revenues, operating
14 expenses and debt service costs and other supporting information. Schedule TSC-10
15 presents the development of the rates necessary to generate the Division's recommended
16 revenues.

17 Q. WHAT TIME PERIODS HAVE YOU UTILIZED IN MAKING YOUR
18 DETERMINATION OF NEWPORT'S REVENUE REQUIREMENTS?

19 A. Consistent with Newport Water's filing, I have utilized a test year that corresponds the
20 fiscal year ended June 30, 2006 and a rate year that corresponds to the fiscal year (FY)
21 ending June 30, 2008 as the basis for determining the Water Division's revenue
22 requirements and the revenue increase necessary to recover those requirements.

23 Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THE
24 APPROPRIATE INCREASE IN REVENUES IN THIS PROCEEDING?

1 A. As shown on Schedule TSC-1, it is my recommendation that Newport Water receive a
2 revenue increase of \$995,106 in this proceeding. This amount is \$585,790 less than the
3 increase of \$1,580,896 that Newport Water has identified as necessary based on rate year
4 revenues at present rates. In its application, Newport identified the rate increase being
5 sought as \$1,318,863. This amount was based on the cost of service requested in this
6 case compared to the revenues approved in Docket No. 3675. The actual increase
7 requested is greater because the rates approved in Docket No. 3675 are projected to
8 produce less revenue in the rate year than the level of revenue that was approved in
9 Docket No. 3675.

10 Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO HOW THE
11 ADDITIONAL REVENUES SHOULD BE RECOVERED?

12 A. I have accepted Newport Water's proposal to recover the allowed increase through a
13 uniform percentage increase in existing rates and charges for metered water services and
14 fire protection services, with one exception. That is, for reasons explained in detail later
15 in my testimony, I am proposing to not adjust the billing charge for water service in this
16 proceeding.

17

18 **Review of Rate Year Expenses**

19 Q. PLEASE PROVIDE AN OVERVIEW OF THE APPROACH THAT YOU
20 HAVE TAKEN IN THE REVIEW AND EVALUATION OF NEWPORT
21 WATER'S CLAIMED OPERATING EXPENSES FOR THE RATE YEAR?

22 A. I have reviewed Newport Water's claims for the rate year in light of the amounts
23 approved in Docket No. 3675 for the 2006 test year, actual 2006 test year expenses, and
24 historical expenses for years prior to FY 2006. To perform this evaluation, I have also

1 reviewed the justification for the claimed increases or decreases in expenses for the rate
2 year based on the supporting documentation provided in Newport Water's testimony as
3 well as in its responses to Division, Commission and intervenor data requests.

4 Based on my review, I believe that several elements of Newport Water's claimed
5 costs are likely to overstate actual rate year expenses (e.g., injury pay, legal advertising,
6 conferences and training, tuition reimbursement, etc.). However, for the most part, the
7 cost elements in question are small. In developing my recommendation, I have elected to
8 accept Newport Water's requested rate year expenses where the amount of the expense is
9 small and/or where any the amount of any adjustment that I would propose to an element
10 of expense would be small. I have instead focused on several larger elements of costs for
11 which I believe adjustments to the claimed rate year expenses are appropriate. These
12 items are discussed in the subsequent sections of my testimony.

13 14 **Sewer Charges**

15 Q. HOW DID NEWPORT WATER DEVELOP ITS CLAIM FOR SEWER
16 CHARGES?

17 A. Newport Water based its claimed allowance for rate year sewer charges for its Newport
18 plant (Newport Station One) on a waste discharge volume of 25.3 million gallons. This
19 corresponds to the average waste discharged from that plant in FY 2005 and FY 2006.
20 For the Lawton Valley Plant, sewer charges will commence upon completion of the
21 Residuals Management Project at that plant. Newport Water estimated the sewer charges
22 for the Lawton Valley plant based on a projected waste discharge volume of 22.831
23 million gallons. In calculating the rate year costs, it was assumed that sewage treatment
24 rates would increase by 3 percent from test year levels.

1 Q. WHAT ADJUSTMENTS ARE YOU PROPOSING TO MAKE TO NEWPORT
2 WATER'S CLAIM?

3 A. I am proposing to make two adjustments to Newport Water's claim. First, I am
4 proposing to adjust the sewer charges for the Newport plant to reflect the average annual
5 volumes of waste discharged for the two years ended January 2007, the most recent data
6 available. As noted by Ms. Forgue, improved operations have resulted in reduced waste
7 discharges from the Newport plant. A review of the historical monthly waste volumes
8 for FY 2005, FY 2006 and the first seven months of FY 2007 indicates that the
9 reductions in volumes continued to take place well into FY 2005. Therefore, utilizing
10 data for the period ended January 2007 will more accurately recognize the reduced
11 ongoing level of waste volumes from the Newport plant.

12 Second, I am proposing to adjust the sewer charges for the Lawton Valley plant to
13 recognize that the Residuals Management Project is not scheduled to be complete until
14 December 31, 2007, six months into the rate year. Accordingly, I have reduced the
15 allowance for sewer charges to one half the amount claimed by Newport Water.

16 Q. HAVE YOU PREPARED A SCHEDULE SHOWING THE DERIVATION OF
17 YOUR ADJUSTMENT?

18 A. Yes. Schedule TSC-3 shows the derivation of my adjustment to sewage disposal costs.
19 For the Newport Plant, the average annual waste volumes for the twelve months ending
20 January 31, 2006 and January 31, 2007 were 22,485,000 gallons and 22,447,000 gallons,
21 respectively. This produces a two-year average waste volume of 22,466,000 gallons.
22 This represents a reduction of 2,834,000 gallons in the average annual volumes utilized
23 by Newport Water. The resulting reduction in sewage charges at the Newport plant is
24 \$14,500. For Lawton Valley, I have reduced the costs claimed by the Water Division by

1 50 percent, from \$121,400 to \$60,700. It is shown on Schedule TSC-3, the total
2 reduction in sewer charges is \$75,200.

3
4 **Vehicle Maintenance Charges**

5 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO VEHICLE MAINTENANCE
6 CHARGES.

7 A. According to Ms. Forgue, the City of Newport has outsourced its vehicle maintenance
8 services. Because vehicle maintenance was not being properly completed due to lack of
9 staff and other reasons prior to the outsourcing in FY 2007, the use of an outside
10 contractor has resulted in an increase in costs. According to Ms. Forgue, the expected
11 increase is 15 percent. However, Newport's claimed rate year vehicle maintenance
12 expenses reflect an increase of more than 15 percent compared to the test year.

13 In order to evaluate Newport's claim, I compared the budgeted costs for FY 2008
14 for the City of Newport as a whole to its actual costs for FY 2006. I then applied this
15 increase of 17.28 percent to Newport Water's actual FY 2006 test year costs to arrive at a
16 rate year level of costs for Newport Water of \$117,795. This represents a reduction of
17 \$8,055 to Newport Water's claim, as reflected on Schedule TSC-4.

18
19 **Electricity Costs**

20 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO THE LEVEL OF
21 ELECTRICITY COSTS REFLECTED BY NEWPORT WATER FOR THE
22 RATE YEAR?

23 A. In developing its claim for the rate year electricity costs to be included as a contribution
24 to the Electricity Restricted Account, Newport included a 6 percent increase in electricity

1 rates. However, according to the response to Commission data request Set 1, question 16
2 (Comm. 1-16), Newport Water's power supply charges are not subject to change through
3 December 2009. In addition, the distribution rates of National Grid are locked in through
4 2009. Therefore, I have adjusted electricity costs to exclude the 6 percent rate increase
5 recognized by Newport Water. As summarized on Schedule TSC-5, this adjustment
6 reduces rate year expenses by \$25,170.

7
8 **Allowance for Doubtful Accounts**

9 Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO NEWPORT WATER'S
10 CLAIMED ALLOWANCE FOR DOUBTFUL ACCOUNTS.

11 A. Newport Water has included \$30,000 in rate year expenses for doubtful accounts. This
12 expense allowance was previously authorized in Docket No. 3578. However, Newport
13 Water has not experienced any uncollectibles or bad debt write-offs in the last three years
14 and does not consider any of its accounts receivables to be uncollectible. Accordingly, I
15 am proposing to adjust rate year expenses to exclude the \$30,000 expense for bad debt
16 costs included as the allowance for doubtful accounts. I have reflected this adjustment on
17 Schedule TSC-2, but have not included a separate schedule for this adjustment.

18
19 **Debt Issuance Fees**

20 Q. WHAT CLAIM HAS NEWPORT WATER MADE FOR FEES RELATED TO
21 THE ISSUANCE OF NEW DEBT?

22 A. Newport Water has included \$30,000 in consultant fees in the rate year for SRF
23 borrowing costs. According to RFC Schedule C, this amount represents projected legal
24 and other fees associated with the planned additional SRF borrowing in 2008.

1 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO MAKE TO THE
2 TREATMENT OF THESE SRF RELATED BORROWING COSTS?

3 A. I am proposing to exclude the \$30,000 from rate year consultant fees. Instead, I am
4 proposing that the costs that Newport Water incurs for legal or other fees in conjunction
5 with the issuance of the new debt be charged to the Debt Service Restricted Account.
6 This is consistent with the fact that such fees are debt related costs. Moreover, they are
7 not recurring annual expenses and the \$30,000 projection is not known and certain. A
8 review of RFC Schedule 9 and the update to that schedule provided in response to Div. 2-
9 7 indicates that sufficient funds will be available in the Debt Service Restricted Account
10 to pay these costs in FY 2008 without increasing the contribution to that account.
11 Accordingly, removing the SRF related amounts from consultant fees reduces rate year
12 expenses by \$30,000. This adjustment is presented on Schedule TSC-6.

13

14 **Self Insurance**

15 Q. PLEASE SUMMARIZE NEWPORT WATER'S CLAIM FOR SELF
16 INSURANCE.

17 A. Newport Water has included \$25,000 in rate year operating requirements for self-
18 insurance. According to Ms. Forgue, this item is intended to pay for claims not covered
19 by Newport Water's insurance policy. (Forgue Direct Testimony at page 16.) The
20 requested allowance of \$25,000 represents a reduction from the \$52,000 approved in
21 Docket No. 3675 for self insurance.

22 Q. WHAT HAS BEEN NEWPORT WATER'S EXPERIENCE WITH REGARD
23 TO DAMAGE CLAIMS NOT COVERED BY INSURANCE?

1 A. During the FY 2006 test year, Newport Water incurred an expense of \$404. During the
2 three prior years, Newport Water incurred an expense of \$12,500 in FY 2003 and no
3 expense in either FY 2004 or FY 2005.

4 Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THE
5 APPROPRIATE TREATMENT OF SELF INSURANCE?

6 A. A common approach to addressing the exposure for claims not covered by insurance is to
7 utilize reserve accounting. Under such an approach the amounts included in rates as an
8 expense are credited to a reserve account and actual claims paid are charged to that
9 reserve account. For investor owned utilities, the balance in the reserve is then deducted
10 from rate balance.

11 Consistent with this approach, I am proposing that reserve accounting be adopted
12 by Newport Water. Based on the historical level of expenses, a \$25,000 per expense
13 allowance proposed by Newport appears unnecessarily high. I am proposing that the
14 reserve accrual included in rates be set at \$10,000 per year. This amount can be reviewed
15 and adjusted in future proceedings. If the Commission deems it appropriate, a separate
16 restricted account could be required for the self insurance reserve. However, given the
17 nominal number of dollars involved, I do not believe that establishing another restricted
18 account is essential.

19 Q. WHAT IS THE EFFECT OF YOUR RECOMMENDATION ON RATE YEAR
20 OPERATING REQUIREMENTS?

21 A. As shown on Schedule TSC-7, my adjustment reduces operating requirements for the rate
22 year by \$15,000.

23

City Services

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Q. WHAT ADJUSTMENTS ARE YOU PROPOSING TO MAKE TO THE AMOUNTS INCLUDED IN THE COST OF SERVICE FOR PAYMENTS TO THE CITY OF NEWPORT FOR LEGAL AND ADMINISTRATIVE SERVICES AND DATA PROCESSING SERVICES?

A. I have made two adjustments to the amounts included in the test year for payments to the City of Newport for legal and administrative services and data processing services. First, most of the costs allocable to the Water Division are based on its claimed cost of service relative to the City of Newport’s budgeted costs (either including or excluding the schools and library). I have revised the allocations to reflect my adjustments to the Water Division’s total costs.

Second, Newport Water has made an adjustment to the data processing costs subject to allocation to include \$705,000 of capital costs not included in the budget. Since no explanation has been provided for this adjustment and it does not appear in the City budget provided in response to Div. 1-21, I have excluded this capital cost from the data processing costs subject to allocation to Newport Water.

Q. HAVE YOU PREPARED A SCHEDULE THAT PRESENTS YOUR ADJUSTMENTS TO CITY SERVICES EXPENSE?

A. Yes. The calculation of my adjustments to legal and administrative and data processing costs from the City of Newport are shown on Schedule TSC-8. As shown on page 1 of this schedule, my adjustment to the allocation of legal and administrative charges to reflect the Division’s cost of service results in an increase in these charges of \$30,924. This is because there was an error in the cell references in Newport Water’s model. In that model, all costs allocated on this basis of budget were allocated according to the

1 Water Division's percentage of the total Newport budget including the schools and
2 library even though five of the eight departments are shown as being allocated based on
3 the percentage of the total budget excluding the schools and library.

4 As also shown on page 1 of Schedule TSC-8, my adjustments to the calculation of
5 the data processing costs allocable to Newport Water reduce those costs by \$82,336.
6 This change is the result of both excluding the \$705,000 of unexplained capital costs
7 from the costs subject to allocation and updating the allocation factor to reflect the
8 Division's overall cost of service recommendation.

9
10 **Debt Service**

11 Q. WHAT CLAIM HAS NEWPORT WATER MADE FOR DEBT SERVICE

12 A. In its filing, Newport Water has reflected projected FY 2008 debt service totaling
13 \$1,304,900. This includes (rounded) \$1,010,000 for its October 2004 Bond Refunding
14 debt, \$88,000 for interest on its SRF Series A debt and \$207,000 of principal and interest
15 on a projected SRF Series B debt issue assumed to take place at the end of FY 2007.

16 Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO MAKE TO THIS
17 CLAIM?

18 A. I am proposing to include a total debt service allowance of \$1,221,000 including
19 \$1,010,000 for the debt service on the October 2004 Bond Refinancing debt and
20 \$211,000 (rounded up from \$210,779) for principal and interest on the SRF Series A
21 debt. The \$211,000 that I have included for the SRF Series A debt represents the
22 payments due in March and September of 2008, which are the amounts that will be due
23 during the first 12 months the rates approved in this case will be in effect. I have not
24 included any debt service on a potential new SRF Series B bond issue. To date, no

1 drawdown schedule for the new debt has been provided to SRF and the structure and
2 terms of the Series B loan have not been determined. Accordingly, it is my expectation,
3 based on Newport Water's experience with the SRF Series A debt, that any payments for
4 the new Series B debt in 2008 would be nominal and there would be sufficient funds in
5 the restricted Debt Service account to cover any small amounts. To the extent that,
6 during the pendency of this proceeding, Newport Water and the RICWFA establish a
7 debt service payment schedule that includes payments in 2008, I will modify my debt
8 service allowance if necessary.

9 Q. HAVE YOU PREPARED A SCHEDULE SHOWING THE CALCULATION
10 OF YOUR ADJUSTMENT TO DEBT SERVICE EXPENSE?

11 A. Yes. As shown on Schedule TSC-9, my proposed allowance for debt service represents a
12 reduction of \$83,900 compared to Newport's request.

13
14 **Health Insurance Costs**

15 Q. DO YOU HAVE ANY COMMENTS WITH REGARD TO HEALTH
16 INSURANCE COSTS?

17 A. Yes. In response to Div. 1-4, Newport Water noted that the City of Newport utilizes any
18 co-payments or other cost sharing amounts for employee medical and dental insurance as
19 contributions to the OPEB Trust account to fund currently unfunded retiree health
20 benefits. Therefore, it should not have recognized employee co-payments as an offset
21 against rate year benefits expenses. I have not made an adjustment to correct this error
22 because the amount of co-payments recognized is small (approximately \$3,000). In
23 addition, the response to Div. 1-6 indicates that the net increase in medical and dental
24 premiums is likely to be somewhat less (\$8,000 to \$9,000) than incorporated in the Water

1 Division's filing. Therefore, because the net difference is not significant, I have not
2 made an adjustment to either eliminate co-payments or to reflect revised insurance
3 premiums.
4

5 **Repayment of the City**

6 Q. WHAT CHANGE HAS NEWPORT WATER REQUESTED WITH REGARD
7 TO REPAYMENT OF THE CITY OF NEWPORT FROM THE RESTRICTED
8 ACCOUNT ESTABLISHED IN DOCKET NO. 3578?

9 A. In Docket No. 3578, the Commission authorized the Water Division to repay the City of
10 Newport a total of \$2.5 million that had been advanced by the City for use by the Water
11 Division. One-half of the money to repay the City was set aside from funds available in
12 Newport Water's restricted debt service account. The other one-half of the money was to
13 be recovered from ratepayers at the rate of \$250,000 per year for five years. The
14 repayment is taking place over five years, with the final \$500,000 payment scheduled for
15 June 30, 2008.

16 In this case, Newport Water is requesting that the schedule to repay the debt to the
17 City of Newport be altered. Instead of making the \$500,000 payment scheduled for June
18 30, 2007, it is proposing to utilize that payment plus the remaining funds in the
19 Repayment to City account (approximately \$298,000) to pay down its accounts payable
20 balance with the City. Because this would utilize the \$250,000 set aside from the debt
21 service restricted in Docket No. 3578 for the June 30, 2008 payment, that payment would
22 be reduced to \$250,000, leaving \$750,000 still owed to the City of Newport. Newport
23 Water is proposing to extend the collection of \$250,000 per year from ratepayers for an
24 additional three years (through FY 2011) in order to repay the remaining \$750,000.

1 Q. WHAT REASON HAS NEWPORT WATER CITED AS THE CAUSE FOR
2 THE NEED TO MAKE THIS REQUEST?

3 A. As discussed in some detail by Ms. Forgue and Mr. Smith, Newport Water has cited cash
4 flow shortfalls as causing it to being unable to make timely payments to reimburse the
5 City of Newport for employee payrolls and other accounts payable. The Water
6 Department has indicated that lower than projected revenues and the timing of the rate
7 increase in its last rate proceeding in Docket No. 3675 after the rate year began are
8 largely to blame for its cash flow issues.

9 Q. DO YOU HAVE ANY COMMENTS WITH REGARD TO THE CAUSES OF
10 NEWPORT WATER'S CASH FLOW DIFFICULTIES?

11 A. Yes. Newport Water's cash flow problems are exacerbated by the fact that the Water
12 Division bills the vast majority of its retail customers only three times per year. This
13 means that Newport Water will have approximately two months' worth of unbilled retail
14 revenues outstanding at all times. (This is in addition to billed accounts receivable.) In
15 addition, billing only three times per year means that the full annual effect of any
16 authorized rate increases will not be realized for seven to eight months after the rates go
17 into effect.

18 Q. DO YOU HAVE A RECOMMENDATION TO HELP MITIGATE NEWPORT
19 WATER'S CASH FLOW PROBLEMS?

20 A. Yes. It is my recommendation that Newport Water move from billing its retail customers
21 that are currently billed every four months to bi-monthly billing. This will result in a
22 significant improvement in cash flow by both reducing the balance of unbilled revenues
23 and by reducing the time that it takes for Newport to begin to realize the full annual effect
24 of the rate increases that it receives in this and future rate cases.

1 A. Newport Water has historically been allowed to include an operating revenue allowance
2 or operating reserve equal to 1.5 percent of its operating costs in its total cost of service.
3 In this case, Newport Water has requested that it be allowed to increase its operating
4 reserve to 6 percent of annual O&M expenses. This would produce an operating revenue
5 allowance of approximately \$415,000 as compared to approximately \$150,000 under the
6 traditional methodology that has been used in prior Newport Water cases. According to
7 Mr. Smith, any amounts not needed to cover unexpected expenses or reduced revenues
8 due to lower than expected sales would be used to establish an Operating Reserve Fund
9 equal to 45 days of O&M expense or approximately \$850,000.

10 Q. HAS NEWPORT WATER PROPOSED ANY LIMITATIONS ON HOW THE
11 ADDITIONAL MONEY COULD BE SPENT?

12 A. No. In his testimony, Mr. Smith did not propose any restrictions. Instead, he indicated
13 that the Commission could order restrictions on how the reserve fund could be spent. As
14 an example, he suggested the Commission could require that four percent of the total six
15 percent allowance be restricted, with Newport Water requiring Commission approval to
16 spend the restricted funds.¹

17 Q. WHAT IS YOUR POSITION WITH REGARD TO THIS REQUEST?

18 A. It is my recommendation that the operating revenue allowance included in the total cost
19 of service remain at the traditional level of 1.5 percent of total operating costs. In making
20 this recommendation, I recognize that in the recent Woonsocket Water Department
21 (Docket No. 3800) and Kent County Water Authority (Docket No. 3660) proceedings,
22 the Commission approved operating revenue allowances based on 1.5 percent of
23 operating costs excluding debt service, infrastructure replacement, and capital

¹ It should be noted that this would leave two percent of O&M expenses, or approximately \$135,000 to be spent without separate approval. This is less than the \$150,000 operating revenue allowance based on 1.5 percent of total operating costs.

1 expenditures. However, because of Newport Water's recent cash flow problems, I have
2 continued to base the operating revenue allowance on 1.5 percent of total operating costs
3 in this proceeding. In light of my subsequent recommendation to allow Newport to
4 establish an Operating Reserve Fund, it would be appropriate to review the basis on
5 which operating revenue allowance is determined in Newport Water's next general rate
6 proceeding.

7 Q. DO YOU HAVE AN ALTERNATIVE PROPOSAL FOR ESTABLISHING A
8 FUNDED OPERATING RESERVE?

9 A. Yes. As discussed previously, I am recommending that Newport Water move to bi-
10 monthly billing for those customers that are currently billed three times per year or every
11 four months. Because it will not be possible for Newport to make this transition over
12 night, it is not possible to predict the amount of additional rate year revenues that would
13 result from the additional billing charges that more frequent billing will produce.
14 Accordingly, I am not proposing to make any adjustment to rates in this case to account
15 for such additional revenues. Instead, it is my recommendation that the additional billing
16 charge revenues net of any incremental meter reading, billing and postage costs be used
17 to establish a separate Operating Reserve Fund.

18 Q. DO YOU HAVE ANY RECOMMENDATIONS REGARDING THE
19 IMPLEMENTATION AND OPERATION OF THIS FUND?

20 A. Yes. First, I would propose that Newport Water be required to track the additional
21 revenues that are realized from the increased number of billing charges as well as any
22 incremental costs that it incurs to render the additional bills. Newport Water should then
23 submit a quarterly report to the Commission and Division regarding the revenues and
24 costs for review and verification of the amount set aside in the reserve fund.

1 With regard to operation of the fund, I would recommend that, consistent with
2 Mr. Smith's suggestion, the Operating Reserve Fund be treated as a restricted account.
3 Newport Water should be required to submit requests to the Commission and the
4 Division if it proposes to utilize monies from the fund and Commission approval would
5 be required prior to use of the funds. Consistent with Newport Water's response to
6 Div. 2-6, the monies set aside in the Operating Reserve Fund could not be used to pay
7 for:

- 8 • Expenses not authorized by the Commission.
- 9 • Expenses not included in the Water Division's budget.
- 10 • Payments to the City of Newport for legal and administrative services or
11 data processing services in excess of the amounts approved in this docket
12 or subsequent dockets.
- 13 • Expenses otherwise funded through other restricted accounts.

14 The goal of these limitations is to ensure that Newport Water does not have a source of
15 cash to spend without Commission oversight.

16 Q. HAVE YOU ESTIMATED THE POTENTIAL BILLING CHARGE REVENUE
17 THAT COULD BE REALIZED BY MOVING FROM BILLING EVERY FOUR
18 MONTHS TO BILLING EVERY OTHER MONTH?

19 A. Yes. According to Mr. Smith's rate year revenue calculations, Newport Water has
20 approximately 14,100 customers that are billed three times per year. If all of those
21 customers were billed bi-monthly or six times per year, the Water Division would realize
22 approximately \$561,000 of additional revenue based on the current billing charge of
23 \$13.25.

24 Q. ARE YOU RECOMMENDING THAT THE ADDITIONAL BILLING
25 CHARGES RESULTING FROM MORE FREQUENT BILLING BE USED IN
26 FUTURE CASES TO FUND THE OPERATING RESERVE FUND?

1 A. No. It is my recommendation that, in Newport Water’s next rate case, the rates and
2 revenues be reset to match the Water Division’s overall cost of service. In doing so, the
3 revenues from the increased frequency of billing should be taken into account. To the
4 extent that continued funding of an Operating Reserve Fund is deemed to be appropriate
5 in that proceeding, the proper mechanism to do so can be addressed at that time.

6 Q. DO YOU HAVE ANY ADDITIONAL COMMENTS WITH REGARD TO
7 YOUR RECOMMENDATION CONCERNING ESTABLISHING AN
8 OPERATING RESERVE FUND AND PAYING DOWN NEWPORT WATER’S
9 ACCOUNTS PAYABLE?

10 A. Yes. I have attempted to craft an alternative solution that will allow Newport Water to
11 meet its objectives of improving cash flow, reducing its accounts payable and
12 establishing an operating reserve fund without simply increasing the amount included in
13 rates. If rates are increased as Newport has proposed, the burden falls entirely on
14 ratepayers. By moving to bi-monthly billing to accomplish these objectives, the onus
15 will be on the management of Newport Water to take the actions necessary to accomplish
16 the improvements it has sought in this case.

17

18 **Rate Design**

19 Q. HAVE YOU DEVELOPED RECOMMENDED RATES TO RECOVER THE
20 REVENUE INCREASE THAT YOU HAVE IDENTIFIED AS NECESSARY?

21 A. Yes. I am proposing that the allowed revenue increase be recovered through a uniform
22 percentage increase in all rates for water service and fire service, with the exception of
23 the billing charge for water service. To minimize the impact on customers from moving
24 to bi-monthly billing, I am proposing to hold the billing charge constant at the existing

1 rate of \$13.25 per bill. In turn, I am proposing to increase the commodity charge for
2 retail water service to recover the revenue increase that would have otherwise been
3 recovered through the uniform percentage increase in the billing charge. This
4 recommendation has no effect on rates for the Navy or Portsmouth.

5 The calculations of my rate recommendations are presented on Schedule TSC-9.
6 As shown on page 1 of that schedule, the revenue increase of \$995,106 that I have
7 recommended on behalf of the Division represents an increase of 11.60 percent over the
8 rate year revenue at existing water and fire service rates. Page 2 of Schedule TSC-9
9 presents the calculation of the rates necessary to generate this increase and provides a
10 proof of revenue at proposed rates. I would note that the increase in the retail commodity
11 charge necessary to recover the revenue that would have been generated by the uniform
12 percentage increase in the billing charges was \$0.06 per thousand gallons.

13 Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?

14 A. Yes, it does.

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**BEFORE THE
PUBLIC UTILITIES COMMISSION
OF RHODE ISLAND**

**CITY OF NEWPORT)
UTILITIES DEPARTMENT,)
WATER DIVISION)** **DOCKET NO. 3818**

**SCHEDULES ACCOMPANYING THE
DIRECT TESTIMONY
OF
THOMAS S. CATLIN

ON BEHALF OF THE
DIVISION OF PUBLIC UTILITIES AND CARRIERS**

MAY 2007

EXETER
ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 20904

CITY OF NEWPORT--WATER DIVISION

Summary of Revenues and Expenses at
Present and Proposed Rates
Rate Year Ended June 30, 2008

	Rate Year Amount Per Newport	Division Adjustments	Rate Year at Present Rates	Proposed Rate Increase	Rate Year at Proposed Rates
Revenue					
Customer Charge	\$ 682,468	\$ -	\$ 682,468	\$ -	\$ 682,468
Retail Consumption	5,085,099	-	5,085,099	674,681	5,759,780
Wholesale/Bulk Sales	1,863,504	-	1,863,504	214,807	2,078,311
Fire Protection	948,275	-	948,275	109,768	1,058,043
Miscellaneous	443,076	-	443,076	-	443,076
Total Revenue	\$ 9,022,422	\$ -	\$ 9,022,422	\$ 999,256	\$ 10,021,678
Expenses					
Water Administration	1,785,992	(135,037)	1,650,955	-	1,650,955
Customer Accounts	614,997	-	614,997	-	614,997
Source of Supply-Island	568,165	(1,600)	566,565	-	566,565
Source of Supply-Mainland	107,100	(4,100)	103,000	-	103,000
Treatment & Pumping-Newport Plant	1,437,499	(25,100)	1,412,399	-	1,412,399
Treatment & Pumping-Lawton Valley	1,229,718	(67,700)	1,162,018	-	1,162,018
Water Laboratory	220,400	-	220,400	-	220,400
Transmission & Distribution Maintenance	940,395	(1,300)	939,095	-	939,095
Fire Protection	14,000	-	14,000	-	14,000
Subtotal	\$ 6,918,266	\$ (234,837)	\$ 6,683,429	\$ -	\$ 6,683,429
Payment to City General Fund	250,000		250,000	-	250,000
Debt Service	1,304,900	\$ (83,900)	1,221,000	-	1,221,000
Capital Outlays	1,715,056		1,715,056	-	1,715,056
Total Expenses	\$ 10,188,222	\$ (318,737)	\$ 9,869,485	\$ -	\$ 9,869,485
Operating Reserve	415,096	(267,054)	148,042	-	148,042
Total Cost of Service	\$ 10,603,318	\$ (585,790)	\$ 10,017,528	\$ -	\$ 10,017,528
Revenue Surplus/(Deficiency)	(\$1,580,896)	\$585,790	(\$995,106)	\$ 999,256	\$4,150

CITY OF NEWPORT--WATER DIVISION

Summary of Division Adjustments to
Rate Year Expenses at Present Rates
Rate Year Ending June 30, 2008

<u>Description</u>	<u>Amount</u>	<u>Source</u>
Sewer Charges	(75,200)	Schedule TSC-3
Vehicle Maintenance Costs	(8,055)	Schedule TSC-4
Electricity Costs	(25,170)	Schedule TSC-5
Allowance for Doubtful Accounts	(30,000)	Refer to Testimony
SRF Debt Issuance Consulting Fees	(30,000)	Schedule TSC-6
Self Insurance	(15,000)	Schedule TSC-7
City Services--Legal & Administrative	30,924	Schedule TSC-8
City Services--Data Processing	(82,336)	Schedule TSC-8
Updated Debt Costs	(83,900)	Schedule TSC-9
Operating Reserve	<u>(267,054)</u>	See Note (1)
Total Expense Adjustments	<u>\$ (585,790)</u>	

Note:

(1) Based on 1.5% of total expenses as reflected on Schedule TSC-1.

CITY OF NEWPORT--WATER DIVISION

Adjustment to Sewer Charges for
Newport Water Treatment Plants
Rate Year Ending June 30, 2008

Newport Plant

Volumes for 12 Months Ending 1/31/2006 (1)	22,485,000
Volumes for 12 Months Ending 1/31/2007 (1)	22,447,000
Average Annual Volume	<u>22,466,000</u>
Unit Charge (1)	<u>\$ 0.00532</u>
Annual Charge per Division (rounded)	\$ 119,500
Annual Charge per Newport Water (2)	<u>134,000</u>
Adjustment to Newport Station Sewer Charges	<u><u>\$ (14,500)</u></u>

Lawton Valley Plant

Annual Charge per Newport Water (2)	\$ 121,400
Charge for January-June 2008	<u>60,700</u>
Adjustment to Lawton Valley Sewer Charges	<u><u>\$ (60,700)</u></u>

Total Adjustment to Sewer Charges \$ (75,200)

Notes:

(1) Per response to Div. 1-15.

(2) Per RFC Schedule 3.

CITY OF NEWPORT--WATER DIVISION

Adjustment to Vehicle Maintenance Costs
Rate Year Ending June 30, 2008

	<u>Adjustment</u>
City of Newport Total Vehicle Maintenance (1)	
Actual FY 2006 (Test Year)	\$ 1,150,337
Budget FY 2008 (Rate Year)	<u>1,349,142</u>
Growth Factor	1.1728
Water Division Vehicle Maintenance	
Actual FY 2006 (Test Year)	\$ 100,437
Growth Factor	<u>1.1728</u>
Adjusted Rate Year Expense	\$ 117,795
Amount per Newport Water	<u>125,850</u>
Adjustment to Vehicle Maintenance	<u><u>\$ (8,055)</u></u>

Notes:

(1) Per response to Div. 1-16.

(2) Per RFC Schedule 2.

CITY OF NEWPORT--WATER DIVISION

Adjustment to Electricity Costs
 Rate Year Ending June 30, 2008

	<u>Rate Year Use (kWh) (1)</u>	<u>Rate (2)</u>	<u>Rate Year Amount</u>
Administration	57,000	\$ 0.100	5,700
Supply-Island	272,000	0.100	27,200
Supply-Mainland	648,000	0.105	68,000
Newport Plant (3)	1,877,500	0.095	178,400
Lawton Valley	1,180,000	0.100	123,000
Distribution	216,000	0.100	<u>21,600</u>
Total Per Division			\$ 423,900
Amount per Newport Water (1)			<u>449,070</u>
Adjustment			<u><u>\$ (25,170)</u></u>

Notes:

- (1) Per response to Div. 1-23.
- (2) Current rate excluding 6% Increase
- (3) Includes \$5,000 for normal pump station electricity costs.

CITY OF NEWPORT--WATER DIVISION

Adjustment to Reflect Consulting Fees Related to SRF Borrowing
as Charges to Debt Service Restricted Account
Rate Year Ending June 30, 2008

	<u>Total</u>
Consulting Fees Related to Planned SRF Borrowing (1)	\$ 30,000
Amount to be included in O&M Expense	<u>\$ -</u>
Adjustment to Include costs in Debt Service Resrtricted Account	<u><u>\$ (30,000)</u></u>

Note:

(1) Per RFC Schedule C and Comm. 1-19.

CITY OF NEWPORT--WATER DIVISION

Adjustment to Normalize Self Insurance Expense
Rate Year Ending June 30, 2008

	<u>Total</u>
Self Insurance Expense per Newport Water	\$ 25,000
Allowance per Division	<u>10,000</u>
Adjustment to Include costs in Debt Service Resrtricted Account	<u><u>\$ (15,000)</u></u>

Note:

(1) Per RFC Schedule 2.

CITY OF NEWPORT--WATER DIVISION

Adjustment to City Services Costs
 Rate Year Ending June 30, 2008

	<u>Total City Budget</u>	<u>Adjustment</u>	<u>Allocable Budget</u>	<u>Allocation to Water Division</u>	<u>Percent (1)</u>
City Council	\$ 149,932	\$ (51,962)	\$ 97,970	\$ 10,226	10.44%
City Manager	451,350	(40,000)	411,350	42,938	10.44%
City Solicitor	384,374	(192,187)	192,187	27,314	14.21%
City Clerk	538,658	(187,143)	351,515	36,692	10.44%
Finance Administration	347,357	(173,679)	173,679	24,684	14.21%
Assessment	303,983	(100,314)	203,669	28,946	14.21%
Collections	274,005	-	274,005	38,943	14.21%
Administrative Services	258,420	-	258,420	36,728	14.21%
Facilities Maintenance	654,108		654,108	32,705	5%
Total Allocated on Budget	\$ 3,362,187	\$ (745,285)	\$ 2,616,902	\$ 279,177	0.00%

Human Resources, Accounting, Purchasing

71,395

Total

\$ 350,572

Amount per Newport Water

319,648

Adjustment to Legal & Administrative

\$ 30,924

	<u>Total City Budget</u>	<u>Adjustment</u>	<u>Allocable Budget</u>	<u>Allocation to Water Division</u>	<u>Percent (1)</u>
Data Processing Services	\$ 904,412	-	904,412	\$ 94,405	10.44%
Amount per Newport Water				176,741	
Adjustment to Data Processing Services				\$ (82,336)	

Note:

(1) Refer to page 2 of this schedule..

CITY OF NEWPORT--WATER DIVISION

Calculation of City Services Allocation Factors
 Rate Year Ending June 30, 2008

<u>Percentage Excluding Schools and Library</u>	FY2007	
	<u>Adopted Budget</u>	<u>Percentage</u>
General Fund Less School & Library	\$ 48,523,621	68.84%
Harbor	\$ 667,883	0.95%
Water Fund	\$ 10,017,528	14.21%
WPC	\$ 8,633,784	12.25%
Parking	\$ 1,681,564	2.39%
Beach	\$ 959,973	1.36%
Total Budget	\$ 70,484,353	100.00%

<u>Percentage Including Schools and Library</u>	FY2007	
	<u>Adopted Budget</u>	<u>Percentage</u>
General Fund Including School & Library	\$ 74,007,978	77.12%
Harbor	\$ 667,883	0.70%
Water Fund	\$ 10,017,528	10.44%
WPC	\$ 8,633,784	9.00%
Parking	\$ 1,681,564	1.75%
Beach	\$ 959,973	1.00%
Total Budget	\$ 95,968,710	100.00%

CITY OF NEWPORT--WATER DIVISION

Adjustment to Reflect Updated Debt Service Costs
for Debt Service Restricted Account Contribution
Rate Year Ending June 30, 2008

	<u>Total</u>
2004 Bond Refinancing Debt (1)	\$ 1,010,000
SRF Series A Debt (2)	<u>211,000</u>
Adjusted Debt Service Requirement (1)	\$ 1,221,000
Amount per Newport Water Filing (2)	<u>1,304,900</u>
Adjustment to Debt Service Resrtricted Account Contribution	<u><u>\$ (83,900)</u></u>

Notes:

(1) Per RFC Schedule B.

(2) Per response to PWFD 1-18. Reflects March and September 2008 payments.

CITY OF NEWPORT--WATER DIVISION

Calculation of Uniform Percentage Increase in Rates
 Required to Generate Additional Revenues
 Rate Year Ending June 30, 2008

<u>Customer Class</u>	<u>Existing Rate</u>	<u>Rate Year Sales (1) (1,000 gals)</u>	<u>Rate Year Revenues at Existing Rates</u>
Retail	\$ 4.070	1,249,410	\$ 5,085,099
Navy	\$ 2.510	373,306	936,998
Portsmouth	\$ 2.000	463,253	<u>926,506</u>
Metered Sales Revenues at Existing Rates			\$ 6,948,603
<u>Type of Charge</u>	<u>Existing Charge</u>	<u>Number Billed (1)</u>	<u>Rate Year Revenues at Existing Rates</u>
Billing Charge	\$ 13.25	51,507	682,468
Fire Protection Charges (Public)	\$ 675.00	982	662,850
Fire Protection Charges (Private)			
less than 2"	\$ 13.25	-	-
2"	55.00	-	-
4"	343.00	55	18,865
6"	687.00	234	160,758
8"	1,572.00	62	97,464
10"	2,596.00	-	-
12"	4,169.00	2	<u>8,338</u>
Total Private Fire Service			\$ 285,425
Total Rate Year Revenues from Existing Rates and Charges			<u>\$ 8,579,346</u>
Net Rate Year Revenue Requirements (2)			<u>\$ 9,574,452</u>
Additional Revenue Needed			\$ 995,106
% Revenue Increase Required			<u><u>11.60%</u></u>

Notes:

(1) Per Schedule RFC 5.

(2) Per Schedule TSC-1. Equals total cost of service less miscellaneous revenue.

CITY OF NEWPORT--WATER DIVISION

Calculation of Proposed Rates and
Proof of Revenue at Proposed Rates
Rate Year Ending June 30, 2008

<u>Customer Class</u>	<u>Existing Rate</u>	<u>Percent Increase (1)</u>	<u>Proposed Rate</u>	<u>Rate Year Sales (2) (1,000 gals)</u>	<u>Rate Year Revenues at Proposed Rates</u>
Retail (3)	\$ 4.070	11.60%	\$ 4.610	1,249,410	\$ 5,759,780
Navy	2.510	11.60%	\$ 2.800	373,306	1,045,257
Portsmouth	2.000	11.60%	\$ 2.230	463,253	1,033,054
Metered Sales Revenues at Proposed Rates					\$ 7,838,091
<u>Type of Charge</u>	<u>Existing Charge</u>	<u>Percent Increase (1)</u>	<u>Existing Charge</u>	<u>Number Billed</u>	<u>Rate Year Revenues at Proposed Rates</u>
Billing Charge (3)	\$ 13.25	0.00%	\$ 13.25	51,507	682,468
Fire Protection Charges (Public)	\$ 675.00	11.60%	\$ 753.00	982	739,446
Fire Protection Charges (Private)					
less than 2"	\$ 13.25	11.60%	\$ 15.00	-	-
2"	55.00	11.60%	61.00	-	-
4"	343.00	11.60%	383.00	55	21,065
6"	687.00	11.60%	767.00	234	179,478
8"	1,572.00	11.60%	1,754.00	62	108,748
10"	2,596.00	11.60%	2,897.00	-	-
12"	4,169.00	11.60%	4,653.00	2	9,306
Total Private Fire Service					\$ 318,597
Total Rate Year Revenues from Proposed Rates and Charges					\$ 9,578,602
Net Rate Year Revenue Requirements (4)					\$ 9,574,452
Difference					\$ 4,150

Notes:

- (1) Per page 1 of this schedule.
- (2) Per Schedule RFC 5.
- (3) The billing charge has not been increased and the retail volumetric rate was adjusted to recover the revenue increase that otherwise would have been recovered through a uniform percentage increase in the billing charge.
- (4) Per Schedule TSC-1. Equals total cost of service less miscellaneous revenue.