STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: CITY OF NEWPORT, UTILITIES DIVISION, WATER DEPARTMENT

DOCKET NO: 3818

MEMORANDUM IN SUPPORTOF NEWPORT WATER'S PROPOSED CHANGES IN RATES

August 20, 2007

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I. INTRODUCTION

On January 29, 2007 pursuant to Rhode Island General Laws § 39-3-11 and Part II of the Rhode Island Public Utilities Commission's ("Commission") Rules of Practice and Procedure, the City of Newport, Utilities Department, Water Division ("NWD") filed an application to increase rates. NWD's proposed rates were designed to collect additional operating revenue in the amount of $1,580,896 to support a $10,603,318 total cost of service. The impact of this request would have resulted in a 15% increase in total cost of service. For a typical residential customer, the impact of this request would have resulted in an increase of $48.75 per year or 18.44%. In support of its filing NWD submitted testimony and supporting schedules from Harold Smith and Julia Forgue.

As required, The Division of Public Utilities and Carriers ("Division") reviewed NWD's proposed rate change and submitted testimony and supporting schedules from Thomas Catlin. In addition, NWD's wholesale customers, the Portsmouth Water & Fire District ("PWFD") and the United States Department of the Navy ("Navy"), intervened in this Docket. PWFD filed testimony and supporting schedules from Christopher Woodcock, William McGlinn and Phillip Driscoll, and the Navy submitted testimony from Larry Allen. After the filing of surrebuttal testimony by the Division and Intervenors, NWD filed supplemental testimony and schedules prepared by Harold Smith.

Through this supplemental testimony, NWD revised its original request. As set forth in RFC Schedule 1 Hearing, NWD's revised request was for an overall net operating revenue requirement of $9,528,422, or an 11% increase in total cost of service. At the hearings held on July 24 and 25, 2007, NWD submitted a schedule summarizing the parties' respective positions (NWD Exhibit 12). This scheduled showed only one substantial area of disagreement between NWD and the Division –

the funding of the operating reserve. In addition, this schedule showed approximately three substantial areas of disagreement with PWFD in the areas of Debt Service, Capital and City Services. There were no substantial disagreements regarding revenue requirements with the Navy.

This memorandum will address the areas of disagreement identified above and several other issues raised during the hearing:

1) Operating Reserve
2) Bi-Monthly Billing
3) NWD Payables
4) Debt Service and Capital Funding
5) City Services Funding

II. ARGUMENT

"Character is like a tree and reputation like its shadow. The shadow is what we think of it; the tree is the real thing." - Abraham Lincoln

In opening statements, counsel for NWD urged the Commission to examine the "tree" in this case, not the shadow. In closing remarks, Chairman Germani made a similar request by asking the parties to focus on the "light" rather than the "heat." As such, in this memorandum NWD will focus on the key issues submitted to the Commission while attempting to avoid the rancor that marked the pre-filed testimony.

Clearly, the most serious issue confronting NWD is the severe under collection of revenue since the 2004 decision in Docket 3578. This issue is the "tree" or the "light" in this Docket, and it was particularly illuminated by two exhibits. The first was Commission 3, which included NWD's response to Commission Data Request 2-1. (See Appendix) This data response set forth NWD's annual consumption from FY00 to FY07, and it demonstrates consistent decreased consumption between FY04 and FY07. This last year, FY07, is particularly troubling. In FY07, the projected consumption, as established in Docket 3675 was 2,168,572 thousand gallons. However, the preliminary figures show that NWD only sold 1,896,780 thousand gallons. Thus, NWD's consumption was down approximately 13%.

The second revealing exhibit was NWD 11. (See Appendix) This document shows the effect of NWD's under collection since Docket 3578. Based on consumption projections in Dockets 3578 and 3675 NWD should have collected $34,225,588 between FY04 and FY07. However, due to decreased consumption, NWD has only collected $28,896,012. This is a deficit of $5,329,576. This problem permeates many of the issues litigated in this Docket and many of the issues discussed herein below.

1. OPERATING RESERVE

Clearly, the most important issue to be decided by the Commission is the establishment and funding of an operating reserve. NWD's proven under collection of revenue demonstrates the critical need for a reserve. Furthermore, while there has been some disagreement among the parties over funding this reserve, there does not seem to be any disagreement as to its necessity.

As discussed during the hearings, the Commission has historically established an operating reserve to meet unforeseen expenses. However, this customary reserve, equal to 1.5% of total operating costs, has been woefully inadequate. For example, in FY07 NWD paid $137,043 to settle a tax dispute with the Town of Middletown and $294,000 to cover retroactive pay increases for union employees. These combined expenses of $431,043 far exceeded the $137,209 operating reserve allowed in Docket 3675. Furthermore, since NWD did not collect the full amount of revenue in FY07, there was no operating reserve. As such, these expenses had to be paid out of revenues that were intended to meet normal O&M expenses.

Certainly, there will always be unforeseen and unbudgeted costs, and an operating reserve should play some role in covering such expenses. However, NWD does not seek a reserve so it can exceed budgeted expenses or spend more than is allowed by the Commission. As this Docket has clearly demonstrated, an operating reserve is necessary due to the unpredictable nature of water consumption by NWD's customers – including its wholesale customers PWFD and the Navy.

Before submitting a rate filing to the Commission, NWD spends a great deal of effort and resources developing the proper expense requests for O&M, Capital, Debt Service, etc. Once the case is submitted, the Division, PWFD and the Navy then spend a great deal of time and resources examining the propriety of NWD's request. In addition, the parties' experts use their experience, training and skill to forecast consumption. Then after the parties have spent a great deal of time and money setting the proper expenses and projected consumption, NWD is bound to stay within the expense limits decided by the Commission. Yet, despite all this work, everything going forward from the completion of a Docket is dependent on the most unpredictable factor of all – water consumption, which in many cases is dependent on a more unpredictable variable – the weather.

Since the decision in Docket 3578, NWD has not collected $5,329,576 for expenses the parties and the Commission deemed appropriate. As a result, NWD was forced to make choices among competing vendors, including the City of Newport. As set forth in NWD Exhibit 13, in FY07 NWD went from a positive cash flow of $439,949 in July 2006 to a deficit of $1,485,606 in June 2007. (See Appendix) This coincided with NWD's severe under collection of revenue in this fiscal year. While much has been made over the timing of NWD's filing, no rate filing in FY07 – no matter when it was submitted – would have stemmed the tide and prevented the deficit.

As Mr. Catlin testified, it is preferable to have an operating reserve that can be used concurrently with a revenue shortfall. "It's not particularly helpful in all cases to have a large revenue shortfall this year to collect it a year from now or 16 months from now when you get through the year and realize oh, we are short."[1] Mr. Woodcock has taken a similar position on this matter when testifying on behalf of utilities other than PWFD. As he acknowledged at the hearing, he previously testified for the Pawtucket Water Supply Board as follows: [2]

> **Q: Can't the utilities just file for another rate increase if revenues fall short of expectations?**
> A: Yes they can, but even this remedy has serious short comings. A utility may not know the extent of shortfalls in sales until well into the year. Even if they suspected such reductions, it would be difficult to predict the extent so far in advance. This remedy is further compounded by regulatory lag. Assuming at least a month to prepare and file a case followed by at least six months of investigations and hearings, we are looking at more than seven months before a decision. With quarterly billing of most accounts, the full impact of new rates does not even begin to impact the utility until about a year after the preparation of the case began, and the full increase will not be collected for another 12 months! (Woodcock direct, PWSB Docket 3674 direct, p. 14, lines3-5)

If NWD's FY07 consumption is repeated in the rate year, there will be another serious revenue shortfall. As Mr. Nault pointed out, if FY08 consumption is similar to FY07, then NWD's revenue will be down by about $800,000.[3] NWD simply cannot sustain this continued under collection of revenue without some type of safety net.

Simply put, there is no viable substitute for a proper operating reserve to assist NWD when revenues decline due to lower consumption. NWD must be given an opportunity to pay legitimate expenses deemed reasonable by the parties and approved by the Commission in rate cases. Thus,

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1 Transcript v.II, p. 16
2 Transcript v. II, p. 122-123
3 Transcript v. I, p. 72

NWD seeks to collect 6% of O&M costs in FY 08 and FY 09 to fund an operating reserve with an approximate balance of $830,000, roughly equal to 45 days worth of operating costs. As Mr. Smith testified, this request is consistent with the AWWA Manual M-1 that suggests the "one-eighth rule" in which the target balance for the operating reserve is one-eighth of annual O&M costs, which is the same as 45 days of O&M costs.[4]

Once the target funding is met, the annual contribution can be reduced or redirected. NWD anticipates issuing approximately $13 million dollars in debt over the next three to four years, thus there will be a need for additional future funding in debt service.5 In addition, as set forth below, NWD has committed to preparing a cost of service study within the next two years, and NWD may be back before the Commission even sooner. Thus, NWD will be back before the Commission by the time the operating reserve is funded.

NWD recognizes there should be some restrictions placed on this operating reserve. These restrictions can be tied to either under collection of revenue, unforeseen expenses or both. Thus, NWD is agreeable to any reasonable restrictions imposed by the Commission.

As set forth above, the parties' only real dispute is how this account should be funded. These funding issues are intertwined with the proposed move to bi-monthly billing and payment of NWD's outstanding payables. Thus, the question of how to fund this reserve is examined in sections 2 and 3 below.

2. BI-MONTHLY BILLING

The question of whether NWD should move to bi-monthly billing was debated thoroughly in pre-filed testimony. In fact, there was no consensus until July 6, 2007, when NWD submitted

[4] H. Smith direct, p. 16

Harold Smith's supplemental testimony and schedules. When the hearings began, the parties agreed that NWD should move to bi-monthly billing as soon as possible. Thus, the Commission is left to decide two issues (a) should NWD transition to bi-monthly billing; and (b) if any excess revenue is generated how it should be used.

A. Transition to Bi-Monthly Billing

The move to bi-monthly billing was first raised by the Division in Thomas Catlin's direct testimony. Mr. Catlin recognized that some of NWD's cash flow problems stem from tertiary billing. NWD currently bills the majority of its retail customers once every four months. Mr. Catlin suggested that NWD begin billing these customers six times per year rather than three. Mr. Catlin believed that increased billing frequency would reduce unbilled revenue and allow NWD to realize the full impact of rate increases faster. In addition, Mr. Catlin took the position that bi-monthly billing could assist in funding the operating reserve and reducing NWD's payables.

NWD agreed with Mr. Catlin's assessment that increased billing would be beneficial. Certainly, increased billing would help cash flow. NWD also believed that increased billing would benefit its customers. In fact, NWD had planned to increase its billing frequency upon completion of the remote radio read program. However, NWD was resistant to an immediate move to bi-monthly billing.

This resistance was based on a number of obstacles – both long term and short term – identified in Ms. Forgue's rebuttal testimony.[6] On a long term basis, NWD's existing capital plan called for the remote radio read program to be completed over five years. Thus, NWD's believed that an immediate move to bi-monthly billing should include an acceleration of this program. To do

5 Transcript v. I, p. 55

this, NWD would have to use funding from bonds rather than capital. This funding change would cut completion of this project from five years to approximately two and a half years.

However, in the intervening two and a half years, NWD would face a number of short term challenges. As Ms. Forgue testified, an immediate move to bi-monthly billing would be difficult as it would depend on increased meter reading to provide reliable usage data. This would result in either increased costs to improve meter reading or a dependence on estimated reads for the additional billing cycles. Furthermore, Ms. Forgue expressed concern about the effect on NWD's customers. Among these concerns was the potential objection that increased billing based on estimated reads provides no added value other than an increased charge. 7

In his surrebuttal testimony, Mr. Catlin continued to advocate for bi-monthly billing to improve NWD's financial health. Mr. Catlin also addressed some of Ms. Forgue's concerns. Mr. Catlin was supported by Mr. Woodcock, who recommended an acceleration of the remote radio read program and an immediate move to bi-monthly billing. NWD responded by submitting supplemental testimony in which it agreed to transition to bi-monthly billing as soon possible. As such, NWD revised its Capital Plan and the proposed funding for Capital and Debt Service. These revisions are covered more fully in Section 4 below. NWD also requested $81,300 for costs associated with the transition to bi-monthly billing.

At the hearing, the Commission raised a number of concerns that echoed those mentioned by Ms. Forgue. The predominant concern was the impact on customers, and NWD shares these concerns. However, NWD believes that the overall, long-term advantages of increased billing will benefit its customers. To begin with, the debate and eventual consensus over this issue led to an

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6 Forgue rebuttal, p. 6-9

agreed acceleration of the remote radio read program, which has a number of benefits. This program will allow NWD to collect better usage data that will assist in developing reliable cost of service studies for future rate cases. In addition, NWD can improve leak detection in the distribution system by conducting daily readings in specific areas where a problem is suspected. Bi-monthly billing will also shorten the duration of unknown leaks in residential homes from four months to two months, which is especially beneficial to NWD's many temporary seasonal residents. In addition, bi-monthly billing will result in smaller bills, which will be more affordable and predictable, and will allow NWD's customers to better budget for water costs. In addition, these smaller bills will likely be paid in a timely manner, thus lessening the need for collection efforts and improving cash flow.

Certainly, it is in the customers' best interest that NWD maintain positive cash flow and improve its financial position. NWD cannot continue operating in a deficit position. Luckily, over the past four years, NWD has not been forced to cut back on necessary capital projects because it fully funds the restricted capital and debt service accounts. However, the severe under collection of revenue has forced NWD to cut back its O&M expenses and choose among competing expenses. Fortunately, the City of Newport has allowed NWD to give payroll and city service expenses low priority. However, NWD cannot continue to ignore these obligations, and depending on the Commission's decision in this Docket, the City of Newport may become the first priority among competing payables. None of this benefits NWD's customers.

B. Revenue from Bi-Monthly Billing

As set forth above, it is Mr. Catlin's position that bi-monthly billing will provide several financial benefits. In addition to improving cash flow, Mr. Catlin suggested that increased billing

7 Forgue rebuttal, p. 6-9

revenue can be used to fund NWD's operating reserve and reduce its payables. In FY 08, Mr. Catlin estimates that NWD will generate $300,000 of additional revenue if the billing charge remains at $13.25, and the 14,100 tertiary customers are billed bi-monthly.[8] Mr. Catlin recommends this money be combined with the existing 1.5% of total operating costs to fund a restricted operating reserve. Mr. Catlin also suggests that "converting to more frequent billing will result in a significant one time bump in revenue due to the reduction in unbilled revenues", and that this "bump" be used to reduce NWD's accounts payable. [9]

Prior to the hearings, both NWD and PWFD opposed Mr. Catlin's suggested use of these funds. As Mr. Woodcock testified:

> **Q: Mr. Catlin has suggested that the increased revenues from more frequent readings should provide sufficient new cash to eliminate the need for the higher operating reserve that you and Newport propose. Do you agree?**
> A. I agree that the increased billing should indeed provide additional cash flow and allow Newport to recognize revenues from increased rates faster. I do not agree that it should be a substitute for a more realistic operating reserve however. As the Commission is aware, the increased revenues from more frequent billings was an issue in Docket 3626 (Woonsocket Water). Because Newport remains in a negative cash position, I have no problem with increasing the revenues due to more frequent billing to help them out of this negative position.[10]

However, Mr. Woodcock completely changed his position during live testimony without providing any substantive explanation. Nevertheless, NWD believes that Mr. Woodcock's surrebuttal position was correct, the operating reserve should be separately funded in rates at 6% of O&M expenses. Any excess revenues generated by bi-monthly billing should be used to reduce NWD's outstanding payables.

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8 Transcript v. II, p. 17
[9] Catlin direct, p.17

3. NWD PAYABLES

As of June 30, 2007 NWD had outstanding payables in the amount of $1,485,606.[11] Originally, NWD sought to reduce these payables by restructuring the $1,000,000 balance owed to the City of Newport on the $2,500,000 loan approved in Docket 3578. The City agreed to forgo the $500,000 June 2007 payment so it could be applied to NWD's payables along with any available balance in the "Repayment to City Account." The $1,000,000 balance would then be paid over the course of four years at $250,000 per year. This proposal was made for one simple reason - it would allow NWD to reduce payables that were caused by an under collection of revenue ***without*** building any new funding into existing rates.

However, on June 22, 2007, the Commission directed NWD to make the $500,000 installment payment to the City of Newport. This order effectively denied NWD's request to use these funds to reduce its payables. Thus, NWD revised its position and now requests that any increased revenues realized from bi-monthly billing be used to reduce payables. However, the Division and PWFD have taken different positions on this issue.

As set forth above, it is Mr. Catlin's advocates using the one time revenue "bump" to reduce NWD's accounts payable. At the hearing, Mr. Catlin testified that:

> "It's – I haven't done a specific calculation. What I did do is look at the amount of unbilled revenues that exist today and assume – if you assume that the unbilled revenues would be reduced by something approaching half by more frequent billing, I estimate it probably might – the additional cash infusion would probably be somewhere in the 7 to 900,000 range." 12

NWD's objection to this proposal is twofold. First, it is speculative. The amount of the

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[10] Woodcock Surrebuttal, p. 6

"bump" is unknown. Furthermore, if NWD's consumption continues to decline, the amount may be far less than assumed. Second, this "bump" does not represent excess revenues, it is merely the collection of unbilled revenues. NWD will still collect the same amount of revenue, it will just collect it faster. Therefore, it is not additional discretionary revenue. It must still be used to pay NWD's ongoing bills. Thus, while this "bump" may help NWD's ongoing cash deficiency and cash flow problems, it should not be the sole source of reducing NWD's payables.

PWFD's position on this issue is contradictory and constitutes more heat than light. Mr. Woodcock's pre-filed testimony on this issue was both acerbic and conflicting. Initially he argued that *none* of NWD's payables be brought current. [13] However, in surrebuttal, he reversed his position and argued that any increased revenue from bi-monthly billing be used to reduce NWD's payables.[14]

At the hearing, Mr. Woodcock once again reversed his position. Without any notice or explanation on direct examination, Mr. Woodcock changed his mind and rescinded his surrebuttal testimony on this issue during cross-examination. In fact, Mr. Woodcock did not have any real substantive explanation for his wholesale change on this critical issue except to say: "I hadn't given it the full thought I should have…"[15] In addition, at the hearing PWFD seemingly revised its position on the payables by focusing on $709,420.54 of accrued expenses due to the City of Newport as reflected in NWD's FY05 annual report. As such, NWD will address Mr. Woodcock's original position on the reduction of payables and NWD's FY05 annual report.

In Mr. Woodcock's pre-filed testimony, his argument against NWD reducing payables was

[11] NWD Exhibit 13
[12] Transcript, v.II, p.11
[13] Woodcock direct, p. 22
14 Woodcock surrebuttal, p. 6

essentially threefold: (a) the Docket 3578 settlement agreement prohibits NWD from paying expenses incurred with the City of Newport as of June 30, 2005 [16] (b) The City of Newport should be penalized for its alleged unwillingness "to consider the financial plight of the Water Department." [17] (c) NWD did not document payables owed to the City of Newport. [18] It is NWD's position that each these arguments should be rejected.

A. Docket 3578 Settlement Language

PWFD's central argument focuses on the settlement language in Docket 3578. As set forth in Mr. Woodcock's surebuttal testimony:

> "All the parties, including Newport, agreed that the rates approved in Docket 3578 were sufficient for FY 2005. To assure that no additional requests would be made, the settlement agreement approved by the Commission said: "Newport *Water further agrees 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."* [19]

This argument is flawed for several reasons.

At the outset, it is important to closely examine the context of this language and the reason for its inclusion in the settlement agreement. As the Docket 3578 Order states, NWD had not been consistently funding its restricted accounts as required by the Commission in Docket 2985.[20] When the problem was discovered by NWD, it "endeavored to correct the problem by transferring unrestricted cash to the restricted accounts." [21] "The result of the cash transfers was to put the unrestricted cash account in a negative position." [22] This negative position was reversed by

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[15] Transcript, v.II, p. 101
[16] Woodcock direct, p. 22
[17] Woodcock direct, p.14, 20, 28; Woodcock surrebuttal, p.26, 27.
18 Woodcock direct, p. 24
19 Woodcock surrebutal, p. 24
20 Order #17992, p. 7
21 Id.
22 Id.

transferring money from the City's general fund to the water department. [23] Thus, NWD sought to repay the City of Newport for monies transferred from the general fund to the water department. PWFD and the Division initially objected to this request.

PWFD argued that NWD could not accurately account for the $2,500,000 general fund transfer. [24] Furthermore, PWFD argued that the general fund transfer was caused by NWD spending more on operating expenses than was allowed in Docket 2985. [25] "Therefore, Mr. Woodcock argued that Newport Water be held accountable for its own "uncontrolled spending" and thus, should not be authorized to repay the City through future rates. He argued that it was the Newport Water and not the Navy or Portsmouth who caused the Newport to overspend." [26]

The Division also objected that NWD had not accurately accounted for the general fund transfers and that they were caused in part by NWD's improper funding of its restricted accounts.[27] The Division also agreed with PWFD that NWD had exceeded its allowed O&M expenses. [28] Thus, the Settlement Agreement and Commission Order contained provisions to address these concerns.

First, the Commission noted that "Non-compliance with prior Commission Orders contributed to the necessity for the City of Newport to cover the Water Department's expenses."29 Thus, stringent financial reporting requirements were instituted to ensure NWD's compliance with the Commission's orders. Second, the Commission ordered NWD to fund its restricted accounts at full dollar amounts rather than a percentage of collections. "This method would hold the required funding amount constant at the levels agreed to in the settlement. During future reviews of the

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23 Id.
24 Id. at p. 43
25 Id.
26 Id.
27 Id. at 31
28 Id. at 61

restricted funding, it will be easy to determine if the accounts are being funded properly as the funding should not fluctuate." [30] Third, NWD would "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."

Since the entry of the Order in Docket 3578, NWD has complied with each of these directives. It is uncontested that NWD has fully funded its restricted accounts and complied with each and every reporting requirement. More importantly, NWD is not seeking "to recover in rates any additional monies that it may borrow from the City of Newport up through and including June 30, 2005."

In Mr. Woodcock's testimony he seeks to define the word "loan". [31] However, the most obvious and applicable definition is "an amount of money given to somebody on the condition that it will be paid back later." [32] Certainly, given the issues in Docket 3578, this was the intent of the settlement language. As Mr. Woodcock argued in Docket 3578, NWD was to be accountable for spending. Thus, NWD was prohibited from accepting money from the City's general fund to cover unauthorized expenses, and then seek to recover funding in rates to repay the City. NWD has abided by this agreement.

The City of Newport has not transferred any money from the general fund to the water fund to cover unauthorized expenses, and NWD has not exceeded the expenses authorized in Dockets 3578 or 3675. Thus, NWD is not seeking rates to repay the City of Newport for money advanced from the general fund to cover "uncontrolled spending." There simply was no transfer of money from the general fund to the water fund, and there was no loan.

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29 Id. at 67
30 Id. at68
31 Woodcock Surrebuttal, p. 24
32 Encarta North American Dictionary

Thus, NWD is not seeking "additional" revenue to reimburse the general fund for transfers used to meet unauthorized expenses. Rather, NWD is seeking to pay approved expenses that would have already been paid had it collected the agreed upon revenues. NWD is simply seeking to pay legitimate approved expenses that have gone unpaid due to a lack of revenue. If the outstanding payables were owed to outside vendors this would not even be debated.

Furthermore, NWD is not seeking to repay money it borrowed from the City of Newport as of June 30, 2005. All of the current unpaid expenses owed to the City of Newport are FY07 expenses. 33 In framing its argument, PWFD asks this Commission to look at a single snapshot – the FY05 annual report. NWD, on the other hand, asks the Commission to view the whole movie – NWD Exhibit 13. The FY05 annual report merely shows that on a particular date in time, June 30, 2005, NWD had accrued $709,420.54 in expenses to the City of Newport. It does not show that NWD borrowed this money. It simply shows that as of June 30, 2005 NWD had received "bills" from the City. NWD Exhibit 13 shows that after these bills were received, they *were* paid. Like any company, bills are routinely paid 30 to 60 days after receipt. NWD is no different. As set forth in NWD Exhibit 13, the cash deficit shrank from $919,761 in June 2005 to $54,069 in August 2005.

There is nothing in the Docket 3578 Order or Settlement Agreement that prohibits NWD from engaging in this practice. There was no requirement that NWD's obligations to the City of Newport be brought current or zeroed out as of June 30, 2005. The settlement language simply sought to address the parties' concern that NWD not accept transfers from the City's general fund that were not properly accounted for to cover "unauthorized" expenses. If NWD had any inkling that PWFD would argue for such a strained interpretation of the Docket 3578 settlement agreement, then

33 Transcript v. I, p. 164

it certainly would have ignored outside vendors and operating expenses to ensure that the City's invoices were zeroed out.

The expenses owed to the City of Newport do not result from "uncontrolled spending" at all. Rather, the unpaid expenses clearly stem from the under collection of revenue. In viewing the whole "movie" in NWD Exhibit 13, it is clear that the payable balance fluctuates considerably between June 2005 and June 2006. It is also evident that the balance was cleared and Newport was in the black as of July 2006. Thus, all of NWD's current payables are FY 07 expenses.

In examining NWD 13 it is clear that the current deficit was established in FY 07. This coincides with decreased consumption in the fiscal year as set forth in NWD's response to Commission 2-1. Between July 2006 and June 2007, NWD went from a positive cash balance of $439,949 to a negative balance of $1,485,606.[34] This is the deficit that NWD seeks to erase – the deficit caused by lowered consumption in FY07 that resulted in NWD's inability to remain current on its ongoing expenses with the City of Newport.

B. Penalizing the City of Newport

It should not escape notice that Portsmouth is the only party arguing against NWD reducing its payables. The Division, which represents the interest of all the ratepayers, does not object to NWD's payment of overdue expenses to the City of Newport. While NWD disagrees with the Division's proposed funding source, at least the Division recognizes the need to reduce these payables. As Mr. Catlin testified: " I tried to make a constructive recommendation as to how one way might be to deal with some of the problems that Newport Water is facing…"[35] "My

34 NWD Exhibit 13
35 Transcript v. II, p. 26

recommendation was to make a first step and then evaluate where we stand in 18 month…" [36]

While the Division represents the ratepayers as a whole, PWFD only represents their interest, which in this case is to penalize NWD and the City of Newport. This position is narrow, short sighted and certainly not in the best interest of the rate payer. As set forth above, PWFD isolated one line in the Docket 3578 Settlement Agreement, without any context, to achieve its own goal. The most telling portion of Mr. Woodcock's testimony regarding the settlement language is that which precedes the language itself:

> "All the parties, including Newport, agreed that the rates approved in Docket 3578 were sufficient for FY 2005. To assure that no additional requests would be made, the settlement agreement approved by the Commission said: "Newport *Water further agrees 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."* [37]

Mr. Woodcock is correct that all the parties agreed that the rates approved in Docket 3578 were sufficient. In fact, all the parties – NWD, PWFD, the Division and the Navy – set the projected consumption to produce the appropriate revenues. NWD did not set consumption by itself. Furthermore, NWD did not exceed the expenses provided for in Dockets 3578 or 3675. Unfortunately, the consumption projections set by all the experts in Docket 3578 and Docket 3675 did not come to fruition. This led to a $5,329,576 difference between allowed revenues and collected revenues.

Given the clear evidence that NWD did not collected the proposed revenues, Mr. Woodcock still argues that the payables – which are comprised of legitimate expenses approved in Dockets 3578 and 3675 – should not be reimbursed:

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36 Transcript v. II, p. 38
37 Woodcock surrebutal, p. 24

> "As discussed above, nearly 70% of the increase in payables from June 30, 2005 to June 30, 2006 was due to sales that were lower than projected. I do not know of a situation where the Commission has granted additional revenues to a Rhode Island water utility because sales were lower than projected. Certainly this situation is not unique in Rhode Island." [38]

Thus, it would appear that under *no* set of circumstances would Portsmouth endorse the payment of legitimate expenses that have gone unpaid due a lack of consumption by NWD's customers, which ironically includes PWFD. It is also apparent that PWFD has taken this position for punitive reasons. In reviewing Mr. Woodcock's testimony there can be no mistaking PWFD's motives:

> "This problem was caused by Newport. Perhaps if the City budget is forced to pay for the mess it will give some needed attention to the Water Department in the future." [39]

> "If Newport citizens get angry enough perhaps the voters will get the attention of the City Manager and the City Council."[40]

Essentially, Mr. Woodcock wants the City of Newport, the City Manager and the City Council to "pay" because of lower consumption by NWD's customers. In reality, NWD's "mess" is the result of a $5,329,576 under collection of revenue since Docket 3578 caused by decreased consumption. It is patently unfair to penalize the City of Newport, the City Manager and the City Council for decreased water consumption, which was clearly beyond its control. It is also patently unfair to penalize the City of Newport for attempting to help the water department through this financial crisis.

As set forth above, since NWD was required to fully fund its restricted accounts, the only place it could choose among competing expenses was in O&M. The City of Newport could have

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38 Woodcock direct, p. 23
39 Woodcock surrebuttal, p. 26

insisted that payroll and city services be paid first, and if NWD is not able to pay its outstanding payables to the City, this will happen. The City will be well within its right to insist on the immediate payment of all future payrolls and city service expenses. While NWD is a municipal department, the City should not have to provide unreimbursed subsidies when collections are low.

PWFD has argued that NWD should have filed this rate case sooner. While this is a seemingly attractive argument, it is more heat than light. First, Mr. Woodcock cited conflicting dates by which NWD should have filed – early calendar year 2006, spring 2006 and fall 2006 – after the completion of Docket 3675.[41] Starting with the first date suggested by Mr. Woodcock, a filing in early 2006, using calendar 2005 as a test year, would have been impractical. Docket 3675 had just been decided in November 2005 and rates had barely begun to take effect. Similarly, as Mr. Woodcock acknowledged, by spring 2006, NWD was not yet able to evaluate the impact of summer consumption at the new rates.[42] By June 2006 it was clear that the increased rates from Docket 3675 would not be sufficient to help NWD due to declining consumption. [43] As such, NWD began preparing a rate case using FY06 as a test year. [44]

Mr. Woodcock made much ado about the timing of the City Council's approval of the new rate filing, but once again his argument is more heat than light. The simple fact is that the FY06 test year audit was not complete until December 2006. Thus, at most, there was a two month delay between audit completion, Council approval and filing. Certainly, NWD concedes that it is preferable for any water utility to file a rate case in the fall preceding the proposed rate year. With the seven month lag between filing and decision, a fall filing ensures that new rates are in effect

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40 Id. at 27
41 Woodcock direct, p. 25, surrebuttal p. 22
42 Transcript v. II, p. 122
43 H. Smith rebuttal, p. 23-24

during the summer months at the beginning of the rate year. However, as the Commission knows, not every water utility filing is made in the fall.

Furthermore, as demonstrated during Mr. Woodcock's cross examination, a fall filing would have had no substantial impact on the deficit. In fact, a filing on October 1, 2006 would have been decided by April 30, 2006, at which time the deficit would have been $1,570,582, which is higher than it was in June 2006. The regulatory process is simply too slow to address to address a problem such as NWD's caused by under collection of revenue.

Mr. Woodcock's position is also disingenuous. It strains credibility to say Portsmouth's position would have been different had NWD filed this case three or four month earlier. No matter when this case was filed, Portsmouth would have objected to NWD reducing its payables. Thus, the Commission would have been faced with the same arguments.

Mr. Woodcock also suggested that NWD could have sought emergency relief. 45 However, as the Commission knows, the emergency relief standard in R.I.G.L. §39-1-32 is stringent. Furthermore, given the changing nature of NWD's debt prior to FY07, an emergency petition would not have been warranted. If NWD had filed an emergency filing in early 2006 with a calendar year 2005 test year, the deficit would have been $311,509 as of December 31, 2005. Furthermore, the new rates from Docket 3675 would have been in place for only two to three months. Clearly, this would not constitute an emergency. Also in July 2006, NWD's deficit had been cleared and in the following months, August through October 2006, the deficit was manageable at $209,738, $161,718 and $124,986 respectively.46 Again, this would not have constituted an emergency.

If PWFD advocates emergency petitions every month when NWD runs a deficit, then NWD

44 Id.

will adopt this procedure. In fact, NWD may *have* to do so if payroll and city services are given priority from this point forward. However, this would seem contrary to the ratepayers' best interest as it will simply escalate rate filing costs.

Without an operating reserve, municipal water utilities like NWD are often faced with difficult choices when consumption decreases and revenues decline. In NWD's case, the City allowed outside vendors to be paid ahead of payroll and city services. However, if these expenses go unreimbursed, this practice will no doubt end immediately. The City will no longer allow NWD to delay payroll reimbursement so that outside bills can be paid. This will put NWD in a precarious position. In fact, it is not hard to imagine NWD coming to the Commission on monthly basis if expenses such as payroll are given first priority and there is no money to pay outside vendors and services.

C. Documentation of Payables

PWFD contends that NWD also violated the Docket 3578 settlement agreement directing NWD to provide "appropriate documentation" for loans made by the City of Newport after June 30, 2005 and to "monitor and track its costs and properly account for how the loan proceeds are applied." Once again, this language provides context to the Docket 3578 settlement agreement. The main concern was that NWD not accept any money from the general fund, and if it did, that the transferred "proceeds" be tracked. However, no money has been transferred from the general fund to the water fund, and NWD has not accepted or "applied" loan proceeds either before or after June 30, 2005. Furthermore, the unpaid payroll and city services invoices have been properly documented and monitored.

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45 Woodcock direct, p. 24-25

Each month NWD submits cash flow reports and a trial balance as approved by the Commission. Each of these reports documents the exact amount of unpaid expenses due to the City of Newport on a monthly basis. In fact, these reports have enabled the Commission and all the parties to monitor the fluctuations in the amounts due to the City. Through these reports, NWD has been clearly able show the amount of unpaid expenses and that the deficit was caused by uncollected revenue, not unapproved expenses or uncontrolled spending.

4. CAPITAL/DEBT SERVICE FUNDING

After reviewing the parties' surrebuttal testimony, and following the Commission's June 22, 2007 decision denying NWD's restructure of the $1 million dollar balance owed to the City, NWD revised its revenue request. The biggest change was the proposed funding of Capital and Debt Service. As set forth above, NWD moved the remote radio read program funding from Capital to Debt Service. In addition, NWD reduced its rate year request for Debt Service. NWD was able to do this by using Capital funds previously earmarked for the radio read program and moving them to Debt Service. In addition, because NWD is no longer requesting restructuring of $1 million balance owed to the City, $250,000 per year will remain in Debt Service when the loan is retired in FY 08. At the time of hearing, all the parties agreed with NWD's plan for funding these accounts.

The only area of disagreement was between NWD and Portsmouth, and it revolved around the use of excess capital funds in FY09, FY10 and FY11. Because NWD moved the radio read program out of capital, there will be balances of $632,819, $467, 916 and $452,696 in these respective fiscal years, even after the transfer of funds to debt service.47 PWFD has requested that

46 NWD Exhibit 13
47 Transcript v. II, p. 91-92

NWD commit these funds to "water age improvements".[48] Specifically, Portsmouth wants NWD commit to the purchase and installation of mixing equipment in the four million gallon reservoir at the Lawton Valley Treatment Plant before NWD converts to the use of chloramines in the treatment process. This request highlights PWFD's narrow focus on its own interests, and PWFD's advancement of its own agenda without consideration to the ratepayer.

The installation of mixing equipment was suggested by the consultants who examined age issues related to water delivered to PWFD from the Lawton Valley plant. This suggestion was based on conceptual models, without consideration to constructability issues.[49] Furthermore, this "reservoir" is actually an enclosed four million gallon storage facility that also plays a vital role in the treatment process as it is used to backwash filters at Lawton Valley.

As Ms. Forgue testified, installing mixing equipment at Lawton Valley is a complicated project. In addition to Health Department approval, a number of construction issues must be addressed before installing the equipment – i.e. how to support the roof during construction; whether the reservoir, which has never been completely shut down, can be taken offline; how water will be treated if the reservoir can be taken offline; whether taking the reservoir offline will require total plant closure; and, if the plant is completely closed how will water be provided to customers.

NWD offered to commit funds to design the potential installation. However, PWFD deemed this to be unacceptable. PWFD wants capital funds committed to this project so it can be completed before the conversion to chloramines. Yet, neither Mr. Woodcock nor Mr. McGlinn could provide any testimony on the cost of this project.[50] Furthermore, this request ignores one very important detail – NWD may not convert to chloramines.

48 Transcript v. II, p. 92

As Ms. Forgue testified, NWD is conducting extensive pilot testing examining eleven different options for the conversion to chloramines. NWD won't know if the chloramines conversion is viable until the testing is complete. [51] As Mr. McGlinn, himself, acknowledged, it's possible the testing will suggest that NWD *not* convert to chloramines. [52] Apparently, this is of little concern to PWFD.

It should be noted that while PWFD is afforded intervenor status under the Commission's Rules of Practice and Procedure, the fact remains they are a wholesale customer that is under no obligation to buy water from NWD. As Mr. McGlinn acknowledged, there is no contract that binds PWFD to buy water from NWD or continue as a wholesale customer. [53] In fact, Mr. McGlinn's prefiled testimony states only that PWFD "will continue to rely on NWD for all of its water for the foreseeable future."[54] As Mr. McGlinn candidly stated, PWFD has looked for alternative water sources in the past, and it has a "water supply management plan that lists a whole lot of options that we always try keep up to date on." [55] Thus, while PWFD is allowed to participate in NWD's rate filings, their self interest should not be served to the detriment of the utility and NWD's customers as a whole.

Essentially, PWFD is asking the ratepayers to pay an undetermined amount of money for the installation of mixing equipment before an event that may not happen. Clearly, NWD cannot agree to this request, and asks the Commission to reject it as well.

49 Transcript v.I, pp. 199-201, 204-205
50 Transcript v. II, p. 92, 181-184
51 Transcript v. I, p. 178
52 Transcript v. II, p. 187
53 Transcript v.II, p.172
54 McGlinn direct, p. 4

5. CITY SERVICES

As a municipal department of the City of Newport, NWD utilizes a number of City services. If the City did not provide these services, NWD would have to outsource. Thus, NWD, like other municipal utilities, pays for its share of these services that provide benefits to the water department.

For instance, as Ms. Forgue testified the City Solicitor's office represents the water department in several non-regulatory matters, i.e. tax appeals, labor negotiations and legal issues with the Towns of Middletown and Portsmouth, such as the recent fire code violations issued by the Portsmouth Fire Department. Furthermore, since NWD does not have a "board" that oversees its operations, the Newport City Council acts as the de facto "Water Board." [56] As such, Ms. Forgue reports directly to the City Manager, and keeps him informed on all work that goes on in the water department. [57] In turn, the City Manager reports to the City Council, which approves all water department expenditures over $4,000.[58] As such, as certain percentage of the overall budgets for each of these departments is allocated to NWD.

As both Mr. Smith and Mr. Catlin testified, there is no perfect way to precisely account for this percentage. [59] However, the relationship between a water utility's budget and a city's budget is often used as a proxy for determining an appropriate charge, and this methodology is used by municipalities across the country. [60] As such, even though this methodology may not be perfect, it is an acceptable methodology. Therefore, NWD asks that the Commission approve the City Services funding recommended by NWD and the Division.

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55 Transcript v.II, p.170-171
56 Transcript v. I, p. 227
57 Transcript v. I, p. 213
58 Transcript v. I, p. 213, 227-228
59 Transcript, v. I, p. 79, 94-95, v.II p. 60
60 Transcript v. I, p. 93

III. CONCLUSION

The City of Newport, Utilities Division, Water Department has met its burden of proof in this matter and has demonstrated that its requested rates are both necessary and reasonable.

WHEREFORE, The City of Newport, Utilities Division, Water Department prays that The Rhode Island Public Utilities Commission approve its proposed rate increase in this Docket, and that this Commission approve all other relief it deems meet and just.

CITY OF NEWPORT,
UTILITIES DEPARTMENT,
WATER DEPARTMENT
By its attorney,

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CERTIFICATION

I hereby certify that I sent by electronic mail a copy of the within to all parties set forth on the attached Service List on August 20, 2007.

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APPENDIX 1

Docket No. 3818

City of Newport, Rhode Island **RFC Schedule F Comm. 2-1**
Response to Comm. 2-1
Water Consumption Summarized by Class

	Annual Consumption in 1000s Gallons										
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	Test Year - FY 2006	FY 2007	FY 2006 Projected in Docket 3675	8-Year Average FY 2000 - FY 2007	**FY 2008 Rate Year**
Annual Consumption, by Class (1)											
Residential (T&M)	682,937	698,765	773,872	780,666	736,577	716,037	749,409	734,927	758,019	734,149	**749,409**
Commercial (T&M)	703,460	620,182	561,576	564,052	640,632	554,248	472,160	429,791	541,165	588,044	**472,160**
Governmental (T&M)	20,634	20,197	19,222	19,132	23,134	19,463	21,379	25,905	20,582	20,452	**21,379**
Navy (M)	466,167	450,247	307,051	348,222	511,299	417,869	373,306	278,441	415,093	410,594	**373,306**
PWFD (M)	438,179	442,582	455,142	451,723	422,944	429,465	463,253	425,635	429,416	443,327	**463,253**
Metered, Sundry Billed	5,866	4,431	6,353	5,244	3,992	4,919	6,461	2,080	4,297	5,324	**6,461**
Total (in 1000's Gallons)	2,317,243	2,236,404	2,123,216	2,169,039	2,338,578	2,142,001	2,085,969	1,896,780	2,168,572	2,201,890	**2,085,969**

<u>APPENDIX 2</u>

NEWPORT WATER COLLECTIONS

1. PAST FILINGS

Docket 3578
Filed 11/28/03
Test Year April 1, 2002 – March 31, 2003
Rate Year FY04 (July 1, 2003 – June 30, 2004)
Decision June 22, 2004
No increase
Revenues Allowed - $7,832,300

Docket 3675
Filed 4/15/05
Test Year June 1, 2003 – June 30, 2004
Rate Year FY 06 (July 1, 2005 – June 30, 2006)
Decision November 10, 2005 – half way through rate year
Increase 20.48%
(First increase in six years – 3.4% year)
Revenues Allowed - $9,280,494

Docket 3818
Filed 1/29/07
Test Year July 1, 2005 – June 30, 2006
Rate Year FY 08 (July 1, 2007 – June 30, 2008)
Decision August 29, 2007

2. FISCAL YEARS 2004-2007

Fiscal Year	Revenue Allowed	Revenue Collected	Deficit
FY04	$7,832,300	$6,881,261	($951,039)
FY05	$7,832,300	$6,598,223	($1,234,077)
FY06	$9,280,494	$7,389,838	($1,890,656)[1]
FY07	$9,280,494	$8,026,690	($1,253,804)
			($5,329,576)

[1] During the first half of the fiscal year rates were collected according to those allowed in Docket 3578.

APPENDIX 3

Monthly cash flow
Portsmouth 1-6,updated 07-17-07
KLG
FY 2007

Fiscal Year Begins: Jul-05 Newport Water Department

		Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Jun-06
Cash Position (end of month) See monthly cash flow statements	83,324	272,622	726,543	285,435	543,919	190,498	236,451	207,895	409,060	140,214	-219,322	241,723	174,988
Payrolls to transfer		231,917	447,062	405,358	459,333	432,405	460,960	461,981	736,424	689,128	690,057	580,479	810,795
Other to transfer to city					272,582			328,557		40,700	237,500	179,547	239,359
Outstanding Payables (eom)	1,003,085	417,654	333,549	321,383	321,129	178,921	87,000	253,024	156,871	202,425	294,074	339,974	178,674
Totals payables outstanding (eom)	1,003,085	649,572	780,612	726,741	1,053,044	611,326	547,960	1,043,562	893,294	932,253	1,221,632	1,099,999	1,228,828
Total (eom)	**-919,761**	**-376,950**	**-54,069**	**-441,306**	**-509,125**	**-420,828**	**-311,509**	**-835,667**	**-484,234**	**-792,039**	**-1,440,954**	**-858,276**	**-1,053,840**

Fiscal Year Begins: Jul-06 Newport Water Department

	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07
Cash Position (end of month) See monthly cash flow statements	840,012	463,794	392,038	549,515	419,555	415,236	292,729	55,251	213,987	235,670	192,477	246,263
Payrolls to transfer	126,585	246,655	478,637	466,133	476,329	473,453	782,552	1,034,776	1,173,139	1,337,169	1,373,635	1,259,496
Other to transfer to city	113,812	113,812	29,867	29,867	148,617	148,617	118,750	118,750	237,500	296,746	296,746	324,674
Outstanding Payables (eom)	159,665	313,065	45,251	178,501	299,349	592,072	559,989	853,219	163,543	172,337	81,551	147,699
Totals payables outstanding (eom)	400,063	673,532	553,756	674,501	924,295	1,214,142	1,461,290	2,006,745	1,574,181	1,806,252	1,751,932	1,731,869
Total (eom)	**439,949**	**-209,738**	**-161,718**	**-124,986**	**-504,740**	**-798,906**	**-1,168,561**	**-1,951,494**	**-1,360,194**	**-1,570,582**	**-1,559,455**	**-1,485,606**