

**STATE OF RHODE ISLAND AND
PROVIDENCE PLANTATIONS**

**IN RE PROVIDENCE WATER)
SUPPLY BOARD APPLICATION) DOCKET NO. 3832
TO CHANGE RATE SCHEDULES)**

SURREBUTTAL TESTIMONY

OF

THOMAS S. CATLIN

ON BEHALF OF THE

DIVISION OF PUBLIC UTILITIES AND CARRIERS

SEPTEMBER 7, 2007

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 21044

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Surrebuttal 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. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS
7 PROCEEDING?

8 A. Yes. My direct testimony on behalf of the Division of Public Utilities and Carriers (the
9 Division) was submitted on July 18, 2007. My qualifications and experience are set forth
10 in that testimony.

11 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

12 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of
13 Ms. Pamela Marchand, Ms. Jeanne Bonderevskis and Mr. Walter Edge that was
14 submitted on behalf of the Providence Water Supply Board (Providence Water or
15 PWSB). In their rebuttal testimony, Providence Water's witnesses have accepted the
16 adjustments that I recommended with regard to wholesale water sales revenue, capital
17 reimbursement, retiree health expense and City Services expense. In addition, Mr. Edge
18 provided an update of property tax expense and a revised calculation of purchased power

1 costs that I have reviewed and have found reasonable. I am also accepting
2 Ms. Bonderevskis' adjustment for pension over-funding. Accordingly, the specific issues
3 that I am addressing in my surrebuttal testimony are the:

- 4 • Treatment of the property tax refund from the City of Cranston
 - 5 • Administrative and general contract services
 - 6 • Regulatory commission expense
 - 7 • The PUC assessment, and
 - 8 • The operating revenue allowance
- 9

10 Cranston Tax Refund

11 Q. PLEASE SUMMARIZE THE TAX REFUND THAT PROVIDENCE WATER
12 IS TO RECEIVE FROM THE CITY OF CRANSTON AND HOW PWSB HAS
13 PROPOSED TO TREAT THAT REFUND.

14 A. Providence Water and the City of Cranston ("Cranston") have reached a settlement of
15 their dispute over the taxes charged by Cranston on certain tax exempt facilities in the
16 years 2003 through 2007. Under this settlement Cranston will pay Providence Water
17 \$1,508,362 plus interest of \$216.77 per day from August 16, 2007 to the date payment is
18 made. Providence Water has proposed to put the entire amount of this refund in a reserve
19 account to be used to pay for future property tax litigation costs and/or larger than
20 expected increases in tax bills.

21 Q. DO YOU AGREE WITH THIS PROPOSAL?

22 A. No. I do not believe creating a reserve fund to pay for future property tax litigation costs
23 with a balance of over \$1.5 million is reasonable. The total amount spent on contesting
24 property tax claims for the last five years has been \$550,000. While I understand that
25 annual expenditures may increase in the next few years due to the ongoing Scituate

1 litigation, there is no evidence that the costs will approach \$1.5 million. Therefore,
2 setting aside the total refund is unnecessary.

3 I also do not agree that the refund should be used to pay for larger than expected
4 increases in property taxes. PWSB has projected property taxes for the rate year by
5 adjusting FY 2008 property taxes upward by 1.55 percent to reflect one-half year's
6 growth based on the recent historical average annual increase of 3.10 percent. Even if
7 every taxing authority increased its taxes by the maximum five percent, the additional
8 unanticipated increase would only be approximately \$58,000. This is the type of
9 variation in expense that the operating revenue allowance is designed to address.
10 Increases in property taxes in years subsequent to the rate year, along with all other
11 changes in revenues and expenses should be dealt with through rate proceedings.
12 Providence Water should not be allowed to establish a pool of funds to be used to pay for
13 increases in a single element of its total cost of service that were not explicitly included in
14 setting rates.

15 Q. WHAT IS YOUR RECOMMENDATION?

16 A. It is my recommendation that the refund received from Cranston be set aside in an
17 interest bearing account and that \$375,000 per year be flowed back to ratepayers as a
18 reduction to the cost of service for each of the next three years. This will leave over
19 \$385,000 in initial principal plus interest earned on the unrefunded/unspent balance as
20 available to pay for the cost of contesting property taxes. Based on an interest rate of five
21 percent, this should provide Providence Water with over \$550,000 to cover the costs of
22 contesting property taxes over the next three years.

23 Q. DO YOU HAVE ANY OTHER RECOMMENDATIONS?

24 A. Yes. The fund established with the Cranston tax refund should be a restricted account.
25 Providence Water should maintain detailed documentation for all expenditures for

1 property tax disputes and these amounts should be subject to review either annually by
2 the Division or in the context of PWSB's next rate case. In addition, to the extent that
3 Providence Water receives tax refunds or rebates from any other taxing authorities, those
4 amounts should be deposited to this account so that their disposition can be determined in
5 future rate proceedings. At or near the end of three years, an evaluation can be made
6 regarding the status of the account and the treatment of any remaining balance.
7

8 **Administrative and General Contract Services**

9 Q. DID PWSB ACCEPT YOUR ADJUSTMENT TO UTILIZE A THREE-YEAR
10 AVERAGE FOR ADMINISTRATIVE AND GENERAL ("A&G") CONTRACT
11 LEGAL SERVICES AND TO EXCLUDE A&G CONTRACT ENGINEERING
12 SERVICES?

13 A. No. In her testimony, Ms. Bonderevskis noted that these two accounts include costs
14 associated with property tax appeals and that the use of a three-year average level of legal
15 costs and the inclusion of no engineering costs did not reflect the ongoing costs of such
16 litigation. However, she stated that PWSB would agree to my adjustment if the costs of
17 such appeals could be charged to a restricted property tax refund account. In light of my
18 agreement to establish such an account (albeit with less money set aside for property tax
19 litigation), I have continued to include an adjustment to A&G Contract Legal and
20 Engineering Services. However, I have updated the amount of my adjustment to legal
21 services to reflect the actual test year expense (inflated to rate year levels) associated with
22 property tax litigation rather than to utilize a three-year average. As shown on Schedule
23 TSC-8 Surrebuttal, this adjustment reduces rate year expense by \$100,027. (The
24 adjustment to eliminate the A&G Engineering costs is unchanged because the test year
25 expense was for appraisal services associated with the Scituate property tax litigation.)

1 Regulatory Commission Expense/PUC Assessment

2 Q. HAVE YOU REVIEWED MS. BONDAREVSKIS' REBUTTAL TESTIMONY
3 WITH REGARD TO REGULATORY COMMISSION EXPENSE, AND THE
4 PUC ASSESSMENT?

5 A. Yes. Based on the historical data presented by Ms. Bonderevskis, I have accepted
6 Providence Water's estimate of the rate year PUC assessment. Based on the explanation
7 that the \$5,000 line item in rate case expense for City Services is for the study submitted
8 by Mr. Bebyn in this proceeding, I have also accepted PWSB's claim for rate case
9 expenses, including the updated cost estimate. Accordingly, I am not proposing any
10 adjustment to regulatory commission expenses in my final recommendation on behalf of
11 the Division.

12 Operating Revenue Allowance

13 Q. HAVE YOU REVIEWED MS. MARCHAND'S REBUTTAL TESTIMONY
14 REGARDING THE APPROPRIATE OPERATING REVENUE ALLOWANCE?

15 A. Yes. Ms. Marchand continues to request that the operating revenue allowance be
16 increased to three percent of total operating expenses (less miscellaneous revenue).
17 Ms. Marchand did propose that the portion of the three percent allowance applicable to
18 PWSB's restricted accounts expenditures be set aside in a separate restricted fund to be
19 used to cover shortfalls in the revenue needed to fund the restricted accounts. This
20 proposal was made in response to my recommendation to exclude restricted accounts
21 from the expense base if the allowance was increased from 1.5 percent to 3.0 percent
22 because those accounts are already fully reconciled.

23 Q. WHAT IS YOUR RECOMMENDATION?

24 A. At its public deliberation session on August 30, 2007, the Commission addressed a
25 similar proposal in Docket No. 3818 to increase the operating revenue allowance for

1 Newport Water. The Commission decided to continue to set Newport Water's operating
2 revenue allowance at 1.5 percent of total operating expenses. The Commission further
3 indicated that it would consider a generic investigation of the issue of the appropriate
4 operating revenue allowance to develop a consistent policy for all non-investor owned
5 utilities in Rhode Island. Consistent with that decision, it is my recommendation that the
6 operating revenue allowance for Providence Water be established at the traditional level
7 of 1.5 percent of total operating expenses less miscellaneous revenue.
8

9 **Summary and Recommendations**

10 Q. PLEASE SUMMARIZE YOUR UPDATED FINDINGS AND
11 RECOMMENDATIONS.

12 A. As shown on Surrebuttal Schedule TSC-1, it is my recommendation that Providence
13 Water receive a revenue increase of \$6,594,314 in this proceeding. This represents a
14 reduction of \$1,326,758 compared to the increase of \$7,921,072 sought by Providence
15 Water in its rebuttal filing.

16 Q. DOES THIS COMPLETE YOUR SURREBUTTAL TESTIMONY?

17 A. Yes, it does.

**STATE OF RHODE ISLAND AND
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**SCHEDULES ACCOMPANYING THE
SURREBUTTAL TESTIMONY**

OF

THOMAS S. CATLIN

ON BEHALF OF THE

DIVISION OF PUBLIC UTILITIES AND CARRIERS

SEPTEMBER 7, 200

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
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PROVIDENCE WATER SUPPLY BOARD

Summary of Revenues and Expenses at
 Present and Proposed Rates
 Rate Year Ended December 31, 2008

	Rate Year Amount Per PWSB	PWSB Rebuttal Adjustments	Rate Year Amount Per PWSB	Division Adjustments	Rate Year at Present Rates	Increase from Proposed Rates	Rate Year at Proposed Rates
Revenue							
Retail Water Sales	\$ 30,088,423	-	\$ 30,088,423	\$ -	\$ 30,088,423	-	\$ -
Wholesale Water Sales	12,829,126	513,835	13,342,961	-	13,342,961	-	-
Retail Service Charges	3,895,171	-	3,895,171	-	3,895,171	-	-
Private Fire Protection	1,222,140	-	1,222,140	-	1,222,140	-	-
Public Fire Protection	1,526,521	-	1,526,521	-	1,526,521	-	-
Miscellaneous	1,245,739	-	1,245,739	-	1,245,739	-	-
Total Revenue	\$ 50,807,120	\$ 513,835	\$ 51,320,955	\$ -	\$ 51,320,955	\$ 6,594,314	\$ 57,915,269
Expenses							
Operation & Maintenance	27,599,305	(633,096)	26,966,209	(100,027)	26,866,182	-	26,866,182
Insurance	2,967,655	-	2,967,655	-	2,967,655	-	2,967,655
Chemical & Sludge	3,132,565	-	3,132,565	-	3,132,565	-	3,132,565
City Service Expense	1,245,952	(5,597)	1,240,355	-	1,240,355	-	1,240,355
Property Taxes	6,570,792	(352,111)	6,218,681	(375,000)	5,843,681	-	5,843,681
Capitalized Labor	(758,616)	(226,103)	(984,719)	-	(984,719)	-	(984,719)
Net Operations	\$ 40,757,653	\$ (1,216,907)	\$ 39,540,746	\$ (475,027)	\$ 39,065,719	\$ -	\$ 39,065,719
Capital Improvements	2,450,000	-	2,450,000	-	2,450,000	-	2,450,000
Western Cranston Fund	62,069	-	62,069	-	62,069	-	62,069
Infrastructure Replacement	13,900,000	-	13,900,000	-	13,900,000	-	13,900,000
Meter Replacement	1,000,000	-	1,000,000	-	1,000,000	-	1,000,000
Equipment Replacement	600,000	-	600,000	-	600,000	-	600,000
Net Restricted	\$ 18,012,069	\$ -	\$ 18,012,069	\$ -	\$ 18,012,069	\$ -	\$ 18,012,069
Total Expenses	\$ 58,769,722	\$ (1,216,907)	\$ 57,552,815	\$ (475,027)	\$ 57,077,788	\$ -	\$ 57,077,788
Operating Reserve	1,725,719	(36,507)	1,689,212	(851,732)	837,481	-	837,481
Total Cost of Service	\$ 60,495,441	\$ (1,253,414)	\$ 59,242,027	\$ (1,326,758)	\$ 57,915,269	\$ -	\$ 57,915,269
Revenue Surplus/(Deficiency)	\$ (9,688,321)	\$ 1,767,249	\$ (7,921,072)	\$ 1,326,758	\$ (6,594,314)	\$ 6,594,314	\$ -

PROVIDENCE WATER SUPPLY BOARD

Summary of Division Adjustments to
 Rate Year Revenues and Expenses at Present Rates
 Rate Year Ended December 31, 2008

<u>Description</u>	<u>Amount</u>	<u>Source</u>
Wholesale Water Sales Revenue	\$ -	Schedule TSC-3
Total Revenue Adjustments	\$ -	
Capital Reimbursement	-	See Note (1)
Retiree Health	-	See Note (1)
Purchased Power	-	Schedule TSC-6
PUC Assessment	-	See Note (2)
A&G Contract Services	(100,027)	Schedule TSC-8
Property Tax Expense	(375,000)	See Note (3)
Operating Reserve	(851,732)	See Note (4)
Total Expense Adjustments	\$ (1,326,758)	
Total Revenue Requirement Effect of Division Adjustments at Present Rates	<u>\$ (1,326,758)</u>	

Note:

- (1) Adjustment has been incorporated in PWSB Rebuttal Filing.
- (2) The Division has accepted PWSB's rate year estimate.
- (3) Reflects 3 year flow back of Cranston tax refund net of set aside for future tax appeals.
- (4) Based on 1.5% of total expenses net of miscellaneous revenue.

PROVIDENCE WATER SUPPLY BOARD

Adjustment to Wholesale Water Sales Revenue
Rate Year Ended December 31, 2008

Johnston-Under-Registered Purchases (Hcf) (1)	
FY 2003	39,756
FY 2004	64,477
FY 2005	111,975
FY 2006	99,907
Total	<u>316,115</u>
Increase in 4 year Average-Hcf Wholesale Rate	79,029 <u>\$ 0.92453</u>
Additional Revenue	<u>\$ 73,065</u>
Bristol County Water Authority	
Revised Estimate of Purchases (Hcf) (2)	1,257,500
Original Estimate per PWSB (3)	<u>780,749</u>
Additional Purchases Wholesale Rate	476,751 <u>\$ 0.92453</u>
Additional Revenue	<u>\$ 440,771</u>
Total Adjustment to Revenue at Present Rates	<u>\$ -</u>

PWSB has incorporated this adjustment in its Rebuttal filing.

Notes:

- (1) Per response to DIV 3-2.
- (2) Per response to DIV 3-9.
- (3) Per Schedule WEE-1A.

PROVIDENCE WATER SUPPLY BOARD

Adjustment to Annualize the
 Capital Reimbursement Offset to O&M
 Rate Year Ended December 31, 2008

Ongoing Capitalized Labor and Benefits (1)	\$ 777,009	
Rate Year Effect of Contractual Wage Increases (2)	<u>1.0609</u>	
Rate Year Labor and Benefits Capital Reimbursement		\$ 824,329
Test Year Materials and Supplies Charged to IFR Projects (3)	150,771	
Inflation Factor (4)	<u>1.0638</u>	
Rate Year Materials & Supplies Capital Reimbursement		<u>\$ 160,390</u>
Total Capital Reimbursement		\$ 984,719
Capital Reimbursement per PWSB (3)		<u>984,719</u>
Adjustment to Rate Year Expense		<u><u>\$ -</u></u>

PWSB has incorporated this adjustment in its Rebuttal filing.

Notes:

- (1) Per response to DIV 3-6.
- (2) Reflects 3% wages increases for 2 years from year ended 12/31/2006 to rate year ending December 31, 2008.
- (3) Per Schedule WEE-2.

PROVIDENCE WATER SUPPLY BOARD

Adjustment to Retiree Health Reimbursement Expense
Rate Year Ended December 31, 2008

Updated Amount Owed to City of Providence (1)	\$ 1,489,081
Proposed Amortization Period	<u>6 Years</u>
Annual Amortization	\$ 248,180
Amount per Providence Water (2)	<u>248,180</u>
Adjustment to Rate Year Expense	<u>\$ -</u>

PWSB has incorporated this adjustment in its Rebuttal filing.

Notes:

(1) Per response to DIV 3-1.

(2) Per Schedule WEE-6-r.

PROVIDENCE WATER SUPPLY BOARD

Adjustment to Purchased Power Expense
 to Eliminate Projected Increase
 Rate Year Ended December 31, 2008

Account	Amount per Division (1)	Rate Year Amount per PWSB (2)	Adjustment to Rate Year Expense
61523--Pumping	\$ 742,536	\$ 742,536	\$ -
61530--Water Treatment	196,121	196,121	-
61550--T&D	8,825	8,825	-
61580--Administration	120,375	120,375	-
Total Insurance Expense	\$ 1,067,857	\$ 1,067,857	\$ -

Notes:

(1) Reflects actual test year expense per Schedule WEE-9.

(2) Per Schedule WEE-9.

PROVIDENCE WATER SUPPLY BOARD

Adjustment to PUC Assessment
Rate Year Ended December 31, 2008

PUC Assessment per Division (1)	\$ 154,087
PUC Assessment per Providence Water (2)	<u>154,087</u>
Adjustment to Rate Year Expense	<u><u>\$ -</u></u>

Notes:

- (1) Reflects actual test year expense per Schedule WEE-7.
- (2) Per Schedule WEE-7.

PROVIDENCE WATER SUPPLY BOARD

Adjustment to Administrative & General Contract Services Expense
to Remove Property Tax Litigation Related Costs
Rate Year Ended December 31, 2008

Property Tax Litigation Legal Services (1)	\$ 69,651
Inflation Factor (2)	<u>1.0638</u>
Rate Year Legal Costs to be Eliminated	\$ 74,095
Property Tax Litigation Engineering Services (3)	<u>\$ 25,932</u>
Total Adjustment to A&G Contractual Services	<u><u>\$ (100,027)</u></u>

Notes:

- (1) Per response to informal request.
- (2) Per Schedule WEE-2.
- (3) Per response to DIV 3-1. Amount reflected is adjusted to rate year as reflected on Schedule WEE-2.