

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

**IN RE:           NARRAGANSETT BAY COMMISSION :  
                  GENERAL RATE FILING                 :       DOCKET NO. 3905**

**ORDER**

On December 3, 2007, the Narragansett Bay Commission (“NBC”) filed an application for a General Rate Change with the Public Utilities Commission (“Commission”) seeking new residential and non-residential rates designed to collect revenues equal to \$77,231,261. This represents a revenue increase of \$10,924,164 or 16.5%. Rates would increase 17.37% as not all revenue accounts will be impacted by the proposed increase. The proposed effective date of the tariff change was July 1, 2008. At open meeting, on December 20, 2007, the Commission suspended the effective date pending its investigation pursuant to its authority under R.I. Gen. Laws §39-1-11.<sup>1</sup>

The instant rate case filing represents NBC’s ninth rate filing in the last eight years. This rate case filing does not relate to debt service for the Combined Sewer Overflow Abatement Program (“CSO”). The following provides a history of recent rate increases:

DOCKET NO.	FILING DATE	INCREASE REQUESTED	INCREASE ALLOWED	AUTHORIZED REVENUE
3162	6/29/00	\$10,089,441	\$6,669,489	\$36,632,209
3409	12/21/01	\$ 8,834,420	\$8,834,420	\$45,467,359
3483	11/29/02	\$13,826,248	\$7,047,965	\$51,499,178
3592	3/1/04	\$ 4,967,683	\$2,883,974	\$54,380,549
3639	10/4/04	\$ 6,551,225	\$6,551,225	\$60,931,773
3707	11/1/05	\$ 3,108,471	\$2,348,622	\$63,284,139
3775	10/4/06	\$ 6,010,883	\$6,010,833	\$69,295,022
3797	12/1/06	\$ 4,798,797	\$2,621,492	\$71,503,022
3905	12/3/07	\$10,924,164		

<sup>1</sup> R.I. Gen. Laws §39-3-11 authorizes the Commission to suspend the taking effect of proposed rate(s) for a period not to exceed six (6) months in order that it may investigate and hold public hearings on the propriety of the proposed change(s).

## **I. NBC PRE-FILED DIRECT TESTIMONY**

### **A. Testimony of Walter E. Edge, Jr.**

Walter Edge, a certified public accountant, who has provided expert testimony for NBC on numerous occasions, provided pre-filed testimony in support of the requested rate increase. Mr. Edge developed a normalized test year of FYE June 30, 2007 and a rate year of FYE June 30, 2009. Mr. Edge summarized the adjustments made in the previous docket, Docket No. 3797 filed on December 1, 2006. He noted that in order to come to an agreement with the Division of Public Utilities and Carriers ("Division"), NBC eliminated the use of a "composite rates"<sup>2</sup> approach for estimating revenues. Mr. Edge's testimony presented additional information in support of NBC's claim that it's declining consumption results in a revenue generation problem that is not addressed through the normal rate making process. He noted that the prior docket also reduced funding for a number of operating accounts such as health insurance expense, biosolids disposal costs, bad debt expense and maintenance and service agreements. NBC was also required to return \$660,000 to ratepayers over the course of two years from the Special Master restricted account. NBC agreed to reduce its funding level for post retirement health insurance from 8.75% to 3.63%, which is the same funding level used by the State of Rhode Island. Mr. Edge also noted that in the prior Docket, No. 3797, the Division opposed and the Commission rejected NBC's proposal to establish an Operating and Maintenance Reserve Fund.<sup>3</sup>

Mr. Edge discussed a number of concerns that the Commission had with NBC's revenue requirements in the prior docket. First he noted that the Commission disallowed \$1,695 for aquarium expense, reduced NBC's gas account by \$40,458, reduced proposed non-union salary

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<sup>2</sup> NBC provided evidence that a certain percentage of its consumption each year is billed at rates lower than those authorized by the Commission.

<sup>3</sup> NBC Exhibit 1a, Testimony of Walter E. Edge, Jr., December 3, 2007 at 1-4.

increases from 3.75% and 4.5% to a 3.5% salary increase, and the Commission excluded debt and personnel service costs from the calculation of the net operating reserve allowance, resulting in a rate year operating reserve allowance of \$232,224. Mr. Edge identified the two major reasons behind the current request for a rate increase as being (1) the increase in the usage of soda ash in order to meet Rhode Island Department of Environmental Management permit levels for nitrogen removal and (2) a significant shortfall in consumption revenue in FY 2007 which is expected to continue into FY 2008 and FY 2009. He noted that the current filing will also request increases for salaries and wages that include increases in employee benefits, increases for the CSO Phase I Facilities becoming operational in October 2008 and increases for higher costs related to treatment of the additional flow from the CSO tunnel to the Field's Point Wastewater Treatment Facility. Additionally, the filing contains a request for the establishment of a Revenue Stability Fund and a request to extend the multi-year debt compliance filing mechanism.<sup>4</sup>

Although Mr. Edge did not audit the test year, he reviewed the year end audit results, the audited trial balance and the detail posting to many of the general ledger accounts to prepare the test year. He made a number of adjustments to the test year (1) to increase user fee revenues for increases from Docket Nos. 2775 and 3797 and (2) to eliminate \$2,335,650 of interest income earned, legislatively mandated revenue of \$52,525, \$26,400 of related expenses during the test year, grant revenue of \$49,037, and \$5,626 of capital contributions received from an EPA grant that are not available for operations. He eliminated \$54,191 of miscellaneous income and a one time \$258 loss in the Equipment Losses account, removed more than \$6 million of depreciation expense and almost all of the annual amortization expenses reflecting the Capital Outlays purchased in the test year. He added the \$30,832,125 cost of debt service and the \$7,708,031 debt coverage allowance, and removed the \$11,886,975 test year interest expense. Mr. Edge also

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<sup>4</sup> *Id.* at 4-6.

calculated a Net Operating Reserve of \$208,619 in accordance with the Commission approved method in Docket No. 3797. He adjusted test year revenue by \$330,000 to show the amortization of the excess balance in the Special Master restricted account balance. Mr. Edge noted that his adjusted test year represented a normalized level of revenue and expenses for NBC.<sup>5</sup>

Mr. Edge grouped NBC's revenue and expense accounts into five categories: (1) revenues, (2) personnel services, (3) capital outlays, (4) accounts with balances of less than \$200,000, and (5) remaining accounts that were analyzed individually. With regard to revenues, Mr. Edge noted that the downward trend he predicted in Docket No. 3797 continued in FY2007 with billed consumption for that FY being more than 8% lower than the consumption estimate approved in Docket No. 3797 for FY 2008. He based his test year consumption on a continuation of the consumption decline and made a downward adjustment to the three consumption revenue accounts, Residential, Commercial and Industrial, for the interim and rate years, resulting in a reduction in rate year revenue of \$1,494,144.<sup>6</sup>

Mr. Edge also pointed out that user fee revenues collected were approximately 10%, or \$6,147,905, below the \$60,161,321 approved by the Commission in Docket No. 3707. Even though NBC was able to offset this shortfall with savings in certain expense accounts and good budget management, NBC had an operating loss on a ratemaking basis of more than \$800,000 for the test year. Because NBC's amount available funding for restricted carry-forward balance was the most adversely affected, NBC was not able to collect an amount necessary to cover the debt service coverage allowance. Thus its requirements for operating capital outlays and the Capital Improvement Program ("CIP") had less funds available. NBC only had \$1.1 million

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<sup>5</sup> *Id.* at 8-11.

<sup>6</sup> NBC Exhibit 1a, Testimony of Walter E. Edge, Jr., December 3, 2007 at 12-15.

dollars available to carry forward into June 2008 as opposed to the \$7.7 million dollars previously approved by the Commission. He recommended approval by the Commission of NBC's projected rate year revenue calculation, which shows a downward trend, to cover NBC's approximately \$432 million in outstanding debt as well as Commission approval of a restricted revenue stability fund. Finally, he increased all other revenue accounts by \$7,000 for the interest expected from the revenue stability fund, and left the remaining revenue accounts at the test year levels.<sup>7</sup>

Regarding expenses, Mr. Edge adjusted test year salaries for union and non-union employees by 4.00% for 2008 and 4.25% for 2009. He increased the FICA expense and adjusted the pension accounts expense for union employees based on the rate provided to NBC by the State Retirement Board. He calculated the non-union pension expense at 10% of non-union compensation and limited rate year salaries as he had in NBC's prior dockets. He identified the large increase between the test year and the rate year in Retirement Health as a result of the State's retiree health insurance percentage increasing from 2.74% to 5.46% in the rate year. He noted that NBC is not requesting a change in the 244 FTEs previously approved by the Commission in Docket No. 3797. Mr. Edge calculated the rate year health and dental insurance expense by using an average of the prior three years to determine the rate year premium and reducing the rate year cost by the projected employee co-pays for a net increase of \$329,150.<sup>8</sup>

Mr. Edge adjusted the biosolids disposal account by \$51,555 to reflect an increase in the rate year due to the impact of the CSO Phase I Facilities and two CPI adjustments. He reduced the bad debt expense to the Docket No. 3797 approved level of \$60,000. In response to an expected increase of 12%, he adjusted the Maintenance/Service Agreements Account. An increase of

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<sup>7</sup> *Id.* at 15-17.

<sup>8</sup> *Id.* at 18-20.

\$182,776 was also made to Insurance Expense and Workers' Compensation Insurance in response to expected increases in the rate year. Likewise, Mr. Edge adjusted the Fuel, Gas and Electric Costs Accounts by more than \$1 million to reflect (1) increases in the costs of those commodities and (2) the CSO Phase I Facilities pump station being placed in service in October 2008. This included the increased operating costs for the treatment of increased flow at the Field's Point Wastewater Treatment plant resulting from the CSO Phase I Facilities being put in service.<sup>9</sup>

Mr. Edge increased lab supplies by the average of the increase in the annual percentage for FY2005 through FY 2007 and increased the Annual PUC Assessment by the same for a total increase of \$93,732. The adjustment of \$121,283 to the Management/Audit Services Account reflected soda ash costs, which more than doubled, and a 3.07% CPI adjustment. Mr. Edge eliminated Capital Outlay Accounts from the rate year revenue requirement because these are expected to be covered from the restricted carry-forward debt service coverage allowance. He increased debt service by \$1,722,671 to reflect the expense that will result from new borrowing. He expressed concern regarding the end of the compliance filing mechanism that permitted NBC to take advantage of lower interest rates with the VRDO program and noted that it would be advantageous to NBC and its ratepayers for this mechanism to continue for five years.<sup>10</sup>

Mr. Edge explained the proposal that allows NBC to fund an "Operating Reserve for Revenue Stability Fund" was established in order to ensure NBC's liquidity for meeting its debt service obligations, and thereby, allow NBC to maintain its credit rating. He explained that funding would be over a period of time, and at approximately 2% of NBC's approved revenue requirement, or \$1.5 million, per year. The Fund will not exceed 25% of NBC's annual

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<sup>9</sup> *Id.* at 20-22.

<sup>10</sup> *Id.* at 22-24.

operating and maintenance costs, and NBC will seek Commission approval to implement and replenish the fund as needed. He noted that the Fund will be in a separate interest bearing account held and managed by the Trustee, will not be available for general operations to pay for expense overages and will be funded through user fees and not restricted carry forward balances. The purpose of the Fund will be to protect ratepayers by serving as a cushion to ensure that each year's debt service payments will be made. Mr. Edge described this Fund as necessary to ensure revenue stability and as similar to the revenue reserve fund that the Commission has suggested may be appropriate for water utilities because of variable consumption. He pointed out that fixed costs have grown faster than fixed revenues in the past five years. Finally, he again requested, as he did in Docket No. 3797, that the net operating reserve be calculated at 1.5% of the cost of service less debt service related funding.<sup>11</sup>

**B. Testimony of Maureen Gurghigian**

Maureen E. Gurghigian, Managing Director with First Southwest Company and financial advisor to NBC, provided pre-filed testimony to discuss NBC's long-term financing plans, the importance of continuing with the compliance filing mechanism for debt related rate relief, and the Operating Reserve for Revenue Stability Fund. She noted that NBC's long-term financing strategy has resulted in the issuance of both variable and fixed rate revenue bonds and borrowings from the Rhode Island Clean Water Finance Agency ("RICWFA"). NBC's outstanding debt as of September 30, 2007 was \$421.4 million. She described NBC's projected borrowings over the next five years as including both revenue bonds and RICWFA loans, and projected more than \$221 million of debt issuance over this period. Ms. Gurghigian noted that

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<sup>11</sup> *Id.* at 24-28.

NBC's credit rating affects its eligibility for low interest loans and that the Commission's regulatory review and rate setting authority are significant credit rating factors.<sup>12</sup>

Ms Gurghigian pointed out how the multi-year approach providing for timely rate relief for debt service is critical to providing debt management flexibility. She also explained that the creation of an Operating Reserve for Revenue Stability would ensure that NBC has funds to meet all of its obligations whether or not user fees vary. She, like Mr. Edge, recommended funding of this reserve account at a level not to exceed 25% of the annual operations and maintenance cost to be attained over five years beginning in 2009. Ms. Gurghigian noted that this type of fund would help NBC maintain its credit rating.<sup>13</sup>

### **C. Testimony of Joseph Pratt**

Joseph Pratt, the Vice President of the Lois Berger Group who is responsible for Environmental Engineering in New England, also provided pre-filed testimony to provide an update of the construction of NBC's Combined CSO Phase I Facilities and the design of the CSO Phase II Facilities. He noted that construction has progressed well since he last reported in 2004, with approximately 92% of construction projects complete and commencement of operations expected in October 2008. He described the various steps and coordination with the Department of Environmental Management required for this project. He noted that Phase II consists of the construction and connection of the two interceptors along the Seekonk and Woonasquatucket Rivers to the Main Spine Tunnel that was in Phase I. Phase II is expected to cost approximately \$200 million.<sup>14</sup>

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<sup>12</sup>NBC Exhibit 1b, Testimony of Maureen Gurghigian, December 3, 2007 at 1-5.

<sup>13</sup>*Id.* at 5-7.

<sup>14</sup>NBC Exhibit 1c, Testimony of Joseph Pratt, December 3, 2007 at 1-7.



## II. DIVISION PRE-FILED DIRECT TESTIMONY

Thomas A. Catlin, a principal with Exeter Associates, Inc. provided pre-filed testimony on behalf of the Division of Public Utilities and Carriers (“Division”). Mr. Catlin’s testimony presented findings and recommendations with regard to the requested revenue increase and the design of the rates to recover those revenues. He recommended that NBC’s revenue requirement be set at \$75,250,473, which represents an increase of \$7,456,231 over current revenues, and is \$3,467,931 less than that requested by NBC. He agreed with NBC that existing rates, with the exception of septage charges, BOD/TSS surcharges, connection permit fees and pretreatment permit fees, be increased on an across-the-board uniform basis to recover the overall cost of service.<sup>15</sup>

Mr. Catlin proposed adjusting rate year revenues based upon actual test year consumption. He noted that lower than normal water consumption attributable to above normal rainfall, would have caused consumption to be below normal. However, Mr. Catlin recognized that prior to 2007 the overall consumption decline was only 1.5 percent per year. His calculation increased user fee revenues by \$1,494,144. Mr. Catlin noted that NBC employees pay a percentage of their salaries for a healthcare co-share and that NBC caps that co-share at 7.5% of the total premium. He pointed out that, based on his experience, it is not unusual for employers to require a much higher percentage co-share contribution. He made a number of adjustments to NBC’s rate year claim for employee health insurance to account for the premium amounts, number of employees for which premiums are included, wage increases and elimination of a percentage of premium cap on non-union employees. His adjustments reduced health insurance costs for the rate year by \$112,586.<sup>16</sup>

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<sup>15</sup> Division Exhibit 1, Testimony of Thomas A. Catlin, March 13, 2008 at 1-5.

<sup>16</sup> *Id.* at 6-9.

Regarding the cost of biosolid disposal costs, Mr. Catlin increased NBC's projected costs by \$36,520, using a 3% CPI rate for 2009 rather than NBC's 2.6% CPI rate. He reduced Maintenance and Service Agreement costs by \$123,351 because most of the percentage increase used by NBC to average its costs from FY 2004 to FY 2007 occurred from only FY 2004 to FY 2005. Mr. Catlin proposed using a three year average to project liability and workers' compensation insurance expenses in order to eliminate the bias caused by the abnormally high increases from FY 2006 to FY 2007 this resulted in a decrease in this expense of almost \$50,000. Regulatory expense was reduced by \$25,280 to eliminate expenses for FY 2006 fees and to reduce the PUC Assessment to equal the FY 2008 assessment, adjusted by 3 percent for inflation. Mr. Catlin reduced the projected electricity expense by \$31,044, using an average of maximum and minimum expected costs for his calculation. He noted that NBC's proposal was based on maximum use of equipment, which was not realistic.<sup>17</sup>

Mr. Catlin discussed NBC's Operating Reserve for the Revenue Stability Fund proposal and the proposal to fund the same at a rate of 2 percent of the overall revenue requirement until it reached 25 percent of NBC's annual operation and maintenance costs. He disagreed with this approach, instead recommending that the Revenue Stability Fund be funded from the debt service coverage carry-forward, rather than directly from rates as NBC proposed. This reduced the revenue requirement by approximately \$1.5 million. He noted that if the Commission approves the Revenue Stability Fund, it should reduce the Operating Reserve Allowance to just 1 percent of operating expenses excluding debt service, because the Revenue Stability Fund will provide funds to address revenue shortfalls. This recommendation reduced the Operating Reserve by approximately \$175,000. Mr. Catlin also noted that the Division did not object to NBC's being allowed to continue to make compliance filings for adjusting rates to recover debt

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<sup>17</sup> *Id.* at 9-15.

service costs for additional debt with the conditions adopted in Docket No. 3483. Finally, Mr. Catlin recommended a uniform percentage increase in rates excluding connection permit fees, septage fees, BOD/TSS surcharges and discharge permit fees, as NBC proposed, to recover the proposed increase.<sup>18</sup>

### III. NBC REBUTTAL TESTIMONY

In response to Mr. Catlin's testimony, NBC filed the rebuttal testimony of Mr. Edge. Mr. Edge first discussed Mr. Catlin's recommendation that test year consumption units at current rates be used to project the rate year revenue. He noted that Mr. Catlin's approach is an acceptable approach when consumption levels have stabilized; however, he expected NBC's revenues to continue to decline. He indicated that NBC would be agreeable to basing rates on test year consumption if the Commission funds the Revenue Stability Fund so that revenue shortfalls will not adversely affect NBC's financial strength or its ratepayers. Mr. Edge next discussed NBC's request for a Revenue Stability Fund and Mr. Catlin's alternative to fund the Revenue Stability Fund from the debt service coverage carry-forward. Mr. Edge noted that NBC's primary concern is insulating NBC from revenue instability and that either funding mechanism will accomplish this. He recognized that Mr. Catlin's recommendation reduces the proposed rate increase by almost \$1.5 million.<sup>19</sup>

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<sup>18</sup> *Id.* at 15-19. In Docket No. 3483, the Commission set the conditions for the debt service compliance filing mechanism. Those conditions are that the filing shall: (1) be filed no later than sixty days prior to its effective date; (2) be limited for debt service and debt service coverage for CIP projects; (3) contain a revised limited cost of service schedule reflecting the changes to the revenue and expense accounts affected by the VRDO/TECP program; (4) contain testimony and schedules in support of the debt service, and debt service coverage proposed as well as current and projected annual debt service payment schedules; (5) contain a summary of funds currently available for the CIP program and the projected funding needed for the rate year period; (6) contain a summary of funding received from RICWFA, including funds requested, received, the interest rate, and repayment schedules; (7) contain a summary of how prior years' debt service coverage funds were utilized; (8) contain a calculation of new rates based on a uniform percentage increase to rates; and (9) contain a showing of compliance with prior Commission orders and the requirements of Section 2.11 of the Commission's Rule of Practice and Procedure.

<sup>19</sup> NBC Exhibit 2, Rebuttal Testimony of Walter E. Edge, Jr. at 1-4.

Mr. Edge agreed with all of Mr. Catlin's adjustments to employee Health Benefits Costs except for the \$50,000 reduction due to his elimination of a cap on non-union employee contributions. He noted that it provides an attraction to future hires and that the amount is so minimal that eliminating it does not justify the detriment to morale it would cause. Mr. Edge accepted Mr. Catlin's \$36,520 adjustment to biosolid disposal costs and his reduction of \$123,351 to the maintenance and service agreements account with the exception of the \$58,776 fee that NBC will have to pay for the process control and automation system at Bucklin Point. He accepted Mr. Catlin's adjustments to insurance expense and electricity cost. Mr. Edge did not agree with Mr. Catlin's \$19,080 reduction for the proposed PUC assessment. He stated that because NBC's allocation to the PUC budget has increased over the last three years by an average of 13% annually, Mr. Catlin's 3% adjustment was not justified. Finally, Mr. Edge noted that should the Commission allow the establishment of either a Revenue Stability Fund or an O&M Reserve Fund to protect NBC from revenue shortfalls, it can accept the Division's net operating reserve calculation that reduces the Operating Reserve Allowance to 1 percent of operating expenses excluding debt service.<sup>20</sup>

#### **IV. DIVISION SURREBUTTAL TESTIMONY**

The Division filed the Surrebuttal Testimony of Thomas Catlin on April 17, 2008. He identified the three remaining issues as the cap on non-union employee contributions towards health care premiums, the annual fee for service contract costs and the regulatory expense. Mr. Catlin noted that he had not changed his position regarding the elimination of the cap on health insurance contributions for non-union employees. He agreed with Mr. Edge that \$58,776 should be added to the level of service contract costs, because of NBC has a new agreement for the process control and automation system at Bucklin Point that was not initially included in NBC's

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<sup>20</sup> *Id.* at 4-7.

request. Lastly, he noted that he agrees to allow for an increase of \$12,000 for the PUC assessment and therefore, he adjusted his original adjustment of (\$25,280) to (\$12,450). Mr. Catlin also pointed out that funding a Revenue Stability Fund or O&M Reserve from the debt service coverage carry-forward is preferable to having ratepayers contribute an additional \$1.5 million per year for the next five (5) or six (6) years. He also noted that Mr. Edge was not opposed to his recommendation for an operating revenue allowance of only 1 percent of operating expenses excluding debt service as long as the Commission approved either an O&M Reserve or Revenue Stability Fund.<sup>21</sup>

## V. HEARING

After published notice, the Commission conducted a public hearing on April 29, 2008 at the Commission offices located at 89 Jefferson Boulevard, Warwick, Rhode Island. The following appearances were entered:

FOR NBC	:	Peter J. McGinn, Esq.
FOR THE DIVISION	:	Leo Wold, Esq. Special Assistant Attorney General
FOR THE COMMISSION	:	Patricia S. Lucarelli, Esq. Chief of Legal Services

Walter E. Edge, Jr. testified on behalf of NBC and noted that NBC was prepared to accept the Division's position on regulatory expense because the amount in dispute was minimal.<sup>22</sup> He also testified regarding the Division's proposal to eliminate the cap on the co-share for healthcare paid by non-union employees, noting that if the Commission were to eliminate the premium cap for healthcare co-shares for non-union employees, NBC would likely

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<sup>21</sup> Division Exhibit 2, Testimony of Thomas A. Catlin, April 17, 2008 at 1-3.

<sup>22</sup> Transcript of Hearing ("T."), April 29, 2008 at 12.

negotiate from a higher co-share for union employees.<sup>23</sup> When questioned about NBC's pension,

Mr. Edge noted that it has been funded at ten percent of budgeted wages and that is how it continues to be funded.<sup>24</sup> He explained that if it becomes over funded, typically, the money is just left there with the hope that it will eventually balance out with shortfalls in subsequent years.<sup>25</sup> He testified against funding it for less in subsequent years when it was overfunded and also against taking money out of it, until the assumptions were able to be reviewed over a period of time.<sup>26</sup>

Mr. Edge was also questioned regarding the 4.0% to 4.25% salary increases proposed for FY 2008 and FY 2009 respectively. He acknowledged that if NBC were to use the 3.5% authorized by the Commission as an increase for non-union salaries in FY 2008, salary expense would be less than what he calculated.<sup>27</sup> Commissioner Bray requested that NBC provide to the Commission the difference between the 4.0% salary increase proposed and the 3.5% salary increase allowed by the Commission for FY 2008.<sup>28</sup> NBC responded on May 19, 2008 that the difference was \$35,245.<sup>29</sup>

Thomas Catlin testified on behalf of the Division and pointed out the three differences between the Division's position and that of NBC. He identified those differences as the proposed elimination of a cap on non-union co-shares for healthcare, the regulatory expense and the funding of an operating reserve.<sup>30</sup> He pointed out that the Division recommended that the operating reserve be funded through the restricted cost carry forwards, rather than as an

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<sup>23</sup> *Id.* at 7-8.

<sup>24</sup> *Id.* at 44-45.

<sup>25</sup> *Id.* at 46.

<sup>26</sup> *Id.* at 46-56.

<sup>27</sup> *Id.* at 16.

<sup>28</sup> *Id.* at 57.

<sup>29</sup> NBC Response to Commission Data Request made during April 29, 2008 hearing filed on May 19, 2008.

<sup>30</sup> *Id.* at 65.

additional revenue requirement on ratepayers as proposed by NBC.<sup>31</sup> Mr. Catlin questioned the level of funding that NBC proposed, but noted that because NBC's actual billings are based on water consumption that is declining, it is difficult with less revenue, to fund all that needs to be funded.<sup>32</sup> Mr. Catlin recommended funding be from the restricted carry forward balance, rather than having ratepayers pay more. He noted that the only downside to this was that the ratepayers would no longer receive interest on the restricted carry forward balance since it will be expended.<sup>33</sup> He recommended funding at a lower level than that proposed by NBC, suggesting that NBC put aside \$1.5 million for the next three years and then reevaluate the fund.<sup>34</sup>

Maureen Gurghigian also testified for NBC noting that any type of reserve, whether for revenue stability or an O&M reserve, would be viewed favorably by financial markets and rating agencies.<sup>35</sup> She noted that either reserve would be perceived as contributing to NBC's financial stability.<sup>36</sup> Ms. Gurghigian testified in favor of the Commission approving the existing filing mechanism, for issuing debt service on a short or abbreviated filing basis, being extended through 2013.<sup>37</sup>

## VI. COMMISSION FINDINGS

At an open meeting on June 12, 2008, the Commission considered NBC's application for a General Rate Change.<sup>38</sup> The Commission discussed and deliberated on the issues identified by the parties as being in dispute, as well as other issues addressed during the hearing by the Commission. The Commission first discussed NBC's request to fund a Revenue Stability Fund and if allowed, how such a fund would be funded. The Commission unanimously approved

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<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at 68.

<sup>33</sup> *Id.* at 69.

<sup>34</sup> *Id.* at 69-70.

<sup>35</sup> *Id.* at 82, 94.

<sup>36</sup> *Id.* at 83.

<sup>37</sup> *Id.* at 88.

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allowing NBC to create a Revenue Stability Fund, to be used in the event of serious revenue shortfalls resulting from decreases in consumption. This Fund is to be funded from NBC's debt service carry forward, which will not cause rates to increase as a result of its creation. It is understood that this alternative use of the debt service carry forward will result in such funds not being available for capital projects. The Commission approved funding of \$1.5 million dollars per year with a cap of \$4.5 million, and with any interest earned on the money in the fund remaining in the fund balance.

The Commission also discussed NBC's current Operating Reserve Allowance and voted two to one to allow this to be funded in the amount of one percent of Operating Expenses excluding Debt Service and Personnel Expense. In his testimony, Mr. Edge noted that should the Commission approve its proposal to create a Revenue Stability Fund, NBC would be accepting of a 1% Operating Reserve that excluded only Debt Service.<sup>39</sup> In Order No. 19062 in Docket No. 3797, the Commission discussed the reasons for an Operating Reserve.<sup>40</sup> One of those reasons was to address unexpected increases in expenses that are beyond the control of the utility. Both Debt Service and Personnel Expense costs are deemed to be within the control of NBC. Furthermore, NBC's own witness, Mr. Edge, testified during the hearing that NBC "has always been able to control their expending in such a fashion that they come in under budget and frequently under what the Commission proposes."<sup>41</sup> Because the utility continues to show that it can find savings even though it experiences a revenue shortfall, it does not need an Operating Reserve at the same level of a utility that is unable to find savings in such situations. Therefore

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<sup>39</sup> NBC Exhibit 2, Rebuttal Testimony of Walter E. Edge, Jr. at 4.

<sup>40</sup> Factors considered by the Commission in setting an Operating Reserve include: significant revenue fluctuations, unanticipated increases in fuel costs, unexpected increases in expenses which are beyond the control of the utility and necessary to meet expenses approved in the cost of service. See Docket No. 3797, Order No. 19062 (citations omitted).

<sup>41</sup> T. at 18.



the 1% is deemed to be sufficient for NBC. The Commission has previously omitted Personnel Costs in the Operating Reserve calculation and indicated that because Personnel Costs are controllable by NBC. They can be controlled by such measures as co-sharing healthcare premiums, salary freezes or layoffs.<sup>42</sup> Additionally, the majority of the Commissioners still believe that because Personnel Costs are within the control of NBC, excluding them from the Operating Reserve calculation will incentivize NBC to keep such costs low.

Regarding Regulatory Expense, the Commission was satisfied that the compromise made by NBC and the Division is fair and reasonable, and approved the agreed decrease of \$12,450 for a total of \$191,011. Additionally, the Commission unanimously agreed to allow NBC to continue with the current debt service compliance filing mechanism provided for in Docket No. 3483 for the period FY 2009 through FY 2013. Those conditions set forth in Order No. 17558 shall continue to apply. Specifically, all compliance filings seeking a rate increase under the TECP/VRDO program shall: (1) be filed no later than sixty days prior to its effective date; (2) be limited to debt service and debt service coverage for CIP projects; (3) contain a revised limited cost of service schedule reflecting the changes to the revenue and expense accounts affected by the VRDO/TECP program; (4) contain testimony and schedules in support of the debt service, and debt service coverage proposed as well as current and projected annual debt service payment schedules; (5) contain a summary of funds currently available for the CIP program and the projected funding needed for the rate year period; (6) contain a summary of funding received from RICWFA, including funds requested, received, the interest rate, and repayment schedules; (7) contain a summary of how prior years' debt service coverage funds were utilized; (8) contain a calculation of new rates based on a uniform percentage increase to rates; and (9) contain a

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<sup>42</sup> See Docket No. 3739, Order No. 19062 (citations omitted).

showing of compliance with prior Commission orders and the requirements of Section 2.11 of the Commission's Rule of Practice and Procedure.<sup>43</sup>

The Commission discussed NBC's request for ratepayers to fund salary increases for employees at 4% for FY 2008 and 4.25% for FY 2009. The Rhode Island Supreme Court has previously ruled that "expenses, including wage and salary increases that affect post-test year finances, are facts which are subject to the Commission's scrutiny."<sup>44</sup> Courts in other jurisdictions have also ruled similarly.<sup>45</sup> Thus, this Commission has the authority to review and, if justified, to disallow salary increases in rates. In its review of whether the proposed increase in salaries and wages was reasonable, the Commission looked at a number of things. First it looked at the rate of inflation which NBC agreed, for the Bucklin Point management contract, to be 3% and found that the proposed salary increases exceeded this rate of inflation. Additionally, another factor the Commission considered in determining whether the request for a 4.25% salary increase for FY 2009 was reasonable, was NBC's approved salary increase for FY 2008. In Docket No. 3797, NBC requested salary increases of 3.75% for the interim year and 4.5% for the fiscal year ending 2008. The Commission rejected NBC's proposal, and after detailed discussion, approved an increase of 3.5%. In the instant matter, Mr. Edge's testimony notes that NBC negotiated COLA increases for its union employees at 2.75% and 3% for FY 2008 and FY

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<sup>43</sup> See Docket No. 3483, Order No. 17558.

<sup>44</sup> *New Eng. Tel. v. PUC*, 115, R.I. 356, 381 (1976).

<sup>45</sup> *C & P Telephone Co. of W.Va. v. PSC*, 301 S.E.2d 798 (WV 1983), *Pacific Tel. v. PUC* 401 P.2d 353, 377 (CA 1965). *New England Telephone Co. v. PUC*, 470 A.2d 772 (ME 1984), *Southwestern Bell Tel. Co. v. Ark. PSC*, 824 F.2d 672 (8th Cir., Ark., 1987), See *Mississippi PSC v. Home Tel. Co.* 110 So.2d 618, 622-623 (MS 1964) (stating, "a regulatory commission has the power to disallow excessive salaries for ratemaking purposes."), See also *Application of Northwestern PSC*, 297 N.W. 2d 462 (SD 1980) (recognizing the authority of the PSC to reduce salaries).

2009, respectively.<sup>46</sup> The 4.25% for FY 2009 for non-union employees is greater than the 3.5% increase allowed by the Commission for FY 2008.

The Commission also considered the increases recently allowed to other water utilities when considering NBC's request for an increase for salaries as it has done in the past. For example, in Docket No. 3832, Order No. 19145, the Providence Water Supply Board, another non-investor owned utility, was allowed a 3% increase in salaries for 2008. Additionally, NBC bases its pension funding for the non-union Defined Benefit Plan on the assumption that wage increases will average 3.5% over the long-term.<sup>47</sup> In the instant matter, NBC provided no evidence to justify such a large percentage increase in salaries for its employees. The Commission expressed concern, in light of the current economy, that NBC would allow for such considerable pay increases. By a vote of two to one, the Commission limited the amount to be provided for the FY 2009 non-union salary increase to 3 percent. The decision of the majority was supported by the rationale set forth above.

The Commission deliberated on the Division's recommendation that eliminated the percentage of premium cap on the healthcare co-share paid by non-union employees. Elimination of the cap will result in a \$50,000 savings to ratepayers. The majority of the Commissioners found that non-union employees would continue to pay only a relatively small percentage of their salary as a co-share for healthcare.<sup>48</sup> Additionally, Mr. Catlin's testimony represented that it is not unusual for employers to require co-shares of a greater percentage than

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<sup>46</sup> NBC Exhibit 1a, Testimony of Walter E. Edge, Jr., December 3, 2007 at 18.

<sup>47</sup> See Response to Commission Data Request #5 in Docket 3651; see also Docket 3651 April 8, 2008 Compliance Filing.

<sup>48</sup> Employees hired before July 1, 2004 would co-pay 1.1% for a single person health care plan and 2.4% for a family plan in fiscal year 2009. For employees hired after July 1, 2004, the percentages are 1.25% and 2.7%, respectively. Response to Division Data Request # 1-24.

the 7.5% of premium cap. The additional \$50,000 of funding by employees that allows NBC to further reduce the amount of healthcare cost is not unreasonable.

Finally, the Commission accepted NBC's rate design to increase existing rates, other than septage charges, BOD/TSS surcharges, connection fees and pretreatment permit fees, on an across the board percentage basis.

Accordingly, it is hereby

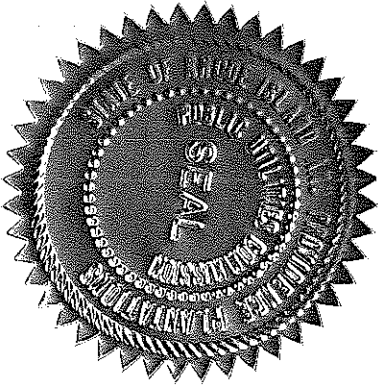
(19380) ORDERED:

1. Narragansett Bay Commission's General Rate Filing filed on December 3, 2007 is denied and dismissed.
2. A revenue increase of \$7,236,917 resulting in a cost of service of \$75,031,159 is hereby approved for usage on and after July 1, 2008.
3. The establishment of a Revenue Stability Fund in the amount of \$1.5 million per year from debt service carry forward, with a cap of \$4.5 million, is approved. Interest in this Fund shall remain in the Fund balance.
4. The Commission will continue to restrict those accounts previously restricted, namely Debt Service--\$32,554,796 and Debt Service Coverage--\$8,138,699. Debt Service Coverage funding may be used for: (1) the payment of Capital Improvement Program projects; (2) capital outlays; and (3) funding the Revenue Stability Fund.
5. Funding of an Operating Reserve at 1% of operating expenses, excluding Debt Service related costs and Personnel Expense in the calculation, is approved.
6. Narragansett Bay Commission compliance tariffs, filed on June 24, 2008, are hereby approved.

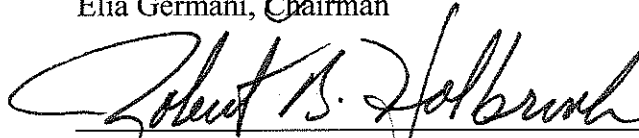
7. The Parties shall act in accordance with all other findings and instructions contained in this Report and Order.

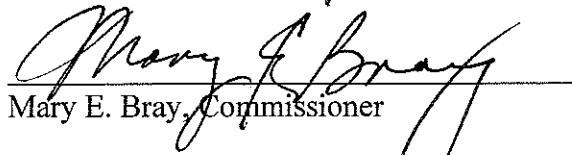
EFFECTIVE AT WARWICK, RHODE ISLAND JULY 1, 2008, PURSUANT TO OPEN MEETING DECISION ON JUNE 12, 2008 AND JULY 3, 2008. WRITTEN ORDER ISSUED AUGUST 20, 2008.

PUBLIC UTILITIES COMMISSION



  
\_\_\_\_\_  
Elia Germani, Chairman

  
\_\_\_\_\_  
Robert B. Holbrook, Commissioner

  
\_\_\_\_\_  
Mary E. Bray, Commissioner

## Appendix A

### Cost of Service

	NBC Position	Commission Adjustments	Proforma Cost of Service
<b>REVENUES</b>			
User Fee Revenues	\$ 64,383,218	\$ - 0 -	\$ 64,383,218
Other Service Revenues	2,497,190		2,497,190
Miscellaneous	<u>920,834</u>	<u>( 7,000)</u>	<u>913,834</u>
Total Revenues	<u>\$ 67,801,242</u>	<u>\$ ( 7,000)</u>	<u>\$ 67,794,242</u>
<b>EXPENSES</b>			
Personnel Services	\$ 17,687,447	\$ ( 159,000)	\$ 17,528,447
Operating Supplies & Expenses	13,750,251		13,750,251
Professional Services	2,868,999	( 12,450)	2,856,549
Amortization	9,690		9,690
Debt Related Costs	26,562		26,562
Debt Service	32,554,796		32,554,796
Debt Coverage	<u>8,138,699</u>	<u>-</u>	<u>8,138,699</u>
Total Expenses	<u>\$ 75,036,444</u>	<u>\$ (171,450)</u>	<u>\$ 74,864,994</u>
Operating Reserve	514,746	( 348,581)	166,165
Revenue Stability Fund	<u>1,500,000</u>	<u>(1,500,000)*</u>	<u>-0-</u>
<b>COST OF SERVICE</b>	<u>\$ 77,051,190</u>	<u>\$ 2,020,031</u>	<u>\$ 75,031,159</u>
<b>RATE YEAR REVENUES AT PRESENT RATES</b>			<u>67,794,242</u>
<b>REVENUE INCREASE</b>	<u>\$ 9,249,948</u>	<u>\$ ( 2,013,031)</u>	<u>\$ 7,236,917</u>

\* The Commission will allow annual funding of \$1,500,000 for a Revenue Stability Fund from the carry-forward of funds in the Debt Coverage Account.

### Cost of Service Adjustments

#### Revenue

Elimination of interest income from Revenue Stability Fund \$7,000

#### Personnel Services

Elimination of cap on health insurance co-payments by  
non-union employees \$50,000

Salary increase for fiscal year 2009 adjusted to reflect a  
3% increase for non-union employees \$93,000

Salary overheads adjusted (17.65%) \$16,000

Total Personnel Services Adjustment \$159,000

Professional Services-Regulatory Expenses \$12,450

#### Operating Reserve

Adjustment to reflect Operating Reserve at 1% of the  
Cost of service less personnel and debt-related accounts \$348,581