STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
BEFORE THE PUBLIC UTILITIES COMMISSION

IN RE: THE CITY OF NEWPORT,	:	
UTILITIES DEPARTMENT WATER DIVISION	:	Docket No. 4025
APPLICATION TO CHANGE RATE SCHEDULES	:	

PORTSMOUTH WATER AND FIRE DISTRICT'S
PRE-HEARING BRIEF ON
REPAYMENT TO THE CITY OF NEWPORT

I. INTRODUCTION

For years Newport Water failed to properly manage its finances and ran up an enormous debt to the City. Newport Water mismanaged its finances so badly that in Docket 3578 it could neither document alleged loans from the City nor explain where the borrowed money went. Notwithstanding this lack of documentation or detail, Newport Water – under instruction from the City – sought to pay millions of dollars to the City. Portsmouth argued that Newport Water could not recover any of that money pursuant to Providence Water Supply Board v. Malachowski, 624 A.2d 305 (R.I. 1993). The unauthorized loans and unexplained spending negated the oversight and rate-setting functions the law consigns to this Commission.

After much discussion and difficult negotiations among the parties, Portsmouth agreed to a settlement allowing Newport Water to pay back millions of dollars to the City – provided that Newport Water agreed to cap the repayment and not to pay any additional amounts owed to the City as of the close of FY 05. These forbearances were critical aspects of the settlement intended to limit the repayment and bring an end to Newport Water's undocumented borrowing.

The Commission approved the settlement in the Report and Order in Docket 3578. The Commission's Order provided that Newport Water could repay \$2.5 million it had borrowed from the City, *but it could not repay other amounts borrowed up through and including June*

30, 2005: "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." (See Docket 3578, Report and Order, Appendix A at 5).

Only a short while later, Newport Water sought to renege on its promise and repay further amounts owed to the City as of June 30, 2005. In Docket 3818, this Commission rejected Newport Water's request to require ratepayers to bear this added burden. Instead, the Commission authorized further repayment to the City only "if Newport Water realizes savings from efficiencies, and such funds are not required for expenses included in the revenue requirement." (Order No. 19240 at 31, 46). The Commission plainly fashioned an Order designed to prevent any further burden on the ratepayers caused by Newport Water's ad hoc financial arrangements with the City. Once again, however, Newport Water is attempting in this docket to repay the City on the backs of its ratepayers. While the Commission is not bound by its determinations in prior cases, see In re Verizon Rhode Island, Docket No. 3445A, 2005 R.I. PUC LEXIS 13, *27 (Apr. 6, 2005), citing New England Tel. Co. v. PUC, 118 R.I. 570, 592 n. 9 (1977), it should reject this attempt by Newport Water to obtain what all expected would be prohibited.[1]

[1] Portsmouth recognizes that in the prior docket the Commission left open the possibility that Newport Water could repay $1,584,171 owed to the City if, and only if, it realized "savings from efficiencies." (Order No. 19240 at 38). Given the settlement, however, in which Newport Water agreed that it would not repay money borrowed from the City prior to June 30, 2005 (or afterwards if the loans were not properly documented), Portsmouth believes the Commission should have foreclosed the possibility entirely. In light of the issues discussed herein, the Commission should consider whether it is appropriate to amend Order No. 19240 to more closely conform to the provisions of the settlement.

II. DISCUSSION

A. The Commission Should Not Permit Newport Water To Repay $709,421 Of The $1,584,171[2] Debt Because It Includes Amounts Owed to the City of Newport at the Close of Fiscal Year 2005

Although Newport Water agreed not to seek to recover in rates any additional monies owed to the City up through and including June 30, 2005, this is the second consecutive docket in which it has sought permission to violate that agreement. Newport Water reported a debt of $709,421 owed to the City in its 2005 annual report to the Commission. Newport Water explained that it borrowed about half of this amount because it could not meet its payroll. (Docket 3818, Hrg. Trn., July 24, 2007 at 143:2-7). The remaining portion included other expenses that the City paid on behalf of Newport Water. (Docket 3818, Hrg. Trn., July 24, 2007 at 149:6-24). Because it is money Newport Water owed to the City at the close of FY 05, rate recovery is barred by the Report and Order issued in Docket 3578

Newport Water previously claimed that the $709,421 was not actually "borrowed" from the City. But as before, this argument falls flat. Newport Water has operated in a deficit position since at least 2005. (Docket 3818, Hrg. Trn., July 24, 2007 at 140:16-20 and 154:2-19). It has not had the money to meet payroll and other expenses. (Docket 3818, Hrg. Trn., July 24, 2007 at 154:2-19). By remaining indebted to the City, Newport Water avoided borrowing money from a bank – a transaction that Newport Water acknowledged would clearly be a loan. (Docket 3818, Hrg. Trn., July 24, 2007 at 151:21-24). The $709,421 should not be characterized any differently because the money came from the City instead of a bank. A loan

[2] In another example of Newport Water's chronic inability to provide the Commission with reliable figures, Newport Water's 2007 annual report showed that Newport Water's payables to the City actually amounted to $1,901,413 – not $1,584,171. The difference is significant: $317,242, or about 20% higher than the Commission believed when it issued Order No. 19240. Given that the annual report presented audited financial information, it is likely that the $1,584,171 was in error. However, the hearing at which Newport Water presented these figures was three weeks after the fiscal year ended. On such an important matter, it should have been able to provide the Commission with reliable information.

is a sum of money provided for the payment of something with the expectation of repayment.[3] (See In re Providence Water Supply Board, Docket 3832, 2007 R.I. PUC LEXIS 94, *106-07 (Dec. 13, 2007); see also BLACK'S LAW DICTIONARY 947 (7th ed. 1999) (a loan is "a grant of something for temporary use")).

Indeed, in its 2005 annual report to the Commission, Newport Water included the $709,421 owed as of FY 05 as part of a $1.2 million short-term "note" owed to the City. (Docket 3818, Hrg. Trn., July 25, 2007 at 203:15-204:18). A note is a loan, plain and simple. No one told Newport Water how to characterize this debt –Newport Water designated this debt as a short term note in 2005 with full knowledge of all the facts and without coercion of any type. (Docket 3818, Hrg. Trn., July 25, 2007 at 202:1-16).

Newport Water contends that the $709,421 owed as of FY 2005 was previously paid and that the money currently owed to the City consists of post-2005 debt. Nonsense. First, Newport Water owed the City $709,421 at the close of FY 2005, about $1.2 million at the close of FY 2006, and nearly $1.7 million at the close of FY 2007. The debt was not repaid -- *it grew*. Second, although Newport Water claims it paid its pre-June 30, 2005 payables to the City, it did not have sufficient revenues to catch up. Accordingly, it has a continuing amount payable to the City.[4] (Docket 3818, Forgue Direct Testimony, at 6:25-27 ("Newport Water was in the position of paying for fiscal year 2005 expenditures from fiscal year 2006 revenue."), 7:8-10 ("...in fiscal year 2007 approximately $1.5 million of revenue will go towards funding expenditures from fiscal year 2006")). Thus, although Newport Water has claimed that the

[3] Indeed, during the hearing in Docket 3818, the Commission recognized that the money Newport Water received from the City was borrowed. (See Docket 3818, Hrg. Trn., July 24, 2007, at 168:19-171:10; see also id. at 137:22-171:16).

[4] In fact, although Newport Water has a continuing amount payable to the City, as of late that payable has been *decreasing*. In FY 08, according to its annual report, Newport Water paid down nearly $1 million owed to the City. At the same time, according to the same report, payables to vendors are *increasing*. Given that Newport Water's cash position has remained relatively static, the clear implication is that Newport Water is paying the City rather than its vendors, and deferring expenditures that the Commission approved after Newport Water represented that the expenditures were necessary.

$1,584,171 deficit resulted from FY 2007 operations, in actuality at least $709,421 can be traced to before June 30, 2005.[5] (Docket 4025, Forgue Rebuttal, at 8:14 ("It was this deficit (that built up in FY07) that the Commission allowed Newport [Water] to reduce through efficiencies in the Docket 3818 Order.")). Newport Water cannot erase the debt simply by rolling it forward.[6] Moreover, repayment of the $709,421 debt would have violated the Report and Order from Docket 3578 -- which prohibited repayment. (Docket 3578, Report and Order, Appendix A at 5).

In sum, the Commission should not allow Newport Water – under any circumstances – to pay back $709,421 of the $1,584,171 owed to the City.[7] (See Docket 3578, Report and Order, Appendix A at 5).

B. The Commission Should Not Permit Newport Water To Repay Any Of The Additional Debt Because Newport Water Violated The Commission's Previous Order By Not Documenting Such Debt

With respect to any additional money that Newport Water owes to the City for post-2005 borrowings, there is no evidence before the Commission to suggest these loans were

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[5] To put it simply, if Newport Water did not owe the City $709,421 at the close of FY 2005, its debt today would be that much less. Newport Water has never paid off its debt to the City – it just rolled the debt forward. Newport Water's claim that it "paid off" the 2005 debt and simply accumulated new debt in 2006 and 2007 is self-serving semantics.

[6] Newport Water has claimed that it had a surplus in July 2006, i.e. that the pre-June 30, 2005 payables to the City were repaid. (Docket 4025, Forgue Rebuttal, at 8:9-11.) This claim is a red herring that the Commission should reject out of hand. First, it is irrelevant whether Newport Water had a surplus. If it had started FY 2006 owing nothing to the City, as the settlement contemplated, its "surplus" would have been greater by $709,421. Second, the only reason that Newport Water showed a surplus in July 2006 was because that month the City prepaid a full year's worth of public fire protection charges. If the City had been billed and paid according to the approved tariff, only 1/12 the annual fire charge would have been paid in July and there would have been *no surplus* for the month. That the City paid upfront does not alter the fact that Newport Water started out on July 1, 2005 with a deficit of approximately $700,000.

[7] Furthermore, "[o]ne of the central principles of ratemaking is that rates must be prospective. It is well settled that rates are exclusively prospective in nature and that future rates may not be designed to recoup past losses." Providence Gas Co. v. Burke, 475 A.2d 193, 197 (R.I. 1984). This rule against retroactive ratemaking "serves to protect present customers from paying for a utility's past operating deficits." Narragansett Elec. Co. v. Burke, 415 A.2d 177, 179 (R.I. 1980). No compelling reason has been advanced for why this rule should not be followed in this docket. Nor has any compelling reason been advanced for why the expectations of the parties to the settlement agreement should not be honored, or why the Commission should jeopardize the willingness of parties in future dockets to enter into settlement agreements.

properly documented as required by the Report and Order in Docket 3578.[8] (Docket 3578, Report and Order, Appendix A at 5). Newport Water and the City, at their peril, ignored the Commission's previous Order. (See also Providence Water Supply Bd. v. Malachowski, 624 A.2d 305, 310 (R.I. 1993) (under R.I. Gen. Laws § 39-3-11.1, which allows a municipal water utility to change its rates for the purpose of reimbursing loans made by any city or town, the "existence and legitimacy" of loans must be established by documentation)). This is not a matter of form over substance. As the Commission is aware, when Newport Water previously borrowed money from the City without documentation, *it also could not explain what happened to the money.* Therefore, because Newport Water has not complied with the Order requiring documentation, the City should not be repaid for any additional debt accumulated post-2005.

C. Newport Water Has Neither Identified Any Efficiencies, Nor Applied To The Commission For Authorization To Apply Savings From Efficiencies To Pay Down The Debt Owed To The City

In Order No. 19240, the Commission wrote that "if Newport Water realizes savings from efficiencies, and such funds are not required for expenses included in the revenue requirement, it may use such savings to pay down the accounts payable balance [i.e. $1,584,171] owed to the City." (Order No. 19240 at 38). This decision did not give Newport Water license to determine for itself whether it had realized savings from efficiencies. At its Open Meeting on August 30, 2007, the Commission made clear that this debt could be paid down only if: (1) Newport Water could find efficiencies in its operations that would be a potential source of revenues and (2) Newport Water first applied to the Commission and received permission to use that money to pay down the debt. (See Minutes of Open Meeting

[8] Portsmouth believes there is no such documentation because in the previous docket it asked Newport Water to provide any documentation that existed. Newport Water provided none, because it claimed that no loans were made. Moreover, Newport Water is required by the settlement to provide such documentation to the other parties, including Portsmouth.

Held August 30, 2007, at 2). Newport Water has not met the requirements of the Commission's Order.

First, Newport Water failed to demonstrate that it generated any "savings from efficiencies." To the contrary, Newport Water has affirmatively established through its own testimony that it deliberately deferred incurring "expenses included in the revenue requirement" to pay back the City. This is akin to robbing Peter to pay Paul – Newport Water seeks to take funds that should be used to meet expenses included in the revenue requirement and instead give them to the City.[9] Newport Water has simply deferred incurring expenses for the express purpose of accumulating an account balance to repay the City, as the following testimony by Newport Water illustrates:

- "Newport was able to reduce its payables due to increased revenue and its conservative approach to purchasing, which reduced operations and maintenance spending." (Docket 4025, Forgue Direct Testimony, at 7:7-8);

- "Many of these [normalization] adjustments were necessary due [to] Newport's efforts to reduce its outstanding payables." (Id. at 13:10-15);

- "The spending in conferences and training was cut back in FY 08 to reduce our outstanding payables and does not reflect a normal year of expenses." (Id. at 14:26-27);

- "The purchasing of office supplies was curtailed in an effort to reduce our outstanding payables." (Id. at 16:2-3);

- The normalization adjustment to temporary salaries "was done to conserve cash in order to reduce outstanding payables." (Id. at 16:26-29);

- "In addition, $2,825 that was budgeted for security changes and other enhancements was delayed until FY 09 in order to reduce payables." (Id. at 17:7-10);

- "Raw material purchases for dam repairs were limited, as well as tree removals budgeted at $3,000 were not performed." (Id. at 18:19-24);

[9] This is not surprising given that the City exercises complete control over Newport Water. However, as much as the City may wish to prioritize its own needs over the operational and maintenance needs of the water system, the Commission authorized Newport Water to collect those funds to meet expenses in its revenue requirement – not to pay back the City.

- "The Water Division deferred maintenance at the plant including repairs to air handling equipment, heat and hot water heater maintenance, and replacement of analyzers." (Id. at 20:11-13);

- "The Water Division has deferred maintenance at the [Lawton Valley] plant, including maintenance to heat and hot water heater systems, valve updates, spare parts, and supplies, in an effort to reduce outstanding payables." (Id. at 21:20-26);

- "Maintenance has been deferred at [70 Halsey Street and the Forest Avenue pump station]. By way of example, roof replacement, air conditioning, and overhead doors were deferred during FY 08." (Id. at 24:18-22);

- "In an effort to reduce our outstanding payables, the replacement of materials inventory, including ductile iron pipe, fittings, tapping sleeves, etc. were kept at a minimum during the test year." (Id. at 24:25-27);

- "In an effort to reduce our outstanding payables, the replacement of materials inventory, including copper pipe, service boxes, fittings, etc. was kept at a minimum during this year. Replacement of service barricades, safety cones and tools was also deferred." (Id. at 25:4-7);

- "Maintenance has been deferred at both [70 Halsey Street and the Forest Avenue pump station] due to cash flow concerns." (Id. at 33:9-13);

- "Newport Water has deliberately curtailed spending where possible by scrutinizing every expense to determine if it is absolutely vital. Unfortunately, necessary expenses in accounts such as dues and subscriptions and conferences and training have been targeted as areas where spending is curtailed in order to address the cash flow issue. Newport Water is now approaching a point where its cash flow problems are moderating, and while we always review expenses, we hopefully are reaching operations where our expenses are balanced by our revenues. This will allow us to make expenditures on necessary items that have been curtailed in past years due to the cash flow issues." (Docket 4025, Forgue Rebuttal, at 5:11-23).

In total, Newport Water did not spend $230,000 in FY 08 that had been approved by the Commission as part of the revenue requirement in Docket 3818. Presumably, the same pattern was repeated in FY 09, meaning that almost $500,000 in spending was deferred. Newport Water did not "realize savings from efficiencies," it openly seeks to take funds collected to "meet expenses included in the revenue requirement" and instead use them to pay the City. This scheme directly contradicts the Commission's Order and impermissibly burdens the ratepayers who will pay the price for Newport Water's temporary deferrals in the years to come. For this reason, the Commission should not permit Newport Water to pay down the debt owed to the City.[10]

Second, Newport Water failed to identify any "efficiencies" in response to a direct data request. In response to Portsmouth's request to identify efficiencies from which Newport Water has realized savings, Newport Water did not identify a single efficiency – and the Commission should hold Newport Water to that response. Instead, Newport Water stated that it spent less money in FY08 than was allowed by the Commission in Docket 3818. (Newport Water's Response to PWFD 5-1, citing RFC Schedule 3). According to Newport Water, these savings resulted primarily from Newport Water "cutting back a number of expenses in an effort to reduce payables." (Newport Water's Response to PWFD 5-1; Docket 4025, Forgue Direct Testimony, at 13:10-24). Newport Water misses the point – deferring maintenance costs and other necessary expenses included in the revenue requirement does not create savings through efficiencies. To the contrary, Newport Water confirmed that, while it was "comfortable" postponing preventative maintenance in FY 06, "continuing to do so would most likely result in widespread equipment failures that could impact our ability to provide service." (See Docket 3818, Forgue Direct Testimony, at 13:26-14:5). In other words, the ratepayers will pay for these expenses in the next year or the following year, and may have to pay more due to imprudent choices by Newport Water to defer necessary activities.

[10] Newport Water deferred these necessary expenses even though its water sales in FY 08 were higher than projected, resulting in a $464,308 windfall compared to the Commission approved revenue in Docket 3818. With so much unexpected money available, there should have been no need for Newport Water to defer the expenses described by Newport Water in its testimony above. In other words, whereas Newport Water testified that it is "hopefully reaching operations where [its] expenses are balanced by [its] revenues," that balance was already achieved in Docket 3818, thanks to the additional $464,308 resulting from the increased water sales. To the extent Newport Water had problems with cash flow, it was because Newport Water was paying so much to the City – $952,252 in FY 08. (See Newport Water 2008 Annual Report).

Moreover, in this Docket 4025, Newport Water has asked the Commission for permission to use revenue resulting from the change to quarterly billing to repay the City for outstanding payables. (See Forgue Direct Testimony, at 5:13-24 ("Newport would request that the balance of this fund be used to pay any outstanding payables Newport has at the conclusion of this case.")). The change from tri-annual to quarterly billing was ordered by the Commission in Docket 3818. (See Order No. 19240 at 46). It is not an "efficiency" within the meaning of Order No. 19240. Accordingly, consistent with both the settlement agreement in Docket 3578 and Order No. 19240, Newport Water cannot use this money to pay its debt to the City.

Third, Newport Water has consistently underspent the money approved by the Commission for expenses, and simply refers to the resulting surplus as "savings." To take one example, in Docket 3818, the Commission approved $30,000 for Repairs & Maintenance – Equipment. In FY 08, Newport Water spent only $2559 on that cost center, a difference of $27,441. (Docket 4025, Forgue Direct Testimony, at 33:9-15 ("Maintenance has been deferred...due to cash flow concerns."). And yet, in the current docket, Newport Water has actually increased to $32,000 the amount of money it seeks for Repair & Maintenance – Equipment, (Docket 4025, Forgue Direct Testimony, at 33:9-15), and has included the same items from Docket 3818, as the following table demonstrates:

Repair & Maintenance – Equipment		**Amount Approved (Docket 3818)**	**Amount Actually Spent (FY-08 Test Year)**	**Delta**		**Amount Requested (Docket 4025)**
Roof		18,000	-	18,000		15,000
Air Conditioning		4,000	-	4,000		4,000
Overhead Doors		3,000	-	3,000		3,000
Miscellaneous		5,000	2,559	2,441		3,000
Equipment Racks		-	-	-		7,000
TOTAL		**30,000**	**2,559**	**27,441**		**32,000**

As the table above illustrates, the Commission approved funds for Repair & Maintenance - Equipment in Docket 3818, even though Newport Water had not spent funds approved by the Commission in Docket 3675 on this same line item – while claiming that continued deferral "would most likely result in widespread equipment failures." (See Docket 3818, Forgue Direct Testimony, at 13:26-14:5). Now, in Docket 4025, Newport Water again has largely deferred maintenance on this line item in FY 08 (and presumably FY 09) due to cash flow problems and to reduce outstanding payables. (See Docket 4025, Forgue Direct Testimony, at 24:18-22). This does not square with Newport Water's express admission that such deferrals would lead to widespread equipment failures and other problems.

Finally, the Rhode Island Supreme Court specifically prohibits the type of conduct that Newport Water asks this Commission to sanction. See Providence Gas Co. v. Burke, 475 A.2d 193, 197 (R.I. 1984) ("[o]ne of the central principles of ratemaking is that rates must be prospective. It is well settled that rates are exclusively prospective in nature and that future rates may not be designed to recoup past losses.").

III. CONCLUSION

For the foregoing reasons, the Commission should reject Newport Water's request to repay monies owed to the City.

Respectfully submitted,

PORTSMOUTH WATER AND FIRE DISTRICT

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CERTIFICATION

I hereby certify that I mailed a copy of the within **PORTSMOUTH WATER AND FIRE DISTRICT'S PRE-HEARING BRIEF ON THE ISSUE OF REPAYMENT TO THE CITY OF NEWPORT** to all parties set forth on the attached Service List on the 26th day of May, 2009.

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