

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
PUBLIC UTILITIES COMMISSION

IN RE: CITY OF NEWPORT WATER :  
DIVISION APPLICATION TO : DOCKET NO. 4243  
CHANGE RATE SCHEDULES :

**REPORT AND ORDER**

**I. Introduction**

On April 18, 2011, the City of Newport, Utilities Department, Water Division (“Newport Water”) a municipal utility, filed with the Public Utilities Commission (“Commission”) a rate application pursuant to R.I.G.L. § 39-3-11. In its filing, Newport Water requested a total revenue increase of 37.7%, to collect an additional \$3,509,382 for operating revenues, for a total revenue requirement of \$15,038,048. The impact of this request on the typical residential customer’s bill with annual consumption of 55,200 gallons annually, if granted, would result in an increase of \$140.28 per year or 37.7%.<sup>1</sup> Newport Water also proposed a four year rate plan under R.I.G.L. § 39-15.1-4 which would allow Newport Water to use an abbreviated process to increase rates to collect additional operating revenues to support increased debt service for certain capital improvements.

On May 5, 2011, the Commission suspended the effective date of Newport Water’s requested rate increase in order to conduct a full investigation and to hold public hearings. The parties to the docket were the Division of Public Utilities and Carriers (“Division”) on behalf of the ratepayers, Portsmouth Water and Fire District (“PWFD”),

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<sup>1</sup> On April 18, 2011, Newport Water filed a Motion for Exemption from Filing Requirement to utilize a different test year than that required by the PUC Rule 2.6(b). No objection was received. On May 5, 2011, the Commission approved the request at an Open Meeting.

a wholesale customer, and the United States Navy (“Navy”), the utility’s largest single customer.<sup>2</sup>

The instant general rate case filing represents Newport Water’s fifth such filing in the last eight years. The following table provides a brief history:

Docket No.	Filing Date	Amount Requested	Amount Allowed	% Increase
3578	11/28/03	\$ 606,662	\$ 0	0.00%
3675	4/15/05	\$1,852,451	\$1,513,407	20.48%
3818	1/29/07	\$1,580,896	\$ 911,458	10.74%
4025	12/9/08	\$3,353,023	\$2,044,097	21.55%
4243	4/18/11	\$3,509,382	\$2,222,258	22.5%

## II. Newport Water’s Pre-Filed Testimony

Newport Water submitted the Direct Pre-Filed Testimony of Julia Forgue, Director of Utilities, and Harold Smith of Raftelis. Noting that current revenues would not be sufficient to support expenses in the rate year, Ms. Forgue indicated that Newport Water used a test year of Fiscal Year 2010 (July 1, 2009 to June 30, 2010) and a rate year of Fiscal Year 2012 (July 1, 2011 to June 30, 2012).<sup>3</sup> According to Mr. Smith, Newport Water would require \$3,522,921 of additional rate revenue to adequately fund operations and maintenance (“O&M”) and capital costs.<sup>4</sup> The proposed rates are based on a three year historical average of water consumption for the period commencing FY 2008 and ending FY 2010.<sup>5</sup>

<sup>2</sup> The Navy did not file testimony or participate at the hearings.

<sup>3</sup> Newport Water Exhibit 1A (Pre-Filed Testimony of Julia Forgue), p. 2.

<sup>4</sup> Newport Water Exhibit 1B (Pre-Filed Testimony of Harold Smith), p. 3.

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

Mr. Smith and Ms. Forgue explained that the proposed increase is primarily related to upcoming capital improvements, including the construction of a new water treatment plant at Lawton Valley and an additional treatment unit at the Station One Treatment Plant.<sup>6</sup> According to Ms. Forgue, Newport Water anticipates borrowing in excess of \$87 million over the next five years to fund the treatment plant projects. Therefore, Ms. Forgue explained that Newport Water was proposing a multi-year rate plan to meet its projected debt service needs.<sup>7</sup> The multi-year rate plan anticipates successive annual rate increases to support debt service. She noted that the Capital Improvement Program expenses will increase from the Test Year through FY 2014 and then return to a figure closer to the Test Year level in FY 2015.<sup>8</sup> According to Mr. Smith:

Newport Water anticipates securing additional loans of approximately \$18.6 million in FY 2012 to fund repairs to the Easton Pond Dam and to begin funding improvements to Station One and the construction of a new treatment plant at Lawton Valley. The improvements at Station One and the new water treatment plant will require Newport [Water] to secure loans of approximately \$37.0 million, \$32.3 million and \$5.7 million in fiscal years 2013, 2014 and 2015, respectively.<sup>9</sup>

Therefore, according to Mr. Smith, Newport Water's Capital Improvement Plan will require Newport Water to secure in excess of \$90 million over the upcoming four years.<sup>10</sup> He explained that Newport Water assumed a thirteen percent (13%) cost associated with the borrowing, a six percent (6.0%) interest rate, and a repayment schedule that included

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<sup>6</sup> Newport Water Exhibit 1A at 2; Newport Water Exhibit 1B at 3.

<sup>7</sup> Newport Water Exhibit 1A at 3. The Treatment Plant Projects are listed on the Rhode Island Department of Health's Project Priority List making them eligible for subsidized Drinking Water State Revolving Fund ("DWSRF") loans through the Clean Water Finance Agency ("CWFA"). *Id.* at 8.

<sup>8</sup> *Id.* at 9-10.

<sup>9</sup> Newport Water Exhibit 1B at 6-7.

<sup>10</sup> *Id.*

principal and interest payments on the full loan amounts in the year in which the debt is issued.<sup>11</sup>

Ms. Forgue updated the Commission on the status of the water treatment project since the last case. She indicated that Requests for Proposals had been received for a design/build plan. She anticipated completion of the water treatment plant projects to be completed by the end of 2014. She noted that since her testimony in Docket No. 4025, pilot testing resulted in changes to the projects such as the addition of advanced treatment technologies which increased costs.<sup>12</sup>

Ms. Forgue then explained the normalization and rate year adjustments and the differences in expenses granted in Docket No. 4025 for those adjustments that exceed \$10,000. The areas discussed included Salaries & Wages, including overtime, temporary and benefits, various types of insurance, conferences and training, consultant fees, contract service, water and sewer expense, electricity, taxes, City Services, gas and vehicle maintenance, other various maintenance expenses, operating supplies, chemicals and customer service supplies expense.<sup>13</sup> The total amount of normalizing adjustments to the Test Year was \$1,810,487, with \$565,908 related to operating requirements exclusive of debt service and capital spending.<sup>14</sup> The total rate year adjustments to the normalized Test Year was \$4,422,919, with \$1,166,951 related to operating requirements exclusive of debt service and capital spending.<sup>15</sup>

Next, Ms. Forgue discussed the status of Newport Water's Cost of Service Study and results of the demand study. She reminded the Commission that the parties had

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<sup>11</sup> *Id.* at 9-10.

<sup>12</sup> *Id.* at 6-8.

<sup>13</sup> *Id.* at 11-21.

<sup>14</sup> Newport Water Exhibit 1B, RFC Schedule 2.

agreed to conduct a demand study during the summer of 2010 and 2011 unless all of the parties waived the collection of information in 2011. She explained that Newport Water would be collecting data during the summer of 2011 because the parties had not all agreed to waive the second data collection period. She indicated that she anticipated filing a cost of service study in late fall of 2011 or early winter.<sup>16</sup> As a result, Mr. Smith applied the proposed rates as an across-the-board increase.<sup>17</sup>

Finally, Ms. Forgue requested the Commission eliminate the monthly and quarterly reporting requirements that were ordered in Docket No. 3578, namely, (1) monthly cash flow statement and narrative; (2) monthly trial balance; (3) quarterly statement of net assets-comparative; (4) quarterly statement of revenues, expenses, and changes in fund net assets year-to-date; (5) quarterly statement of revenues, expenses, and changes in fund net assets – comparative for the quarter; (6) quarterly statement of cash flows for year-to-date; (7) restricted account analysis; (8) expenses for conferences & training; and (9) report on progress of IFR programs. As a basis for this request, Ms. Forgue asserted that the concerns expressed by the Commission in Docket No. 3578 had been addressed by Newport Water and that there are better ways for Newport Water to use its staff time in order to implement the extensive Capital Improvement Plan.<sup>18</sup>

### **III. PWFD's Pre-Filed Testimony**

On August 18, 2011, Christopher P. N. Woodcock, a consultant working on behalf of PWFD, filed direct testimony. Using the same test year and rate year as Newport Water, Mr. Woodcock recommended that Newport Water receive a revenue

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<sup>15</sup> *Id.*

<sup>16</sup> Newport Water Exhibit 1A at 21.

<sup>17</sup> Newport Water Exhibit 1B at 11.

<sup>18</sup> Newport Water Exhibit 1A at 22-24.

increase of \$1,572,559 through a uniform percentage increase to existing rates and charges.<sup>19</sup> Mr. Woodcock indicated that PWFD supports the upgrades of the water treatment facilities.<sup>20</sup>

Mr. Woodcock proposed downward adjustments to: (1) Debt Service (to adjust for the fact that full payments will not be made in the rate year and to adjust for what he viewed as overstated issuance and interest costs);<sup>21</sup> (2) City Services (to adjust for and to propose a different methodology for three city departments);<sup>22</sup> (3) Capital Spending from Revenues (\$1.5 million to adjust for historical spending);<sup>23</sup> (4) Consultant Costs (to adjust for what he viewed as double counting of expenses attributed to consultant costs where some would be part of the bond issuance);<sup>24</sup> (5) Various Operating Expenses (to adjust for updated information);<sup>25</sup> and (6) Various expense items that were rounded up to the nearest \$1,000 to round up or down to the nearest whole dollar.<sup>26</sup> Mr. Woodcock also recommended a modification to the billing costs shared with Newport Water's Water Pollution Control Division and Middletown. The result added \$7,975 to revenue offsets.<sup>27</sup> Mr. Woodcock opposed the cessation of the monthly and quarterly reporting with the exception of Conference and Training figures. However, he indicated that PWFD would be amenable to a reformatting of the reports to reduce the burden on

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<sup>19</sup> PWFD Exhibit 1 (Direct Testimony of Christopher P. N. Woodcock), p. 4-5.

<sup>20</sup> *Id.* at 5.

<sup>21</sup> *Id.* at 6-11.

<sup>22</sup> *Id.* at 12-14.

<sup>23</sup> *Id.* at 15-17.

<sup>24</sup> *Id.* at 18-21.

<sup>25</sup> *Id.* at 14-15.

<sup>26</sup> *Id.* at 5.

<sup>27</sup> *Id.* at 18.

Newport Water.<sup>28</sup> Finally, Mr. Woodcock sought a breakdown of pumping costs between Lawton Valley and Station One.<sup>29</sup>

#### **IV. Division's Pre-Filed Testimony**

On August 18, 2011, the Division submitted the Direct Pre-Filed Testimony of its consultant, Thomas Catlin of Exeter Associates. Using the same test year and rate year as Newport Water, Mr. Catlin recommended that Newport Water receive a revenue increase of \$1,689,645 through a uniform percentage increase to existing rates and charges for metered water service and fire protection service.<sup>30</sup>

Mr. Catlin proposed downward adjustments to nine specific areas: (1) Employee Vacancies (\$130,088 reflecting a number of employee vacancies based on prior year averages); (2) Benefits (\$112,284 reflecting an average of two vacant positions based on the average wages and benefits which represent three of the five historical vacancies and which are among the lowest at Newport Water);<sup>31</sup> (3) Consultant Fees (\$116,900 representing over-estimated expenses, updated expenses, and an improper classification of expenses);<sup>32</sup> (4) Chemicals (\$85,522 representing updated costs);<sup>33</sup> (5) Sewer Charges (\$39,340 after reducing the wastewater volumes based on a two-year average and to reflect the approved sewer rates which were estimated by Newport Water in its initial filing);<sup>34</sup> (6) City Services – Legal & Administrative (\$38,024 correcting for a miscalculation by Newport Water and to adjust the calculations based on Mr. Catlin's

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<sup>28</sup> *Id.* at 22-25.

<sup>29</sup> *Id.* at 25-26.

<sup>30</sup> Division Exhibit 1 (Pre-Filed Testimony of Thomas Catlin), pp. 4-5, TSC-1.

<sup>31</sup> *Id.* at 6-7, TSC-2, TSC-3, TSC-4. Mr. Catlin also noted that overtime estimates may have been overstated, but the expense adjustment would be small. Therefore, to be conservative, Mr. Catlin chose to accept Newport Water's estimates. *Id.* at 7.

<sup>32</sup> *Id.* at 8-10, TSC-2, TSC-5.

<sup>33</sup> *Id.* at 10-11, TSC-2, TSC-6.

<sup>34</sup> *Id.* at 11-12, TSC-2, TSC-7.

proposed Operating Budget); (7) City Services – Data Processing (\$47,775 correcting for a miscalculation by Newport Water and to adjust the calculations based on Mr. Catlin’s proposed Operating Budget);<sup>35</sup> (8) Debt Service (\$1,620,483 based on the fact that a full year of principal and interest will not need to be made in the rate year and to reduce the estimated costs of issuance and interest rate);<sup>36</sup> and (9) Operating Reserve (\$17,098 to reflect the other reductions).<sup>37</sup> Mr. Catlin also reflected an \$8,582 increase in revenue requirement offsets to reflect costs that should have been billed to the Water Pollution Control Division and Middletown but which were not.<sup>38</sup> Finally, Mr. Catlin supported the multi-year rate plan proposal made by Newport Water.<sup>39</sup>

#### **V. Newport Water’s Rebuttal Testimony**

On September 21, 2011, Newport Water submitted the Rebuttal Testimony of Julia Forgue, Harold Smith, and Maureen Gurghigian, Managing Director at First Southwest Company, in order to respond to the pre-filed testimony of PWFD and the Division.

In his Rebuttal Testimony, Mr. Smith accepted Mr. Catlin’s adjustments to (1) salaries and wages and benefits to recognize potentially vacant positions during the Rate Year; (2) adjust various costs (benefits, chemicals, sewer charges) based on updated information since the original filing; (3) adjust City Services costs to conform with the approved methodology in Docket No. 4025; (4) adjust the revenues from the Water Pollution Control Division and Middletown; and (5) adjust the Operating Revenue

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<sup>35</sup> *Id.* at 12-13, TSC-2, TSC-8.

<sup>36</sup> *Id.* at 13-17, TSC-9. Mr. Catlin proposed basing the debt service requirement on an assumed 10% cost of issuance rather than 12% and a 4% rather than 6% interest rate. The cost of issuance was based on historical borrowings and the interest rate was based on recently issued AAA rated municipal bonds. *Id.* at 15-16.

<sup>37</sup> *Id.* at TSC-1, TSC-2.

<sup>38</sup> *Id.* at 19, TSC-2, TSC-11.



Allowance to reflect the other adjustments. Mr. Smith did not entirely agree with Mr. Catlin's adjustments to consultant fees and debt service.<sup>40</sup>

Mr. Smith agreed with Mr. Woodcock's recommendation to reduce the annual contribution to the capital restricted account from \$2.75 million to \$2.5 million.<sup>41</sup> However, he disagreed with Mr. Woodcock's proposals to adjust the consultant fees, to alter the methodology for allocating City Services, and to continue requiring Newport Water's periodic filings with the Commission. Finally, while Mr. Smith agreed not to round up to the nearest \$1,000, he did not agree to round to the nearest dollar, but rather settled on rounding up to the nearest \$100, indicating that it would provide a small cushion to the rates.<sup>42</sup>

Addressing consultant fees, Mr. Smith stated that his primary disagreement with Mr. Catlin was the proposed reduction of "Non-Rate Case Related" consultant fees. Responding to both Mr. Catlin's and Mr. Woodcock's respective testimony, he stated that Newport Water had not double-counted consultant fees, but rather, had allocated those costs among different accounts to reflect the areas of consultant support. Mr. Smith did reduce the amount for Code Red to \$3,000 consistent with Newport Water's response to Division Data Request 1-10. Additionally, he separately identified the Demand Study, included \$40,000 to reflect a four-year amortization, reduced the total amount for the Division to \$34,500 and reduced the total amount for financial consultants to \$72,400 to reflect the recovery of the Demand Study costs under the new line item.<sup>43</sup>

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<sup>39</sup> *Id.* at 17-18.

<sup>40</sup> Newport Water Exhibit 3 (Pre-Filed Rebuttal Testimony of Harold Smith), pp. 2-6.

<sup>41</sup> *Id.* at 14, 22-23.

<sup>42</sup> *Id.* at 14, 18.

<sup>43</sup> *Id.* at 6-9.

Explaining his disagreement with Mr. Catlin and Mr. Woodcock regarding the debt service allowance, Mr. Smith agreed that while Newport Water would not be required to make debt service payments in the Rate Year to fund the treatment plant projects, additional debt service costs will be required to fund the Easton Pond Dam Repair Project and professional services related to the treatment plant projects. While Mr. Smith disagreed with Mr. Catlin's proposal to delay the debt issuances by one year, he did reduce the debt service allowance to \$1,589,369 for the rate year. He explained that the revised debt service allowance assumes a borrowing in October 2011 of approximately \$6.7 million to fund the East Pond Dam Repair Project, with an interest payment due in March 2012. Additionally, Mr. Smith stated that Newport Water will be issuing \$5.1 million in Bond Anticipation Notes to fund professional services related to the Treatment Plant Projects.<sup>44</sup> Therefore, "the resulting Rate Year debt service is the sum of debt service on Newport's existing revenue bonds and SRF loans, and interest payments for the" October 2011 borrowing and the Bond Anticipation Notes.<sup>45</sup>

With regard to the issuance costs and interest rate, Mr. Smith agreed to reduce the issuance costs by one percent to 12% of the capital costs of each borrowing and rejected the proposal to lower the assumed interest rate. He stated that there was no guarantee that RICWFA would be able to provide funding for the entire treatment plant project and that his position is based on advice from Ms. Gurchigian, Newport Water's financial advisor.<sup>46</sup> Responding to Mr. Woodcock's concern that rates may be too high, Mr. Smith noted that Newport Water will be able to offset future increases during the multi-year rate

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<sup>44</sup> *Id.* at 9-10.

<sup>45</sup> *Id.* at 10.

<sup>46</sup> *Id.* at 11-12, 19-20.

plan whereas if the rates are insufficient, Newport Water's ability to borrow may be jeopardized.<sup>47</sup>

Noting that Newport Water will need to borrow more than \$86 million between FY 2012 and FY 2014 in order to fund the Treatment Plant Projects, Ms. Gurghigian stated that ideally, the multi-year funding would take place through the RICWFA and the DWSRF. However, she stated that while the projects qualify for subsidized funding, RICWFA cannot guarantee the availability of funds through the DWSRF for the entire amount needed. Therefore, Ms. Gurghigian anticipated Newport Water would utilize a combination of market rate and subsidized loans. She believed that while the Bond Buyer Revenue Bond Index has been between 5.10% and 5.35% over the past twelve months, because the tax exempt rates are at a historical low, the use of a projected 6.0% interest rate is reasonable. Additionally, she indicated that modeling debt issuance costs at 12.0% was reasonable with the expectation that a debt service reserve fund would be set at 10% of par or maximum annual debt service with an additional 1.5% to 2.0% of other costs of issuance.<sup>48</sup>

Ms. Gurghigian maintained that these levels were not unreasonably conservative because of the need for the Commission to review future rates before they can go into effect under the multi-year rate plan. She stated that “[b]ond rating agencies and investors will look at Newport’s projected rates and debt service coverage very carefully. Smoothing out rate increases for a multi-year capital program is viewed positively by rating agencies.”<sup>49</sup> This means that Newport Water will be in a better position if it has

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<sup>47</sup> *Id.* at 20-21.

<sup>48</sup> Newport Water Exhibit 4 (Pre-Filed Rebuttal Testimony of Maureen Gurghigian), pp. 2-6.

<sup>49</sup> *Id.* at 6.

sufficient funds in place as it begins the process of seeking funds for the treatment plant projects in order to maintain a good bond rating and be eligible for better interest rates.<sup>50</sup>

Addressing Mr. Woodcock's concerns about City Service allocations, Mr. Smith stated that deviating from the approved cost allocation methodology approved by the Commission in Docket No. 4025 is unfair and inequitable. He noted that at the time Docket No. 4025 was being litigated, the parties were aware of the upcoming increases in capital projects. Additionally, he disagreed with Mr. Woodcock's position that the City Manager, City Solicitor and Finance Department would not have increased administrative responsibilities as a result of the increased capital expenditures. Therefore, Mr. Smith maintained that the results of the cost allocation methodology were not unexpected and should not be altered in this case.<sup>51</sup>

Turning to Mr. Woodcock's opposition to the elimination of the monthly and quarterly reporting, Mr. Smith agreed with Ms. Forgue that they should be eliminated. Ms. Forgue explained that she does not disagree that gathering the type of information provided to the Commission is important, but that she tracks the information internally through the water department's computer system. She questioned the continued usefulness of the unique reports that Newport Water is required to generate and suggested that Newport Water provide the monthly cash flow narrative and the "standard financial reports that other water utilities file."<sup>52</sup>

Finally, Ms. Forgue and Mr. Smith addressed three other issues, two of which were not addressed by the other parties. Regarding the first issue, addressed by Mr. Woodcock regarding pumping costs, Ms. Forgue stated that Newport Water has tracked

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<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 23-25.

pumping expenses and provided a schedule with her testimony. Regarding the second issue, the funding of restricted accounts, Ms. Forgue advised that Newport Water had recently changed the way it was funding its restricted accounts in order to be in strict compliance with its bond indentures due to its reading of the Commission's prior rate orders which Newport Water believed required it to fund its restricted accounts before O&M. However, bond counsel had advised that Newport Water must begin funding its accounts in the following order: (1) Operating Fund for O&M Expenses (Electricity, Chemicals, Retiree Insurance, Accrued Benefits Buyout, Salary & Wage Increase); (2) Restricted Accounts for O&M Expenses; (3) Debt Service Account; (4) Operating Revenue Allowance Account; (5) Capital Spending Account; (6) Other Restricted Accounts.<sup>53</sup> Finally, Mr. Smith stated that he had made revisions to Newport Water's projected Rate Year consumption figures. Instead of continuing to use the three-year historical average used in his direct testimony, Mr. Smith proposed utilizing a two-year average of FY 2010 and FY 2011 because it was close to the three-year average but lower by 59,551 gallons. Mr. Smith utilized the lower figure to provide Newport Water with a cushion against declining usage, something which Newport Water has experienced over recent years.<sup>54</sup>

## **VI. PWFD's Surrebuttal Testimony**

On May 13, 2009, PWFD filed the Surrebuttal testimony of Christopher P.N. Woodcock. Mr. Woodcock primarily agreed with the Division's revenue adjustments, with the exception of City Services, which he believed the Commission should revisit in

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<sup>52</sup> Newport Water Ex. 2 (Rebuttal Testimony of Julia Forgue), pp. 7-8.

<sup>53</sup> *Id.* at 9-10.

<sup>54</sup> Newport Water Ex. 3 at 27.

light of the increased debt service requirements.<sup>55</sup> Mr. Woodcock continued to disagree with Newport Water on the following items: (1) Consultant Fees; (2) Debt Service; (3) Water Sales, (4) Chemical Costs; (5) Rounding of Values; (6) City Services; (7) Reporting to the Commission; and (8) Pumping Costs.

Mr. Woodcock proposed an allowance of \$211,000 within the Administration operating expenses for Consultant Fees. He made a downward adjustment of \$73,900 to the Rates/Legal/Financial category on the basis that the consultant fees related to bond issuances, certifications and other financial matters related to the treatment plant upgrades would be more appropriately included in the debt service costs.<sup>56</sup>

With regard to debt service, Mr. Woodcock continued to express concern that Newport Water's projections of interest and issuance costs were too high. In addition, he seemed to indicate that the Commission should not approve a multi-year rate plan because the timing of the debt service issuances had changed since the filing of Newport Water's direct case. He stated that the Commission should only allow funding for new bonds once Newport Water presents the true and actual costs. Mr. Woodcock believed that Newport Water's restricted debt service account would be sufficient to pay the first year costs for the first debt service issuance.<sup>57</sup>

Addressing projected water sales, Mr. Woodcock proposed using a three year average as initially proposed by Newport Water rather than the two year average used in Newport Water's rebuttal.<sup>58</sup> He noted that using the updated figures through FY 2011 as part of a three year average results in a reduction from the water use allowed in the most

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<sup>55</sup> PWF D Ex. 2, (Surrebuttal Testimony of Christopher P.N. Woodcock), p. 1.

<sup>56</sup> *Id.* at 3-4.

<sup>57</sup> *Id.* at 7-8.

<sup>58</sup> *Id.* at 8.

recent docket. He stated that “while it is more than the FY 2010 use, it is less than the FY 2009 use and very close to the amount for the most recent year (FY 2011).”<sup>59</sup>

Turning to chemical costs, Mr. Woodcock indicated that chemical usage should be based on the same assumptions as water sales. Therefore, with the exception of sodium hydroxide, which would be based on the nine months of FY 2009 and all of FY 2010 and 2011, he recommended that chemical usage be based on the average of sales for FY 2009-FY 2011.<sup>60</sup>

Discussing the rounding of values, Mr. Woodcock continued to advocate for rounding to the nearest dollar. Recognizing that Mr. Smith had rounded up to the nearest \$100 in Newport Water’s Rebuttal, Mr. Woodcock still maintained that such rounding, which amounts to an additional \$2,700, is unnecessary because the operating revenue allowance already provides Newport Water with a cushion.<sup>61</sup>

With regard to City Service expense, Mr. Woodcock stated that “[t]he only difference at this point is whether [Newport Water’s] \$100 million capital program impacts the level of effort that other City departments provide to [Newport Water].” Mr. Woodcock stated that while the Commission reviewed City Services in prior dockets, it did not evaluate the impact of the large capital investment in those dockets. He claimed that there is a change in circumstances resulting from the large capital investment program to warrant Commission review of the methodology regarding four departments of the City of Newport (City Manager, City Solicitor, a portion of Finance, and MIS-

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<sup>59</sup> *Id.* at 9.

<sup>60</sup> *Id.* at 10.

<sup>61</sup> *Id.*

Other). He argued that Newport Water did not present sufficient evidence to support the percentage increase in payments to these departments.<sup>62</sup>

Regarding Newport Water's periodic reports to the Commission, Mr. Woodcock stated that he agreed that Newport Water should not be spending time and ratepayer funds generating reports that are not useful to the utility or the parties to the docket. Instead, Mr. Woodcock suggested that Newport Water provide its internal reports to the parties to allow them to determine whether they would be sufficient.<sup>63</sup>

Finally, Mr. Woodcock expressed concern that Newport Water had not provided separate pumping costs despite the fact that it had represented to PWFDD that it had been tracking the cost separately.<sup>64</sup>

#### **VIII. Division's Surrebuttal Testimony**

On October 20, 2011, the Division submitted the Surrebuttal Testimony of Thomas Catlin in which he recommended Newport Water receive a revenue increase of \$2,119,747, or twenty-one point nineteen percent (21.19%).<sup>65</sup> Mr. Catlin continued to propose downward adjustments to three specific areas, accepting Newport Water's Rebuttal positions on Employee Vacancies, Benefits, Chemical Costs, Sewer Charges and Debt Service. Mr. Catlin still proposed adjustments to the following: (1) Consultant Fees (\$28,400) (to reflect his position that these particular costs should be included in the project and debt service costs); (2) City Services – Legal & Administrative (\$193); (3) City Services – Data Processing (\$240).<sup>66</sup> The Operating Revenue Allowance was also adjusted as a result of Mr. Catlin's other adjustments. While Mr. Catlin still had concerns

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<sup>62</sup> *Id.* at 11-14.

<sup>63</sup> *Id.* at 15.

<sup>64</sup> *Id.* at 16.

<sup>65</sup> Division Exhibit 2 (Surrebuttal Testimony of Thomas Catlin), p. 7, TSC-1.



that the debt service interest rates and issuance costs proposed by Newport Water may still be too high, because there will be an opportunity for the Commission to review those costs before setting the future rates, he maintained that they did not need to be determined with certainty in this rate case.<sup>67</sup> Finally, Mr. Catlin continued to advocate for a Rate Year sales volume based on a three-year average as being more consistent with recent actual consumption than a two year average.<sup>68</sup>

#### **X. Settlement Agreement and Revised Tariffs**

On November 1, 2011, Newport Water filed a Settlement Agreement entered into with PWFD and the Division.<sup>69</sup> Newport Water's settled total cost of service was \$12,835,200, requiring additional operating revenue in the Rate Year of \$2,222,258, or an increase of 22.5 percent to be applied uniformly to all rate classes. The impact on a typical residential customer using 14,800 gallons of water per quarter would be an annual increase of \$83.60, from \$372.04 to \$455.64.<sup>70</sup> Additionally, the Settlement Agreement recommended Commission approval of the multi-year rate plan, subject to the requirements of R.I.G.L. § 39-15.1-4, including providing the Commission, with copies to the parties to this docket with "updated information regarding its borrowings including but not limited to the anticipated interest rates, borrowing costs, draw schedules, project costs as well as the anticipated date and source of the borrowings."<sup>71</sup>

The parties resolved their issues regarding the allocation of City Services paid by Newport Water for the City Manager, City Solicitor (50 percent of costs), Finance

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<sup>66</sup> *Id.* at 2-3, TSC-2.

<sup>67</sup> *Id.* at 3-4.

<sup>68</sup> *Id.* at 4-5.

<sup>69</sup> A copy of the Settlement Agreement is attached hereto as Exhibit A. The Navy later filed correspondence with the Commission indicating that it did not object to the terms of the Settlement Agreement.

<sup>70</sup> Joint Exhibit 1, Settlement Agreement, pp. 3-4.

Administration (80 percent of costs), and MIS (other). Noting that the City Service allocation has been based on the relationship between Newport Water's budget and the City budget, including debt service and capital costs, the parties agreed that for the purposes of the instant docket and future dockets, "the allocation of City Service payments will not include or be based on debt services and capital expenses included, identified or anticipated in this docket and identified in RFC Schedule 4 Rebuttal and RFC Schedule 5 Rebuttal."<sup>72</sup> The result of the modification is a rate year decrease of \$11,527 for City Service allocations.<sup>73</sup>

As part of the Settlement Agreement, Newport Water agreed to respond to certain outstanding Data Requests propounded by PWFD. Newport Water also agreed to separate pumping costs from treatment costs in all future rate filings. Finally, the parties agreed that Newport Water will continue to fund the restricted Salary and Wage Increase account, but to reduce the annual funding to \$80,931.<sup>74</sup>

One issue unresolved by the Settlement Agreement was Newport Water's reporting requirements. Paragraph sixteen of the Settlement Agreement stated: "Newport and Portsmouth disagree in this Docket concerning the reports Newport [Water] files with the Commission. Both parties made their positions known to the Commission and will abide by the Commission's decision and order on whether Newport [Water] should continue to file these reports."<sup>75</sup>

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<sup>71</sup> *Id.* at 4.

<sup>72</sup> *Id.* A copy of RFC Schedule 4 Rebuttal and RFC Schedule 5 Rebuttal are marked as Exhibit B and attached hereto.

<sup>73</sup> Joint Exhibit 1, p. 5.

<sup>74</sup> *Id.* at 5.

<sup>75</sup> *Id.*

## **XI. Hearing**

Following notice, on July 25, 2011, a public hearing was conducted at Newport City Hall for the purposes of taking public comment. A public hearing was also conducted on November 1, 2011 at the Commission's Offices, 89 Jefferson Boulevard, Warwick, Rhode Island for the purpose of taking evidence on the propriety of the Settlement Agreement. The following appearances were entered:

FOR NEWPORT WATER: Joseph Keough, Jr., Esq.

FOR PWFD: Gerald R. Petros, Esq.  
Adam Ramos, Esq.

FOR DIVISION: Jon Hagopian, Esq.  
Special Assistant Attorney General

FOR COMMISSION: Cynthia G. Wilson-Frias, Esq.  
Senior Legal Counsel

Newport Water presented Maureen Gurghigian to discuss issues surrounding the financing of the future capital projects and presented Julia Forgue and Harold Smith in support of the Settlement Agreement. PWFD presented Christopher Woodcock. The Navy did not present any witnesses. The Division presented Thomas Catlin.

Discussing the multi-year rate plan, Ms. Gurghigian explained that when a utility is undertaking a large capital project which will require several borrowings over a period of time, it is important to have a financial structure that will allow it to be completed over time. She stated that even though the Commission will not be approving actual rates related to all of the anticipated borrowings in this docket, bondholders and rating agencies need to know that the financial structure is in place.<sup>76</sup> Therefore, she stated,

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<sup>76</sup> Tr. 11/1/11 at 10-12.

“fine-tuning, as long as it complies with the indenture, after the approval is fine.”<sup>77</sup> What the Commission is being asked to approve in this case is the ability of Newport Water to return to the Commission at least sixty (60) days prior to each borrowing related to those capital projects identified in the filing for approval of rates related to that borrowing without filing a full rate case. At that time, the Commission would review the amount of the borrowing, whether it will be subsidized or not, the anticipated interest rate and issuance cost and any other costs related to the borrowing and approve the new rates related to that borrowing. Newport would then file for approval by the Division to enter the borrowing. Although the Settlement anticipates a filing by Newport Water with the Commission sixty (60) days prior to the borrowing, counsel for Newport Water agreed that practically speaking, the time frame would most likely be ninety (90) days prior to the borrowing.<sup>78</sup>

After the Commission took a recess to review the final Settlement, the remaining witnesses were presented as a panel. Mr. Smith explained that the final consumption figure was arrived at using different methodologies for retail and wholesale customers. The wholesale consumption figure is the three year average for the most recent three-year period. The retail consumption figure was based on the average annual change in sales over the most recent ten-year history applied to FY 2011 sales. Therefore, the parties agreed to a 1.7 percent decline in sales applied to the FY 2011 retail sales to arrive at the retail projection for FY 2012.<sup>79</sup> Mr. Catlin testified that he believed this methodology is correct for Newport Water which has experienced a continual decline in consumption and that when he compared the resulting consumption figures to those used in his surrebuttal

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<sup>77</sup> *Id.* at 12.

<sup>78</sup> *Id.* at 17-19.

testimony, the numbers were very close and therefore, the compromise reached is reasonable.<sup>80</sup> He did agree that it would be reasonable to review consumption calculations and methodologies in future water rate cases for all utilities.<sup>81</sup>

Regarding the timing of future rate filings, Mr. Smith clarified that the July 1, 2012 date in the multi-year rate plan is not a fixed date, but rather, is more a function of the financing schedule that Newport Water will ultimately enter into. He agreed that there would also be a filing to change the rate design after the demand study had been completed. He also noted that Newport Water had agreed during discovery to attempt to time its filings to reduce the number of rate changes a customer would experience in a twelve-month period. At the hearing, PWFD's legal counsel represented that PWFD was agreeable to that approach.<sup>82</sup>

Turning to the issue of city service payments, the parties agreed to a change in the methodology of calculating the city service allocation for four departments from a ratio between Newport Water's budget and the City of Newport's budget to a ratio between each budget exclusive of debt service and capital costs.<sup>83</sup> This resulted in an allocator of 13.06 percent applied to the four departments.<sup>84</sup> However, the Settlement allowed Newport Water to collect \$11,527 to pay city services during the Rate Year.<sup>85</sup> In future rate cases, the methodology agreed to in this case would be used, but the \$11,527 would not automatically continue.<sup>86</sup> Mr. Woodcock clarified that if there is new debt service or

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<sup>79</sup> *Id.* at 26-27.

<sup>80</sup> *Id.* at 28-29.

<sup>81</sup> *Id.* at 29-30.

<sup>82</sup> *Id.* at 33-35.

<sup>83</sup> *Id.* at 38.

<sup>84</sup> *Id.* at 42.

<sup>85</sup> *Id.* at 36-37, 44.

<sup>86</sup> *Id.* at 44.

new capital projects identified in the future, whether those items should be included or excluded from the calculation is an open question.<sup>87</sup>

Discussing the amount required to be deposited into the restricted salary and wage increase account set up in Docket No. 4025, the parties agreed that the account still needs to be funded so that when the labor negotiations are completed, Newport Water will already have funds available in the event there is a need for Newport Water to meet any retroactive payroll obligations. However, the parties did agree to reduce the monthly funding from \$91,214 to \$80,931 for a difference of \$283 per month. The purpose of the reduction is to allow Newport Water to utilize the \$283 to meet other non-union payroll increases in the Rate Year.<sup>88</sup>

Regarding the funding methodology of all accounts, legal counsel for Newport Water explained that going forward, Newport Water will be funding its accounts in strict compliance with its Trust Indentures. Therefore, the first accounts to be funded are O&M accounts, then debt service, debt service reserve and the others in order of priority as set forth in the Trust Indenture. As a result, in the future, like other water utilities, IFR will be the last account funded. This means that when undercollections occur, the IFR account may be underfunded as is seen when reviewing other water utilities finances. The positive of this for Newport Water is that the lags in covering payroll paid to Newport Water's employees by the City of Newport as seen on the monthly cash flow reports should be greatly reduced. However, Ms. Forgue explained that there will always

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<sup>87</sup> Tr. 11/1/11 at 43.

<sup>88</sup> *Id.* at 56-58, 61.

be a lag simply because of the timing of payroll versus when the funds are transferred from the water fund to the City of Newport.<sup>89</sup>

Turning to the one outstanding issue of reporting requirements upon which the parties could not reach unanimity, Ms. Forgue explained that she has access to the City's daily cash receipts and a listing of all accounts payable. On a monthly basis she reviews the budget for the department which has a listing of the budgeted amounts for each line item, the amount encumbered and the remaining balance. She also reviews every purchase requisition within the departments after the Deputy Director of Engineering and Deputy Director of Finance. She also has access to the checking account to see what has been posted and the cash balance. In addition, she can view a listing of payrolls that need to be transferred and of City Services that need to be paid. Newport Water agreed to provide a copy of the reports upon which Ms. Forgue relies to the Commission and parties to this docket for review to determine whether there could be a less time-consuming way to provide financial information to the Commission on a regular basis. Mr. Woodcock testified that he did not find any of the current submissions "unuseful." He was not sure if the reports described by Ms. Forgue would provide the same type of information the Commission had previously sought.<sup>90</sup>

## **XII. Settlement Tariffs**

On November 22, 2011, Newport Water submitted Schedules and Tariffs reflecting the revenue requirement and adjustments contained in the Settlement Agreement. On November 23, 2011, the Commission requested the parties file any objections to the revised Schedules and Tariffs no later than November 28, 2011. No

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<sup>89</sup> *Id.* at 59-60.

objections were filed. On November 28, 2011, legal counsel for the Division advised the parties and Commission through an e-mail that Mr. Catlin had reviewed the Schedules and Tariffs and found them to be in accordance with the provisions of the Settlement Agreement.

### **XIII. Commission Findings**

At an Open Meeting on November 29, 2011, the Commission considered the evidence presented in the record and approved the Settlement Agreement and related revenue requirement. Newport Water's rate filings are always thoroughly reviewed by the parties and the Commission finds that this case is no exception. Therefore, based on the filings of the parties, the discovery responses and the live testimony, the Commission has ample evidence in the record to find that the Settlement Agreement entered into by the parties represents a fair result for the utility and its customers.

The Commission recognizes that with the exception of the timing of the debt service issuance and related costs, the parties were not that far apart in their direct cases. By the time the parties filed surrebuttal, the differences in Rate Year revenue requirement were within \$340,901 between Newport Water and PWFD, with the Division's position in between the two. The Commission notes that approximately two-thirds of the difference between the parties was directly related to the projected rate year consumption levels posited by each party. While the Commission accepts the Settlement Agreement methodology of projecting Rate Year consumption for the purposes of settlement in this case, the Commission cautions utilities that this should not be considered a new methodology that will simply be applied to all water utilities absent a clear record to

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<sup>90</sup> *Id.* at 50-53. Newport Water provided the Commission and other parties with the reports on November 3, 2011.



support a finding that projecting decline in future sales is appropriate. Furthermore, as Mr. Catlin stated at the hearing, the settled retail consumption level is very close (a difference of approximately 2%) to what he had recommended in his Surrebuttal Testimony which proposed using a three year historical average.<sup>91</sup>

The multi-year rate plan, designed to address upcoming debt service requirements, is a balanced way to allow the utility to seek financing based on an anticipated rate schedule while providing protection to ratepayers against excessive rates in the event the debt service issuance schedule or costs change. In this docket, the Commission is approving the proposed multi-year rate plan, subject to Newport Water submitting compliance filings as required by R.I.G.L. § 39-15.1-4 (c) and the Settlement Agreement. Because Newport Water will be required to make compliance filings prior to implementing new rates, the Commission will have the opportunity to review the more precise debt service requirement, the updated estimated interest rates and updated estimated costs of issuance. This will allow Newport Water an expedited review of its debt service request to ensure adequate rates to fund its capital projects while also ensuring just and reasonable rates for ratepayers. The Commission notes that while the multi-year rate plan anticipates rate increases on July 1, 2012, July 1, 2013, and July 1, 2014, these dates and the amounts set forth in the plan may change. If there is a delay in the financing, Newport Water should notify the Commission as soon as it becomes aware of the delay and subsequently, should file a Motion to Amend the Rate Plan once it knows when the subsequent debt service issuances and related rates will be needed.

After the hearing, Newport provided the financial reports that Ms. Forgue receives monthly for her staff meetings. These are certainly helpful for her day-to-day

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<sup>91</sup> See Schedule TSC-12 (updated 10/2/2011), Schedule TSC-12 (updated 10/31/2011).

management of the utility, but are not necessarily helpful to the regulators. The following are the reports currently required of Newport Water: a reconciliation of each restricted account on a quarterly basis within 30 days of the end of the quarter; a balance sheet, income statement and cash flow statement on a quarterly basis within 30 days of the end of the quarter; updates on its Conference and Training Costs in its quarterly reports within 30 days of the end of the quarter; a monthly cash reconciliation to include cash inflow and cash outflows within 15 days of the end of the month. Inflows and outflows should be compared to budget with an explanation of any deviation from the budget by more than 10%, on a quarterly basis within 15 days of the end of the quarter. Newport Water also files a monthly narrative of accounts payable to the City and outside vendors; and monthly statements on an accrual basis consistent with a format and due date previously approved by the Public Utilities Commission. All parties agreed that the Conference and Training costs are no longer necessary.

The reason Newport Water has all of the additional reporting requirements was the result of the Commission's findings in Docket No. 3578 wherein the Commission stated:

At an Open Meeting on June 22, 2004, the Commission approved the Settlement with modifications which were conceded to by the parties at the June 2, 2004 hearing. At the outset, the Commission notes that the past year and a half has been a challenge for Newport Water and its relations with the Commission. Once again, Newport Water did not take the Commission's Order seriously, causing the parties to exchange voluminous numbers of discovery requests. Once again, Newport Water was unable to appropriately file a cost study and track its expenses and revenues. However, the Commission believes that it has been abundantly clear about the necessity to comply with Commission Orders in the instant case. In fact, there is real money at stake for the City of Newport and its Water Division in the event noncompliance continues. Newport Water is at a crossroad. Its new management has expressed the desire to prove to the Commission that it is serious about following through and maintaining a financially sound utility. The Commission has confidence that Newport Water

can meet each and every requirement that is being imposed in this case if it is serious in its claims. The Commission is hopeful that the requirements imposed in this case will be of assistance to the management of the Water Division and to the City of Newport in managing the system. The Commission believes that the accumulation of data will also be of use to Newport Water and the other parties when the next rate filing is made. The relationship between the regulator and the utility does not need to be adversarial and it would behoove every utility to maintain open lines of communication with the Commission in order to avoid the harsher than normal adversarial nature of the instant proceeding.<sup>92</sup>

The above-referenced paragraph sets forth the main reason for the implementation of the numerous reporting requirements Newport Water has had to comply with for the past seven years. The Commission finds that these requirements have been useful to the utility, the intervenors to Newport Water's rate filings and to the Commission. Where Docket No. 3578 had several boxes worth of discovery designed to review expenses and revenues, this docket had far fewer with the responses fitting in a two-inch binder. Newport Water is now able to track its expenses and revenues, it now has a checking account which is separate from the City of Newport, and it has implemented management practices which ensure compliance with Commission orders. The Commission finds that Newport Water has been in compliance with its Orders and has taken positive steps toward completing a cost study which it currently anticipates filing in 2012. Therefore, commencing in December 2011, Newport Water shall provide the following, with an electronic copy to all parties to the instant docket: (1) a reconciliation of each restricted account on a quarterly basis within 30 days of the end of the quarter; (2) a report on the progress of the IFR and Capital Programs on a quarterly basis within 30 days of the end of the quarter; (3) the monthly narrative on a monthly basis within 15 days of the end of the month; (4) the semi-annual reports required of all water utilities; and (5) the annual report required of all water utilities.

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<sup>92</sup> Order No. 17992 issued September 23, 2004, p. 64.

According, it is hereby

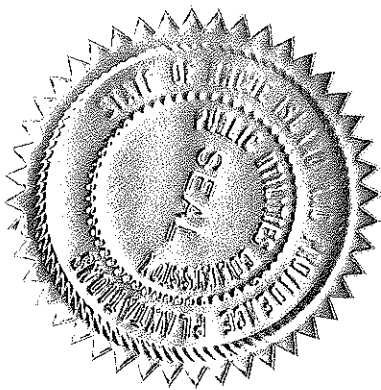
(20636) ORDERED

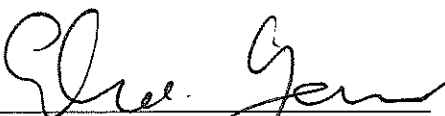
1. The City of Newport, Utilities Department, Water Division's Application for a General Rate Increase, filed on April 18, 2011, is hereby denied and dismissed.
2. The City of Newport, Utilities Department, Water Division will receive a total cost of service of \$12,835,200, which equates to a revenue increase of \$2,222,258, effective for usage on and after December 1, 2011.
3. City of Newport, Utilities Department, Water Division shall restrict the following accounts in the following amounts collected through rates: Debt Service - \$1,589,369; Capital - \$2,500,000; Chemicals - \$596,922; Electricity - \$611,534; Retiree Insurance - \$514,000; Accrued Benefits Buyout - \$175,000; and Restricted Salary Increases \$80,931.
4. City of Newport, Utilities Department, Water Division shall fund its Restricted Accounts monthly on a whole dollar basis and not on a percentage of collections basis.
5. City of Newport, Utilities Department, Water Division shall comply with the following periodic reporting requirements commencing in December 2011:
  - (a) A reconciliation of each restricted account on a quarterly basis within 30 days of the end of the quarter;
  - (b) A report on the progress of the IFR and Capital Programs on a quarterly basis within 30 days of the end of the quarter;

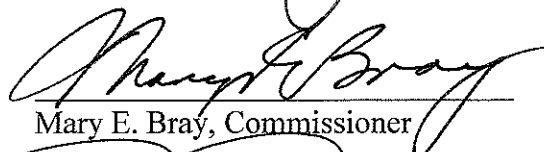
- (c) A monthly narrative on a monthly basis within 15 days of the end of the month;
  - (d) The semi-annual reports required of all water utilities;
  - (e) The annual report required of all water utilities.
6. City of Newport, Utilities Department, Water Division shall provide the parties to the docket with a copy of all reports made to the Commission in compliance with this Order.
7. City of Newport, Utilities Department, Water Division's Tariffs, filed on November 22, 2011, are hereby approved for effect on and after December 1, 2011.
8. City of Newport, Utilities Department, Water Division shall comply with all other findings and instructions as contained in this Report and Order and with all terms of the Settlement Agreement incorporated herein.

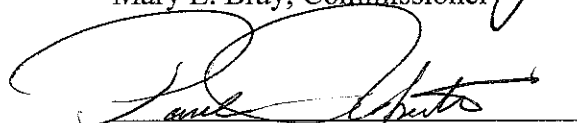
EFFECTIVE AT WARWICK, RHODE ISLAND PURSUANT TO AN OPEN MEETING DECISIONS ON NOVEMBER 29, 2011. WRITTEN ORDER ISSUED FEBRUARY 3, 2012.

PUBLIC UTILITIES COMMISSION



  
Elia Germani, Chairman

  
Mary E. Bray, Commissioner

  
Paul J. Roberti, Commissioner

**NOTICE OF RIGHT OF APPEAL PURSUANT TO R.I.G.L. SECTION 39-5-1, ANY PERSON AGGRIEVED BY A DECISION OR ORDER OF THE COMMISSION MAY, WITHIN SEVEN DAYS (7) DAYS FROM THE DATE OF THE ORDER, PETITION THE SUPREME COURT FOR A WRIT OF CERTIORARI TO REVIEW THE LEGALITY AND REASONABLENESS OF THE DECISION OR ORDER.**