DEPARTMENT OF THE NAVY
NAVAL FACILITIES ENGINEERING COMMAND
1322 PATTERSON AVENUE, SE, SUITE 1000
WASHINGTON NAVY YARD, DC 20374-5065

VIA FIRST CLASS MAIL AND ELECTRONIC MAIL

Luly E. Massaro, Commission Clerk
State of Rhode Island Public Utilities Commission
89 Jefferson Boulevard
Warwick, Rhode Island 02888

September 12, 2016

Re: Docket No. 4595 – City of Newport, Utilities Department Water Division Application to Change Rate Schedules

Dear Ms. Massaro:

Enclosed for filing in the above-referenced matter is an original plus nine (9) copies of the Initial Brief of the United States Department of the Navy. An electronic copy of this document has been provided to the parties on the service list.

Please call me at (202) 685-9122 if you have any questions concerning this filing. Thank you for your attention to this matter.

Sincerely,

Allison M. Genco, Esq.
Department of the Navy

cc: Service List for Docket No. 4595 *(via electronic mail)*

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION

Newport Water Division - Rate Application to Collect Additional Revenues of $1,304,595 for a Total Cost of Service of $20,151,440 (filed 12/23/15)	**Docket No. 4595**

INITIAL BRIEF OF THE UNITED STATES DEPARTMENT OF THE NAVY

Introduction

The United States Department of the Navy ("Navy") submits its Initial Brief in the above-captioned matter. Naval Station Newport, in Newport, Rhode Island, is the second-largest customer of the Newport Water Department ("Newport Water"). The Navy has participated in this proceeding through the submission of direct testimony, surrebuttal testimony, and data requests. This Brief will address cost of service, class revenue allocation, and the design of rates to recover Newport Water's proposed revenues.

Class Cost of Service

In its direct testimony, Navy stated it had a concern with respect to its Maximum Day Demand factor calculated by Newport Water in the cost of service study used to allocate to Navy the costs incurred to meet system peak water demand. Navy's specific concern is that its Maximum Day Demand factor in this rate case is overstated as a result of Newport Water using Navy usage data that is not reflective of Navy's operations in a typical or normal test year. (Collins, Direct Testimony at page 2.)

As explained in Navy's direct testimony, the Maximum Day Demand factor is the ratio of a class's maximum day of water usage to its average day usage, where the average day usage is the class's total annual water consumption divided by 365 days. The class maximum day demand factors are used to develop class allocation factors that are then used to allocate costs that Newport Water incurs to meet the system maximum day of water usage and the system maximum hour of water usage to various classes. (Collins, Direct Testimony at page 3.)

Navy further explained that if a utility does not use data reflective of a normal test year to calculate proposed class Maximum Day Demand factors used in allocating costs to classes and setting rates, its rates likely will not reflect cost causation since the atypical usage could introduce rate subsidies among customer classes. (Collins, Direct Testimony at page 3.)

The Maximum Day Demand factor for Navy as proposed by Newport Water in its direct testimony is 2.93. In the last rate case, Navy's factor was 1.73. This is an increase of approximately 70%. As a result of this large increase in Navy's Maximum Day Demand factor since the previous rate case, Navy determined that it was prudent to examine Navy's specific water usage used by Newport Water to calculate Navy's Maximum Day Demand factor. (Collins, Direct Testimony at page 3.)

Navy reviewed its water usage (provided in Newport Water's response to FEA Request 1-7) that Newport Water utilized in calculating Navy's Maximum Day Demand factor in this rate case. (Collins, Direct Testimony at page 4.)

Based on Navy's review of the usage data used to calculate its Maximum Day Demand factor, Navy determined that water usage for Navy that occurred during the period March 6 -18, 2015 was not representative of Navy's operations in a normal test year. During this time Navy experienced a water main break that was difficult to repair and the subsequent water loss was included in the calculation of Navy's Maximum Day

Demand factor for Fiscal Year 2015 used for the instant rate case. (Collins, Direct Testimony at page 4.)

In its direct testimony, Navy explained that using such abnormal data will not result in appropriate cost allocation to various classes. As a result, Newport Water's rates will not best reflect class cost causation. (Collins, Direct Testimony at page 4.)

Navy explained that, for example, excluding the excess water usage resulting from its main break during the March 2015 period, Navy's Maximum Day Demand factor would have been approximately 1.99. Using this Maximum Day Demand factor in Newport Water's cost of service model would have resulted in a cost of service rate increase of approximately 17% to Navy instead of Newport Water's 26% rate increase proposed in its direct testimony. (Collins, Direct Testimony at pages 4-5.)

Removing extraordinary events, such as water loss resulting from main breaks, to normalize a utility's test year is reasonable. It was Navy's understanding that in past rate cases, Newport Water has excluded usage due to main breaks when calculating peaking demand factors for its classes. Basing allocations on usage that is not representative of normal operations would result in a class that experiences such a main break paying more than its fair rates based on its cost of service calculated with the usage data reflective of its normal operations. (Collins, Direct Testimony at page 5.)

Navy recommends that Newport Water in future rate cases remove water usage associated with main breaks consistent with treatment in past rate cases not only for Navy but all customer classes. This will normalize test year water usage that is used to calculate peaking factors used in the allocation of costs to rate classes. It is appropriate to set rates reflective of normal conditions, and a main break that created the maximum day demand for a customer class is not a normal condition. (Collins, Direct Testimony at page 5.)

Class Revenue Allocation

Newport Water's proposed rate revenues compared to present rates under Newport Water's proposed billing determinants result in a system average increase of 6.6% in rate revenues. However, as a result of Newport Water's proposed revenue allocation, three classes see large increases relative to the system average increase in rate revenues. Based on Newport Water's direct testimony, the Navy, Portsmouth and Private Fire classes would see increases of 26%, 28%, and 12%, respectively. These increases are more than 1.5 times the system average increase. (Collins, Direct Testimony at page 6.)

It is important to establish rates on cost of service, but gradualism and mitigating rate shock are also important considerations when setting rates for customers. Rate shock can adversely affect customers with respect to budgeting and consumption decisions, as well as impact their contribution to the economy of Rhode Island. (Collins, Direct Testimony at page 6.)

Considering the fact that the cost of service study presented in this case is not reflective of Navy's normal operation, it is imperative that the principle of gradualism be applied until a cost of service study based on normal operation is developed in a future rate case. (Collins, Direct Testimony at page 6.)

The principle of gradualism provides protection to customers against sudden large increases in their utility rates or "rate shock", which would adversely affect their budgeting and level of consumption. Gradualism can give consumers sufficient time to make desired budgeting and consumption decisions based on price signals contained within the respective rate class's rate structure. (Collins, Direct Testimony at pages 6-7.)

Gradualism applied to the revenue allocation approach constrains movement to full class cost of service. This is done to limit bill impacts on any one class. Movement

toward cost-based rates should be considered in conjunction with mitigating undue customer bill impacts. (Collins, Direct Testimony at page 7.)

In determining the revenue allocation in this proceeding, the Commission should recognize the harm that large water rate increases can inflict on customers as well as on the economic base in the state of Rhode Island. Large increases have the potential to adversely impact the economic contributions of customers by making it more costly for customers to operate. For these reasons, Navy recommends the Commission restrict the size of the rate increase for certain classes proposed by Newport Water. (Collins, Direct Testimony at page 7.)

In its Order in RIPUC Docket No. 4065, the Commission has previously determined that it was appropriate to limit the distribution of the rate increase for certain customer classes to 150% of the average overall system rate increase approved by the Commission. (Collins, Direct Testimony at page 7.)

Navy recommended in direct testimony that the Navy, Portsmouth and Private Fire rate class increases all be capped at 1.5 times the 6.6% system average increase in rate revenues, or 10.02%. The remainder of Newport Water's proposed revenue increase not provided by these classes would be spread among the remaining classes based on their revenues at present rates. Navy's proposed revenue allocation is shown in Navy's direct testimony, Schedule BCC-1.

To the extent that Newport Water's Commission-approved revenue increase differs from its direct case, the class revenue allocations would be adjusted accordingly.

Rate Design

Using Newport Water's proposed base charges and the volumetric charges and Private Fire protection charges resulting from Navy's proposed revenue allocation produces the rates shown in Navy's direct testimony, Schedule BCC-2, page 1. These rates compare to Newport Water's rates summarized on Schedule BCC-2, page 2.

The proof of revenue resulting from Navy's proposed rates is shown in Schedule BCC-3.

To the extent that Newport Water's approved Commission revenue increase differs from its direct case, the class rates and revenue proof would be adjusted accordingly.

Position of Newport Water and the Division

In his direct testimony, Mr. Jerome Mierzwa on behalf of the Division of Public Utilities and Carriers also recommended gradualism for Newport Water's revenue allocation. Specifically, he recommended that retail volumetric rates remain unchanged and that the increase in revenues generated above the indicated cost of service of retail customers be proportionately allocated to reduce the volumetric rates of Newport Water's two wholesale customers, Navy and Portsmouth.

While Newport Water does not disagree with Navy's recommendation for gradualism in its rebuttal testimony, Newport Water disagrees with Navy's specific proposal to limit any one class to 1.5 times the system average increase.

In his rebuttal testimony, Mr. Smith explained that demand factors for Navy and Portsmouth were determined using actual daily meter data for each wholesale customer. For Navy, this is consistent with the Commission's Report and Order in Docket No. 4355, Newport Water's last rate case. The Commission ordering paragraph 4 at page 18 of the Report and Order states the following:

> City of Newport, Utilities Department, Water Division shall continue to obtain daily reads of the Navy's meters so that the City of Newport, Utilities Department, Water Division, will have this information for inclusion in its next General Rate Filing.

However, as explained in Navy's testimony, Navy recommends that any usage resulting from extraordinary events be excluded from Navy's usage utilized in calculating its demand factors. (Collins, Surrebuttal Testimony at page 4.)

In his rebuttal testimony, Mr. Smith removed the usage related to an extraordinary main break that occurred in March 2015 on the Navy's system when calculating Navy's Maximum Day Demand factor. As an alternative to Navy's proposed capping, a revised Maximum Day Demand factor has been calculated by Mr. Smith for Navy and he has utilized that revised factor in the cost of service study. Newport Water's revised Navy Maximum Day Demand factor is 2.04, as compared to the original value of 2.93. (Collins, Surrebuttal Testimony at pages 2-3.)

The revised Maximum Day Demand factor for Navy results in a recommended increase of 17% in Navy's volumetric charge as compared to the 25% increase in the volumetric rate originally recommended by Mr. Smith in his direct testimony. Mr. Smith's proposal results in an approximate overall increase of 17% for Navy as compared to present rates. (Collins, Surrebuttal Testimony at pages 4-5.)

Navy agrees with Mr. Smith's proposal to remove the usage related to an extraordinary main break on Navy's system for calculating Navy's Maximum Day Demand factor. Using a demand factor for Navy that reflects normal usage in the cost of service study and does not include usage related to an extraordinary main break better reflects Navy's normal operations and is more representative of Navy's actual cost of service. As a result, Mr. Smith's proposal is appropriate. (Collins, Surrebuttal Testimony at page 5.) However, it should be noted that Mr. Smith's proposal is not really gradualism, but reflects ***full class*** cost of service principles.

At approximately 17%, Navy's overall increase is still over 3 times the system average increase of 5.46% in Newport Water rate revenues proposed by Mr. Smith in his rebuttal testimony after accepting certain revenue requirement adjustments in his rebuttal testimony. (Collins, Surrebuttal Testimony at page 5.)

The approximate 17% increase for Navy as compared to present rate revenues is still relatively large compared to the overall system average increase of 5.46% in rate revenues for Newport Water. Navy continues to be faced with continued budget cuts, and as a result, any increase in utility rates is difficult to bear. (Collins, Surrebuttal Testimony at page 6.)

Consistent with Navy's direct testimony, Navy in surrebuttal testimony continued to recommend that the Commission limit the Navy's increase to 1.5 times the Newport Water system average increase approved by the Commission. Based on Newport Water's revised revenue requirement presented in Mr. Smith's rebuttal testimony, this would result in an approximate 8.2% increase in Navy's present rate revenues.

Navy's Current Position

Subsequent to the filing of surrebuttal testimony, Newport presented its revised position regarding class revenue allocation. Newport Water has adopted Mr. Mierzwa's proposal for class revenue allocation in his direct testimony on behalf of the Division. This class revenue allocation is shown in HJS Schedule D-8 Rebuttal Supplemental. At the hearings held July 18, 2016, Newport indicated that Navy agreed with this class revenue allocation. (Transcript, page 13.) Newport Water has correctly stated Navy's position with respect to Newport Water's current proposed class revenue allocation.

Allison M. Genco, Esq.
Department of the Navy

CERTIFICATE OF SERVICE
RI PUC Docket No. 4595

I hereby certify on this 12th day of September, 2016, a copy of the cover letter and the Initial Brief of the United States Department of the Navy were electronically transmitted to the individuals listed below. An original hard copy and nine (9) copies of this filing were sent via first class mail to the Clerk of the Rhode Island Public Utilities Commission.

Allison M. Genco, Esq.

Parties/Address	E-mail Distribution	Phone
Joseph A. Keough, Jr., Esq. Keough & Sweeney 41 Mendon Ave. Pawtucket, RI 02861	jkeoughjr@keoughsweeney.com;	401-724-3600
Julia Forgue, Director of Public Works Newport Water Department 70 Halsey St. Newport, RI 02840	jforgue@cityofnewport.com; lsitrin@CityofNewport.com; rschultz@CityofNewport.com; wyost@CityofNewport.com;	401-845-5601
Harold Smith Raftelis Financial Consulting, PA 511 East Blvd. Charlotte, NC 28203	Hsmith@raftelis.com;	704-373-1199
Christy Hetherington, Esq. Dept. of Attorney General 150 South Main St. Providence, RI 02903	Chetherington@riag.ri.gov; steve.scialabba@dpuc.ri.gov; pat.smith@dpuc.ri.gov; John.bell@dpuc.ri.gov; al.mancini@dpuc.ri.gov; jmunoz@riag.ri.gov; dmacrae@riag.ri.gov;	401-222-2424
~~Stacy Sherwood~~ Jerome Mierzwa Exeter Associates, Inc. 10480 Little Patuxent Parkway, Suite 300 Columbia, MD 21044	~~Sherwood@exeterassociates.com;~~ jmierzwa@exeterassociates.com;	~~410-992-7500~~
Gerald Petros, Esq. Adam Ramos, Esq. Hinckley, Allen & Snyder 100 Westminster St., Suite 1500 Providence, RI 02903	gpetros@haslaw.com; aramos@hinckleyallen.com; cwhaley@hinckleyallen.com; jmansolf@hinckleyallen.com;	401-274-2000
William McGlinn Portsmouth Water & Fire District 1944 East Main Rd.	wmcglinn@portsmouthwater.org;	401-683-2090 ext. 224

PO Box 99 Portsmouth, RI 02871		
Christopher Woodcock Woodcock & Associates, Inc. 18 Increase Ward Drive Northborough, MA 01532	Woodcock@w-a.com;	508-393-3337
Luly E. Massaro, Commission Clerk Public Utilities Commission 89 Jefferson Blvd. Warwick, RI 02888	Luly.massaro@puc.ri.gov; Cynthia.WilsonFrias@puc.ri.gov; Sharon.ColbyCamara@puc.ri.gov;	401-780-2107