

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

**IN RE: CITY OF NEWPORT, DEPARTMENT OF UTILITIES :
GENERAL RATE FILING : DOCKET NO. 4595**

REPORT AND ORDER

I. Introduction

On December 23, 2015, the City of Newport, Department of Utilities, Water Division (Newport Water), filed with the Public Utilities Commission (PUC or Commission) a request to increase its revenue requirement by \$1,304,595 to support a total cost of service of \$20,151,440.¹ On January 15, 2016, the PUC suspended the effective date of the requested rate change beyond January 23, 2016, in order to fully investigate the propriety of Newport Water's proposed rate increase.² The Navy and the Portsmouth Water and Fire District (PWFD) filed Motions to Intervene which were unopposed and became effective on January 23, 2016 and February 5, 2016, respectively.³

Following an exchange of discovery, a public comment hearing, and evidentiary hearings, on September 20, 2016, the PUC approved a \$184,452 increase in Newport Water's revenue requirement, to support a total cost of service of \$19,090,130.⁴ The annual impact on a typical residential customer using 5,000 gallons per month is \$1.56 or 0.2%. The impact on PWFD wholesale rates is approximately 2.8% and the Navy experienced no increase for most of its usage.⁵

¹ Smith Test. at HJS Sch. A-4; http://www.ripuc.org/eventsactions/docket/4595-NewportWater-RateFiling_12-23-15.pdf.

² Open Meeting Minutes (Jan. 15, 2016); <http://www.ripuc.org/eventsactions/minutes/011516.pdf>.

³ PWFD Mot. to Intervene; <http://www.ripuc.org/eventsactions/docket/4586-Portsmouth-Intervene.pdf>.

⁴ Open Meeting Minutes (Sept. 20, 2016); <http://www.ripuc.org/eventsactions/minutes/092016.pdf>; Open Meeting Minutes (Sept. 29, 2016); <http://www.ripuc.org/eventsactions/minutes/092916.pdf>.

⁵ Schedules HJS A-3 Compliance and HJS-4 Compliance; [http://www.ripuc.org/eventsactions/docket/4595-NWD-ComplianceFiling\(9-21-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-NWD-ComplianceFiling(9-21-16).pdf).

II. Proposed Rate Increase

In support of its rate filing, Newport Water submitted the direct and rebuttal testimony of Julia A. Forgue, Director of Utilities; Harold J. Smith, Newport Water's rate consultant; and Laura Sitrin, the City of Newport's Finance Director. In rebuttal, the revised proposed increase was reduced to \$975,639, including miscellaneous and non-operating revenues, to support a total cost of service of \$19,649,570. The main drivers of the proposed increase were: salaries, wages, and benefits (\$244,895); water/sewer charges (\$231,626); property taxes (\$104,843); repairs and maintenance (\$103,826); electricity (\$96,856); chemicals (\$76,738); accrued benefits buyout (\$43,500); laboratory supplies (\$18,703); retiree insurance coverage (\$18,437); and Lead Plant Operator stipend (\$10,503).⁶ In addition, as explained by Ms. Sitrin, a portion of the increase resulted from changes to the City of Newport's Cost Allocation Manual which governs the city's recovery of the costs of services it provides to its revenue generating departments, including Newport Water. The specific changes related to the Legal & Administrative and Data Processing categories resulting in a change to Newport Water of \$79,617.

III. Discussion of the Disputed Issues and Findings

During the pendency of the case, the PUC received written testimony from the Division of Public Utilities and Carriers (Division), the Navy, and PWFD on areas of agreement and disagreement. Discovery was exchanged, and evidentiary hearings were conducted on July 19-20, 2016, and August 2, 2016. Live testimony was provided by Ms. Forgue, Mr. Smith, Ms. Sitrin, Newport Water's witnesses; Brian Collins, the Navy's witness; Christopher Woodcock, PWFD's witness; and witnesses for the Division including John Bell, Assistant Chief Accountant for the Division, and Stacy Sherwood and Jerome Mierzwa, two of the Division's rate consultants.

⁶ Smith Rebuttal at HJS Sch. A-1B Rebuttal; [http://www.ripuc.org/eventsactions/docket/4595-NWD-Smith\(6-3-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-NWD-Smith(6-3-16).pdf).

In its Surrebuttal testimony, PWFD recommended a significantly lower revenue increase of \$335,140 to support a total cost of service of \$19,009,116.⁷ To support the reduced rate increase, and cover increased expenses in the Rate Year, Mr. Woodcock proposed lowered funding for certain restricted accounts as well as withdrawing funds from accounts he maintained were overfunded.⁸ He also objected to certain changes made to the Cost Allocation Manual that resulted in increases to the City Service expense.⁹ Mr. Woodcock additionally recommended the PUC reject certain aspects of Newport Water's cost allocation study and related rate design.¹⁰

The Navy's main issue concerned was the magnitude of its increase relative to the system average increase. According to the Navy, under ratemaking policy of gradualism, the Navy's increase should be limited to 1.5 times the system average increase.¹¹

The Division made several adjustments in its direct case which were accepted by Newport Water. In its Surrebuttal testimony, the Division accepted some of Newport Water's adjustments, withdrew others, and made an additional reduction to the City Service expense. The Division recommended a revenue increase of \$902,188 to support a total cost of service of \$19,576,119.¹²

Following all prefiled testimony, the following issues remained outstanding and were the subject of the evidentiary hearings: the treatment capital allocator; demand factors and consistency of time periods; gradualism and avoidance of rate shock; rate case expense; restricted accounts; chemicals; electricity; retiree insurance; accrued benefits; revenue reserves; salaries; and city services. At an Open Meeting held on September 20, 2016, the PUC made the following decisions

⁷ Woodcock Surrebuttal at SW Surebut. Sch. A-4; [http://www.ripuc.org/eventsactions/docket/4595-PWFD-Woodcock\(7-1-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-PWFD-Woodcock(7-1-16).pdf).

⁸ Woodcock Surrebuttal at 3-12.

⁹ *Id.* at 13-17.

¹⁰ *Id.* at 17-30.

¹¹ Collins Surrebuttal at 3; [http://www.ripuc.org/eventsactions/docket/4595-Navy-Collins\(6-29-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-Navy-Collins(6-29-16).pdf).

¹² Sherwood Surrebuttal at 2, Schedule SLS Surrebuttal-1; [http://www.ripuc.org/eventsactions/docket/4595-DPU-Sherwood\(7-1-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-DPU-Sherwood(7-1-16).pdf).

based on the evidence in the record supporting its conclusion that a \$184,452 increase in Newport Water's revenue requirement was appropriate.

A. Treatment Capital Allocator

Newport Water has traditionally allocated treatment capital costs based on the actual historical demands of each customer class. In Docket No. 4355 and in this matter, Newport Water proposed to allocate treatment capital costs based on the projected customer class usage. In support of this proposal, Newport Water witness Smith testified that when Newport Water was designing the treatment plant projects, it used a twenty-year projection of average day and peak day demands provided by PWFD and the Navy.¹³ Mr. Smith argued that this proposal resulted in a more equitable allocation of costs than use of historical demands.¹⁴ Neither the PWFD nor the Division agreed with Newport Water's proposal.

PWFD witness Woodcock testified that the allocation of costs should not be based on a single bond issuance (related only to the treatment plant work) where all others are based on the traditional methods that consider all capital and debt expense. He contended that to accept Newport Water's proposal would result in two different allocation methodologies for capital costs.¹⁵ According to Division witness Mierzwa, Newport's proposed allocation of treatment capital costs was inconsistent with actual customer class demands and the treatment facilities required to serve each class. Therefore, Newport's proposal would result in a misallocation of costs.¹⁶ Mr. Mierzwa recommended using the base-extra capacity model traditionally used to allocate these costs. In response, Newport Water withdrew its proposal.

¹³ Smith Test. at 23-24; http://www.ripuc.org/eventsactions/docket/4595-NewportWater-RateFiling_12-23-15.pdf.

¹⁴ *Id.* at 25.

¹⁵ Woodcock Test. at 21-23.

¹⁶ Mierzwa Test. at 7; [http://www.ripuc.org/eventsactions/docket/4595-DPU-Mierzwa\(4-14-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-DPU-Mierzwa(4-14-16).pdf).

However, this was not the only disputed proposal on allocation of the treatment plant capital costs. Addressing the allocation of costs to classes based on the average day and maximum day demands, in Newport Water's previous two cases, the parties had agreed to an allocation of 63% of the costs to base and 37% of the costs to maximum day. Newport Water proposed retaining this ratio in its cost of service model for the current rate case. PWFD contended that the costs should be split 50% to base (average day) and 50% to maximum day because the treatment plants have a design basis of a combined average day demand of eight million gallons per day (MGD) and a maximum day of sixteen MGD.¹⁷

Neither Newport Water nor the Division supported this proposed change to the cost of service model. At the hearing, Division witness Mierzwa stated that PWFD's proposal "assumes that 50% of those costs are demand or average day related and 50% are maximum day related and we don't know what the right percentages are."¹⁸ Consistent with his position on Newport Water's proposal to allocate water treatment plant capital costs, Mr. Mierzwa, therefore, continued to recommend using the standard base-extra capacity method in the *American Water Works Association Manual M-1, Principles of Water Rates, Fees, and Charges* (AWWA Manual) instead of adopting PWFD's proposal.¹⁹

Upon considering the question of how the treatment capital cost should be allocated, whether based on how the treatment plants were designed or how they have been used, the PUC adopted the Division's position. The Division consistently supported using the base-extra capacity methodology, traditionally favored by utilities and approved by this Commission. PWFD argued against allocating the costs to the customer classes based on the design parameters provided by the

¹⁷ Woodcock Test. at 19.

¹⁸ Hr'g. Tr. at 140 (July 19, 2014).

¹⁹ Mierzwa Direct at 3; Mierzwa Surrebuttal Test. at 2; [http://www.ripuc.org/eventsactions/docket/4595-DPU-Mierzwa\(7-1-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-DPU-Mierzwa(7-1-16).pdf); Hr'g. Tr. at 140.

parties in the planning stages. PWFD, however, argued that the base costs and maximum day costs should be based on the design of the plant. The PUC found the Division's recommendation to continue to use the base-extra capacity method a reasonable resolution of both disputes. The method produces results closer to the actual usage patterns of the customer classes. The allocation factors can be reviewed in future cases if usage changes (retail vis-à-vis PWFD and the Navy).

B. Demand Factors and Consistency of Time Periods

The AWWA Manual explains that “demand costs are associated with providing facilities to meet the peak rates of use, or demands, placed on the system by the customers.”²⁰ Newport Water developed its proposed class demand factors by estimating demand factors using monthly billing data from the period for retail customers and actual daily readings from the Navy and PWFD.²¹ In developing the demand factors, Newport witness Mr. Smith used the system demand data from 2013 and the customer billing data from 2015. Mr. Smith testified that this is consistent with the methodology set forth in the AWWA Manual.²²

Mr. Smith also indicated that he did not use the peaking factors resulting from the 2011/2012 demand study because the information was both somewhat dated and not based on information from the entire residential and non-residential classes, but from samples.²³ At the hearing, Mr. Smith elaborated further on his use of the updated information, noting that all three classes of customers had showed lower peaking factors in the 2011/2012 study.²⁴ Mr. Smith also made an adjustment to the Navy's Maximum Day Demand factor to remove consumption caused by a main break that had caused an anomalous spike in demand.²⁵

²⁰ AMERICAN WATER WORKS ASSOCIATION, MANUAL OF WATER SUPPLY PRACTICES - M-1, PRINCIPLES OF WATER RATES, FEES, AND CHARGES 57 (5th ed. 2000).

²¹ Smith Rebuttal at 21-22.

²² *Id.* at 24.

²³ *Id.* at 22.

²⁴ Hr'g. Tr. at 123-25, 127.

²⁵ *Id.* at 10-11.

PWFD witness Woodcock disputed Mr. Smith's methodology, arguing that the demand factors should be based on the results of the 2011/2012 demand studies wherein a representative sample of retail meters were read on a daily basis for a discrete period of months. He further contended that the information derived from the 2011/2012 demand study is what the AWWA Manual would support using because it constitutes the best available data. Mr. Woodcock argued that the AWWA Manual would support using the method Mr. Smith employed only if actual data were not available to perform a more sophisticated calculation. He also contended that it was not fair to use the estimation method for the retail classes and actual data for PWFD and the Navy.²⁶ He maintained that, regardless of the method, Mr. Smith had not followed the AWWA Manual because the system demand data and customer billing data were not based on the same period of time, thus providing skewed results.²⁷ Mr. Woodcock further provided, at the hearing, that the estimation method had not produced reliable results because the diversity factors fell outside of an acceptable range.²⁸

Navy witness Collins supported Mr. Smith's recalculation of the Navy's Maximum Day Demand factor to account for the effects of the main break on the Navy's usage patterns.²⁹

In his testimony on behalf of the Division, Mr. Mierzwa stated that the witnesses for Newport and PWFD each raised legitimate points with respect to the use of the 2011/2012 demand data to develop the cost of service study.³⁰ He noted that if the data from the 2011/2012 demand study were used, the results would show a slight reduction in the residential and non-residential volumetric rates, a slight decrease to the Navy's rates, no change to PWFD's rates, but significant

²⁶ Woodcock Surrebuttal at 22-24, 28.

²⁷ Woodcock Surrebuttal at 26-28.

²⁸ Hr'g. Tr. at 126.

²⁹ Collins Surrebuttal at 3-5.

³⁰ Mierzwa Surrebuttal at 5-6.

increases to the public and private fire protection rates. Mr. Mierzwa suggested that the Division's recommendation to moderate significant rate increases would "undo a significant portion of the impact of adopting the 2011/2012 demand factors."³¹ He supported Newport Water's use of billing data for the retail rate classes. He also supported the usage of actual daily data from PWFD and the Navy as opposed to the estimated data based on monthly usage of the other customers as being consistent with the AWWA Manual because it constituted the best data available for each of the classes.³² In conclusion, he recommended the PUC adopt the cost of service study presented by Newport in its rebuttal testimony as a starting point for setting rates in this matter.³³

After reviewing the record, the PUC approved Newport Water's decision to use actual daily usage information for PWFD and the Navy for 2015 and the monthly data for retail customers. The 2011/2012 information is dated and was based on a small sample of data at a time when monthly retail data was not available. The uncontroverted testimony was that the class peaks for each class of customers was higher in 2015 than in the 2011/2012 study. The disagreement was over whether this was an anomaly or the new status of the classes. Regardless, this was the result of the more recent 2015 usage. The PUC found that the daily data for PWFD and the Navy is the best available information for those large customers. Further, the monthly data for the residential and non-residential customers is the best available data those entire classes of customers. Two of the three experts testified that Newport Water had followed an accepted methodology using the AWWA Manual guidance. The PUC found the methodology is reasonable.

On the issue of the use of system demand data from 2013 and customer billing data from 2015, the PUC approves of Newport Water's methodology. The PUC notes that this methodology

³¹ *Id.* at 5-6.

³² *Id.* at 6.

³³ *Id.*

is consistent with the Settlement Agreement approved in Docket No. 4355. While that settlement contained the standard language that the agreement would not be binding on the parties in the future, after reviewing the testimony of the witnesses for Newport and the Division, it appears the approach is reasonable and consistent with the AWWA Manual methodology. Finally, noting that Newport had agreed with PWFD's recommendation that a two-year average be used for lost and unaccounted for water, the PUC found this to be reasonable.

C. Gradualism and Avoidance of Rate Shock

In Newport Water's original and rebuttal proposals, some customer classes would experience significant increases while others would experience decreases. The Navy, specifically, would experience an increase in volumetric rates in excess of 15%. In response, Navy witness Collins proposed a cap on the rate increase at 1.5 times the system average.³⁴ In its rebuttal testimony, as noted above, Newport Water revised the Navy's demand factor resulting in a lower increase than had originally been proposed. Given the magnitude of the revised increase, however, Mr. Collins maintained his position that the Navy's increase be limited to 1.5 times the system average.³⁵

In his direct testimony, Division witness Mierzwa noted that under Newport Water's proposals the retail volumetric rates would be reduced while the wholesale volumetric rates would increase over 25%. In his surrebuttal testimony, Mr. Mierzwa noted that even based on Newport Water's rebuttal position, the Navy would experience a 17% increase and PWFD a 26% increase. Moreover, he explained the total overall increase, nearly 90% would be recovered solely from wholesale customers. According to Mr. Mierzwa, a more balanced distribution of the increase

³⁴ Collins Test. at 8; [http://www.ripuc.org/eventsactions/docket/4595-Navy-Collins\(4-14-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-Navy-Collins(4-14-16).pdf).

³⁵ Collins Surrebuttal at 6.

would be appropriate. In both direct and surrebuttal testimony, he consistently proposed no volumetric rate change for retail customers to moderate the increases to the wholesale customers.

PWFD had no objection to applying the principle of gradualism to the proposed increases. PWFD suggested that if the PUC were to adopt the principle of gradualism, it should be applied with reference to the cost of service model, consistent with the testimony of Newport Water witness Smith.³⁶ Mr. Smith, having sponsored alternative proposals that included the Division's proposed application of gradualism, had explained at the hearing that he had first set the retail rates at the level dictated by the cost of service model. Next, noting the lower level dictated by the cost of service model, he calculated the excess revenues that would result from keeping the retail rates at their current level. He then allocated the resulting excess revenue across the Navy, PWFD, and fire protection classes based on the costs that had been allocated to each in the cost of service study. This produced lower rate increases for all three customer classes.³⁷

The PUC adopted the Division's position which relied on the calculations provided by Newport Water, as described by Mr. Smith at the hearing. Mr. Mierzwa testified that the cost of service study is the starting point for designing the appropriate rates for the customer classes.³⁸ The PUC has adopted the principle that, where possible, rates should be set as close to the cost of services as possible. There are exceptions, of course, such as when a strict application of the principle would lead to unfair results in the short term.³⁹ Then, the PUC may turn to Professor Bonbright's practical considerations in setting rates which include the "public acceptability" of the rates.⁴⁰ Where the cost of service study results in one class of customers experiencing a decrease

³⁶ PWFD Post Hearing Memorandum at 18, citing Hr'g. Tr. at 139-40 (July 20, 2016).

³⁷ Hr'g. Tr. at 140 (July 20, 2016).

³⁸ Mierzwa Surebuttal at 6.

³⁹ Hr'g Tr. at 199-200; *See* Order No. 17820 (In re: Pascoag Utility District General Rate Filing) at 18-20, 21-22 (May 5, 2004); [http://www.ripuc.org/eventsactions/orders/3546-3580PascoagOrd17820\(5.5.04\).pdf](http://www.ripuc.org/eventsactions/orders/3546-3580PascoagOrd17820(5.5.04).pdf).

⁴⁰ JAMES C. BONBRIGHT ET AL., PRINCIPLES OF PUBLIC UTILITY RATES 384 (1988).

while three other classes of customers would experience double-digit percentage increases, it is practical and reasonable to depart somewhat from the results of the cost of service study to setting more fair and reasonable rates. Such departure here would produce more manageable increases for the wholesale and fire protection service rate classes while not increasing the volumetric charges of retail customers. The decision here does not really employ the principle of gradualism, the purpose of which is to incrementally move rate classes closer to their cost of service over time. It does, however, advance the principle of avoiding rate shock to certain classes of customers. To use Mr. Mierzwa's words, it provides a "more balanced distribution of Newport [Water's] increase."⁴¹

D. Rate Case Expense

Newport Water had originally requested inclusion of \$250,000 in rate case expense. PWFD had recommended allowing \$137,064 based on a five-year average of Newport Water's costs.⁴² In response to two formal PUC requests, updated rate case expense estimates were provided by Newport Water and the Division. These figures are used to develop the rate year revenue requirement. The parties provided a combined estimate of \$276,866.14.⁴³ All parties agreed that the rate case expense would be amortized over two and a half years.⁴⁴ Expenses for non-rate case consultants will be amortized over five years by agreement of the parties. Including actual rate case expense in the revenue requirement is reasonable and consistent with PUC policy. Amortizing the expense over two and a half years is also reasonable considering that Newport Water had neither sought nor been allowed a multi-year rate plan and particularly because a review

⁴¹ Mierzwa Surrebuttal at 4.

⁴² Woodcock Test. at 9-10; http://www.ripuc.org/eventsactions/docket/4595-PWFD-Woodcock_4-14-16.pdf; Woodcock Surrebuttal at 12.

⁴³ Division Response to Record Request (Sept. 9, 2016); http://www.ripuc.org/eventsactions/docket/4595-DPU-RR_9-12-16.pdf; Newport Water Supp. Response to PUC-4-1; [http://www.ripuc.org/eventsactions/docket/4595-NWD-DR-PUC4-Supp\(9-16-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-NWD-DR-PUC4-Supp(9-16-16).pdf).

⁴⁴ Hr'g. Tr. at 12 (July 19, 2018).

of its recent filings indicates that Newport Water has, absent its one recent multi-year rate plan, routinely filed rate cases approximately every two to two and a half years.

E. Restricted Accounts

Newport Water has eight restricted accounts including the capital, debt service, chemicals, electricity, retiree insurance, accrued benefits, revenue reserve, and salary increase accounts. By the end of the hearings, the parties had agreed to fund the capital account at \$2.5 million. The parties also agreed not to change the funding level of the debt service account from the previously approved levels but had agreed to transfer to the debt service account \$337,000 from the accrued benefits account and \$185,000 from the retiree insurance account. The PUC found the debt service level to be supported by the evidence and approved the proposal to transfer funds from the two other accounts, the balances of which appear to be more than sufficient to meet the state obligations to moderate the necessary rate increase. Adjustments to the remaining restricted accounts follow.

F. Chemicals

Newport Water proposed to include \$761,782 in rates to fund its restricted chemicals account.⁴⁵ PWFD recommended the PUC require Newport Water to use \$125,000 from the restricted chemical account to reduce the revenue requirement sought in this docket.⁴⁶ PWFD contended that because Newport Water showed a \$156,043.12 balance in the account as of June 30, 2016,⁴⁷ even if the chemical expense was as high as Newport Water's updated estimate of \$809,858,⁴⁸ Newport Water would still have sufficient funds in the chemical account to meet its needs after the reduction.

⁴⁵ Newport Water's Response to RR-1; <http://www.ripuc.org/eventsactions/docket/4595-NWD-RR1.pdf>.

⁴⁶ Woodcock Surrebuttal at 5.

⁴⁷ Newport Water's Supp. Response to PUC-2-14.

⁴⁸ Newport Water's Response to RR-1; <http://www.ripuc.org/eventsactions/docket/4595-NWD-RR1.pdf>.

Newport Water argued against reducing the balance in the chemical account at this time because it lacked sufficient experience with the new treatment processes in its new and refurbished water treatment plants. Ms. Forgue testified that Newport Water was finding that because of the varying quality of the raw water, the advanced water treatment system was requiring replacement of certain components more often than expected, causing unreliability in the cost.⁴⁹

The PUC found that because of Newport Water's limited experience with the treatment plants and the operation of the advanced treatment technology, it would not be prudent at this time to reduce the balance of the chemical account. Ms. Forgue testified that the functionality of the advanced treatment technology appears to be affected by the nature of the raw water supply drawn from nine shallow reservoirs. The uncontradicted evidence was that these warm-water reservoirs have experienced algae blooms. These raw water quality issues have led to the degradation of the carbon contacts used in the treatment process faster than expected. As of the hearing, Newport Water had experienced only one full summer with the new and refurbished treatment plants. For these reasons, the PUC declined to order a transfer of funds out of the chemical account. The PUC will review this and all other account balances during Newport Water's next rate case.

G. Electricity

Newport Water requested approval of \$820,442 for electricity expense in the rate year. PWFD recommended reducing the request by \$100,000 based on the balance in the restricted electricity account. At the hearing, Ms. Forgue noted that the June 30, 2016 balance in the restricted electricity account was \$261,089.34. The evidence indicated that the largest electric bill during the prior twelve-month period was approximately \$121,000 and the lowest balance in the restricted account during the same period was \$259,344.⁵⁰ The June 30 balance in the account was

⁴⁹ Hr'g. Tr. at 48-55.

⁵⁰ Hr'g. Tr. at 58, 60, 95-101; Newport Water's Quarterly Reports for the period July 2015 through June 2016.

almost 30% of the overall revenue request. Therefore, the PUC finds that the balance is excessive and orders Newport Water to transfer \$100,000 from the balance of the account to the general operating fund to reduce the overall rate increase. Based on expenses over the recent twelve months and the request in this docket, beginning with a balance of \$161,089, equaling approximately two months of the revenue requirement for electricity, provides an appropriate balance to provide Newport Water a cushion in months where collections may be lower but not allowing Newport Water to hold excessive amounts of ratepayer funds.

H. Retiree Insurance

Newport Water requested \$370,000 of annual funding for the retiree insurance account.⁵¹ As of June 30, 2016, the balance in this account was \$481,209.61.⁵² As noted in Section F, above, the parties had agreed to transfer \$185,000 from this account to debt service, which the PUC approves. For the revenue requirement, the Division recommended \$330,000 in funding which would draw down the fund, leaving a six-month reserve at the end of a two-and-a-half-year period.⁵³ Following the hearing, PWFD recommended \$170,000 in funding which would draw down the balance to \$96,209 by the end of the rate year period, leaving a three-month reserve.⁵⁴

After a review of the record, the PUC found that the current amount in the account is excessive but that any adjustment should be balanced. It found PWFD's recommendation to be too aggressive and the Division's too conservative. The PUC, therefore, approved funding of \$264,999.96 which would draw down the balance to a three-year reserve at the end of a two-and-a-half-year period.⁵⁵

⁵¹ Smith Rebuttal at HJS Schedule A-1A; [http://www.ripuc.org/eventsactions/docket/4595-NWD-Smith\(6-3-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-NWD-Smith(6-3-16).pdf).

⁵² Newport Water's Response to PUC-2-1 Supp.

⁵³ Division Response to RR-3; <http://www.ripuc.org/eventsactions/docket/4595-DPU-RR.pdf>.

⁵⁴ PWFD Post-Hearing Brief at 13; <http://www.ripuc.org/eventsactions/docket/4595-PWFD-Brief.pdf>.

⁵⁵ Newport Water's Compliance Filing at HJS Schedule A-1B Compliance; [http://www.ripuc.org/eventsactions/docket/4595-NWD-ComplianceFiling\(9-21-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-NWD-ComplianceFiling(9-21-16).pdf).

I. Accrued Benefits and Revenue Reserve

Newport Water proposed to reduce funding for the accrued benefits account from \$175,000 to \$59,000.⁵⁶ The balance in this restricted account was \$990,897.52 as of June 30, 2016. As noted in Section F, above, the parties had agreed to transfer \$337,000 from this account to debt service, which the PUC approved. The Division also recommended to cease funding of this account reasoning that even if all of Newport Water's employees left at the same time, Newport Water's obligation would be approximately \$600,000 and the balance in the account, after the transfer, would cover all of their accrued benefits. Accordingly, the Division recommended a transfer from the account of \$300,000 into the restricted operating reserve. PWFD, conversely, recommended an additional transfer of \$500,000 out of the account to reduce the overall rate increase. PWFD argued that leaving a balance of \$153,987 in the account would be reasonable as it would cover three times Newport Water's actual expenditures from the account over the period April 30, 2014 through June 30, 2016.

After review, the PUC adopted the Division's position and ruled that the account should receive no further funding. The PUC found that based on the average obligation per employee, the balance of this account would provide the necessary funding to meet Newport Water's obligation for eighteen employees.

In its decision in Docket 4025 (In re: City of Newport Water Division Application to Change Rate Schedules), the PUC allowed Newport Water a restricted revenue reserve for the utility to draw on, with PUC approval, when a shortfall in rate revenue exceeded 0.5% of that which was expected.⁵⁷ At that time, in 2010 Newport Water was experiencing consistent decline

⁵⁶ Smith Rebuttal at HJS Schedule D-9 Rebuttal.

⁵⁷ Order No. 19940 (In re: City of Newport Water Division Application to Change Rate Schedules) (Mar. 29, 2010), at 66; [http://www.ripuc.org/eventsactions/docket/4025-NWD-Ord19940\(3-29-10\).pdf](http://www.ripuc.org/eventsactions/docket/4025-NWD-Ord19940(3-29-10).pdf).

in sales. The PUC capped the accrued balance of the account at 6% of total rate revenues. Since that time, Newport Water has been able to accrue a positive balance in the account.⁵⁸ As noted above in Section III.J of this Order, the Division recommended transferring \$300,000 from the accrued benefits to the revenue reserve account, fully funding it. Accordingly, the Division also recommended Newport Water cease funding the restricted reserve account.⁵⁹

PWFD had recommended continued funding of the account subject to review in a future compliance filing once the account is fully funded. PWFD, in its post-hearing brief, posited that the restricted revenue reserve account serves the important purpose of protecting Newport Water from reduced usage while also ensuring controls to avoid the build-up of excessive funds. Thus, PWFD stated, “[m]aintaining this reserve account is important to ensure Newport Water’s continued ability to meet its financial obligations and operate a safe and reliable water system.”⁶⁰

The PUC found that the most direct approach was to follow the Division’s recommendation. The transfer from the accrued benefits account to the restricted reserve account will allow it to be fully funded, obviate the need for an additional interim proceeding prior to Newport Water’s next rate case, and meet the goals of maintaining an appropriate level of reserve without accruing an excessive balance.

J. Salaries

At an Open Meeting held on September 20, 2016, just before the decision discussed in this Order, in Docket No. 4243 (In re: City of Newport Application to Change Rate Schedules – Petition for Miscellaneous Relief), the PUC granted Newport Water’s request to transfer

⁵⁸ Newport Water’s Response to PUC-2-1 Supp.

⁵⁹ Division Response to RR-2 and RR-3.

⁶⁰ PWFD Post-Hearing Brief at 12.

\$74,400.79 from the restricted salary increase account to cover salary increases in FY 2016.⁶¹ After the transfer, the salary increase account would have a balance of \$131,744. Newport Water proposed retaining the account while PWFD recommended the PUC order the account closed and the remaining balance transferred to Newport Water's general fund. Accordingly, the salary increase account was originally created at a time when Newport Water's revenue requirement was set before certain labor contracts were finalized and was later tapped for salary increases that were approved during the pendency of a multi-year rate plan. The purposes of the account have been fully satisfied. Furthermore, the account is not needed to fund salary increases in the rate year. For these reasons, it is no longer required. The PUC, therefore, adopted PWFD's recommendation and ordered the account to be closed and the balance transferred to Newport Water's general fund to reduce the level of the revenue increase.

K. City Service Expense

City service expense is an estimate of expense that a host municipality incurs on behalf of its regulated water utility. The PUC's role is to attempt to set a value that appropriately compensates the host municipality while ensuring that the ratepayers are not subsidizing routine municipal expense. This has led to vigorous debate before the PUC in many rate cases, not just those involving Newport Water.

In an attempt to develop some evidence-based and objective allocation for municipalities that do not track their expenses by specific task, the PUC ordered the development of a cost allocation methodology and, in 2010, in its Order in Docket No. 4025, the PUC approved use of a cost allocation manual and the associated methodology for accounting for city service expense for

⁶¹ Order No. 22596 (In re: City of Newport Division Application to Change Rate Schedules – Petition for Miscellaneous Relief) (Nov. 7, 2016); http://www.ripuc.org/eventsactions/docket/4243-NWD-Ord22596_11-7-16.pdf.

Newport Water.⁶² The City of Newport has used the manual to allocate costs to its other enterprise fund accounts. In this case, the City of Newport has updated the manual and Newport Water has requested funding of its city service expense in accordance with the changes set forth in the new manual's methodology.⁶³

At the conclusion of the hearing, there were three outstanding issues remaining on the revised cost allocation manual: (1) the budget allocation percentage; (2) the City Solicitor expense; and (3) the allocation of management information services (MIS) costs. As discussed below, at the hearing, PWFD had proposed different allocations than those proposed by Newport Water claiming that, unlike Newport Water's revisions, PWFD's proposal was consistent with prior approved allocations. Newport Water continued to dispute PWFD's revisions, arguing that it had revised the cost allocation manual consistent with the prior PUC decision.

Whereas the currently disputed cost allocation manual was revised in 2014 using the FY 2015 budget for the City's general fund and enterprise finds to develop the allocators, PWFD advocated for the use of allocation percentages based on the actual FY 2015 expenses, noting that at the hearing, the Division's witness agreed with the concept of using actuals. After a review of the Order and materials in Docket No. 4025, the PUC found that the previously approved cost allocation percentages were based on a comparison of the general fund budget with the enterprise fund budgets. There was no compelling evidence presented to warrant a change from the previously approved methodology and, therefore, it is reasonable to continue using budget numbers to develop the percentages. The PUC ruled that for this case, the percentages should be based on a comparison of the FY 2017 budgets to match the rate year period.

⁶² Order No. 19940 at 61-64.

⁶³ Sitrin Test. at 4-7.

In its revised cost allocation manual, Newport Water changed the allocation of the City Solicitor budget. In its Order in Docket No. 4025, the Commission accepted the general allocator proposed by Newport Water to be applied to City Solicitor costs. However, in that case, the Commission did not accept Newport Water's proposal to apply the allocator to the City Solicitor's entire budget. Rather, it accepted PWFD's proposal to apply the allocator to half of that budget on the basis that Newport Water uses outside legal counsel for many of its legal needs.⁶⁴ In this case, Newport Water proposed to continue to deduct the salaries and benefits for one Assistant City Solicitor and the Municipal and Probate Court Judges but to allocate 100% of the remaining costs based on the general allocator instead of only 50% of those costs.⁶⁵

At the hearing, Ms. Sitrin testified about the responsibilities of the Solicitor's office, noting that the increase in the allocation for the Solicitor's office reflected the fact that certain labor issues are now handled through that office instead of Human Resources. The Human Resources budget was, therefore, reduced.⁶⁶ Ms. Sitrin testified that, during the test year period, the Solicitor's office handled several issues related to the new treatment plants and now handles tax appeals. On cross examination, she agreed that the treatment plant work was largely complete.⁶⁷ Tax appeals used to be handled by the tax assessor's office and Ms. Sitrin testified that Newport had two years of tax appeals pending with PWFD.⁶⁸ On cross examination from the bench, Ms. Sitrin agreed that tax appeals that make it to court have always been handled by the Solicitor's office.⁶⁹ The PUC found that no compelling evidence was presented to require a change to the previously approved allocation for the City Solicitor budget.

⁶⁴ Order No. 19940 at 63.

⁶⁵ Hr'g. Tr. at 29 (July 20, 2016).

⁶⁶ *Id.* at 29-30; Sitrin Test. at 5.

⁶⁷ Hr'g. Tr. at 87.

⁶⁸ *Id.*

⁶⁹ *Id.* at 94-95.

The issue related to the MIS costs was narrow. Previously, the MIS costs were split between MIS – Communications Cost and MIS – Other Costs. Communications was assigned an allocator of 7.9% while the Other costs were assigned the general 13.21% allocator. In the revised cost allocation manual, MIS costs have been combined into one category and assigned the general 13.53% allocator. At the hearing, Ms. Sitrin explained that since the PUC approved use of the first cost allocation manual, Newport installed a completely new communications system using Voice Over Internet Protocol. Instead of separate phone lines to count in each department, all of the phone systems are running over the City’s services with all of the components tied in together. Ms. Sitrin testified that the conversion was necessary due to the antiquated and unreliable nature of the previous system. Thus, she contended, ratepayers benefited from the City’s decision.⁷⁰

Cellular telephones, conversely, are included in each department’s budget and have some effect on the budget to budget comparison.⁷¹ PWFD contended that despite this testimony, Newport Water could segregate those communications costs and that those should continue to be assigned the lower allocator.⁷² In a data response, Newport Water noted that the MIS costs had been combined as part of the Settlement Agreement in Docket No. 4355.⁷³

The PUC found that for this case, Newport Water’s rationale for combining the MIS costs is reasonable. In its next rate filing, Newport Water shall itemize the expenses for cellular phones and other wireless communications devices, including, but not limited to, the cost of the device and the communications/data plans to determine if those costs have a significant impact on the general allocator.

⁷⁰ *Id.* at 82-83.

⁷¹ *Id.* at 84.

⁷² PWFD Post-Hearing Brief at 17-18; *See* Newport Water Response to PWFD-2-13.

⁷³ Newport Water Response to PWFD-2-13; Docket No. 4355 Joint Settlement Schedule HJS Schedule A-1; [http://www.ripuc.org/eventsactions/docket/4355-NWD-ComplianceFilng\(4-25-13\).pdf](http://www.ripuc.org/eventsactions/docket/4355-NWD-ComplianceFilng(4-25-13).pdf).

L. Reporting Requirements

As part of its initial request, Newport Water sought PUC approval to cease complying with certain reporting requirements, including the monthly cash flow reports and the quarterly restricted account analysis. The PUC approved the elimination of the monthly cash flow reports. Since its last rate case, Newport Water has shown that it has appropriately managed its cash flow situation and as such, those reports are no longer necessary. However, the PUC still finds value in the quarterly cash flow analysis, particularly given the focus on the restricted account balances toward the end of this case. Newport Water's request is not approved, and Newport Water shall continue filing its quarterly restricted account analysis.

Service line asset values was a contested issue in this, and in other water cases recently before the PUC.⁷⁴ Newport Water shall allocate an amount not to exceed \$15,000 for an independent evaluator to assess Newport Water's service line asset values. The parties are instructed to file an agreement with the PUC. The parties may seek assistance from the PUC or Division staff to work out the parameters of the work.

M. Compliance Tariffs and Motion to Reopen

Following the Open Meeting decision, on September 22, 2016, Newport Water filed its compliance tariffs and a request for an extension of the suspension period for one week to discuss the ramifications of certain aspects of the Commission's decision.⁷⁵ On September 28, 2016, John Bell, Assistant Chief Accountant of the Division, filed a memorandum indicating that he had reviewed Newport Water's compliance filing and found it to comport with the Commission's

⁷⁴ Woodcock Surrebuttal at 19-22.

⁷⁵ Newport Water's Compliance Tariffs; [http://www.ripuc.org/eventsactions/docket/4595-NWD-ComplianceFiling\(9-21-16\).pdf](http://www.ripuc.org/eventsactions/docket/4595-NWD-ComplianceFiling(9-21-16).pdf).

rulings.⁷⁶ At an Open Meeting on September 29, 2016, after a review of the compliance filing and Division memorandum, the PUC approved the compliance tariffs and schedules.

On October 6, 2016, Newport Filed a Motion to Reopen, noting that as part of its decision, the Commission ordered that Newport make a one-time transfer from the electricity and salary increase accounts to the general operating fund to reduce Newport's request for revenue from rates. Because the Commission only ordered a one-time transfer of funds for FY 2017, Newport stated that it will begin FY 2018 with a built-in \$232,751 deficit to meet Commission approved expenses. In order to allow Newport Water the opportunity to realize the approved revenues after the rate year without a rate increase, Newport Water proposed to keep the \$232,751 revenue offset in place after FY 2017, but to fund it from the restricted operating revenue reserve account annually until its next general rate filing.

As part of the requested relief, Newport stated that it would agree to a compliance mechanism, consisting of the following: Beginning in Fiscal Year 2018, Newport Water would be authorized to withdraw \$232,751 from the restricted Operating Revenue Reserve account. At the conclusion of the fiscal year, Newport Water will submit a reconciliation filing which shows the fiscal year expenses and revenues. If the reconciliation shows that Newport Water did not need some, or all, of the \$232,751 withdrawn from the Operating Revenue Reserve to cover a deficit, it will reimburse the Operating Revenue Reserve in the amount that was not needed. No party objected to the proposal.

At an Open Meeting held on October 31, 2016, the Commission approved Newport Water's motion and the proposed compliance mechanism. The PUC sets rates for a one-year rate period and the utility manages its expenses within that revenue requirement until such time as it

⁷⁶ Bell Mem. (Sept. 28, 2016); <http://www.ripuc.org/eventsactions/docket/4595-DPUC-Memo-Compliance.pdf>.

determines the need for a new revenue requirement. The rates set for the rate year, FY 2017, will allow Newport Water the opportunity to realize its allowed revenues. However, because of the one-time transfers from overfunded restricted accounts to the general fund, Newport Water would not have the same opportunity to realize its full revenue requirement in subsequent years. Newport Water's proposal appropriately balances the needs of the utility with those of the ratepayers.

Accordingly, it is hereby

(23269) ORDERED:

1. The General Rate Filing made by the City of Newport, Department of Utilities, Water Division on December 23, 2015, is hereby denied.
2. City of Newport, Department of Utilities, Water Division is allowed a \$184,452 increase in its revenue requirement, to support a total cost of service of \$19,090,130.
3. City of Newport, Department of Utilities, Water Division's request to extend the statutory suspension period for one week, or until September 30, 2016, is hereby approved.
4. City of Newport, Department of Utilities, Water Division rates allowed by this order are approved for consumption on and after September 30, 2016.
5. City of Newport, Department of Utilities, Water Division shall restrict the following accounts in the following annual amounts:
 - a. Debt Service - \$6,810,996
 - b. Capital - \$2,500,000
 - c. Chemicals - \$761,782
 - d. Electricity - \$820,442
 - e. Retiree Insurance - \$265,000
 - f. Accrued Benefits - \$0

- g. Revenue Reserve - \$0
- 6. City of Newport, Department of Utilities, Water Division shall close the restricted salary account and transfer the balance to its General Operating Fund.
- 7. City of Newport, Department of Utilities, Water Division shall keep the \$232,751 revenue offset in place after FY 2017 but may fund it from the restricted operating revenue reserve account annually until its next general rate filing.
 - a. Beginning in Fiscal Year 2018, Newport Water is authorized to withdraw \$232,751 from the restricted Operating Revenue Reserve account.
 - b. Following the conclusion of each fiscal year, Newport Water will submit a reconciliation filing which shows the fiscal year expenses and revenues.
 - c. If the reconciliation shows that Newport Water did not need some, or all, of the \$232,751 withdrawn from the Operating Revenue Reserve to cover a deficit, it will reimburse the Operating Revenue Reserve in the amount that was not needed.
- 8. City of Newport, Department of Utilities, Water Division's compliance tariffs and schedules filed on September 22, 2016 are hereby approved.
- 9. City of Newport, Department of Utilities, Water Division shall allocate an amount not to exceed \$15,000 for an independent evaluator to assess Newport Water's service line asset values. The parties are instructed to file an agreement with the PUC.
- 10. City of Newport, Department of Utilities, Water Division shall follow all other orders and instructions contained in this order.

EFFECTIVE AT WARWICK, RHODE ISLAND ON OCTOBER 1, 2016, PURSUANT
TO OPEN MEETING DECISIONS ON SEPTEMBER 20, 2016, SEPTEMBER 29, 2016, AND
OCTOBER 31, 2016. WRITTEN ORDER ISSUED AUGUST 31, 2018.

PUBLIC UTILITIES COMMISSION



Margaret E. Curran

Margaret E. Curran, Chairperson

*Herbert DeSimone, Commissioner

*Commissioner DeSimone concurred with the decision but is unavailable for signature.

NOTICE OF RIGHT OF APPEAL: Pursuant to R.I. Gen. Laws § 39-5-1, any person aggrieved by a decision or order of the PUC may, within seven (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.