

**SURREBUTTAL TESTIMONY OF
RALPH SMITH, CPA
BEFORE THE
RHODE ISLAND PUBLIC UTILITIES COMMISSION**

**PROVIDENCE WATER SUPPLY BOARD
RATE CASE
DOCKET NO. 4618**

**ON BEHALF OF
THE DIVISION OF PUBLIC UTILITIES AND CARRIERS**

January 10, 2017

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1 **I. INTRODUCTION**

2 **Q. What is your name, occupation, and business address?**

3 A. My name is Ralph Smith. I am a Certified Public Accountant licensed in the State of
4 Michigan and a senior regulatory consultant at the firm Larkin & Associates, PLLC,
5 Certified Public Accountants, with offices at 15728 Farmington Road, Livonia,
6 Michigan 48154.

7
8 **Q. Have you previously submitted testimony in this proceeding?**

9 A. Yes. I submitted my direct testimony on October 14, 2016.

10

11 **Q. What is the purpose of your surrebuttal testimony?**

12 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimonies of
13 Nancy Parrillo and Ricky Caruolo of Providence Water Supply Board ("PWSB,"
14 "Providence Water" or "Company").

15 **II. DIVISION ADJUSTMENTS ACCEPTED BY PROVIDENCE WATER**

16 **Q. Has Providence Water accepted some of the Division's recommended**
17 **adjustments that were discussed in your Direct Testimony?**

18 A. Yes. As stated on page 11 of PWSB witness Nancy Parrillo's Rebuttal Testimony,
19 the Company has accepted these Division recommended adjustments:

- 20 • Increase Miscellaneous Revenue by \$54,429
21 • Reduce the funding of the Chemical Account by an additional
22 \$200,000.

1 At pages 4-5 of her Rebuttal Testimony, Ms. Parrillo indicates that
2 Providence Water agrees with the following portions of the payroll clearing and
3 overhead rate adjustments:

- 4 • \$49,842 to reflect projected wage increases through the rate year, and
- 5 • \$68,885 for the payroll clearing (overhead rate applied).

6 She indicates at page 3 of her Rebuttal that Providence Water's acceptance of
7 these two portions of the payroll adjustments reduce PWSB's revenue request by
8 \$118,727.

9 At page 5, she also indicates Providence Water's agreement with the
10 Division's proposal to reduce the Workers Compensation Insurance expense by
11 \$136,455.

12 **III. CONTESTED ADJUSTMENTS**

13 **Q. What issues addressed in your Direct Testimony have been contested by**
14 **Providence Water?**

15 **A.** Providence Water has contested a number of issues that were addressed in my direct
16 testimony, including the following:

- 17 • Payroll and Related Expense for 14 New Positions
- 18 • Overtime Expense
- 19 • Overhead Rate Applied
- 20 • Employee Benefits and Payroll Tax Expense
- 21 • Insurance Expense and Restricted Insurance Fund
- 22 • Western Cranston Fund
- 23 • Application of Property Tax Refund Amount

- Payment in Lieu of Taxes for 125 Dupont Drive in Providence

I will briefly address and respond to each of these issues in my Surrebuttal Testimony.

Payroll and Related Expense for 14 New Positions

Q. Did Ms. Parrillo agree with your payroll expense adjustment?

A. No. At pages 2-3 of her Rebuttal Testimony, she claims, as does Mr. Carulo, that Providence Water needs to add 14 new positions.

8

Q. Have you changed your position on including additional payroll cost for 14 new positions based on their rebuttal?

A. No. As recognized by Ms. Parrillo at page 3 of her rebuttal salaries and overtime were less during three of the past four years than allowed in Providence Water's previous rate case, Docket 4406. I am willing to consider some amount of additional payroll expense beyond the test year, such as allowing the payroll listed in PSWB's response to Commission data request 1-2 (reproduced in Ms. Parrillo's Rebuttal Testimony as NEP-REB-9) or an amount of payroll expense that is based on an updated version of Providence Water's actual payroll and staffing. However, based on the information provided to date, Providence Water has not met its burden of proof in justifying a need for payroll and related costs for an additional net increase of 14 new positions. Providence Water has not clearly established that it needs 14 additional positions or that it would be able to fill all of those positions with qualified candidates by the effective date for new water rates in this case, even if the cost for the new additional positions were to be allowed. Providence Water experiences

1 turnover in positions, so at any point in time, it would be expected to have some
2 positions vacant. During the test year, as shown on Ms. Parrillo's rebuttal Exhibit
3 NEP-REB-1, the number of PWSB employees actually declined from 250 at the
4 beginning of the test year to 248 at the end of the test year. Additionally, some
5 aspects of hiring new staff appear to be handled by the City of Providence, rather
6 than by PWSB directly, thus significant delays can occur in filling positions at
7 PSWB. Consequently, it would not be reasonable to increase payroll expense for the
8 net addition of 14 new positions.

9
10 Overtime Expense

11 **Q. Did Ms. Parrillo agree with your adjustment to overtime expense?**

12 A. No. She states on page 3 of her rebuttal testimony that overtime expense was lower
13 during fiscal year 2016 due to warmer weather during the winter months and to
14 budget constraints.

15
16 **Q. Have you changed your position on the appropriate amount of overtime expense
17 based on their rebuttal?**

18 A. Yes. Providence Water has indicated that the test year level of overtime expense was
19 abnormally low in FY2016 and that it would be appropriate to reflect in the cost of
20 service a normal level of overtime expense. I agree in principle that it would be
21 appropriate to reflect a normal level of overtime expense. It would be appropriate to
22 reflect a higher amount of overtime expense than I had recommended in my direct
23 testimony. Basing the allowed overtime expense on a multi-year average would

1 appear to be one way of assuring that a normal level is reflected. Exhibit NEP-REB-
2 1 filed with Ms. Parrillo's rebuttal testimony has overtime cost information for fiscal
3 years 2013, 2014 and 2015 as well as a projected amount for rate year calendar 2017.
4 I would not object to allowing overtime expense based on the average of the amounts
5 listed on Exhibit NEP-REB-1 for fiscal years 2013, 2014 and 2015.

6 Overhead Rate Applied

7 **Q. Did Ms. Parrillo agree with your adjustment for the Overhead Rate Applied?**

8 A. Only partially. She agreed with my increase to the test year amount to reflect the
9 projected wage increases expected to occur through the rate year, which decreases
10 the Company's revenue request by \$118,727, as she notes on page 5 of her Rebuttal
11 Testimony.

12 She disagrees, however, with my assessment that Providence Water has not
13 treated Overhead Rate Applied as being reimbursed from the IFR. At page 4 of her
14 Rebuttal Testimony she explains that Providence in the current rate case has reflected
15 reimbursement of the overhead rate applied amount from the IFR fund. She indicates
16 that Providence Water has deducted the overhead rate applied amount from the cost
17 of service expenses and has included the amount as an expense to be recovered via
18 the IFR funding.

19 **Q. Have you revised your position on the IFR funding-related portion of the**
20 **adjustment?**

21 A. Yes. Upon further review, the treatment described by Ms. Parrillo in her Rebuttal
22 Testimony appears to be consistent with the way the Overhead Rate Applied issue

1 was resolved in Docket 4406. As a result, I am accepting that part of the Providence
2 Water proposal.

3 **Q. Does that resolve the issues that were in dispute about the Overhead Rate**
4 **Applied treatment in the current Providence Water rate case?**

5 A. Yes, I believe it does. With Providence Water's acceptance of the \$118,727
6 adjustment noted by Ms. Parrillo on pages 4-5 of her Rebuttal Testimony, and my
7 acceptance of the Providence Water proposed IFR funding-related portion of the
8 adjustment, this would appear to resolve the disputed issue concerning the Overhead
9 Rate Applied for purposes of the current rate case.

10

11 Employee Benefits and Payroll Tax Expense

12 **Q. Are the adjustments for Employee Benefits and Payroll Tax Expense dependent**
13 **upon the level of staffing and payroll expense allowed?**

14 A. Yes. The Division's adjustments for Employee Benefits and Payroll Tax Expense.
15 The removal of the employee benefits cost that Providence Water requested for
16 vacant positions is consistent with the recommendation in my direct testimony to
17 remove the 14 new positions for full time, permanent employees. Similarly the
18 payroll expense adjustment includes a component to remove the payroll expense for
19 14 new positions to reflect recent actual employee levels, and to adjust for the effects
20 of employee turnover by reflecting known differences for positions that were
21 replaced during the 12 months after the test year. As noted above, the portion of the
22 payroll tax adjustment that relates to the level of overtime payroll expense, is being
23 conceded, based on the agreement that the Providence Water cost of service should

1 reflect a normal level of overtime. In summary, both the employee benefit and
2 payroll expenses are derivative of other adjustments. The amounts allowed for these
3 components of the cost of service are thus dependent upon the resolution of other
4 issues, including the level of staffing and payroll expense allowed.

5
6 Insurance Expense and Restricted Insurance Fund

7 **Q. What has Providence Water indicated in its Rebuttal Testimony concerning the**
8 **amount of insurance expense and the Restricted Insurance Fund?**

9 A. Ms. Parrillo's Rebuttal Testimony at pages 5-6 indicates that Providence Water has
10 accepted the Division's adjustment to adjust insurance expense to remove amounts
11 for worker's compensation that are received as salary, which reduces the Company's
12 originally claimed amount of Workers Compensation Insurance expense by
13 \$136,455.

14 However, she does not agree with the Division's adjustment to reduce the
15 Restricted Insurance Fund. She notes at page 6 of her Rebuttal Testimony that the
16 Insurance Fund is required to be certified annually as to its sufficiency to cover
17 Providence Water's insurance costs. Moreover, the use of the Insurance Fund is
18 restricted to paying insurance premiums and deductibles. She notes that there have
19 been increases in some of the deductible amounts.¹ She has presented in her Exhibit
20 NEP-REB-2, Providence Water's response to Div 1-34 from Docket 4406, as well as
21 NEP-REB-3A (an excerpt from a Trust Indenture dated June 5, 2008 addressing the

¹ At page 5 of her Rebuttal Testimony, for example, Ms. Parrillo notes that the deductible amount that Providence Water could be subject to paying, for general liability claims has risen from \$25,000 to \$50,000 per claim.

1 Insurance Reserve Fund) and NEP-REB-3B (letter dated November 1, 2016 to PWSB
2 from Risk Management and Insurance Consulting Services of New England, signed
3 by Mr. Ronald P. Joseph, President of that firm, regarding the adequacy of PSWB's
4 Insurance Reserve for the 7/1/2016 to 7/1/2017 period).

5
6 **Q. Have you revised the position on the Restricted Insurance Fund based on the
7 Providence Water rebuttal?**

8 A. Yes. I acknowledge that funding of the Restricted Insurance Fund is an important
9 area that should be reviewed in each Providence Water rate case. The evidence
10 presented by Providence Water, including the additional explanations provided in
11 Ms. Parrillo's rebuttal testimony and exhibits show that there is not much room to
12 reduce the Restricted Insurance Fund in the current rate case, especially after
13 recognizing the complexity of planning for insurance payments and deductible
14 amounts, which have increased for certain items, such as for general liability claims.

15
16 Western Cranston Fund

17 **Q. Does Providence Water agree with the Division's recommended reduction in the
18 funding for the Western Cranston Fund?**

19 A. No. At page 10 of her Rebuttal Testimony, Ms. Parrillo opposed that reduction on
20 the basis that the balance in the fund is estimated to be negative by the end of FY2021.

21
22 **Q. Please respond to the Providence Water rebuttal on this item.**

23 A. Even with the updating described on page 10 of Ms. Parrillo's Rebuttal Testimony,
24 the Western Cranston fund is projected to continue to have a positive balance through

1 FY2019. Moreover, it is expected that Providence Water's rates will be re-examined
2 and adjusted prior to the end of FY2021, so consideration of projected fund balances
3 for FY2020 and FY2021 can be addressed in a subsequent Providence Water rate
4 case. For purposes of the current Providence Water rate case, the Division's
5 recommended adjustment, to reduce the annual amount of Western Cranston Fund
6 funding to be provided by ratepayers by \$22,069 per year (which would provide for
7 an annual ratepayer-provided funding level of \$40,000 versus the current \$62,069
8 annual level, as shown on Schedule RCS-12 filed with my Direct Testimony), should
9 be made.

10 Application of Town of Foster Property Tax Refund

11 **Q. What is the Property Tax Refund Fund?**

12 A. In 2015 the Company and the Town of Foster entered into a tax agreement in which
13 Providence Water will receive \$175,000 per year from the Town of Foster for nine
14 years and then will receive approximately \$290,000 in year ten. The tax agreement
15 reflects the overall payment of \$1.6 million to Providence Water related to that refund
16 of property taxes.

17
18 **Q. What is the Division's recommendation concerning the application of that
19 property tax refund?**

20 A. As noted above, the Company has resolved its property tax dispute with the Town of
21 Foster. That resolution will not only result in reducing the going-forward amounts
22 of property tax expense, it has already resulted in refunds being made, which Foster
23 will be paying to Providence Water over the next several years. Since ratepayers

1 have paid to Providence Water a cost of service that has included the higher property
2 tax in prior years, the Town of Foster property tax refund, which is now known with
3 certainty, should be returned to ratepayers as a reduction to Providence Water's cost
4 of service in the current rate case.

5
6 **Q. Has the Providence Water rebuttal testimony caused any change of Division
7 position concerning how to apply the Foster property tax refunds?**

8 A. No. I continue to recommend that the Commission require Providence Water to
9 reflect the Town of Foster refund of \$1,604,528 in the Property Tax Refund account,
10 and to credit customers annually \$175,000 for nine years, for a total of \$1,575,000.
11 The remaining balance in the account should be restricted for use for litigation
12 expenses related to property tax challenges, but not increased property taxes. This
13 recommendation reflects that Providence Water will be receiving at least \$175,000
14 from the Town of Foster for the next nine years (counting the July 2016 receipt)² and
15 reflects a similar treatment to that Ordered by the Commission for the City of
16 Cranston property tax refund in Docket No. 3832.

17

18 Payment in Lieu of Taxes for 125 Dupont Drive in Providence

19 **Q. Has the Company's Rebuttal Testimony caused any change in the Division's
20 recommendation relating to Providence Water's request to charge customers**

² It is noted that the payments to be made on July 15 of each year, 2016 through 2023 are \$175,000 each, and the final payment to be made to the Company from the Town of Foster on July 15, 2024 is \$298,982.58, per the Company's response to DIV 3-2(c).

1 **\$326,000 annually for a new payment in lieu of taxes related to the Central**
2 **Operations Facility located at 125 Dupont Drive?**

3 A. No, however the Division will continue to explore the PILOT issue particularly with
4 respect to Providence Water's overall service territory, governance structure and tax
5 exempt status.

6

7 **Q. Does this complete your surrebuttal testimony?**

8 A. Yes, it does.