

# **GENERAL RATE FILING**

**DIRECT TESTIMONY  
OF GARY S. PRETTYMAN**

January 2018

Submitted to:  
State of Rhode Island and Providence  
Plantations Public Utilities Commission

RIPUC Docket No.

Submitted by:

SUEZ Water Rhode Island Inc.

SUEZ WATER RHODE ISLAND INC.  
GARY S. PRETTYMAN

1 **Q. Please state your name, occupation and business address.**

2 A. My name is Gary S. Prettyman and I am Senior Director, Regulatory Business at  
3 SUEZ Water Management and Services, Inc. My business address is 461 From  
4 Rd, Paramus, NJ 07652.

5  
6 **Q. Please summarize your educational background and professional  
7 experience.**

8 A. I have over thirty-nine years' experience in water and wastewater utility  
9 management and regulatory practice including all aspects of rate increase  
10 applications. I have testified before regulatory commissions on accounting  
11 issues, tariff design, and company policy in numerous proceedings. The details  
12 of my professional experience and educational background are shown in  
13 Appendix A supplementing this testimony.

14  
15 **Q. Have you previously testified before this commission?**

16 A. Yes, I have

17  
18 **Q. What is the purpose of your testimony?**

19 A. The purpose of my testimony is to support the Petitioner's request to establish a  
20 surcharge related to the replacement and rehabilitation of distribution system  
21 transmission and distribution ("T&D") mains, services, hydrants, valves and  
22 meters. Simply put a Distribution System Improvement Charge (DSIC).

23

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1 **Q. Are you sponsoring any exhibits which support the Company's request?**

2 A. Yes. I am sponsoring: 1) Exhibit GSP-1 which summarizes DSIC programs  
3 around the country; 2) Exhibit GSP-2 which is a National Association of  
4 Regulatory Commissions ("NARUC") resolution; and 3) Exhibit GSP-3 which is a  
5 sample DSIC calculation.

6

7 **Q. What is a DSIC?**

8 A. A DSIC allows for rate increases for non-revenue producing investments to  
9 replace aging utility infrastructure outside of a general rate proceeding.

10

11 **Q. Please explain why the Company is requesting a DSIC.**

12 A. It is widely known that water infrastructure in the United States is aging and in  
13 need of repair. The United States Environmental Protection Agency estimates  
14 that the 20-year national water infrastructure need is approximately \$384 billion,  
15 and of that \$245 billion is needed for distribution and transmission projects.  
16 Traditionally, companies would invest in these types of improvements as their  
17 budgets would allow, absent emergencies, and would be required to wait for cost  
18 recovery till their next base rate case.

19

20 By implementing a DSIC program, companies that invest in these types of  
21 improvements would: 1) recover on a timelier basis; and 2) avoid the costs of a  
22 base rate case. Some mains nationally were installed in the late 1800's and  
23 early 1900's. Based upon standard replacement, i.e. rate cases and available

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1 funds, it could take 150 to 200 years or more to replace the whole system. The  
2 replacement of the system should be closer to 100 years which is generally the  
3 expected life of mains. However, as shown below, that is not the case with  
4 SWRI.

5

6 **Q. Can you give an example of SWRI's replacement timetable?**

7 A. Yes. At the end of 2017, SWRI had 154 miles of mains. During 2017, the  
8 Company replaced 0.16 miles of mains. Based solely on this year's activity it  
9 would take approximately 962 years to replace the entire system. Establishing a  
10 DSIC would allow the Company to pursue a more aggressive infrastructure  
11 replacement program.

12

13 **Q. Does SWRI have any specific areas of its service territory that are of**  
14 **concern?**

15 A. Yes. The Company has several areas of concern, including: 1) the River Street,  
16 Pond Street and Winchester Street areas of South Kingston where the mains are  
17 made of asbestos cement and continually experience breaks; 2) the Ocean Road  
18 and Boston Neck Road areas of Narragansett where the mains are also made of  
19 asbestos cement and continually breaks; and 3) the Bonnet Shores area of  
20 Narragansett where the mains are made of asbestos cement and galvanized iron  
21 and continually have breaks. A DSIC program would certainly help to accelerate  
22 main replacement in these problem areas.

23

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1 **Q. When was DSIC first implemented?**

2 A. The first DSIC program was implemented in Pennsylvania in 1997. Since that  
3 time, 16 other states have implemented DSICs. Exhibit GSP-1 summarizes the  
4 17 states that have implemented a DSIC or some type of mechanism that  
5 functions like a DSIC. Please note that different states may call the program  
6 something other than DSIC however when you look at the details, the general  
7 philosophy and most of the components are the same.

8

9 **Q. Has NARUC formed an opinion on this type of program?**

10 A. Yes. The NARUC Committee on Water has endorsed the use of DSIC as a best  
11 practice in its 2005 Resolution Supporting Consideration of Regulatory Policies  
12 Deemed as "Best Practices," set forth as Exhibit GSP-2.

13

14 **Q. What are some of the customer benefits of implementing a DSIC program?**

15 A. Implementation of a DSIC benefits customers by: 1) reducing main breaks and  
16 associated overtime; 2) improving water quality and fire flows; 3) lengthening  
17 time between rate cases which reduces rate case expense; and 4) resulting in  
18 smaller rate increases over time which minimizes rate shock. The types of items  
19 listed above would all result in reduced operating expenses which benefits  
20 customers over time.

21

22 **Q. Are there customer protections?**

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1 A. Yes, Commissions have the ability to review the projects to ensure they are  
2 appropriate and there is generally a cap on the amount of increases that can  
3 happen between rate cases. DSICs in other states also require that an earnings  
4 analysis be performed to determine if a company is over earning; if a company is  
5 over earning, then the surcharge would stop until such time as the company is in  
6 an under earning position. Some states also perform an annual audit of the  
7 program to review the actual projects implemented by the company.

8

9 **Q. Please discuss the DISC program you are recommending.**

10 A. The DSIC should reflect qualified additions for the previous six-month period that  
11 are non-revenue producing and include additions that are replacing and  
12 rehabilitating in nature. Qualified additions may include among other things:  
13 mains; main cleaning and lining; services, hydrants; valves; short mains and  
14 valves; meters; dead-end looping; and re-location due to government  
15 requirements.

16

17 **Q. Do you recommend a cap on the DISC surcharge?**

18 A. Yes. I recommend a 7.5% cap on the DISC surcharge.

19

20 **Q. What would be included in the revenue requirement for qualified additions?**

21 A. The rate of return would be based upon the Company's last rate case and rate  
22 base would include accumulated depreciation and deferred federal income tax  
23 on qualified additions only, plus depreciation expense. Revenue taxes would be

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1           grossed-up and the revenue requirement would be on a pre-tax basis.

2

3   **Q.   How would the Company recover the DSIC?**

4   A.   A surcharge would be applied to all customer bills equal to the percentage  
5       calculated by dividing the DSIC revenue requirement by the Company's  
6       projected revenues for the next six months. The surcharge will be applied on a  
7       bills rendered basis and the Commission would have 30 days to review a filing.

8

9       On the next six month submittal, a reconciliation on the over(under) recovery of  
10      DSIC surcharge would be included. An earnings test will be provided after one  
11      year of surcharges and every six months thereafter

12

13      The Surcharge will be zeroed out at the next base rate case.

14

15      There should not be any "Gap Period" as a result of base rate case. The Gap  
16      Period represents the time period between when qualified additions are reflected  
17      in base rates and the Company's subsequent DSIC filing. For example, if  
18      increased rates become effective in April and that increase only includes  
19      qualified DSIC additions through the prior December, the next DSIC surcharge  
20      after the rate increase would include qualified additions from January through  
21      September (i.e., six months after the April effective date).

22

23   **Q.   Have you prepared an example of the DSIC calculation?**

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1 A. Yes I have. Please see Exhibit GSP-3. The amounts included in Exhibit GSP-3  
2 are for explanatory purposes only and do not reflect any actual amounts.

3  
4 **Q. Are there any DSIC recovery projects or amounts reflected in the current**  
5 **rate proceeding?**

6 A. No. This would be a new program starting at the conclusion of this proceeding.  
7 None of the projects included in rate base in this case would be included in any  
8 future DSIC filing.

9  
10 **Q. Does this conclude your testimony at this time?**

11 A. Yes, it does.

SUEZ Water Rhode Island  
Distribution System Improvement Charge  
Summary of States that Adopted

<u>State</u>	<u>Adopted</u>	<u>Water</u>	<u>Wastewater</u>	<u>Items Included</u>	<u>Surcharge Maximum</u>	<u>Filing Frequency</u>
Arizona	2013	yes	yes	Mains, services, valves, hydrants, meters, fire mains	5%	Annual
Connecticut	2007	yes		Mains, services, valves, hydrants, meters, cleaning and lining, relocation due to government, leak detection equipment, production meters, pressure reducing valves, improvements to comply with river and stream flow.	10%	Semi-annual
Delaware	2001	yes		Mains, services, valves, hydrants, meters, dead-end looping, relocation due to government, new or additional water treatment facilities to meet new government water quality	7.50% Max in 1 yr 5.00%	Semi-annual
Illinois Amended	2001 2016	yes	yes	Mains, services, valves, hydrants, meters, backflow prevention cleaning and lining, relocation due to government, Collecting and impounding reservoirs, lake river and other intakes Wells and Springs, infiltration galleries and tunnels Supply mains, power generation equipment, pumping equipment Water treatment equip, distribution reservoirs and standpipes  Sewer - power generation equip, force mains, collection mains flow measuring device, reuse meters, receiving wells, pumping equip, reuse distribution reservoirs, reuse T&D mains, T&D disposal equip manholes, improvements to improve I&I	Average Max in 1 yr 2.50% 3.50%	Annual
Indiana Amended Amended Amended	2000 2014 2015 2016	yes	yes	Mains, services, valves, hydrants, meters, other appurtenances	10%	Annual
Maine	2013	yes		Mains, storage tanks, and pumping facilities Stationary physical assets needed to operate a water system.	< \$250k \$250k to \$750k > \$750k 7.50% 5% 3%	Semi-annual
Missouri	2003	yes		Mains, valves, hydrants, main cleaning and lining, relocation due to government	10%	Semi-annual
Nevada	2014	yes	yes	Mains, services, valves, hydrants, meters Other appurtenances need to transport treated water: wells, treatment, storage facilities, booster stations.	n/a	n/a

New Hampshire Amended	2009 2013	yes		Amounts over annual threshold \$50k, mains, valves, hydrants, main cleaning and lining, relocation due to government, production meters pressure reducing valves	Max in 1 yr	7.50% 5%	Annual
New Jersey Amended	2012 2017	yes		Mains, services, valves, hydrants, main cleaning and lining relocation due to government, dead end looping		5%	Semi-annual
New York	2008	yes		Large capital projects with long construction periods with in-service dates in rate years two and beyond. Mains, services, valves, meters are reflected in future rate years of base rate case		As approved	Annual
North Carolina	2013	Yes	yes	Mains, services, valves, hydrants, meters, dead-end looping, relocations due to government, equipment and infrastructure needed for regional water supply and drinking water standards with Commission approval.  Sewer- collection mains, improvements necessary to improve I&I, relocation due to government, pumps, motors, blowers, and other mechanical equipment.		5%	Semi-annual
Ohio	2003	yes	yes	Mains, services, valves, hydrants, meters Chemical feed systems, filters, pumps, motors, generators, main cleaning and relining, Sludge handling equip, lift stations, I&I improvements Relocation due to government.	Water Sewer	4.25% 3%	Annual
Pennsylvania Amended	1997 2012	yes	yes	Mains, services, valves, hydrants, meters, dead-end looping, main cleaning and lining, relocation due to government.  Sewer- collection mains, services, valves, manholes, grinder pumps, air and vacuum release chambers, cleanouts, flow meters, lift stations,	Water Sewer	7.50% 5%	Quarterly
Tennessee	2014	yes		Mains, services, valves, hydrants, meters, relocation due to government water treatment facilities and equipment replacements, raw water and finished water pumping equipment and structures.		None	Annual
Virginia (Alexandria District)	2017	yes		Mains, services, valves, hydrants, meter boxes, dead-end looping, solutions to regional water supply in order to comply with primary and secondary water standards.		7.50%	Annual
West Virginia	2017	yes		No specific facilities, to be determined in each filing	Max in 1 yr	7.50% 3.75%	Annual

Note: This summary is meant to give an overview of each states program. For more detailed information regarding a particular state a review of that states regulations should be made.

***Resolution Supporting Consideration of Regulatory Policies Deemed as “Best Practices”***

**WHEREAS,** A number of innovative regulatory policies and mechanisms have been implemented by public utility commissions throughout the United States which have contributed to the ability of the water industry to effectively meet water quality and infrastructure challenges; *and*

**WHEREAS,** The capacity of such policies and mechanism to facilitate resolution of these challenges in appropriate circumstances supports identification of such policies and mechanisms as “best practices”; *and*

**WHEREAS,** During a recent educational dialogue, the “2005 NAWC Water Policy Forum,” held among representatives from the water industry, State economic regulators, and State and federal drinking water program administrators, participants discussed (consensus was not sought nor determined) and identified over 30 innovative policies and mechanisms that have been summarized in a report of the Forum to be available on the website of the Committee on Water at [www.naruc.org](http://www.naruc.org); *and*

**WHEREAS,** As public utility commissions continue to grapple with finding solutions to meet the myriad water and wastewater industry challenges, the Committee on Water hereby acknowledges the Forum’s *Summary Report* as a starting point in a commission’s review of available and proven regulatory mechanisms whenever additional regulatory policies and mechanisms are being considered; *and*

**WHEREAS,** To meet the challenges of the water and wastewater industry which may face a combined capital investment requirement nearing one trillion dollars over a 20-year period, the following policies and mechanisms were identified to help ensure sustainable practices in promoting needed capital investment and cost-effective rates: a) the use of prospectively relevant test years; b) the distribution system improvement charge; c) construction work in progress; d) pass-through adjustments; e) staff-assisted rate cases; f) consolidation to achieve economies of scale; g) acquisition adjustment policies to promote consolidation and elimination of non-viable systems; h) a streamlined rate case process; i) mediation and settlement procedures; j) defined timeframes for rate cases; k) integrated water resource management; l) a fair return on capital investment; *and* m) improved communications with ratepayers and stakeholders; *and*

**WHEREAS,** Due to the massive capital investment required to meet current and future water quality and infrastructure requirements, adequately adjusting allowed equity returns to recognize industry risk in order to provide a fair return on invested capital was recognized as crucial; *and*

**WHEREAS,** In light of the possibility that rate increases necessary to remediate aging infrastructure to comply with increasing water quality standards could adversely affect the affordability of water service to some customers, the following were identified as best practices to address these concerns: a) rate case phase-ins; b) innovative payment arrangements; c) allowing the consolidation of rates (“Single Tariff Pricing”) of a multi-divisional water utility to spread capital costs over a larger base of customers; *and* d) targeted customer assistance programs; *and*

**WHEREAS,** Small water company viability issues continue to be a challenge for regulators, drinking water program administrators and the water industry; best practices identified by Forum participants include: a) stakeholder collaboration; b) a memoranda of understanding among relevant

State agencies and health departments; c) condemnation and receivership authority; and d) capacity development planning; *and*

**WHEREAS**, The U.S. Environmental Protection Agency's "Four-Pillar Approach" was discussed as yet another best practice essential for water and wastewater systems to sustain a robust and sustainable infrastructure to comprehensively ensure safe drinking water and clean wastewater, including: a) better management at the local or facility level; b) full-cost pricing; c) water efficiency or water conservation; *and* d) adopting the watershed approach, all of which economic regulators can help promote; *and*

**WHEREAS**, State drinking water program administrators emphasized the following mechanisms which Forum participants identified as best practices: a) active and effective security programs; b) interagency coordination to assist with new water quality regulation development and implementation, such as a memorandum of understanding; c) expanded technical assistance for small water systems; d) data system modernization to improve data reliability; e) effective administration and oversight of the Drinking Water State Revolving Fund to maximize infrastructure remediation, along with permitting investor owned water companies access in all States; f) the move from source water assessment to actual protection; *and* g) providing State drinking water programs with adequate resources to carry out their mandates; *now therefore be it*

**RESOLVED**, That the National Association of Regulatory Utility Commissioners (NARUC), convened in its July 2005 Summer Meetings in Austin, Texas, conceptually supports review and consideration of the innovative regulatory policies and practices identified herein as "best practices;" *and be it further*

**RESOLVED**, That NARUC recommends that economic regulators consider and adopt as many as appropriate of the regulatory mechanisms identified herein as best practices; *and be it further*

**RESOLVED**, That the Committee on Water stands ready to assist economic regulators with implementation of any of the best practices set forth within this Resolution.

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*Sponsored by the Committee on Water*

*Adopted by the NARUC Board of Directors July 27, 2005*

SUEZ Water Rhode Island Inc.  
Proposed Sample DSIC Calculation  
January 1, xxxx to June 30, xxxx

Exhibit GSP-3  
Page 1 of 3

	<u>1/1/xx to 6/30/xx</u>
Eligible Investment (page 2)	\$1,500,000
Less: Accumulated Depreciation (page 2)	(5,625)
Less: Deferred Tax (page 2)	<u>(1,969)</u>
Eligible Net Investment	\$1,492,406
Pre-Tax Rate of Return (page 3)	<u>9.33%</u>
Pre-Tax Return on Investment	\$139,241
Add: Depreciation Expense (page 2)	<u>22,500</u>
Revenue Recovery	\$161,741
Revenue Factor (page 3)	<u>1.017061</u>
Total DSIC Revenue Requirement Recovery Amount	<u><u>\$164,500</u></u>
Revenues allowed in Docket No. _____	<u><u>\$5,000,000</u></u>
Percent Increase	<u><u>3.29%</u></u>

**SUEZ Water Rhode Island Inc.**  
**Proposed Sample DSIC Calculation**  
**January 1, xxxx to June 30, xxxx**

Exhibit GSP-3  
Page 2 of 3

	<u>1/1/xx to</u> <u>6/30/xx</u>
Major Projects	\$1,000,000
Blanket Projects	\$500,000
Eligible Investment	<u>1,500,000</u>
 <u>Accumulated Depreciation</u>	
Composite Depreciation Rate (Based upon applicable accounts)	<u>1.5000%</u>
Depreciation Expense	22,500
Half Year Convention	<u>5,625</u>
 <u>Deferred Taxes</u>	
Eligible Investment	\$1,500,000
MACRS Rate for First Year Water Plant	<u>4.00%</u>
Tax Depreciation First Year	15,000
Book Depreciation	<u>5,625</u>
Tax Depreciation Greater Than Book	9,375
Deferred Taxes at 21%	<u><u>\$1,969</u></u>

Note: This schedule is for explanatory purposes.

**SUEZ Water Rhode Island Inc.**  
**Proposed Sample DSIC Calculation**  
**January 1, xxxx to June 30, xxxx**

Approved Capital Structure and Cost Rates

	Capital Structure Ratio	Cost Rate	Weighted Cost of Capital	Pre-Tax Rate of Return
Long Term Debt	45.81%	4.65%	2.13%	2.13%
Common Equity	54.19%	10.50%	5.69%	7.20%
Total	100.00%		7.82%	9.33%

1) capital structure and ROE per current authorized return Docket No. \_\_\_\_\_  
For purposes of this example, the as-filed capital structure and cost rates were utilized.

Revenue Factor

Dollar of Revenue	1.00000
Gross Receipts Tax	0.01250
PUC Assessment	0.00428
Income Before Federal Taxes	<u>0.98323</u>
Revenue Factor	<u>1.017061</u>

Rates per Final Order in Docket No. \_\_\_\_\_

Note: This schedule is for explanatory purposes.