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November 21, 2016

Ms. Luly E. Massaro, Commission Clerk
Public Utilities Commission
89 Jefferson Blvd.
Warwick, RI 02888

*RE: Kent County Water Authority
Docket No. 4611*

Dear Ms. Massaro:

Please find enclosed an original and nine copies of the Surrebuttal Testimony of David Krekorian, CPA, M.S.T. (as corrected) which corrects certain typographical errors in his Surrebuttal Testimony served on Friday.

Yours truly,



Arthur M. Read, II

AMR/lhm
Enclosures

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
BEFORE THE
PUBLIC UTILITIES COMMISSION

Docket No.:4611

Petition of the KENT COUNTY WATER AUTHORITY
Rate Application

**SURREBUTTAL TESTIMONY OF
DAVID P. KREKORIAN, C. P. A., M. S. T.
(AS CORRECTED)**

**ON BEHALF OF THE
COVENTRY FIRE DISTRICT**

November 18, 2016

BEFORE THE
PUBLIC UTILITIES COMMISSION
OF RHODE ISLAND

KENT COUNTY WATER AUTHORITY DOCKET NO. 4611

SURREBUTTAL TESTIMONY OF DAVID P. KREKORIAN C.P.A., M.S.T.
(AS CORRECTED)

1 **I. INTRODUCTION**

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

3 A. My name is David P. Krekorian. I am a Certified Public Accountant and
4 shareholder of David P. Krekorian CPA, LTD. My business address is
5 1615 Pontiac Avenue, Cranston, RI 02920.

6 Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND
7 EXPERIENCE.

8 A. I am a 1980 graduate of Villanova University, Villanova, Pennsylvania
9 where I was awarded a Bachelor's Degree in Accounting. In 1990 I was
10 awarded the degree of Master of Science in Taxation by Bryant University,
11 Smithfield, Rhode Island.

12 I am licensed as a Certified Public Accountant in Rhode Island (since
13 1986) and Massachusetts (since 2012).

14 I am a member of the American Institute of Certified Public Accountants
15 and the Rhode Island State Society of Certified Public Accountants where I
16 serve as the Chair of its Small Firms Committee.

17 I have worked in public accounting continually since 1980.

18 I have been employed at the following CPA firms:

- 19 ➤ James P. Ferolito CPA 1980-1981;
- 20 ➤ Piccerelli Gilstein & Co., 1981-1986;
- 21 ➤ Ernst & Young 1986-1988;
- 22 ➤ Mardo Lachapelle CPA Ltd 1988-1990 and

1 ➤ David P. Krekorian CPA Ltd 1990-present.

2 In my 35 plus years of public accounting, I have provided various
3 accounting, tax and management advisory services to thousands of business,
4 and individual clients as well as municipal clients, such as Coventry Fire
5 District.

6 My business clients have ranged in size from Fortune 100 companies to
7 small startups.

8 In addition to providing traditional tax accounting services, I have been
9 engaged by business clients for numerous special projects that fall outside the
10 mainstream of normal accounting such as: preparing breakeven analysis;
11 preparing monthly, annual and multi-year budgeting, preparing income
12 forecasts, preparing cash flow forecasts, advising on complicated business
13 loan applications and business transactions.

14 I have testified in Family Court and Superior Court where I have been
15 qualified and accepted by the Court as an expert witness and have testified on
16 behalf of various clients in the areas of tax and other financial analysis.

17 I have been engaged by Central Coventry Fire District, as its Treasurer,
18 since 2013 and by The Coventry Fire District, as its Treasurer, from 2014 to
19 the present.

20 I have had substantial experience in preparing and assisting in the
21 preparation of budgets for several of my corporate and municipal clients over
22 the period of my practice.

1 I have served as the Treasurer to and on boards of directors for a variety
2 of nonprofits over my practice.

3 Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY
4 PROCEEDINGS ON UTILITY RATES?

5 A. I have not.

6 Q. HAVE YOU PREVIOUSLY TESTIFIED ON WATER UTILITY ISSUES
7 BEFORE THIS COMMISSION?

8 A. I have not.

9 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

10 A. The purpose of my testimony is to provide a critical analysis of the
11 80.31% increase in public fire hydrant rental rates which the Kent County
12 Water Authority (KCWA) is requesting in its pending petition and to also
13 analyze the optional proposal to eliminate hydrant rental charges and to
14 replace them with an additional fee on its retail customers.

15 Q. HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

16 A. My testimony will present

- 17 ➤ an overview of cost of service methodologies.
- 18 ➤ recent history of the rates charged for hydrant rentals by KCWA,
- 19 ➤ a summary of the change in methodology of cost allocation as it
20 affects Coventry Fire District,

- 1 ➤ an alternative proposal (which I believe to be fairer to the
2 taxpayers and which I believe will provide KCWA with the funds
3 it needs to properly operate over the long term) and
4 ➤ some additional comments.

5
6 **II. OVERVIEW OF COST OF SERVICE METHODOLOGIES**

7
8 Q. WHAT IS THE OBJECTIVE OF A COST OF SERVICE STUDY (“COOS”)?

9 A. A COOS is conducted to assist a utility or rate setting commission in
10 determining the level of costs properly recoverable from each of the various
11 classes of users to which the utility provides service. It allocates the utilities’
12 revenue requirements to the various customer classes of service in a fair and
13 equitable manner. Allocation of recoverable costs to each customer class is
14 generally based on usage and cost causation principles.

15 Q. WHAT ARE THE PRIMARY COOS METHODOLOGIES USED FOR
16 WATER UTILITIES?

17 A. The two most commonly used and widely recognized methods of
18 allocating costs to customer classes for water utilities are the “base-extra
19 capacity method” and the “commodity-demand method”. Both of these
20 methods are described in the American Water Works Association’s
21 (“AWWA”) *Principles of Water Rates Fees and Charges* Sixth Ed. (“AWWA
22 M1 Manual”).

1 Q. IS THE “AWWA M1 Manual” AN ACCEPTED AUTHORITY IN WATER
2 UTILITY RATE SETTING?

3 A. The “AWWA M1 Manual” is an accepted authority in the water utility
4 rate setting. I have relied upon this treatise in preparing my testimony.

5 Q. PLEASE SUMMARIZE EACH OF THESE METHODS.

6 A. Under the base-extra capacity method, investment and costs are first
7 classified into four primary functional cost categories;

- 8 1) base or average capacity,
- 9 2) extra capacity,
- 10 3) customer and
- 11 4) direct fire protection.

12 “Base of average capacity” costs refer to those costs which tend to vary
13 with the total quantity of water used and operation under average load
14 conditions.

15 Such costs may include operation and maintenance expenses of supply,
16 treatment, pumping and transmission and distribution facilities, and capital
17 costs related to plant investment associated with serving customers at a
18 constant or average annual rate of use (100% load factor).

19 Extra capacity costs may also be divided between maximum day and
20 maximum hour costs.

21 “Customer costs” are commonly further divided between meter and
22 service related and account or bill related costs.

1 Once investment and costs are classified to these functional categories,
2 they are then allocated to customer classes. Base costs are allocated according
3 to average water use, and extra capacity costs are allocated on the basis of the
4 excess of peak demands over average demands.

5 Meter and service related customer costs are allocated on the basis of
6 relative meter and service investment or a proxy thereof.

7 Account-related customer costs are allocated in proportion to the number
8 of customers or the number of bills.

9 The CCOS Study presented by Kent County in this proceeding utilizes
10 the base extra-capacity methodology.

11 _____
12 The commodity-demand method follows the same general procedures.

13 However, usage related costs are classified as commodity and demand
14 related rather than as base and extra capacity related. Commodity related costs
15 are allocated to customer classes on the basis of total water use (which is the
16 equivalent to average demand), and demand related costs are allocated on the
17 basis of each class' contribution to peak demand rather than on the basis of
18 class demand in excess of average use.

1 Q. WHAT EFFECT DOES KCWA'S FAILURE TO ALLOCATE IFR COSTS
2 IN ITS 2004 (#3660), 2008 (#3942) AND 2010 (#4142) PETITIONS HAVE
3 ON YOUR ANALYSIS?

4 A: It is critical. By failing to allocate IFR costs in 2004, 2008 and 2010 and
5 by then allocating those costs in the present 2016 (#4611) petition, KCWA
6 makes it impossible to determine whether or not such costs are necessary to be
7 charged to fire hydrant rental and whether the charge is being reasonably
8 allocated. The statutory change relied upon by KCWA took effect in 2009.
9 One would think that there would have had to be an allocation of IFR costs in
10 the 2010 petition, at least.

11 I will discuss another matter dealing with allocation a little further on.

12 The scheme is to pass these costs onto the ratepayers in such a small
13 amount (when expressed in monetary terms) which would tend to disguise the
14 magnitude of the fire hydrant fee increase when expressed as a percentage
15 (80%).

16

17

18 III. HISTORY OF HYDRANT RATES

19

20 In a 2004 KCWA rate petition (Docket #3660), it proposed an overall
21 25% increase in all fees and rates. Fire hydrant rental fees increased from
22 \$95.30 to 119.13 per quarter or \$476.52 per year.

1 In #3660, KCWA did not present a schedule regarding an allocation of
2 IFR [infrastructure replacement] costs.

3 In a 2008 KCWA rate petition (Docket #3942) this Commission denied a
4 requested fire hydrant rental rate increase from \$118.39 to 147.74. Schedule 3
5 of Mr. Woodcock's testimony in support of that petition included \$6M of IFR
6 costs, but did not allocate those costs to fire districts. This is the crux of the
7 whole matter, in my opinion.

8 In 2009, the Legislature made the statutory change to §46-15.6-6 so that
9 in 2009 and thereafter, regulated utilities were obliged to allocate costs among
10 water users, as a class, as opposed to allocating costs among water users,
11 proportionate to their consumption.

12 In a 2010 KCWA rate petition (Docket #4142) the Commission
13 authorized a fire hydrant rental rate increase from \$128.83 to \$139.33 per
14 quarter or \$557.32 per year.

15 KCWA did not present any allocation schedules in that matter (as I
16 would have thought they would have after the 2009 statutory change).

17 The present rate is \$139.33 per quarter or \$557.32 per year.

18 The present petition proposes increasing the fire hydrant rental fee to
19 \$251.22 per quarter or \$1,004.88 per year per hydrant.
20

1 **IV. EVALUATION OF KENT COUNTY’S CLASS COOS**

2

3 Q. IS THE COOS STUDY PRESENTED BY KCWA IN THIS PROCEEDING

4 CONSISTENT WITH THOSE WHICH IT PRESENTED IN PRIOR

5 PROCEEDINGS?

6 A. No it is not; it is inconsistent.

7 The study presented by KCWA proposes a substantial and fundamental

8 change from those of past studies. The major change relates to the method of

9 allocating certain costs to Fire Service customers that KCWA has not included

10 in past billings.

11 Kent County used a change in legislation (Rhode Island General Laws.

12 1956 (2009 Reenactment) §46-15.6-6 (which was enacted in 2009) as what I

13 believe is a pretext to justify its change in methodology. The new §46-15.6-6

14 provided for the cost of infrastructure replacement (IFR) programs and

15 indemnification (as required by that Chapter) to be paid by the water users.

16 The statute states “The cost of infrastructure replacement programs shall

17 be paid by the water users. The charges shall be limited to those *necessary* and

18 *reasonable* to undertake the actions required by this chapter”. The emphasis

19 on the words ‘necessary’ and ‘reasonable’ is mine but the words were written

20 by the Legislature.

21 Q. WHAT WOULD BE THE IMPACT IF THE COMMISSION APPROVED

22 KCWA’S PROPOSED RATE CHANGE FOR HYDRANTS?

1 A. The current rate schedule provides for a quarterly rate of \$139.33 per
2 hydrant. The Coventry Fire District has two hundred twenty-eight (228)
3 hydrants resulting in a rental fee of \$31,767.24 quarterly or \$127,068.96
4 annually.

5 The proposed rate would increase the quarterly fee to \$251.22 per
6 hydrant yielding a District-wide rental fee of \$57,273 quarterly or \$229,092
7 annually.

8 This is an increase of approximately 80%.

9 Coventry Fire District's total operating budget for the fiscal year ended
10 November 30, 2016 is \$2.685M. Hydrant rental costs represented 4.72% of
11 that budget.

12 The proposed increase would nearly double hydrant rental fees to 8.5%
13 of the current budget necessitating a tax increase for all Coventry Fire District
14 taxpayers.

15 It is the opinion of the Coventry Fire District Board of Directors that an
16 increase of this magnitude places an excessive burden on this small District
17 (which has existed since the Legislature formed it in 1889), absent some
18 exigent circumstances (which have not been articulated by KCWA).

19 If the District's budget for the next fiscal year were to increase at the
20 same rate which KCWA proposes to increase its fire hydrant rental fees, CFD's
21 budget would increase from \$2.685M to almost \$4M annually.

1 I believe that this approach violates the rate making principle of
2 “gradualism” which is a gentle way of saying that the increase is so significant
3 that it causes “sticker-shock”.

4 Q. DO YOU FIND KENT COUNTY’S CCOS STUDY TO BE CONSISTENT
5 WITH THOSE PRESENTED IN PRIOR PROCEEDINGS AND TO BE
6 REASONABLE ?

7 A. The KCWA proposed allocation is inconsistent with past proceedings
8 and is unreasonable.

9
10
11 **V. RATE DESIGN**

12
13 Q. WHAT ARE SOME OF THE PRINCIPLES OF A SOUND REVENUE
14 ALLOCATION?

15 A. Traditionally sound allocation should:

- 16 • Yield the total revenue needed;
- 17 • Provide rate stability and predictability, with a minimum of
18 unexpected and material changes which are adverse to
19 ratepayers or to the utility (this principal is generally called
20 “gradualism”);

- 1 • Provide for simplicity, certainty, convenience of payment,
2 understandability, public acceptability and feasibility of
3 application; and
- 4 • Reflect fairness in the apportionment of the total costs of
5 service among the various classes.

6 Q. IS KCWA PROPOSING ANY RATE DESIGN CHANGES IN THIS
7 PROCEEDING?

8 A. Yes. KCWA is proposing to allocate infrastructure replacement costs
9 (IFR) totaling \$1,066,940 to the Fire Service Revenue Requirement. Docket
10 No. 3942 did not have infrastructure replacement costs allocated to the Fire
11 Service Revenue Requirement. The effect of this is an overall increase of
12 \$1.06M added to Fire Service Revenue Requirements and constitutes a rate
13 design change.

14 The fixed cost allocation percentage increases from 8.2% in Docket No.
15 3942 to 16.2% in Docket No. 4611.

16 Further, this causes revenue contribution from Fire Service to increase
17 from 7.3% of total revenues to 11.5% of total revenues (a 63.48% increase).

18 A comparison of these costs and percentages (as shown in Sch. 3 of the
19 KCWA RATE FILING - VOLUME I April 8, 2016 PART1, Pre-Filed
20 Testimony of Christopher PN [sic] Woodcock) follows:
21

	Docket No. 3942		Docket No. 4611	
	<u>Fire Service</u>		<u>Fire Service</u>	
<u>EXPENSE ITEMS</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>
FIXED CHARGES				
Debt Service	19.1%	\$ 751,028	19.8%	\$ 430,431
O & M Reserve	7.8%	38,871	7.7%	3,800
R & R Reserve	19.1%	88,491	19.8%	21,734
Renewal & Replacement				
Equipment	19.1%	19,099	19.8%	19,758
Infrastructure Replacement	0%	0	19.8%	1,066,940
Meter Replacement	0%	0	0%	0
CIP	0.0%	0	19.8%	346,522
Payroll Taxes	11.0%	17,121	11.9%	20,836
PILOT	8.2%	18.1%	<u>4,190</u>	16.2% 21.0%
				<u>4,864</u>
SUBTOTAL FIXED		918,800		1,914,887
OPERATING REVENUE	7.3%	77,575	11.5%	78,498
TOTAL EXPENSES	7.3%	1,577,355	11.5%	2,653,837
Miscellaneous Income	7.3%	(13,065)	11.5%	(27,144)
Interest Income	7.3%	(8,201)	11.5%	(2,977)
Merchandise & Jobbing	7.3%	(174)	11.5%	(1,871)
6.9% of Water Protection Fee	7.3%	(4,414)	11.5%	(5,254)
Total Revenue Requirements	7.3%	\$ 1,551,502	11.5%	\$ 2,616,592

1 The rate design change is simple. The law changed and KCWA seized
2 upon that change to justify a substantial fire hydrant rental rate increase.

3 However, KCWA is taking advantage of only the first element of the
4 statutory change (i.e. rate payers must bear cost increases) without giving any
5 consideration to the remaining two statutory requirements that rates must
6 reflect “reasonableness” and “necessity” as is required by amended §46-15.6-6.

7 The result is an increase from the present rate of \$139.33 per hydrant per
8 quarter to a quarterly fee of \$251.22.

9 I suggest that an increase of this magnitude was never contemplated by
10 the Legislature when it enacted §46-15.6-6.

11 Q. SHOULD THE COMMISSION APPROVE KCWA’S PROPOSED
12 HYDRANT RENTAL INCREASE?

13 A. As presented and as explained, I do not think that the Public Utility
14 Commission should approve KCWA’s proposed fire hydrant rental fee rate
15 increase.

16 KCWA has failed to address what I believe and understand are basic
17 threshold questions, i.e.:

18 ➤ is the proposed rate increase reasonable?

19 ➤ Is the proposed rate increase necessary?

20 KCWA has not provided the Commission with any documentation or
21 evidence which supports a finding of either reasonableness or necessity. Two
22 considerations which the Legislature required be addressed.

1 Furthermore, it is my opinion, that the proposed 80% increase is
2 excessive, unreasonable and unnecessary on its face. Such a large increase
3 places an undue strain on taxpayers, is considered “unreasonable” and conflicts
4 with the change in the statute.

5 Q. IS KCWA PROPOSING ANOTHER RATE ALTERNATIVE THAT IT
6 WANTS THE COMMISSION TO CONSIDER?

7 A. KCWA has made two alternative proposals in its study that allocate
8 Infrastructure Replacement Costs to the Fire Service Revenue Requirement.

9 The first proposal increases the quarterly hydrant fee from \$139.33 to
10 \$251.22. This would impose a large financial burden on the fire districts or
11 municipalities having fire departments.

12 KCWA’s second proposal changes the target taxpayer who will pay the
13 increased fire hydrant rental fee from the Fire District or municipality to the
14 individual customer as a customer service charge. The existing system of
15 billing public fire districts for the total cost of hydrant fees would be
16 eliminated.

17 This proposal has an obvious attraction to a utility. One is reminded of
18 the quotation (attributed to Sen. Russell B. Long, then Chair of the Senate
19 Finance Committee,) to the effect “Don’t tax you. Don’t tax me. Tax that
20 fellow behind the tree.” The “fellow behind the tree” in this case is the
21 individual customer.

1 When divided amongst the thousands of KCWA's individual customers,
2 the increase (expressed as a percentage) does not change. The revenue yield to
3 KCWA is unchanged. KCWA does not lose a cent.

4 The financial pain to the Fire Districts is transferred and they no longer
5 have any incentive to challenge this or future rate increases.

6 The tax increase to KCWA's individual customer will remain unchanged
7 (when expressed as a percentage) but will constitute only a small dollar amount
8 when divided among the large pool of individual customers.

9 Consequently, the individual customer will be unlikely to challenge or
10 question the rate increase if for no other reason than it would be too expensive
11 for him to do so.

12 In short, KCWA's second proposal contemplates dividing the tax among
13 a large population which is less able to complain about it.

14 , But regardless how you slice up the tax or to whom you allocate the
15 burden; the proposed tax will still incorporate the proposed 80% + increase.

16 All that the second proposal really accomplishes is to substitute one class
17 of taxpayers (which is better able to point out the deficiencies in KCWA's
18 proposal) with another class (which is less able to do so).

19 My opinion is that this does not rehabilitate KCWA's faulty rate design
20 (which is still unreasonable and unnecessary) and is inconsistent with good rate
21 design as I understand it to be from the AWWA M1 Manual.

1 Q. WHY IS KCWA PROPOSING THAT FIRE SERVICE COSTS BE BILLED
2 DIRECTLY TO CUSTOMERS AND THAT HYDRANT COSTS INCREASE
3 SO MUCH?

4 A. As I understand KCWA's argument, it provides service to a number of
5 fire districts as well as cities and towns. It has experienced difficulties in
6 collecting payment from two of the public fire districts it serves (Coventry Fire
7 District and Central Coventry Fire District). As a result, KCWA is asking the
8 Commission to consider eliminating charging fire hydrant rental charges
9 directly to the districts and that the Commission allows KCWA to institute a
10 charge to individual retail customers based on meter size.

11 I have reviewed the public records of KCWA including its official
12 Minutes. I note that in its Minutes for its February 25, 2016 meeting (copy
13 attached as Ex. K-1) Director Brown quite frankly indicated that the sole
14 purpose behind changing who paid the rental fee was to address "...current
15 problems [which KCWA has] with the fire districts not paying their charges."

16 However, that problem had been addressed and cured. I cannot see that
17 Mr. Brown's reason for the two proposals exists anymore.

18 As I testify, both fire districts are in compliance with their repayment
19 agreements as to old balances due to KCWA and are current with all new
20 charges as they accrue.

1 CFD had previously questioned KCWA's authority to charge CFD
2 hydrant fees in the first place and withheld payment until KCWA had
3 established that authority to KCWA's satisfaction.

4 KCWA can only charge hydrant rental fees for those hydrants which it
5 has installed at the written request of an end-user (in this case, CFD). CFD
6 asked for those records, in this proceeding via data requests, to prove of its
7 duty to pay KCWA's hydrant rental fees.

8 KCWA failed to respond and CFD asked the Commission to compel it to
9 respond.

10 The Commission's decision required KCWA to either provide the data
11 or, if it did not have it, to say so.

12 KCWA has done neither. CFD believes that KCWA does not have any
13 documentation on this point and, as of my testimony, has not asked for an
14 enlargement of time to respond. In fairness to KCWA, it advised the
15 Commission on November 18th (in response to our inquiry as to where the
16 more responsive answer was) that the person who would have made the
17 response is out on a medical leave since the Commission's October 22nd
18 decision.

19 However, at this point, KCWA has failed to provide more responsive
20 answers, failed to advise CFD that its employee was out sick, failed to request
21 an enlargement of time to respond and, so, I take it that KCWA from the state

1 of the record that KCWA does not have any evidence to support its authority to
2 charge CFD for hydrant rental fees.

3 I also suggest that any ability of KCWA to charge its water users in
4 CFD's district would derive of its ability to charge CFD in the first place and,
5 being unable to charge CFD, cannot then charge CFD's taxpayers.

6 The two districts have recently righted themselves financially and
7 structurally after years of mismanagement. In addition, the Municipal Finance
8 Department of the State of Rhode Island has implemented several requirements
9 whose purpose is to ensure the transparency of the financial condition of all
10 Rhode Island fire districts. These requirements include submission of an
11 annual budget, annual Financial Statement audit and also quarterly reports of
12 budget to actual revenue and expenses.

13 So, whatever financial drain fire districts may have put on KCWA, are
14 now gone. KCWA should not now use the financial drain to justify so
15 dramatic a change as it does by its second proposal, the taxpayer-shifting
16 proposal.

17 Q. WILL CHANGING THE TARGET TAXPAYER FROM MUNICIPAL
18 CUSTOMERS TO RETAIL CUSTOMERS AFFECT CURRENT CHARGES
19 TO RETAIL CUSTOMERS?

20 A. I don't think so.

1 CFD passes its costs through to its taxpayers. I diverge for a moment to
2 note that I think the difference between “taxpayer’ versus “water users” (as
3 defined in §46-15.6-6) is an important one.

4 The significance is that under §46-15.6-6, KCWA can only pass on its
5 IFR costs to “water users”. KCWA’s customers are all, by definition, “water-
6 users” so if it were to charge its customers directly, KCWA would be in
7 compliance with §46-15.6-6.

8 However, if KCWA passes its IFR costs onto CFD, CFD will then pass
9 that charge onto its taxpayers. Those taxpayers may, or may not, be “water
10 users”.

11 CFD taxes all property owners within its district without regard to
12 whether or not the taxpayer is a water user.

13 Thus, taxpayers who use well water, taxpayers who own vacant land and
14 taxpayers who aren’t KCWA customers would pay KCWA’s IFR costs.

15 Conversely, tax exempt water users would not pay KCWA’s IFR costs.
16 Kent County Hospital is listed in Jo-Ann Gershkoff’s testimony as KCWA’s
17 second largest customer. I believe that it is a tax-exempt institution and, thus,
18 would not pay IFR costs under KCWA proposal. The same would be true of
19 churches, schools (such as New England Tech) and other tax-exempt entities.

20 There would be winners and losers. I cannot believe that the Legislature
21 ever intended such a result.

1 Q. SHOULD KCWA'S PROPOSED CHANGE TO THE RECOVERY OF
2 PUBLIC FIRE PROTECTION CHARGES BE APPROVED BY THE
3 COMMISSION ?

4 A. It is my opinion that KCWA's proposed change to the recovery of public
5 fire protection charges should not be approved.

6 KCWA is collecting on the balances in arrears owed by the two fire
7 districts. There is no cause to change from the current billing system.

8 I cannot find any valid reason to transfer the billing to individual
9 taxpayers from the fire districts.

10 I have not found any evidence of necessity or reasonableness as the
11 statute requires.

12 I believe that a fee increase of 80% is excessive.

13 I find that although the law changed in 2009, that KCWA did not seize
14 upon that change in its 2010 rate increase petition (as one might have
15 expected). That suggests to me that relying upon the statutory change now is
16 pretextual.

17
18
19 **VI. ALTERNATIVE PROPOSAL**

20
21 Q. DO YOU HAVE AN ALTERNATIVE PROPOSAL WITH RESPECT TO
22 THE DESIGN OF KCWA'S RATES

1 A. Yes. The law has been changed to allow for the inclusion of IFR costs to
2 be allocated to all water users including Coventry Fire District. Kent County
3 has a right to institute a policy with regard to that change. It seems obvious to
4 me that the drafters of the legislation never anticipated increases as extreme as
5 80% and for that reason, I suggest that this increase be phased in over a ten
6 year period. This would allow KCWA to obtain the funds needed over time
7 and allow its customers to provide for more gradual increases in costs and
8 budgeting in future years.

9
10
11 **VII. OBSERVATIONS**

12
13 Q. DO YOU HAVE ANY OBSERVATIONS WITH RESPECT TO THE
14 DESIGN OF KCWA'S RATES THAT HAVE NOT BEEN ADDRESSED BY
15 YOU PREVIOUSLY?

16 A. Yes. I note that another section of the General Laws that was amended
17 as recently as 2011 (in other words after the Legislature last addressed §46-
18 15.6-6). §39-3-11.1 (copy attached as Ex. K-2) may have some applicability to
19 this matter.

20 In that section the Legislature specifically directed that the PUC "...shall
21 not require the payment of rental fees for fire hydrants from any municipality
22 that has prohibited such fees by ordinance as provided in § 45-39-4 ..." As I

1 read that to include all municipal corporations, such as CFD, in light of
2 language used earlier in the statute, it appears to me that CFD can effectively
3 exempt itself from the imposition of a direct fire hydrant rental fee if it adopts
4 its functional equivalent of an ordinance to that effect. As I understand it,
5 KCWA is a publicly owned water authority and would fall under the strictures
6 of §39-3-11.1.

7 If my understanding is correct, I read that to mean that CFD is able to
8 exempt itself from the imposition of any fire hydrant rental fees.

9 I would assume that this is something which the Commission would take
10 into consideration in its deliberations and I do not recall seeing it mentioned
11 elsewhere in this proceeding.

12 _____
13 I am also struck by KCWA's need for the monies which the increased
14 fire hydrant rental fee would generate.

15 I think that I must comment on KCWA's Management's Discussion and
16 Analysis ("MD&A") as found in its Annual Financial Statements for the Years
17 Ending June 30, 2015 and June 30, 2016 (copies attached as Exs. K-3 and K-
18 4).

19 In each MD&A, KCWA describes its Financial Highlights.

20 In 2015, it wrote: "The Authority's financial condition is **strong** and the
21 Authority's performance for the current year exceeded the budget." [Emphasis
22 added]. It went on to note that user fees were under budget by \$415K (but

1 \$355K higher than the previous year), that water costs spent exceeded
2 budgeted amounts by \$1M and that it saved about \$160K on chemicals.

3 In describing its 2015 Net Position in (a “useful indicator of ... financial
4 position”), KCWA Management reported that assets plus deferred outflows of
5 resources exceeded liabilities plus deferred inflows of resources by \$141M
6 resulting in a total net position of almost \$7M or 5% over the previous year.
7 This “demonstrates that the financial position of ... [KCWA was] ...
8 improving.”

9 That year KCWA paid for \$5.6M of capital additions from revenue
10 without financing.

11 KCWA had similar results in FY2016.

12 KCWA’s financial condition was again described as being “strong” and
13 its performance exceeded the budget.

14 User fees were over budget \$422K higher than the previous year
15 (although over budget by \$6K). Water costs exceeded budgeted amounts by
16 \$600K and that it saved about \$138K on pumping water.

17 In describing its 2016 Net Position, KCWA Management reported that
18 assets plus deferred outflows of resources exceeded liabilities plus deferred
19 inflows of resources by \$148M resulting in a total net position of almost \$7M
20 or 5.23% over the previous year which “demonstrates that the financial
21 position of ...[KCWA was] ... improving.”

1 That year KCWA paid for \$9.8M of capital additions from revenue
2 without financing.

3 In short, if I am reading these reports correctly, KCWA's report clearly
4 shows that it is strong and has increasing net revenues. Even after taking some
5 increased operating costs into account, it was able to pay for capital additions
6 (IFR) at the same level as it proposes to do in the docket, out of revenue.

7 This causes me to question whether KCWA has made a showing that it
8 has any need for such significant fire hydrant rental fee increases, or, for that
9 matter, a need for any increase at all. This of course bears on the issue of
10 whether or not a showing has been made that the infrastructure replacement is
11 necessary and reasonable. My opinion is that it has not.

12
13 _____

14 There is one further issue that I would like to comment on and that is the
15 issue of allocation.

16 Allocation is no more that the assignment of costs to certain products or
17 profit centers so that those costs can be charged to or paid by the product, class
18 of customer or otherwise which is benefitting from the expense.

19 KCWA has provided voluminous financial data in support of its petition.
20 It is extremely complicated and intricate. It is no criticism to note that utilities
21 are complicated engines and that it is not always easy to understand their
operation.

1 In this matter, the issue of allocation is of paramount importance. The
2 statute now allows KCWA to charge to “Fire Service” (one of its products, if
3 you will) a percentage of the IFR costs.

4 The percentage amount of the allocation then directly determines that
5 cost of Fire Service which flows down, in turn, and becomes a part of the fire
6 hydrant rental fee.

7 In attempting to understand how KCWA allocated its IFR, I reviewed
8 KCWA’s filings in Docket # 3942. The applicable schedule was Schedule 3 in
9 both #3942 and #4611.

10 In #3942, KCWA allocated 100% of its IFR to “General Water” and 0%
11 to “Fire Service”. This is so, because the law at the time did not allow IFR to
12 be charged to Fire Service.

13 However, General Water was allocated 90.7% of all Expense Items.

14 To the best of my knowledge, the financial facts in 2008 were the same
15 as in 2016 and I expected to see 90.7% of all Expense Items to be allocated to
16 “General Water” or something close to that.

17 I did not.

18 In 2016 General Water was only charged 81.5%.

19 “Fire Service” on the other hand saw its allocation of “Expense Item”
20 increase from 8.2% in #3942, to 16.2% in #4611. It almost doubled.

21 I then reviewed the notes, references to other schedules and followed the
22 bread trail throughout the prefiled financial documents and testimony in an

1 attempt to educate myself as to KCWA's thinking behind changing the
2 allocation at all and to such a significant extent.

3 I was unable to find any clear explanation for the change. I eventually
4 ended up at KCWA's assignment of a "demand factor" (an element of
5 calculating usage and, hence, a basis for allocation). There the trail ended and,
6 after many hours, I could not grasp how the "demand factor" was arrived at.

7 In fact, to my reading it was a purely subjective number. They just
8 plugged in a number into their equation and an allocation came out of the other
9 end.

10 This is important because if any element of the calculation is
11 unsupported then the entire calculation collapses and is unworthy of trust.

12 In reviewing the prefiled testimony in its entirety, as to fire hydrant
13 rental fees only (as that was the focus of CFD's interest), I came to the
14 conclusion that one of KCWA's "product lines" (i.e. water service) was
15 producing less revenue over the years with the closing of the mills and their
16 replacement with suburban housing. In order to replace that revenue, KCWA
17 had to increase the cost of one of its other products (i.e. 'Fire Service') and
18 that's why the allocation is increased.

19 Basically KCWA needed the money and needed to find a pocket to take
20 it from.

1 That is my impression and, if I am on or even near the mark, then the
2 allocation of so significant a percentage of IFR costs to “Fire Service” is
3 inequitable on its face and surely is unnecessary and unreasonable.

4 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

5 A. Yes it does.

6

EXHIBIT K-1

KENT COUNTY WATER AUTHORITY

MINUTES OF THE REGULAR MEETING
OF THE BOARD

February 25, 2016

A meeting of the Board of Directors of the Kent County Water Authority was held on the 25th day of February 2016, at 3:30 p.m. at the offices of the Authority in West Warwick, RI, in the Joseph D. Richard Board Room.

Vice Chairman Masterson opened the meeting at 3:30 p.m. Board members Treasurer Joseph Gallucci, and Secretary Edward Inman were all present together, along with the General Manager/Chief Engineer Timothy J. Brown, Legal Counsel Patrick J. Sullivan, Esq., Director of Technical Services John Duchesneau and Treatment Manager/Water Project Engineer Dave Simmons. Vice Chairman Masterson led the group in the pledge of allegiance. Chairman Boyer was excused for medical reasons and Mr. Giorgio was absent.

APPROVAL OF THE MINUTES

The minutes of the regular board meeting and the executive session portion of the meeting of January 21, 2016 were presented for approval. Mr. Inman moved passage, seconded by Mr. Gallucci and the minutes were unanimously approved.

GUESTS

Thaylon Waltonen – S & T Hardware, Fence Damage

Mr. Brown introduced Mr. Waltonen to the board and Mr. Simmons presented several large pictures that illustrated damage to the fence that is located at the Mishnock facility on Nooseneck Hill Road. There were several areas with significant damage.

Mr. Waltonen invited the board to walk the perimeter of the fence to view the damage. He said he didn't know who caused the damage, when it was done or how the damage was caused. He commented that he thought it was recent since he recently walked the area and found no damage. He added that in one area of damage, that is where his employees park their personal cars. He went on to describe how the Pool Doctor retail store protects its fence with a series of poles sticking out of the ground. He also said he had a camera in that area but it isn't pointed in the area of the fence.

Mr. Masterson declined Mr. Waltonen's invitation to walk the property as did Mr. Inman, saying that the damage is clear on the photographs. Mr. Masterson added that he didn't think it was appropriate for the rate payers to pay for the damage that was caused by a third party.

Mr. Masterson took the opportunity to inform the board that he had some business for East Greenwich on February 1, 2016 that caused him to be in the KCWA building for about 1.5 hours. He said he was extremely impressed with his observations; everyone was working hard on their tasks. He said there was an energy in the building and commended Mr. Brown's management and his management team that he felt was responsible for creating such a lively and energetic work environment.

GENERAL MANAGER/CHIEF ENGINEER'S REPORT

GENERAL:

Revised Capital Improvement Program, Review

Mr. Brown reported that this is currently on his desk. He said this is key to the upcoming rate filing. He planned to present it to the board at a special meeting of the board. It must be both understood and approved by the board. He predicted a filing in the end of March, 2016.

Rate Case Review

Mr. Brown provided a quick overview of the rate case with some major items.

He said there would be two rate schedule proposals presented to the board, and eventually to the PUC, and they will be asked to select the one that they approve. One will be as the hydrants is currently charged, and the alternative will be with no charges for the hydrants, with those charges to be built into the regular rate. This, he explained, is as a result of the current problems they have with the fire districts not paying their charges.

Mr. Brown summarized both rate schedules and their respective percentage increases to the fixed cost and metered rate. He also added that, pursuant to RI law, there will be a component of a seasonal rates as well.

Mr. Inman raised questions regarding the propriety of the proposed changes in the way hydrants are billed. He asked Mr. Brown if there is any enabling authority surrounding the proposed changes. Mr. Brown advised that the PUC sets the rates and has the full authority to do so in their rules and regulations.

Mr. Gallucci and Mr. Brown had a discussion regarding how the City of Warwick pays for the hydrants owned by KCWA, as there are hydrants owned by the city as well.

Bid Printing Services Consumer Confidence Reports, Award Services

Mr. Brown informed the board that the printing of the consumer confidence report, required by law, was put out to bid and there was one bid received. He recommended the bid to be awarded to Graphic Image of Milford, CT in the amount of \$8,810.00.

Mr. Gallucci moved, and seconded by Mr. Inman, to award the bid to print the consumer

EXHIBIT K-2

§ 39-3-11.1. Changes in rates of publicly owned water authorities.

Rhode Island Statutes

Title 39. Public Utilities and Carriers

Chapter 39-3. Regulatory Powers of Administration

Current through Public Law 542 of the 2016 Legislative Session

§ 39-3-11.1. Changes in rates of publicly owned water authorities

- (a) Notwithstanding any other provisions of this chapter, the commission shall not have the power to suspend the taking effect of any change or changes in the rates, tolls, and charges filed and published in compliance with the requirements of §§ 39-3-10 and 39-3-11 by any public waterworks or water service owned or furnished by a city, town, or any other municipal corporation defined as a public utility in § 39-1-2, when the change or changes are proposed to be made solely for the purpose of making payments or compensation to any city or town for reimbursement of any loans or advances of money previously issued to any public waterworks or water service by any city or town under existing contracts or arrangements; provided, however, that the change or changes shall take effect subject to refund or credit pending further investigation, hearing, and order by the commission within eight (8) months after the effective date. The public waterworks or water service shall file with the commission the new rate schedule along with the documentary evidence of the indebtedness supporting the new rates. Further, the rate schedule shall be published in a newspaper of general circulation in the service area by the waterworks or water service at least ten (10) days prior to the effective date thereof.
- (b) The provisions of this section shall not be construed to bar recovery of loans or advances of money not otherwise reflected in existing rates, tolls, and charges issued to May 19, 1982.
- (c) In setting rates for publicly owned water authorities, the commission shall not require the payment of rental fees for fire hydrants from any municipality that has prohibited such fees by ordinance as provided in § 45-39-4 and has given notice to the commission of said ordinance.

Cite as R.I. Gen. Laws § 39-3-11.1

History. P.L. 1982, ch. 428, § 1; P.L. 2011, ch. 189, §1; P.L. 2011, ch. 278, §1.

EXHIBIT K-3

KENT COUNTY WATER AUTHORITY
Management's Discussion and Analysis (MD&A)

Year Ended June 30, 2015

FINANCIAL HIGHLIGHTS

The Authority's financial condition is strong and the Authority's performance for the current year exceeded the budget. The following are the key financial highlights:

- User fees were under budget by roughly \$415 thousand although they were \$355 thousand higher than the prior year.
- The Authority spent nearly \$1 million more on purchase of water than budgeted.
- The Authority spent roughly \$160 thousand less than budgeted on chemicals in the current year.

FINANCIAL ANALYSIS

NET POSITION

Net position over time may serve as a useful indicator of a government's financial position. In the case of the Authority, assets plus deferred outflows of resources exceeded liabilities plus deferred inflows of resources by \$141,278,996 as of June 30, 2015. This represents an increase in total net position of \$6,728,295 or 5.00% from FY 2014 and demonstrates that the financial position of the Authority is improving.

The operations of the Authority are accounted for on a Proprietary Fund Type (Enterprise Fund) basis. The Authority operates in a manner similar to private business enterprises where the costs of providing goods or services to the general public, support of a Capital Improvement Program, and funding of an Infrastructure Replacement Program are financed or recovered through user charges approved by the PUC.

Condensed financial information from the statements of net position and operations is presented below. The statement of net position provides information on the assets and liabilities of the Authority, with net position reported as the difference between assets and liabilities. The statement of operations of the Authority reflects all revenues earned and all expenses incurred for each fiscal year:

Continued

EXHIBIT K-4

KENT COUNTY WATER AUTHORITY
Management's Discussion and Analysis (MD&A)
Year Ended June 30, 2016

FINANCIAL HIGHLIGHTS

The Authority's financial condition is strong and the Authority's performance for the current year exceeded the budget. The following are the key financial highlights:

- User fees were \$6 thousand over budget and \$422 thousand higher than the prior year.
- The Authority spent nearly \$600 thousand more on purchase of water than budgeted.
- The Authority spent roughly \$138 thousand less than budgeted on pumping power in the current year.

FINANCIAL ANALYSIS

NET POSITION

Net position over time may serve as a useful indicator of a government's financial position. In the case of the Authority, assets plus deferred outflows of resources exceeded liabilities plus deferred inflows of resources by \$148,665,517 as of June 30, 2016. This represents an increase in total net position of \$7,386,521 or 5.23% from FY 2015 and demonstrates that the financial position of the Authority is improving.

The operations of the Authority are accounted for on a Proprietary Fund Type (Enterprise Fund) basis. The Authority operates in a manner similar to private business enterprises where the costs of providing goods or services to the general public, support of a Capital Improvement Program, and funding of an Infrastructure Replacement Program are financed or recovered through user charges approved by the PUC.

Condensed financial information from the statements of net position and operations is presented below. The statement of net position provides information on the assets and liabilities of the Authority, with net position reported as the difference between assets and liabilities. The statement of operations of the Authority reflects all revenues earned and all expenses incurred for each fiscal year: