

KENT COUNTY WATER AUTHORITY
Docket No. 4611
Response of The Division of Public Utilities and Carriers'
To Kent County Water Authority's First Set of Data Requests

KCWA-DIV 1- 1. Regarding page 11, lines 5-7 of Mr. Morgan's prefilled direct testimony: Does Mr. Morgan disagree with the response to Division Data Request 3-11 that shows that the various studies are required more than once and need to be updated periodically? Please list all water rate dockets before the RI Public Utilities Commission in the past five years where the Division has recommended against the funding of studies that are required under state law.

Response:

No, Mr. Morgan acknowledges that these studies may need to be updated periodically. Mr. Morgan's testimony on this issue is explained not just on page 11, lines 5 through 7, but beginning on page 10, line 20 through page 11, line 20. The referenced section of his testimony explains that the adjustment removing these costs was made because the Authority has not fully substantiated its claim for recovery of these costs. Mr. Morgan's adjustment was based upon the Authority's response to the Division's Data Request 3-11 and Mr. Woodcock's Schedule 1-D, page 1.

The Authority indicated that the Water Supply System Management Plan and the Infrastructure Renewal & Replacement Plan are required by state law to be prepared every 5 years. The amount for these studies aggregated with the CIP program. (The Authority referenced Mr. Woodcock's Schedule 1D, page 1 of 5 for the basis of the amounts included in the cost of service). Therefore, there is no way to separate the Water Supply System Management Plan and the Infrastructure Renewal & Replacement Plan for inclusion in the cost of service. The Water Supply System Management Plan and the Infrastructure Renewal & Replacement Plan costs would have been included in the cost of service if the requested amounts were provided in a level of detail to determine the amounts associated with the Water Supply System Management Plan and the Infrastructure Renewal & Replacement Plan.

The Authority indicated that the CIP is updated on a 5-year interval, but not required by law. Hence, the frequency of the update appears to be at the discretion of the Authority. Nevertheless, the amount associated with the CIP is aggregated with the Water Supply System Management Plan and the Infrastructure Renewal & Replacement Plan, so there is no means of determining the reasonableness of the amount included in the cost of service.

The Authority indicated that the Conservation Study is required by the Water Efficiency Act. However, the Authority provided no time period required by the Act for the frequency of such study nor when such study was last prepared. The Authority also does not provide when the next study will be prepared. In the response to the Division's Data Request 3-11, the Authority states that "planning documents and devices by KCWA". The phrase quoted implies that the Authority has some discretion regarding timing of and preparation of the study. Hence, Mr. Morgan is unable to determine if cost in the proceeding is reasonable or whether the 5-year period over which the costs are spread is reasonable.

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Response to KCWA-DIV 1-1 Continued:

The Authority indicated that the Vulnerability Study will be updated on its own accord. However, the Authority does not provide any data which allows one to determine the reasonableness of its choice of a 5-year recovery period. No dates are provided for when the study was last prepared, or when the new study will be prepared.

Mr. Morgan has not performed a study that lists all water rate dockets before the RI Public Utilities Commission in the past five years where the Division has recommended against the funding of studies that are required under state law. The justification for the adjustment proposed by Mr. Morgan is explained above. In short, the Authority has not adequately supported the amounts it is seeking to recover. Simply because a study is required by law does not exempt the Authority from having to properly support its claim for those costs.

Response prepared by: Lafayette Morgan

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KCWA-DIV 1- 2. Regarding page 11, lines 101 of Mr. Morgan's prefilled direct testimony: Please list each docket where the RI PUC issued an order "authorizing (a) deferred accounting" of the cost of various studies, particularly for Water Supply Management Plan, Infrastructure Renewal & Replacement, Conservation, Vulnerability, and Capital Improvement. If Mr. Morgan cannot find such an order, please explain why it would be appropriate in this particular docket.

Response:

Given there is no line 101 on page 11 of Mr. Morgan's testimony and based upon the issue in question, it is assumed that the reference is to page 11, lines 10 and 11 of Mr. Morgan testimony. Mr. Morgan has not conduct such a study of Commission Orders. To put the reference in the proper context, the full explanation from Mr. Morgan's testimony on page 11, lines 5 through 11 is:

First, with the exception of the CIP study, all of the other studies appear to have been conducted before the test year, according to the response to Division 3-11. Therefore, it would be improper to include them in the cost of service because they are prior period costs. For such costs to be eligible for recovery, there needs to be a Commission Order authorizing deferred accounting for future recovery. As far as I am aware, there are no Commission Orders authorizing deferred accounting for these costs.

As stated above, Mr. Morgan was discussing, in general terms, all studies are presented in the Authority's adjustment, not just the Water Supply Management Plan, Infrastructure Renewal & Replacement, Conservation, Vulnerability, and Capital Improvement. As a matter of normal ratemaking practice, prior period costs are not allowed to be recovered in current rates unless there is prior Commission authorization, which should be in an Order authorizing deferred accounting. Where there are laws requiring studies or certain costs to be incurred on a recurring basis, a rate making adjustment can be made to recognize those costs. However, because a study is required by law does not exempt the Authority from having to properly support its claim for those costs. Please refer to the response to the Division response to KCWA-DIV 1-1 for additional explanation of Mr. Morgan's adjustment.

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KCWA-DIV 1- 3. Regarding page 12, line 16 of Mr. Morgan's prefilled direct testimony: Does Mr. Morgan consider the water & sewer maintenance CPI-U index to be a more or less broad measure as compared to his proposal? Please explain.

Response:

The water and sewer maintenance CPI-U is less broad because it focuses on only maintenance costs for water and sewer. The inflation rate, as used by the Authority, is applied to more than maintenance expenses.

Response prepared by: Lafayette Morgan

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KCWA-DIV 1- 4. Regarding page 12, line 22 of Mr. Morgan's prefilled direct testimony: Does Mr. Morgan agree that the overall CPI-U and the water & sewerage maintenance sub-category are published by the Bureau of Labor Statistics and are not Mr. Woodcock's "own measure"?

Response:

The CPI-U subcategory for water & sewer maintenance is published by the Bureau of Labor Statistics. To be clear, what Mr. Morgan has referred to as Mr. Woodcock's "own measure" of inflation is the rate he actually uses in the cost of service, and explained on page 17 of his direct testimony.

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KCWA-DIV 1- 5. Regarding page 13, lines 1-3 of Mr. Morgan's prefilled direct testimony: Does Mr. Morgan agree that Mr. Woodcock did NOT propose "the use of the CPI" as his measure of inflation for the Kent County Water Authority?

Response:

Mr. Woodcock does not use one specific CPI index rate published by the Bureau of Labor Statistics as his inflation rate. However, the inflation rate Mr. Woodcock uses in the cost of service study is calculated by taking the CPI-U for all items and multiplying that CPI by a multiplier that was derived from the CPI-U for all items and the CPI from the subcategory for water & sewer maintenance. All the numbers used in his calculation are CPI numbers, there is no way one can claim that he did not use the CPI.

Response prepared by: Lafayette Morgan

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KCWA-DIV 1- 6. Regarding page 14, lines 1-5 of Mr. Morgan's prefilled direct testimony: Please list all inflation indices referenced in section 2.6(c)(4) of the Commission's Rules. Has the index proposed by Mr. Morgan been used or approved by the RI PUC as a measure of inflation in any docket involving a water utility to Mr. Morgan's knowledge? If so, please list the docket number(s).

Response:

The full text of Section 2.6(c)(4) is below:

"Inflationary adjustments. These adjustments are based upon projected cost increases, e.g. Consumer Price Index changes."

Mr. Morgan has not conducted study of the various inflation factors used by RI PUC water utilities. However, Mr. Morgan is unaware of a water utility that has used the FOMC inflation projection. It is important to recognize that past inflation rates alone are not a good predictor of future inflation. Hence, even if a water utility has used past CPI as their projection of future inflation, it does not make that choice the proper measure of inflation.

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KCWA-DIV 1- 7. Please provide a summary table showing the FOMC's projected core price index for personal consumption expenditures for a period two year's [sic] out vs. actual inflation rates.

Response:

The requested analysis has not been prepared by Mr. Morgan. The projected inflation rate used by Mr. Morgan is 2.0. The August 2016 CPI for all goods is 1.1.

Response prepared by: Lafayette Morgan

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KCWA-DIV 1- 8. Regarding page 13, lines 7-9 of Mr. Morgan's prefilled direct testimony: Is it Mr. Morgan's testimony that the Bureau of Labor Statistics' CPI-U for water & sewerage maintenance is only "maintenance related"? If so, please explain the basis for this belief. If not, please explain his testimony on page 13, lines 4-13 that suggests that the index is not applicable to items that are not "maintenance".

Response:

Mr. Morgan's position is based upon the descriptive title of the category.

Response prepared by: Lafayette Morgan

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KCWA-DIV 1- 9. Regarding page 14, lines 7-9 of Mr. Morgan's prefilled direct testimony: Please explain why Mr. Morgan chose the core price index as reported by the FOMC.

Response:

The core price index was used because it excludes food and energy.

Response prepared by: Lafayette Morgan

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KCWA-DIV 1- 10. Regarding page 14, line 20 of Mr. Morgan's prefilled direct testimony: Does Mr. Morgan consider the Bureau of Labor Statistics Consumer Price Index to be "reputable"?

Response:

Yes. However, it is important to recognize that past inflation rates alone are not a good predictor of future inflation. To derive the future inflation rate, Mr. Morgan has chosen another reputable source, the FOMC, rather than calculating a multiplier based upon past periods that goes back 7 years, as proposed by the Authority.

Response prepared by: Lafayette Morgan

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KCWA-DIV 1- 11. Regarding page 14, lines 8 of Mr. Morgan's prefilled direct testimony: What evidence can Mr. Morgan point to that would demonstrate that his proposed inflation index is a more accurate predictor of inflation two years out than the overall CPI-U or the water and sewerage maintenance sub-category.

Response:

The inflation projection used by Mr. Morgan is taken directly from the Federal Reserve Open Market Committee. This projected inflation rate was not manipulated in any manner by Mr. Morgan. The Federal Open Market Committee, or FOMC, is the Fed's chief body for monetary policy. The FOMC typically meets eight times a year, and if economic conditions require additional meetings, the FOMC can meet more often. At each meeting a senior official at the Federal Reserve Bank of New York discusses developments in the financial and foreign exchange markets. Staff from the Board of Governors then present their economic and financial forecasts. The Board's Governors and all 12 Reserve Bank presidents offer their views on the economic outlook. The forecasts produced are used in national and international decision making. Hence, the data are well developed and vetted by authorities in economics. On the other hand, the inflation rate produced by the Bureau of Labor Statistics (BLS) is just as solid and reputable. However, it is largely a reporting of historical activity. If the planning outlook is short-term, the BLS data are probably reasonable to use. However, the Authority's rates produced from this proceeding goes out to FY 19 (the fiscal year ending June 2020). Given that the rates being established in this proceeding are for a period exceeding one year, the inflation rate should not be based on past inflation rates as proposed by the Authority. Moreover, the Authority's inflation factor is not a single CPI factor, as calculated by BLS. Instead, it is a manipulation of the CPI indices. If one were to adopt the CPI as the inflation factor, the inflation rate would be 1.1, based upon August 2016 CPI as reported by BLS. The most recent 3-year average (based upon the 12 months ended August) is .93. Although these rates are less than the 2.0 that Mr. Morgan has recommended, they are much less than the Authority's proposed rate of 3.08.

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KCWA-DIV 1- 12. Regarding page 15, lines 18-24 of Mr. Morgan's prefilled direct testimony:
Please indicate where in Division data request 3-8 Mr. Morgan asked for "the final plant additions for FY 2016". Does Mr. Morgan have any reason to disbelieve the response provided that showed well in excess of \$11 million "to be closed to Plant FYE 2016"? If so, please explain.

Response:

Although the data request does not request final plant additions, in the response it states:

"I believe Mr. Woodcock is referring to the following projects that will be [emphasis added] the end of FY 2016".

The project list provided in the response is described as "Projects to be [emphasis added] Closed to Plant FYE 2016"

In these citations, the Authority describes the plant additions in the future tense, which indicates the actual amount were not finalized. Mr. Morgan's testimony indicates his belief that the amount was not the final amount. Mr. Morgan also indicated his willingness to include the final amount when provided. There was no expression of doubt regarding the amount in excess the \$11,000,000.

Response prepared by: Lafayette Morgan

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KCWA-DIV 1- 13. Regarding page 16, lines 6-20 of Mr. Morgan's prefilled direct testimony:

- a. Is Mr. Morgan registered as a Municipal Advisor by the MSRB or SEC under the Dodd-Frank Act?
- b. Please list all bond issues where Mr. Morgan has helped prepare, interpret, or implement provisions of a revenue bond trust indenture for a municipal water utility.
- c. Please provide Mr. Morgan's understanding of how the Kent County Water Authority must make monthly payments to accounts in order to make timely principal and interest payments on its revenue bonds, including the name and amounts required for each such payment.
- d. If the Authority needs to make a \$1,540,000 principal payment in July 2016 (first month of FY 2017), how does the Authority make that payment under the Trust Indenture? Does Mr. Morgan disagree that the funds to make this payment must be accumulated and deposited into accounts in the PRIOR fiscal year under the Trust Indenture?

Response:

- a) Mr. Morgan is not registered as a Municipal Advisor by the MSRB or SEC under the Dodd-Frank Act.
- b) Mr. Morgan has not helped prepare, interpret, or implement provisions of a revenue bond trust indenture for a municipal water utility.
- c) In the response to Division 3-12, KCWA explains that it has to deposit the debt service requirements monthly to the Trustee so that the funds are available when the payment is due.
- d) Yes. See the response to Subpart (c).

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KCWA-DIV 1- 14. Regarding page 21, line 4 of Mr. Morgan's prefilled direct testimony: Please explain why Mr. Morgan believes the first (3.85%) step increase presented on Schedule 5 is "burdensome". Burdensome on who? Does Mr. Morgan also believe the second step increase of 6.28% is "burdensome"?

Response:

The statement on page 21, line 4 of Mr. Morgan's testimony reads:

"Consequently, I think it would be burdensome to ramp-up the IFR expenditures during this period."

Mr. Morgan does not state that the entire step increases of 3.85 and 6.28 percent would be burdensome. Mr. Morgan's testimony indicates that inclusion of an increase of \$533,333 in IFR funding is contrary to Mr. Woodcock and Mr. Brown's testimonies. Mr. Morgan, therefore, indicated that to increase rates by an additional \$533,333 per year when a \$2.1 million rate increase has been justified would be burdensome to ratepayers.¹

Response prepared by: Lafayette Morgan

¹ Based on Mr. Morgan's analysis.

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KCWA-DIV 1- 15. Regarding page 21, lines 10-16 of Mr. Morgan's prefilled direct testimony:
Please explain how Mr. Morgan derived a \$600,000 salvage value for old meters. What does he base this on?

Response:

The savings is based on the response to DIV 3-4. In the response, the Authority states:

"Please note FY 2019 step increase has \$600,000 of meter program budgeted. We fully expect that will be offset by scrap value and hopefully bid program cost savings."

Response prepared by: Lafayette Morgan