

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

SUEZ WATER RHODE ISLAND, INC.) DOCKET NO. 4800

SUPPLEMENTAL TESTIMONY IN SUPPORT OF SETTLEMENT
OF
MATTHEW I. KAHAL

ON BEHALF OF THE
DIVISION OF PUBLIC UTILITIES AND CARRIERS

September 21, 2018

BEFORE THE
PUBLIC UTILITIES COMMISSION
OF RHODE ISLAND

SUEZ WATER RHODE ISLAND, INC.) DOCKET NO. 4800

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MATTHEW I. KAHAL

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is Matthew I. Kahal. I am employed as an independent consultant retained
3 in this matter by the Division of Public Utilities and Carriers (“Division”). My
4 business address is 1108 Pheasant Crossing, Charlottesville, Virginia 22901.

5 Q. HAVE YOU PREVIOUSLY TESTIFIED IN THIS PROCEEDING?

6 A. Yes. On June 8, 2018, I submitted Direct Testimony on behalf of the Division
7 concerning the fair rate of return for SUEZ Rhode Island, Inc. (“SUEZ” or “the
8 Company”). I recommended at that time an overall rate of return of 6.98 percent
9 including a return on equity or (“ROE”) of 9.0 percent.

10 Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY AT
11 THIS TIME?

12 A. Subsequent to the filing of rebuttal testimony by the Company, the parties initiated
13 settlement discussions to resolve all issues in this case. Those discussions have taken
14 place over the past two months culminating in the comprehensive Settlement
15 Agreement filed with the Commission on September 17, 2018. The settlement is
16 supported by both the Company and the Division, but my understanding is that no
17 party opposes. Hence, this settlement is uncontested.

1 With respect to rate of return issues, the settlement accepts the Division's
2 position on capital structure and cost of debt (including the inclusion of short-term
3 debt) and an ROE of 9.4 percent. This results in an overall cost of capital of 7.20
4 percent as shown on Exhibit 4, page 3 of 3 of the filed settlement. Please note that
5 based on Company witness Walker's testimony, the Company requested 10.5 percent.
6 Thus the settlement ROE is somewhat above the Division's filed position but well
7 below the Company's request.

8 The purpose of my Supplemental Testimony at this time is to discuss why I
9 believe that the settlement rate of return – and particularly the 9.4 percent – is a fair
10 and reasonable award in this case in the context of a comprehensive settlement of the
11 entire rate case.

12 Q. IS THE SETTLEMENT CAPITAL STRUCTURE CONSISTENT WITH
13 COMMISSION PRECEDENT FOR THIS COMPANY?

14 A. A. Yes, it is fully consistent. It is based on the 2017 year-end actual consolidated
15 capital structure of the Company's parent (inclusive of short-term debt for the year),
16 SUEZ Water Resources, Inc. which is the same approach adopted by the Commission
17 in past cases. My Direct Testimony discusses why it is necessary and appropriate to
18 use the parent capital structure, and I also show that the resulting ratemaking capital
19 structure is in line with that of other water utility companies.

20 Q. WERE YOU INVOLVED IN THE DEVELOPMENT OF THIS
21 SETTLEMENT?

22 A. Yes. I consulted with the Division Staff during settlement discussions on the rate of
23 return (and particularly the ROE) aspects of the settlement. During that process, I
24 advised the Division that I believed the negotiated ROE of 9.4 percent to be a

1 reasonable outcome for this case.

2 Q. WITH RESPECT TO RATE OF RETURN, DO YOU SUPPORT THIS
3 SETTLEMENT?

4 A. While I obviously cannot comment on all aspects of this settlement, I believe that the
5 7.20 percent overall return and 9.4 percent ROE included in the settlement are just,
6 reasonable and fair to both the Company and customers. This ROE and overall return
7 are far below the requested rate of return; it incorporates the Division's capital
8 structure/cost of debt position; and it is adequate to encourage and facilitate necessary
9 capital spending by the Company on water infrastructure and facilities, without
10 providing an excessive return. I therefore recommend Commission approval of the
11 rate of return aspects of this settlement.

12 Q. YOUR DIRECT TESTIMONY RECOMMENDS A 9.0 PERCENT ROE
13 BASED ON MARKET EVIDENCE. WHY THEN DO YOU SUPPORT
14 THE SOMEWHAT HIGHER FIGURE OF 9.4 PERCENT?

15 A. The 9.4 percent settlement ROE is somewhat higher than my June 2018 Direct
16 Testimony recommendation, but I believe it to be reasonable in the context of a
17 comprehensive settlement of this rate case. As noted above, it is far below the 10.5
18 percent request of the Company, and it is even below the midpoint of the Division
19 and the Company positions – which would be 9.75 percent. Thus the settlement to
20 some extent reflects the points of view on cost of capital of both the Company and the
21 Division, but it is far closer to the Division's position. Moreover, the 9.4 percent
22 settlement ROE is below the ROE of 9.65 percent that was approved in 2014 in the
23 Company's last rate case in Docket No. 4434. (See Commission Order No. 21593
24 approving settlement, March 28, 2014.) I would note that in the last case, the
25 Division's litigation position on ROE was 9.25 percent.

1 As I explain below, the 9.4 percent is reasonable, appropriate and fair to both
2 the Company and customers for the following reasons:

- 3 • While my DCF analysis supports a finding of 9.0 percent, this covers a
4 historical time period ending in April 2018 and extending back to
5 November 2017. There has been a modest upward movement in capital
6 costs during the past year through September 2018 which is not fully
7 reflected in my historical DCF study. This recent upward trend since late
8 last year justifies a consideration of a slightly higher ROE than the 9.0
9 percent based on the six months ending April 2018.
- 10 • This Commission has recognized the merits of resolving rate cases
11 through settlement and the need for compromise on issues, provided such
12 compromises are reasonable and fair to customers. I believe this is the
13 case with this proposed settlement rate of return.
- 14 • I have compared available information on state commission ROE awards
15 in water and other utility rate cases during 2017 and early 2018, and I
16 believe that the 9.4 percent award is consistent with that range. This
17 information provides support for the notion that the settlement ROE is
18 both adequate for the Company's financial integrity and fair to customers.

19 Q. HAS THERE BEEN AN UPWARD TREND IN CAPITAL COSTS SINCE
20 LATE 2017 AND EARLY 2018?

21 A. Yes. I show this on my Direct Testimony at page 6 of Schedule MIK-2 and page 2 of
22 Schedule MIK-5. These tables show an upward movement in interest rates since
23 November 2017 through April of 2018. My cost of equity finding partially accounts
24 for the trend during those six months, but that trend has continued past April of this
25 year through September 2018. There has also been a modest uptick in inflation
26 indicators in recent months, consistent with the modestly higher interest rate
27 environment, and the Federal Reserve Open Market Committee has made clear that
28 further increases in the short-term interest rates that it controls are likely later this
29 year and into 2019. That said, I strongly caution the Commission from relying on
30 anyone's forecast of interest rates in setting rate of return, because those forecasts are

1 at best speculative and have a poor track record of accuracy. Nonetheless, the readily
2 observed trends over the past year (through today) are clear, and as my Direct
3 Testimony states, should be considered. The settlement ROE of 9.4 percent locks in
4 for customers a relatively favorable ROE through the end of the next SUEZ rate case
5 during what may be a period of rising capital costs. This protection is further reason
6 to find that the settlement ROE is both fair and beneficial to customers.

7 Q. HOW DOES THE SETTLEMENT ROE OF 9.4 PERCENT COMPARE TO
8 NATIONWIDE ROE AWARDS?

9 A. My Direct Testimony cites to state commission ROE decisions for water utilities for
10 2017 and early (first quarter) 2018 as compiled by Regulatory Research Associates
11 (“RRA”). For 2017, the average award was 9.56 percent, with a range of 9.0 – 10.4
12 percent. For first quarter 2018, the ROE awards averaged 9.23 percent, with a range
13 of 8.9 to 9.6 percent. I also note that ROE awards for gas and electric utilities have
14 been similar, averaging in the mid 9s. This information is important because it
15 demonstrates that the 9.4 percent settlement in this case is financially adequate for the
16 Company. That is, water utilities have been able to operate successfully and access
17 capital on reasonable terms with state commission ROE awards in roughly the mid 9s.
18 Consistency with state commission awards over the past year or so also helps
19 demonstrate that the 9.4 percent settlement ROE in this case is reasonable and fair for
20 customers. Finally, I note that the 9.4 percent in this settlement is a material
21 reduction from the 9.65 percent awarded to the Company by this Commission in the
22 last case in approving the 2014 settlement.

23 Q. HAS THE COMMISSION RECOGNIZED THE MERITS OF
24 COMPROMISE IN REACHING SETTLEMENT RESOLUTION IN RATE
25 CASES?

1 A. Yes, I believe that it has. The Commission's order in the Company's last case in
2 2014, in approving a settlement, states at page 26, "The Commission applauds the
3 parties for the compromises they have made throughout this rate case "... I believe
4 that the 9.4 percent settlement ROE provides some recognition of both the Company
5 and Division positions on ROE, with the final outcome closer to the Division's
6 testimony recommendation. The Commission approved a similar ROE compromise
7 in the Company's last rate case.

8 For all of the reasons stated in my Supplemental Testimony, I believe that 9.4 percent
9 is a reasonable resolution of this case that fully accounts for both customer and utility
10 needs, notwithstanding my DCF result of 9.0 percent using data from earlier this year.
11 I recommend that the rate of return component of the settlement --7.20 percent overall
12 and 9.4 percent ROE -- be approved without modification.

13 Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY?

14 A. Yes, it does.

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AFFIDAVIT

Matthew I. Kahal, being first duly sworn, deposes and says that he is the same Matthew I. Kahal whose Supplemental Testimony in Support of Settlement accompanies this affidavit: that such testimony was prepared by him; that he is familiar with the contents thereof; that the facts set forth therein are true and correct to the best of his knowledge, information and belief; and that he does adopt the same as his sworn testimony in this proceeding.



Matthew I. Kahal

Subscribed and sworn before me on this 20 day of Sep, 2018.



Notary Public

My Commission Expires: 2/2019

DEBORAH M ADAMS
Notary Public
State of Maryland
Howard County