COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

REQUEST OF KENTUCKY-AMERICAN WATER COMPANY FOR APPROVAL TO DEFER CERTAIN EXPENSES AS REGULATORY ASSETS	))))	CASE NO. 2008-00440

O R D E R

On October 9, 2008, Kentucky-American Water Company ("Kentucky-American") requested Commission approval to establish a regulatory asset for expenses that totaled $184,700 and were related to the preparation of a water conservation and management plan and a non-revenue water program. For the following reasons, we deny the request.

In our Order of April 25, 2008 in Case No. 2007-00134,[1] the Commission directed Kentucky-American to "retain a qualified consultant(s) to assist in developing a water conservation, leak-mitigation and demand management plan consistent with the best practices of the water industry." We further directed that the plan include "a program or programs to cost-effectively reduce non-revenue water."

In response to this Order, Kentucky-American retained Strand Associates, Inc. to assist in the preparation of the water conservation and demand management program at a cost of $140,700 and retained Gannett Fleming, Inc. to prepare the non-revenue

[1] Case No. 2007-00134, *Kentucky-American Water Co.* at 89 (Ky. PSC Apr. 25, 2008). Kentucky-American's acknowledgement of this agreement is found at several locations in that case record. *See* Transcript of 11/26/2007 Hearing at 128-29; Rebuttal Testimony of Linda C. Bridwell at 9 (filed Nov. 13, 2007); Kentucky-American Water Company's Post-Hearing Brief at 13-14 (filed Mar. 20, 2008).

water program at a cost of $44,000. Kentucky-American now requests Commission approval to accrue these expenses as a regulatory asset for accounting purposes only and proposes that the issue of rate-making treatment be addressed in its next general rate case.[2]

A regulatory asset is created when a rate-regulated business is authorized by its regulatory authority to capitalize an expenditure that, under traditional accounting rules, would be recorded as a current expense. The reclassification of an expense to a capital item allows the regulated business the opportunity to request recovery in future rates of the amount capitalized. Our authority to establish regulatory assets arises under the Commission's authority to regulate utilities[3] and to establish a system of accounts.[4]

The Commission has previously identified four categories of expense that may be treated as regulatory assets.[5] These are

> (1) an extraordinary, nonrecurring expense which could not have reasonably been anticipated or included in the utility's planning; (2) an expense resulting from a statutory or administrative directive; (3) an expense in relation to an industry sponsored initiative; or (4) an extraordinary or nonrecurring expense that over time will result in a saving that fully offsets the cost.[6]

The expenses currently before us do not fall within any of these categories.

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[2] After Kentucky-American filed its request, it applied for a general rate adjustment. *See* Case No. 2008-00427, *Kentucky-American Water Co.* (Ky. PSC filed Oct. 31, 2009). Ultimately, Kentucky-American reached agreement with all intervening parties regarding an adjustment in general rates. The Commission approved this agreement on June 1, 2009. This agreement does not specifically address rate-making treatment for the proposed regulatory asset, nor did the Commission make any specific finding as to the treatment of the proposed regulatory asset. *See* Case No. 2008-00427, Order of June 1, 2009.

[3] KRS 278.040.

[4] KRS 278.220.

[5] Case No. 2008-00436, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Dec. 23, 2008).

[6] *Id.* at 4.

First, the expenses related to Kentucky-American's study and preparation of a water conservation, leak-mitigation, and demand management plan should have been reasonably anticipated. Conservation and demand management have been matters of concern for the water utility and this Commission since at least 1985.[7] Kentucky-American has prepared or commissioned several studies on various aspects of these issues during the last two decades.[8] The effectiveness and efficiency of its conservation and demand management programs and the costs of such programs have been issues in several rate-making proceedings.[9] Kentucky-American has acknowledged the need to implement and revise such programs on an ongoing basis.[10]

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[7] *See, e.g.*, Case No. 9283, *Kentucky-American Water Co.* (Ky. PSC Oct. 1, 1985) (directing Kentucky-American to file a demand reduction techniques study within its next general rate application); Case No. 9696, *Kentucky-American Water Co.* (Ky. PSC Apr. 28, 1987) (review of study on water conservation proposals).

[8] *See, e.g.*, Brown and Caldwell, *Demand Management Alternatives* (Sep. 1992); Kentucky-American Water Co., *Conservation Plan* (Jan. 27, 1994); Kentucky-American Water Co., *Demand Management Plan* (Jun. 14, 2001).

[9] *See, e.g.*, Case No. 1997-00034, *Kentucky-American Water Co.* (Ky. PSC Aug. 30, 1997) at 31, 41; Case No. 2000-00120, *Kentucky-American Water Co.* (Ky. PSC Nov. 27, 2000) at 29-32; Case No. 2000-00120, *Kentucky-American Water Co.* (Ky. PSC May 9, 2001) at 11; Case No. 2004-00103, *Kentucky-American Water Co.* (Ky. PSC Feb. 28, 2005) at 58-60.

[10] For example, Kentucky-American advised the Commission in June 2001 that:

> KAWC recognizes that a continuous conservation effort is an important component of its planning process. KAWC's planning process integrates traditional supply side planning and management with demand management concepts, including ongoing customer conservation education. It has developed a company policy that supports the belief that it is KAWC's responsibility to exercise leadership in the development of practices that improve water use efficiency.

Kentucky-American Water Co., *Demand Management Plan* (Jun. 14, 2001) at 5.

Similarly, In November 2007, a Kentucky-American official testified before the Commission that new demand management studies would be necessity if the proposed Kentucky River Station II was constructed. *See* Case No. 2007-00134, Rebuttal Testimony of Linda C. Bridwell at 10 ("Certainly KAW will need to conduct a new comprehensive plan that includes the new facilities, and then update that plan as the demands grow and capacity of the plant is utilized. Additionally, KAW needs to revise its current demand management plan once the new facilities are in place and be prepared to update it again as the plant capacity is utilized.").

Given its recent levels of non-revenue water, the need for additional attention to this area was readily apparent. Between 2005 and 2008, Kentucky-American's water loss ratios have ranged from 12.78 percent to 14.94 percent. The studies are neither extraordinary nor unusual but are actions that reasonable utility management would undertake in the ordinary course of business to reduce utility costs.

Second, the expenses at issue are not extraordinary or nonrecurring charges that result in savings over time. We recognize that, while the studies are likely to result in a savings over time, their cost is relatively small. When compared to the utility's requested rate base of $303 million or to its pro forma operation and maintenance expense of $32 million, the studies' cost of $184,700 is *de minimis*.

In this regard, Kentucky-American's present request for creation of a regulatory asset is similar to its request in Case No. 2000-00120[11] for the creation of a regulatory asset for certain reorganization costs totaling $197,362. Finding that the costs were "immaterial," we denied the request. The proposed regulatory asset in that case represented only 0.1386 percent of the proposed rate base. The proposed regulatory asset currently before the Commission represents a smaller amount and a much smaller portion of the water utility's rate base.

Finally, we find that the costs at issue do not result from a regulatory directive or industry-sponsored initiative. Although we directed Kentucky-American to develop a water conservation, leak-mitigation, and demand management plan in Case No. 2007-00134, Kentucky-American had already agreed to perform the studies at the Attorney

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[11] Case No. 2000-00120, *Kentucky-American Water Co.* (Ky. PSC Nov. 27, 2000) at 22-23.

General's suggestion.[12] Given Kentucky-American's repeated representations that it continually reviews its conservation initiatives and periodically evaluates them for potential future changes and that construction of the proposed Kentucky River Station II would require a review of its existing demand management program,[13] our Order of April 25, 2008 merely formalized a course of action that Kentucky-American was already undertaking.

The Commission, having reviewed the evidence of record and being otherwise sufficiently advised, finds that Kentucky-American's request to defer as a regulatory asset the costs associated with the water conservation program, the demand management program, and non-revenue water program should be denied.

IT IS THEREFORE ORDERED that Kentucky-American's request to defer the costs associated with the water conservation program, the demand management program, and non-revenue water program as a regulatory asset is denied.

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[12] Case No. 2007-00134, *Kentucky-American Water Co.* (Ky. PSC Apr. 25, 2008), Direct Testimony of Scott J. Rubin at 4; Rebuttal Testimony of Linda C. Bridwell at 10; Kentucky-American Water Company's Post-Hearing Brief at 12-13.

[13] *Supra,* note 10. *See also* Case No. 2007-00134, Rebuttal Testimony of Linda C. Bridwell at 10 ("Certainly KAW would welcome the opportunity for an independent review of the [leak detection] program and any cost effective recommendations for improvement as part of a conservation program evaluation.")

By the Commission

ENTERED

AUG 26 2009

KENTUCKY PUBLIC SERVICE COMMISSION

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