COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY-AMERICAN WATER COMPANY FOR AN ADJUSTMENT OF RATES SUPPORTED BY A FULLY FORECASTED TEST YEAR	))))	CASE NO. 2012-00520

COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION TO THE ATTORNEY GENERAL

Pursuant to 807 KAR 5:001, the Attorney General ("AG") shall file with the Commission no later than May 1, 2013, an original, one paper copy and one electronic copy of the following information, with a copy to all parties of record. Responses to requests for information shall be appropriately bound, tabbed and indexed. Each response shall include the name of the witness responsible for responding to the questions related to the information provided.

Each response shall be answered under oath or, for representatives of a public or private corporation or a partnership or association or a governmental agency, be accompanied by a signed certification of the preparer or the person supervising the preparation of the response on behalf of the entity that the response is true and accurate to the best of that person's knowledge, information, and belief formed after a reasonable inquiry.

The AG shall make timely amendment to any prior response if he obtains information which indicates that the response was incorrect when made or, though correct when made, is now incorrect in any material respect. For any request to which the AG fails or refuses to furnish all or part of the requested information, he shall provide a written explanation of the specific grounds for his failure to completely and precisely respond.

1. Assuming that Mr. Rackers' adjustments are accepted, state the total amount of allocated costs for billing and collection, meters and service lines that Mr. Kalcic believes should be recovered through service charges. Provide all work papers, show all calculations, and state all assumptions used to derive the total amount

2. Refer to Direct Testimony of Brian Kalcic at 10. Explain why, if service charges are limited to the recovery of customer-related costs, the effect on consumption charges should be considered.

3. Refer to Direct Testimony of Brian Kalcic at 11. Describe how Mr. Kalcic determined that all GMS service charges should be increased 10.7 percent. Provide all work papers, show all calculations, and state all assumptions used to derive Mr. Kalcic's recommended increase.

4. Refer to Direct Testimony of Brian Kalcic, Schedule BK-2 at 2. Provide a schedule of class revenue subsidies similar to this schedule using the rates proposed by the AG and Lexington-Fayette Urban County Government ("LFUCG").

5. State whether, in Mr. Kalcic's opinion, the AG's and LFUCG's proposed rates eliminate all subsidies. Explain.

6. Refer to the Direct Testimony of Dr. J. Randall Woolridge at 6. State whether the sentence beginning at line 16 should read: "This differential primarily reflects the additional *return* required . . . ."

7. Refer to the Direct Testimony of Dr. J. Randall Woolridge at 14 and Exhibit JRW-12 at 1.

a. Show Dr. Wooldridge's calculation for the authorized returns on equity ("ROE") for American Water Works Company and Aqua America, Inc.

b. State whether Dr. Woolridge agrees that the most recently authorized returns for the regulated subsidiaries of American Water Works and Aqua America, Inc. are correctly reflected in Kentucky-American Water Company's ("Kentucky-American") Response to Item 23 of Commission Staff's Second Request for Information.

c. State whether, in Dr. Woolridge's opinion, investors are aware of authorized and earned ROEs for regulated water utilities.

d. If investors are aware of authorized and earned ROEs for regulated water utilities, state whether, in Dr. Woolridge's opinion, a water utility would likely attract equity investors if its state regulatory commission approved an 8.5 percent ROE, given the ROE awards and earned returns shown in Exhibits JRW-4 and JRW-12 and in Kentucky-American's Response to Item 23 of Commission Staff's Second Request for Information.

8. State whether Dr. Woolridge has assessed whether Value Line's long-term projections of utility EPS growth share the same problem of upward bias that he attributes to Wall Street analysts. If yes, provide the results of such assessment.

9. State whether analysts' EPS long-term growth projections for utilities are likely to take into account that the utilities are subject to ROE regulation.

10. Refer to the Direct Testimony of Dr. J. Randall Woolridge at 40, lines 16–17 and Exhibit JRW-10 at 1. State whether the Discounted Cash Flow ("DCF") growth rate of 4.5 percent is for the Gas Proxy Group and not for the Water Proxy Group.

11. Refer to the Direct Testimony of Dr. J. Randall Woolridge at 48-49 and Exhibit JRW-11 at 6. State whether the second-to-lowest value of mean equity risk premium studies is from a study that Dr. Woolridge conducted and that the time period is the year 2013.

12. Refer to Direct Testimony of Dr. J. Randall Woolridge at Exhibit JRW-10. Explain why averaging median values, as Dr. Woolridge has done in calculating his dividend yield and growth rates in his DCF study, produces meaningful estimates of Kentucky-American's cost of equity.

13. Refer to Direct Testimony of Stephen Rackers at 3-7. List and provide a copy of each state utility regulatory commission decision or opinion in which the ratemaking treatment of a reserve created to meet the requirements of Financial Accounting Standards Board Interpretation No. 48 ("FIN 48") is discussed. This listing should include the name of the state commission, case number, case style, and date of decision or opinion.

14. State for each of the statements below whether Mr. Rackers agrees. If he does not agree, explain why not.

a. "Theoretically, net earnings are earned when customer service is provided, and become the property of the stockholders. This requires that a cash working capital requirement should be recognized for the lag in receipt of operating income."[1]

b. "While it is true that recording depreciation does not require the expenditure of cash at the time the expense is recorded and charged to the customer,

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[1] Case No. 92-452, *Notice of Adjustment of the Rates of Kentucky-American Water* Company (Ky. PSC Nov. 19, 1993) at 20.

cash was expensed at the time the property was acquired, the recorded depreciation is used to reduce the investment in that property even though approximately one-and-one half month's depreciation (equivalent to the revenue lag) has not yet been received from the customer."[2]

15. Explain why the Commission should reverse its long-standing position on including non-cash items and net income in Kentucky-American's lead-lag study.

16. At page 19 of his written direct testimony, Mr. Rackers states: "Based on discussions with KAWC [Kentucky-American] personnel, the Company has agreed to revise its calculation of net income for cash working capital to eliminate income taxes."

a. Identify each participant who was involved in these discussions and the party that he or she represented.

b. Provide all documents, studies, electronic mail messages, and correspondence between the AG and Kentucky-American related to the revised calculation of net income for cash working capital.

17. At page 19 of his direct testimony, Mr. Rackers states: "[T]he amount of working capital requested by KAWC would be immaterial if the Company appropriately eliminated depreciation, amortization, deferred income taxes and net income for the reasons I previously discussed." Calculate Kentucky-American's forecasted cash working capital requirement if the items noted by Mr. Rackers are eliminated. Provide all workpapers, show all calculations, and state all assumptions used in the calculation of cash working capital.

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[2] Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* § 5.08[2] (Matthew Bender Nov. 1991).

18. State whether Mr. Rackers believes that the use of the 1/8 formula approach to calculate Kentucky-American's cash working capital is a reasonable alternative to the use of a cash working capital study. Explain.

19. In its Response to Item 69(a) of Commission Staff's Second Information Request, Kentucky-American states: "Neither American Water nor Kentucky-American has performed any studies or analysis of the financial effects of the BT program on Kentucky-American." Explain why the Commission should allow recovery of the allocation of the financial and billing software costs to the Kentucky-American in the absence of a benefit analysis.

20. Refer to Kentucky-American's Response to Commission Staff's Third Information Request, Item 26. State whether the expenditure of $12 million on the Billing Transformation program is reasonable for a company of Kentucky-American's size. Explain.

21. Refer to Kentucky-American's Response to the Commission Staff's Third Information Request, Item 27. Kentucky-American states that the Service Company Call Center costs are being directly charged to Kentucky-American based on the formula of call frequency and call duration.

a. State whether, given that the Service Company uses a formula to calculate the amount of Call Center costs billed to Kentucky-American, the AG considers the costs to be directly charged. Explain

b. State whether, if the Call Center costs are considered allocated costs, the change in allocation factors from the proportionate number of customers to the current formula requires the Service Company contract to be amended. Explain

22. Refer to Kentucky-American's Response to Commission Staff's Third Information Request, Item 24(c). For each statement below, state whether the AG agrees with the statement. Explain:

a. Kentucky-American is an active participant in the Business Transformation program.

b. Kentucky-American's and the ratepayer's interests and concerns have been adequately represented.

23. State whether the revenues that Kentucky-American no longer receives as a result of its decision to terminate the billing services for LFUCG should be should be recovered through the rates assessed for water service provided to Kentucky-American's customers. Explain.

24. Refer to Kentucky-American's Response to Commission Staff's Third Information Request, Item 28.

a. Describe the effect of the lack of board-approved budgets for Kentucky-American and American Water Service Company ("Service Company") on the reliability and accuracy of the forecast financial information.

b. The Commission has determined that Kentucky-American's budgeting for revenues and expenses is reasonably accurate based upon an analysis that compares the actual amounts to the budgets for a 5-year historical period. State whether, since the forecast is based upon a budget that has been adjusted, the forecast be considered accurate without the historical comparisons.

c. State whether, in the absence of board-approved budgets, Kentucky-American's proposed rate adjustment should be based upon a historical test-period. Explain.

25. Refer to Kentucky-American's Response to Commission Staff's Third Information Request, Item 32. State whether that AG agrees with Kentucky-American that the preferred stock dividend should be included in the interest-synchronization calculation.

26. State whether the AG agrees that the use of slippage adjustments is appropriate in general adjustment rate proceedings in which a fully forecasted test period is used to account for the effect of capital construction budget variances for the 10 years prior to the forecasted period.

27. Refer to Kentucky-American's Response to Commission Staff's Second Information Request, item 41. State whether the AG agrees with the slippage adjustments set forth in that response.

28. Explain why the AG witnesses have not proposed or recommended slippage adjustments.

29. In his written brief in Case No. 2012-00096,[3] the AG stated that the record of that proceeding contained "evidence of indifference, poor management, and the disregard of the rights of consumers persisting over a long period of time." He further stated that Kentucky-American's "next application for a rate adjustment is the proper forum for addressing issues pertaining to prudence."[4] Identify the issues pertaining to prudence to which the AG was referring and describe the effect of each of these issues on Kentucky-American's proposed revenue requirement.

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[3] Case No. 2012-00096, *Application of Kentucky-American Water Company for a Certificate of Public Convenience and Necessity Authorizing Construction of the Northern Division Connection* (Ky. PSC May 31, 2012).

[4] Brief of the Attorney General at 2-3.

30. In its brief in Case No. 2012-00096, LFUCG stated that Central Division customers should not be required to pay for the costs related to the Northern Division Connection Project.

a. State whether the AG agrees with this position. Explain.

b. If the AG agrees that Central Division customers should not be required to pay for the costs related to the Northern Division Connection Project, describe how Kentucky-American should recover the costs of the Northern Division Connection Project.

c. Assume that the Commission determined that the costs related to the Northern Division Connection Project should be recovered through a surcharge on Northern Division customers. Describe how such a surcharge should be designed.

31. State whether the AG supports the continued use of uniform rates for Kentucky-American customers, regardless of the division that serves the customer. Explain.

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cc: Parties of Record

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