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 THIRD REQUEST FOR INFORMATION TO KENTUCKY-AMERICAN WATER COMPANY

Pursuant to 807 KAR 5:001, Kentucky-American Water Company ("Kentucky-American") shall file with the Commission no later than March 20, 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.

Kentucky-American shall make timely amendment to any prior response if it 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 Kentucky American fails or refuses to furnish all or part of the requested information, it shall provide a written explanation of the specific grounds for its failure to completely and precisely respond.

1. Refer to Kentucky-American's Response to Commission Staff's Second Request for Information, Item 22. State whether, along with analysts' measures of earnings growth, a multi-stage DCF model rather than a constant growth DCF model should be used to reflect the impact of expected inflation-adjusted growth of the economy beyond five years. Explain.

2. Refer to Kentucky-American's Response to Commission Staff's Second Request for Information, Item 23 at 2.

a. State whether Dr. Vander Weide testified in any of the proceedings that resulted in the Return on Equity ("ROE") awards indicated in the second column. If yes, list each proceeding in which he testified, provide his testimony in that proceeding and a copy of the decision in that proceeding, with the portion of the decision addressing his testimony highlighted.

b. Columns two and three of the table on page 2 indicate that 11 of the 16 ROE awards granted by a state regulatory agency during 2012 and 2013 were below 10 percent. Of the water utilities owned by American Water Works Company ("American Water"), six out of eight ROE awards granted in 2012 and 2013 were below 10 percent. All other things being equal, describe the effect of this information on investors' expectations of Kentucky-American's ROE in 2013.

3. In Case No. 2012-00393,[1] Kentucky-American projected its issuance of $8 million in long-term debt in November 2012. In the present case, Kentucky-American

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[1] Case No. 2012-00393, *Application of Kentucky-American Water Company for Issuance of Indebtedness and Continued Participation with American Water Capital Corp.* (Ky. PSC filed Aug. 31, 2012).

has included the November 2012 long-term debt issuance in its forecasted capital structure.[2]

a. Confirm that Kentucky-American issued $8 million of long-term debt in November 2012 as originally projected.

b. (1) If Kentucky-American issued $8 million of long-term debt in November 2012, provide the terms and conditions of the $8 million long-term debt issuance. Include in the response the issuance date, actual interest rate, debt issuance cost, and principal amount.

(2) If Kentucky-American did not issue $8 million of long-term debt in November 2012, provide Kentucky-American's current projections for the issuance date, principal amount, interest rate, and the debt issuance cost and the reasons for the delay in the issuance of the projected debt.

4. In Case No. 2012-00393, Kentucky-American projected that the issuance of $3 million of long-term debt in March 2013 and in March 2014. In this current proceeding, Kentucky-American projects these issuances will be in May 2013 and May 2014. State the reasons for the changes in the dates of issuance.

5. At page 8 of his direct testimony, Scott Rungren states that he added 2 percent to the September 7, 2012 Bloomberg's forward yield curve for 30-year Treasuries "to capture the estimated spread at which BBB+ rated utilities have issued above the 30 year treasury rate." List each state utility regulatory commission that has accepted Mr. Rungren's methodology to project the long-term interest rate and provide a representative decision from that commission.

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[2] Kentucky-American's Response to Commission Staff's First Request for Information, Item 3(a), W/P 7-4 at 78.

6. In its Response to Item 46 of Commission Staff's Second Request for Information, Kentucky-American provides a comparison of budgeted to actual debt issuance for the four-year period from 2009 through 2012. During this four-year period, Kentucky-American's actual weighted cost of debt is 86.57 percent[3] of the budgeted weighted cost. Explain why, in light of this information, Kentucky-American's projection for long-term interest rates is "indicative of the rate the Company will attain on issuances in 2013 and 2014."[4]

7. Calculate Kentucky-American's projected long-term interest rate using the Bloomberg's forward yield curve for 30-year Treasuries for February 28, 2013.

8. At page 20 of her direct testimony, Linda Bridwell states: "Each month, depreciation is recognized for 1/12th of each account's annual depreciation rate, multiplied by each account's prior month UPIS balance." In its prior forecasted rate cases, Kentucky-American calculated depreciation expense by multiplying the 13-month average utility plant is service by its depreciation rate.[5]

a. State whether Kentucky-American's calculation of depreciation expense in this current case conforms to the methodology that it has used in prior forecasted rate cases. If not, explain the reason for the change in methodology.

b. Calculate depreciation expenses for the forecasted test-period using the 13-month average utility plant in service balances. Compare the results by

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[3] Actual: \$6,706,875 (Interest) ÷ \$117,390,000 (Principal) = 5.713%. Budgeted: \$7,852,373 (Interest) ÷ \$119,002,000 (Principal) = 6.599%. 5.713% (Actual Weighted Cost-of-Debt) ÷ 6.599% (Budgeted Weighted Cost-of-Debt) = 86.57%.

[4] Kentucky-American's Response to the Commission Staff's Second Information Request, Item 45(a).

[5] *See, e.g.*, Case No. 97-034, *Application of Kentucky-American Water Company to Increase its Rates* (Ky. PSC Sept. 30, 1997) at 43.

account to the depreciation expenses that Kentucky-American has requested in this proceeding.

9. At page 21 of her direct testimony, Linda Bridwell states that depreciation expense and the Cost of Removal ("COR") have been separated. State whether Kentucky-American's methodology for these two expenses in the current proceeding conforms to the methodology that Kentucky-American proposed and the Commission accepted in Case No. 2010-00036.[6]

10. At page 12 of his direct testimony, Lance Williams describes projects I12-300003 and IP-1235-5, the Northern Division Connection. On February 28, 2013, the Commission granted Kentucky-American a Certificate of Convenience and Necessity to construct the Northern Division Connection.[7]

a. Describe the effect of the date of the Commission's action, if any, on Kentucky-American's projected construction schedule for the Northern Division Connection.

b. Provide a schedule listing each item currently included in rate base, capital structure, and income statement that involves the Northern Division Connection. Show the effect of the construction of the Northern Division Connection on Kentucky-American's requested revenue requirement increase.

c. If Kentucky-American's projected construction schedule for the Northern Division Connection is affected by the date of the Commission's action, provide a schedule similar to the schedule provided in Item 10(b) that shows the effect

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[6] Case No. 2010-00036, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Dec. 14, 2010).

[7] 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 Feb. 28, 2013).

on Kentucky-American's revenue requirement. Provide all workpapers, state all assumptions, and show all calculations used to derive this Response.

11. Provide separate rate base, capital structure, income statement, and revenue requirement for the Central and Northern Divisions. Provide all workpapers, state all assumptions, and show all calculations used to derive this Response.

12. Refer to Kentucky-American's Response to Lexington-Fayette Urban County Government's ("LFUCG") First Request for Information, Item 17.

a. State the number of instances during the period from January 1, 1990 to December 31, 2012 that LFUCG has requested that a public fire hydrant be inspected outside of the normal annual inspections that Kentucky-American performs.

b. State the number of instances during the period from January 1, 1990 to December 31, 2012 that Lexington Fire Department has requested that a public fire hydrant be inspected outside of the normal annual inspections that Kentucky-American performs.

c. State the number of reported instances during the period from January 1, 1990 to December 31, 2012 that a public fire hydrant has been inspected during a normal annual inspection and then failed to operate within normal parameters.

13. Refer to Kentucky-American's Response to LFUCG's First Request for Information, Item 21

a. Describe how Kentucky-American would become aware that a private fire hydrant is "no longer operable."

b. Describe how Kentucky-American would become aware that an owner of a private fire hydrant has taken the hydrant out of service.

c. Describe how Kentucky-American would become aware a private fire hydrant has failed to operate.

14. Assume the Commission determines that a unified rate approach should be abandoned and that rates for each division within Kentucky-American's operations must be based on that division's cost of service.

a. Provide a revised Cost of Service Study that establishes rates for the Northern Division and Central Division, separately, based upon the cost of serving each division. This study should include:

(1) A breakdown of costs assigned to the Northern Division.

(2) A breakdown of costs assigned to the Central Division.

(3) A billing analysis for each division with sufficient customer detail as to allow for verification of the rates.

b. List and describe the capital costs that are currently assigned to both divisions jointly that would require separate assignment if separate rates are established for each division.

15. State whether Kentucky-American agrees with the following statement: "The most appropriate rate mechanism for recovery of the costs associated with the Northern Division Connection Project is a surcharge on Northern Division customers." Explain.

16. Assume that the Commission determines that a surcharge on Northern Division customers is the most appropriate rate mechanism for recovery of the costs associated with the Northern Division Connection Project. Describe how Kentucky-American would calculate the level of such surcharge. This description should include the time period over which the surcharge should be collected, the costs to be included

in the surcharge, and any credits that Northern District customers should receive for benefits that Central Division customers derived from the use of facilities that were available to the Central Division only prior to construction of the Northern Division Connection Project. Provide all work papers, state all assumptions, and show all calculations used to derive the response.

17. a. Given that Kentucky-American finances construction with short-term debt that is subsequently converted to long-term debt and equity, explain why Kentucky-American should earn a return on the Distribution System Improvement Charge ("DSIC") investment that compensates it for the weighted cost-of-capital.

b. Explain why, if Kentucky-American is allowed to use the weighted cost-of-capital to calculate the return on the DISC investment, Kentucky-American would not be overcompensated in the short-term.

18. At page 14 of his direct testimony, Lance Williams states: "The areas where the system has exceeded its useful life have restricted flow, as well as increased potential for main breaks." State for each year from 2003 through 2012 the number of main breaks that Kentucky-American experienced on water mains that were six inches in diameter or smaller and 75 years old or older, the cost to repair the break, and the estimated water loss.

19. List each American Water subsidiary that currently uses a tariff rider similar to Kentucky-American's proposed DSIC and state the frequency of its general rate adjustment proceedings for the 10 years prior to implementing the tariff rider and the frequency of general rate adjustment proceedings since adopting the tariff rider.

20. Refer to Kentucky-American's Response to Commission Staff's Second Request for Information, Item 50. Provide all work papers, show all calculations and

state all assumptions used to derive the estimated construction/replacement cost of $190 per linear foot.

21. For each of Kentucky-American's last five applications for general rate adjustment, state the percentage of purchased power expense and chemical expense to Kentucky-American's requested revenue requirement and the revenue requirement that the Commission found reasonable. Provide all work papers, state all assumptions, and show all calculations used to derive the response.

22. State whether Kentucky-American's proposed Power and Chemical Rider eliminates or reduces Kentucky-American's incentive to reduce its power and chemical costs through more efficient operations. Explain.

23. Refer to Kentucky-American's Response to the Commission Staff's Second Information Request, Item 65. State whether the harm to customers or shareholders resulting from over-recovery or under-recovery of a cost may be minimized if a utility files frequent rate cases. Explain.

24. Refer to Kentucky-American's Response to the Commission Staff's Second Information Request, Item 67.

a. In its response to Item 67c, Kentucky-American identifies six members of the Advisory Council. In "American Water Business Transformation May 2010,"[8] which Kentucky-American submitted in response to Item 67a, 78 persons are identified as Advisory Council members. Explain the difference in the two responses.

b. The members of the BT Program Team identified in Kentucky-American's Response are not the same as those listed on page 14 of "American Water Business Transformation May 2010." Explain the differences in the two listings.

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[8] This document is found in the data file named "BT Software and SI Summaries.pdf."

c. Only four of the 78 members of the Advisory Council listed in American Water Business Transformation May 2010" are identified as Kentucky-American employees. The other teams do not list any Kentucky-American employees members. Explain why, given the lack of Kentucky-American employee involvement in the process:

(1) Kentucky-American should be considered as an active participant in the Business Transformation program.

(2) Kentucky-American's interests and concerns should be considered as being adequately represented in the Business Transformation process.

d. List each employee who served on the Business Transformation Steering Committee, identify his or her position, title, and the American Water subsidiary which employed him or her.

e. Provide the minutes of each meeting of the Business Transformation Steering Committee.

25. In its Response to Item 69(a) of the 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." In Case No. 2008-00563,[9] the Commission disallowed the recovery of the allocation of the financial and billing software costs to the applicant because of the absence of any benefit analysis. Explain why the Commission should not make a similar finding in this proceeding.

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[9] Case No. 2008-00583, *Application of Water Service Corporation for an Adjustment of Rates* (Ky. PSC Nov. 9, 2009) at 3-6.

26. Refer to Kentucky-American's Response to Commission Staff's Second Request for Information, Item 69(c). Explain why the expenditure of $12 million on the BT program would be reasonable for a company of Kentucky-American's size.

27. Refer to Kentucky-American's Responses to Commission Staff's Second Request for Information, Items 73(b) and 73(c). Confirm that American Water Service Company ("Service Company") does not bill Kentucky-American directly for each call received at the Call Center, but allocates Call Center costs to each operating subsidiary based on the Call Center allocation formula, call frequency and call duration.

28. In its response to Item 73(e) of the Commission Staff's Second Request for Information, Kentucky-American states that due to the implementation of the Business Transformation initiative in late 2012, the Service Company does not have a board-approved budget for 2014, and for this reason Kentucky-American was unable to respond to Commission Staff's inquiry.

a. Confirm that Kentucky-American has a board-approved budget for 2014.

b. Explain why, in light of the absence of a Service Company budget for 2014, Kentucky-American's proposed rate adjustment should not be based upon a historical test-period.

c. Explain how the reasonableness of the forecasted Service Company charges can be reviewed without historical comparisons.

29. Provide all Steering Committee meeting minutes, electronic mail communications, written correspondence, memorandums, analyses, and studies that discuss the Steering Committee's decision to terminate all billing services provided to non-American Water Affiliates.

30. Explain how, given that Kentucky-American's decision to terminate billing services for Lexington-Fayette Urban County Government has increased Kentucky-American's revenue requirements and increased Lexington-Fayette Urban County Government's cost to bill for sewer and garbage services, the decision benefited Kentucky-American's customers.

31. Refer to Kentucky-American's Response to Commission Staff's Second Request for Information, Item 77.

32. Refer to Kentucky-American's Response to the Commission Staff's Second Information Request, Item 98. The Commission has not historically recognized the preferred stock dividend in the calculation of interest-synchronization and the dividend was not included in Case No. 2010-00036.[10] Explain why Kentucky-American is proposing to included preferred stock dividend as a component of interest expense in the current proceeding.

33. Provide the total amount of unaccounted-for water loss in gallons and as a percentage of total water produced and purchased for the Northern Division for 2011 and 2012.

34. State whether Kentucky-American has a written water loss prevention/leak detection plan for the Northern Division. If yes, provide this plan.

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[10] Case No. 2010-00036, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC filed Feb. 26, 2010).

35. State, if the Northern Division's unaccounted-for water loss exceeds 15 percent of total water produced and purchased for that Division, the cost of infrastructure replacement or rehabilitation necessary to reduce unaccounted-for water to 15 percent.

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