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

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ORDER

Kentucky-American Water Company ("Kentucky-American") has applied to adjust its rates for water service to produce additional revenues of $12,317,702, or 15.05 percent, over forecasted operating revenues from existing water rates of $81,832,138.[1] By this Order, we establish rates that will produce an annual increase in revenues from water sales of $6,904,134, or 8.25 percent, over adjusted forecasted revenues from water sales of $83,642,642; deny Kentucky-American's request to establish a Distribution System Improvement Charge and a Purchased Power and Chemical Charge; and approve adjustments to Kentucky-American's nonrecurring charges.

BACKGROUND

Kentucky-American, a Kentucky corporation, owns and operates water production and distribution facilities that provide water service to 124,344 customers in Bourbon, Clark, Fayette, Gallatin, Grant, Harrison, Jessamine, Owen, Scott, and Woodford counties, Kentucky.[2] It provides wholesale water service to Harrison County

[1] As required by KRS 278.192(2)(b), Kentucky-American submitted its base period update on May 15, 2013, to report the actual results for the base period months that were originally forecasted. This update contains corrections of certain errors and the "slippage" that result in a revised revenue increase of $12,068,431, or $249,271 below the originally proposed increase.

[2] *Annual Report of Kentucky-American Water Company to the Public Service Commission for the Calendar Year Ended December 31, 2012* at 5, 30.

Water Association, East Clark Water District, Peaks Mill Water District, Jessamine-South Elkhorn Water District, and the cities of Georgetown, Midway, North Middletown, Nicholasville, and Versailles.[3] It directly or indirectly provides potable water service to approximately 490,000 persons.[4] Kentucky-American last applied for a rate adjustment in 2010.[5]

Kentucky-American is currently organized into two divisions: Northern Division and Central Division. The Northern Division consists of all facilities located in Gallatin, Grant, and Owen counties, Kentucky. As of May 31, 2012, the Northern Division had approximately 3,862 customers.[6] Kentucky-American's remaining facilities compose the Central Division. The Central Division has approximately 120,500 customers.

PROCEDURE

On November 29, 2012, Kentucky-American notified the Commission in writing of its intent to apply for an adjustment of rates using a forecasted test period. On December 28, 2012, it submitted its application. The Commission established this docket and permitted the following parties to intervene in this matter: the Attorney General of Kentucky ("AG"), Lexington-Fayette Urban County Government ("LFUCG"), and Community Action Council for Lexington-Fayette, Bourbon, Harrison, and Nicholas Counties, Inc. ("CAC").

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[3] *Id.* at 33.

[4] *See* http://www.amwater.com/kyaw/about-us/ (last visited Oct. 20, 2013).

[5] 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).

[6] 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*, Kentucky-American's Response to Commission Staff's First Request for Information, Item 33 (filed July 23, 2012).

On January 22, 2013, the Commission suspended the operation of the proposed rates for six months and established a procedural schedule for this proceeding. Following discovery, the Commission held an evidentiary hearing in this matter on June 4-5, 2013, in Frankfort, Kentucky.[7] We also conducted a public meeting in Lexington, Kentucky, on May 28, 2013 to receive public comment on the proposed rate adjustment. All parties submitted written briefs following the conclusion of the evidentiary hearing.

On July 26, 2013, Kentucky-American notified the Commission of its intent to place the proposed rates into effect for service rendered on and after July 27, 2013. In response, we directed Kentucky-American to maintain appropriate records of its billing to permit any necessary refunds.

[7] The following persons testified at the evidentiary hearing: Cheryl Norton, President, Kentucky-American; Keith Cartier, Vice President of Operations, Kentucky-American; Scott Rungren, Financial Analyst, American Water Works Service Company, Central Division; Melissa Schwarzell, Financial Analyst, American Water Works Service Company, Central Division; Linda C. Bridwell, Manager Rates and Regulation for Kentucky and Tennessee, American Water Works Service Company; Gary VerDouw, Director of Rates, American Water Works Service Company, Central Division; Carl Meyers, Director of Income Tax, American Water Works Company; David Baker, Vice President, American Water Works, North East Division, and President, New Jersey-American Water Company; Paul R. Herbert, President, Valuation and Rate Division, Gannett Fleming, Inc.; Stephen M. Rackers, Consultant, Brubaker and Associates, Inc.; Brian Kalcic, Principal, Excel Consulting; William O'Mara, Commissioner of Finance, LFUCG; and Jack E. Burch, Executive Director, CAC. The following persons submitted written testimony but did not appear at the evidentiary hearing: Lance Williams, Director of Engineering for Kentucky and Tennessee, American Water Works Service Company; Lewis Keathley, Financial Analyst, American Water Works Service Company, Central Division; Jermaine Bates, Rates Analyst, American Water Works Service Company, Central Division; James H. Vander Weide, Professor of Finance and Economics, Duke University; and J. Randall Woolridge, Professor of Finance, Pennsylvania State University. After the hearing, Witnesses Meyers, Vander Weide, and Woolridge responded to written questions from Commission Staff.

ANALYSIS AND DETERMINATION

Test Period

Kentucky-American uses as its forecasted test period the 12-month period ending July 31, 2014.[8] Its base period is the 12-month period ending March 31, 2013.[9]

Rate Base

Kentucky-American proposes a forecasted net investment rate base of $385,994,706.[10] The Commission accepts this forecasted rate base with the following exceptions:

Utility Plant in Service ("UPIS"). Kentucky-American uses capital construction budgets to determine its forecasted UPIS amount of $627,540,378.[11] Kentucky-American separates its construction budgets into three categories: normal recurring construction, construction projects funded by others,[12] and major investment projects.

In prior rate proceedings, the Commission has adjusted forecasted UPIS to reflect 10-year historical trend percentages of actual-to-budgeted construction

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[8] Application ¶ 7.

[9] *Id.* ¶ 8.

[10] *Id.* Ex. 37, Sch. B-1 at 2.

[11] *Id.*

[12] Contributions in Aid of Construction or Customer Advances, which are forms of cost-free capital, fund these projects.

spending.[13] In support of our action, we have noted the imprecision of the budgeting process:

> Budgeting being an inexact science, it is imperative that the historical relationship between the budgets and actual results be reviewed to determine what projects Kentucky-American is likely to have in service or under construction in the forecasted period. A forecasted period does not preclude the examination of historic data and trends but, rather, compels their examination to test the historic to forecasted relationships. Nor will an adjustment based on the historical slippage factor have a devastating impact on Kentucky-American's earning potential. Such an adjustment will have a minimal impact on revenue requirements by eliminating a return on utility plant not in service during the forecasted period due to delayed investment.[14]

These "slippage factors" thus serve as an indicator of Kentucky-American's accuracy in predicting the cost of its utility plant additions and the time period during which new plant will be placed into service.

Kentucky-American did not propose a slippage factor adjustment to its forecasted construction budget in its application. In its base period update, however, it revised its revenue requirement to reflect the effect of a slippage adjustment on its forecast.[15] Applying a slippage factor for normal recurring construction and major investment projects of 122.14 percent and 82.25 percent respectively to its capital construction

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[13] *See, e.g.*, Case No. 92-452, *Notice of Adjustment of Rates of Kentucky-American Water* Company (Ky. PSC Nov. 19, 1993) at 9 - 11; Case No. 95-554, *The Application of Kentucky-American Water Company to Increase Its Rates* (Ky. PSC Sep. 11, 1996) at 2 - 3; Case No. 97-034, *The Application of Kentucky-American Water Company to Increase Its Rates* (Ky. PSC Sep. 30, 1997) at 3 - 7; Case No. 2000-120, *The Application of Kentucky-American Water Company to Increase Its Rates* (Ky. PSC Nov. 27, 2000) at 2 - 4; Case No. 2004-00103, *Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Feb. 28, 2005) at 3 - 4; and Case No. 2010-00036, Order of Dec. 14, 2010 at 4 - 7.

[14] Case No. 92-452, Order of Nov. 19, 1993 at 9.

[15] Rebuttal Testimony of Linda C. Bridwell at 2; Base Period Update-Revised Ex. 37, Sch. B-2 at 2 (filed May 25, 2013).

budgets,[16] Kentucky-American calculated its forecasted UPIS to be $629,839,138, or $2,298,760 greater than the original forecasted UPIS of $627,540,378.[17] In support of its use of a slippage adjustment above 100 percent, Kentucky-American refers to two prior Commission decisions in which we allowed such reverse slippage adjustments.[18]

Although initially opposing the use of a reverse slippage adjustment,[19] the AG subsequently reversed his position and now supports Kentucky-American's proposed adjustment. While having "qualms about the use of a slippage factor mechanism to increase the Company's revenue requirement,"[20] the AG states that the slippage factor served as "an effective regulatory device to correct . . . [Kentucky-American's] former

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[16] For the comparison of actual-to-budgeted construction spending for the 10-year period ending December 31, 2011, see Kentucky-American's Response to Commission Staff's First Request for Information, Item 11(a) (filed January 23, 2013). In its second discovery request, Commission Staff calculated the slippage factors and requested that Kentucky-American apply those factors to all monthly Recurring Capital Expenditure Projects expenditures beginning December 2009 through the end of the forecasted test period. *See* Commission Staff's Second Request for Information, Item 41 (filed Feb. 6, 2013).

[17] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41, Schedule B-1 at 2.

[18] Case No. 2010-00036, Order of Dec. 14, 2010; Case No. 2005-00042, *An Adjustment of the Gas Rates of the Union Light, Heat and Power Company* (Ky. PSC Dec. 22, 2005).

[19] *See* AG's Response to Commission Staff's Request for Information, Item 26 (filed May 1, 2013) ("The Attorney General does not agree with or support the use of an adjustment consequent to a pattern of underbudgeting. It removes an incentive for KAW [Kentucky-American] to accurately budget and properly implement its capital construction program."). In response to a discovery request, AG witness Stephen M. Rackers states:

> KAWC is in possession of all the information regarding its operations, including the budgeting function and construction program. KAWC also controls the timing and completion of the various construction projects. As a result the risk of including the proper level of forecasted plant should be borne by KAWC.
>
> Therefore, the ratepayer protection of a slippage adjustment should not also serve as a mechanism to increase revenue requirement due to potential under budgeting. The incentive for KAWC to control cost is also diminished by allowing a slippage adjustment to increase forecasted construction.

AG's Response to Commission Staff's Request for Information, Item 28.

[20] AG Brief at 4.

'pervasive pattern of overbudgeting for its construction.'"[21] He noted that it "protects ratepayers from overbudgeting and also properly serves to provide the utility with a measure of protection (and risk management)."[22]

We find that a reverse slippage factor adjustment in this proceeding is appropriate and consistent with our prior holdings. In Case No. 2010-00036, we noted that the purpose of the slippage factor "is to produce a more accurate, reasonable, and reliable level of forecasted construction."[23] The application of slippage factors in this proceeding is consistent with that purpose. Accordingly, we find that Kentucky-American's forecasted UPIS should be increased by $2,298,760 to reflect the application of slippage factors for normal recurring construction and major investment projects of 122.14 percent and 82.25 percent respectively.

Business Transformation ("BT") Program. American Water Works Company[24] ("AWWC"), Kentucky-American's parent corporation, is developing and deploying several new, integrated information technology systems to manage the following core functional areas of AWWC and its subsidiaries: human resources, finance and accounting, purchasing and inventory management, capital planning, and customer and field services.[25] The project, which AWWC has named the "Business Transformation"

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[21] *Id.*

[22] *Id.* at 5.

[23] *See* Order of Dec. 14, 2010 at 7.

[24] AWWC, a Delaware corporation, is the largest, investor-owned water and wastewater utility company in the United States. Its 15 regulated subsidiaries currently provide water and wastewater services in 16 states. AWWC currently owns all outstanding shares of Kentucky-American stock. *See* http://www.amwater.com/About-Us/our-subsidiaries.html (last visited Oct. 23, 2013).

[25] Direct Testimony of Gary M. VerDouw at 36 - 37.

("BT") Program, is intended to replace legacy information technology systems, promote greater efficiency, improve customer service, and increase employee effectiveness.[26]

AWWC estimates the BT Program's total cost to be $320.3 million.[27] It intends to allocate this cost to each of its regulated utilities based on the percentage of their customer counts to the overall AWWC regulated utility customer count.[28] This method of allocation is consistent with the terms of the 1989 agreement between American Water Works Service Company and Kentucky-American.[29] AWWC projects an allocation of $12,290,381 of total BT Program costs to Kentucky-American. According to Kentucky-American Witness Gary VerDouw, this cost "equates to a cost of just over $100 per Kentucky American customer, or approximately $10 per year per customer based on the anticipated life of ten years for the BT assets."[30] AWWC will have billed Kentucky-American for its share of BT Program costs to Kentucky-American by 2014.[31] Approximately $11,027,990 of Kentucky-American's forecasted UPIS is attributable to BT Program assets.[32]

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[26] *Id.* at 36.

[27] *Id.* at 37.

[28] *Id.* at 37, 46 - 47.

[29] Agreement between American Water Works Service Co. and Kentucky-American Water Company ("Service Agreement") (Jan. 1, 1989) (available at Kentucky-American's Response to Commission Staff's First Request for Information, Item 32). ¶ 2.4 provides: "All costs incurred in rendering services to Water Company in common with similar services to other Water Companies which cannot be identified and related exclusively to services rendered to a particular Water Company, shall be allocated among all water Companies so served, or, in the case of costs incurred with respect to a particular group of Water Companies, among the members of such group, based on the number of customers served at the immediately preceding calendar year end."

[30] Direct Testimony of Gary M. VerDouw at 37. Kentucky-American indicated that BT Program assets have a ten-year useful life and should be depreciated over a ten-year period. *Id.* at 50 - 51.

[31] *Id.* Ex. BT-1 at 1.

[32] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41 at 122.

The BT Program consists of three information systems: Enterprise Resource Planning; Enterprise Asset Management; and Customer Information System. AWWC deployed the Enterprise Resource Planning system in August 2012.[33] Deployment of the remaining systems began in 2013.[34]

LFUCG opposes inclusion of the BT Program assets into Kentucky-American's rate base for ratemaking purposes.[35] It argues that Kentucky-American has failed to meet its burden of proof that the program is reasonable. More specifically, it notes the absence of any Kentucky-American specific study regarding the program and the lack of any study of possible alternatives to the BT Program.[36]

Our review of the evidence indicates sufficient evidence to support inclusion of the BT Program costs into UPIS. The evidence of record indicates that Kentucky-American's information infrastructure was approaching the end of its useful life and a need to replace the system existed. Most of Kentucky-American's information system had been in service since the 1990s or the early part of the last decade.[37] These systems were not integrated and had limited functionality. They could not perform many of the customer-service technology functions that the public has come to expect.[38]

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[33] *Id.* at 43.

[34] *Id.*

[35] In his brief, the AG took no position on the BT program. In response to discovery requests, AG Witness Rackers stated that without a cost-benefit analysis study that considered whether Kentucky-American could have developed or purchased its own system that met its needs and cost less than $12 million, no determination could be made regarding the reasonableness of the BT Program costs. AG's Response to Commission Staff's Request for Information, Item 20.

[36] LFUCG Brief at 5.

[37] Direct Testimony of Gary M. VerDouw at 38; Kentucky-American's Response to Commission Staff's Third Request for Information, Item 25.

[38] These services include internet billing, appointments for repair calls, self-service inquiry and ordering capabilities, and secure transfer of personal information.

Some supporting software for these systems was no longer available. Moreover, while the lives of some systems could be extended through system customizations, numerous customizations would be required and would be expensive.[39]

The record further indicates that a reasonable and thorough review process was used to determine the needs of AWWC's utilities and to procure the information technology systems. AWWC performed a comprehensive study of its needs.[40] It used a competitive bidding and evaluation process to select its information systems and system integrator. AWWC conducted "extensive analyses of potential service providers, used competitive bidding processes to select key service providers and negotiated 'not to exceed' fixed fee arrangements to ensure effective cost control."[41] Throughout the process it solicited and received comments and input from these corporate stakeholders, including Kentucky-American officials.[42]

BT Program costs compare favorably to similar-sized customer-service information system projects that other utilities in this state have undertaken. The cost of the customer service portion of Kentucky-American's BT Program is approximately $30 per customer.[43] In contrast, Louisville Water Company recently installed a customer-care information system at a cost of $92 per customer. Louisville Gas and Electric

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[39] Direct Testimony of Gary M. VerDouw at 39 - 40.

[40] AWWC, *American Water information Technology Infrastructure Comprehensive Planning Study Report* ("*Comprehensive Planning Study Report*") (Voorhees, N.J. Apr. 13, 2010) (available at Kentucky-American's Response to AG's First Request for Information, Item 168).

[41] Kentucky-American's Response to Commission Staff's Third Request for Information, Item 25.

[42] Rebuttal Testimony of Gary M. Verdouw at 3 - 4.

[43] The total cost of BT Program, not merely the customer-service technology portion, is approximately $100 per customer. *See supra* note 30 and accompanying text.

Company and Kentucky Utilities Company jointly installed a customer-care and billing-information system project whose cost is roughly $68 per customer.[44]

While the record does not indicate any Kentucky-specific analysis of the BT Program, Kentucky-American has identified several benefits that will inure to its customers as a result of the BT Program. These include:

> (1) Optimizing material availability to field personnel, which will enhance the quality and timeliness of field service; (2) increasing efficiencies in recruiting process to minimize work gaps and ensure continuity of service for customers; (3) improving asset reliability and fewer unexpected outages by optimizing reliability-centered maintenance programs; (4) proactively communicating to customers through automated phone messages about incidents in their area; (5) improving employee dispatch, thereby enhancing customer solutions and response times; (6) greater first contact resolution as a result of automation in the bill correction process and redirected resources providing the opportunity to resolve customer requests in a timely manner; (7) opportunities for enhanced bill presentment options; (8) ability to introduce tools that would assist customers in resolving debt issues and eliminate manually intensive collection processes; (9) improving scheduling between field service representatives and customers; and (10) the ability to track service orders that will allow customers to monitor the progress online.[45]

It has also provided evidence of the alternatives that were considered and a reasonable basis for its rejection of those alternatives.[46]

We find that Kentucky-American has adequately demonstrated that the BT Program was necessary for Kentucky-American to meet its service obligations; BT Program assets are currently in use to serve Kentucky-American customers; and, BT

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[44] VR 06052013; 15:13:17 - 15:15:37.

[45] Kentucky-American Brief at 56; *Comprehensive Planning Study Report* at 37 - 39.

[46] *See* Rebuttal Testimony of Gary M. Verdouw at 4 - 5, *Comprehensive Planning Study Report* at 56 - 57.

Program costs were not unreasonable or excessive. Accordingly, we deny LFUCG's proposed adjustment to remove BT Program assets from UPIS.[47]

Accumulated Depreciation. Kentucky-American uses a 13-month average of its accumulated depreciation balances for the period from July 1, 2013, through July 31, 2014, to arrive at forecasted accumulated depreciation of $136,601,885.[48] The Commission finds that forecasted accumulated depreciation should be increased by $31,332 to reflect the effect of construction slippages, which results in an adjusted balance of $136,633,217.[49]

Construction Work in Progress ("CWIP"). Kentucky-American uses capital construction budgets for the period from July 1, 2013, through July 31, 2014, to calculate forecasted CWIP of $6,851,268.[50] The Commission finds that Kentucky-American's forecasted CWIP should be decreased by $554,089 for an adjusted balance of $6,297,179 to reflect the effect of construction slippages.[51]

Working Capital. In its application, Kentucky-American includes a cash working capital allowance of $3,946,000 in its forecasted rate base.[52] It subsequently revised its

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[47] As Kentucky-American has demonstrated BT Program's benefits and costs, our decision in this case is easily distinguishable from other proceedings in which applicants have failed to make such showing. *See, e.g.*, Case No. 2008-00563, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC Nov. 9, 2009).

[48] Application, Ex. 37, Sch. B-1, at 2.

[49] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41 at 38.

[50] Application Ex. 37, Sch. B-4.1 at 2.

[51] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41 at 38.

[52] Application Ex. 37, Sch. B-5.2 at 4.

calculation of cash working capital to remove federal income tax from net income[53] and reflect the effects of slippage.[54] These revisions reduce cash working capital by $854,000 to $3,092,000.[55] Kentucky-American used a lead/lag study that employs the methodology approved in prior Kentucky-American rate proceedings to calculate cash working capital allowance and includes non-cash expenses and common equity profits.

The AG proposes the removal of a working capital component from the rate base.[56] Although conceding that working capital is necessary to recognize the lag between the collection of funds from the ratepayers to pay for the cash expenses that are necessary to fund Kentucky-American's daily operations, the AG argues that non-cash expenses and common equity profits should not be considered in the calculation of working capital, since these items are not cash expenses necessary to fund daily operations.[57] He further argues that, if these items are not considered, the revenue requirement associated with working capital is immaterial and should not be considered.[58]

Opposing this proposal, Kentucky-American notes the Commission has consistently rejected the AG's position in numerous proceedings over the last 20 years.[59] It argues that the proposal should be rejected in light of the Commission's

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[53] Rebuttal Testimony of Linda C. Bridwell at 2.

[54] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41 at 38.

[55] Base Period Update Filing, Ex. 37, Sch. B-5.2 at 4.

[56] Direct Testimony of Stephen M. Rackers at 19.

[57] *Id.* at 15; AG Brief at 13.

[58] Direct Testimony of Stephen M. Rackers at 15.

[59] Kentucky-American Brief at 9 - 11.

longstanding precedent and in the absence of any new argument or support for the AG's position.

Kentucky-American's lead/lag study uses the methodology that the Commission has generally accepted since 1983.[60] Our review of past Kentucky-American rate adjustment proceedings indicates that the AG has consistently presented, and the Commission has consistently refused to adopt, his argument regarding working capital.[61] The AG has offered no new evidence or argument in the current proceeding to disturb our previous findings or to require a change in the Commission's position on this matter. We find his proposal regarding cash working capital should be denied.

After applying all reasonable and necessary adjustments to Kentucky-American's forecasted working capital calculation, the Commission finds the appropriate working capital allowance to be $2,406,000, a decrease of $1,540,000 to Kentucky-American's forecasted level of $3,946,000.

<u>Contributions in Aid of Construction ("CIAC")</u>.[62] In its application, Kentucky-American includes CIAC of $52,238,690[63] as a reduction to rate base. We find that this

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[60] Case No. 8314, *Notice of Adjustment of Rates of Kentucky-American Water Company* (Ky. PSC Feb. 8, 1982) at 6.

[61] *See, e.g.*, Case No. 10069, *Notice of Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC July 31, 1996) at 6 – 8; Case No. 92-452, *Notice of Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Nov. 19, 1993) at 17 – 21; Case No. 95-554, *Notice of Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Sept. 11, 1996) at 21 – 24; Case No. 97-034, *Notice of Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Sept. 30, 1997) at 25 – 28; Case No. 2004-00103, *Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Feb. 28, 2005) at 17.

[62] For a definition of CIAC, see Direct Testimony of Linda C. Bridwell at 28 ("a reduction in rate base that recognizes the value of mains, meters, services or hydrants that are paid for by a third party and thus are not an investment by KAW [Kentucky-American], but fully owned and maintained by the Company."

[63] Application Ex. 37, Sch. B-1 at 2.

amount should be increased by $813,001, to $53,051,691, to reflect the effects of construction slippage.[64]

Customer Advances.[65] In its application, Kentucky-American identifies customer advances as $13,997,843.[66] The Commission finds that customer advances should be increased by $179,147 to $14,176,990, to reflect the effects of construction slippage.[67]

Deferred Maintenance. Kentucky-American incurs maintenance expenses (e.g., tank and hydrator painting and repairs, station cleaning) for which the Commission has historically allowed deferred accounting treatment. With such expenses, Kentucky-American is permitted annual recovery of allowed amortization expense. The unamortized balance of these expenses is generally included in rate base.

In its application, Kentucky-American proposes the inclusion of $4,644,233 of deferred maintenance in its rate base.[68] The allowed amounts are based on actual costs from historical periods and forecasted costs. Among the forecasted maintenance projects whose costs will be deferred are six new tank paintings.[69] The Commission finds that Kentucky-American's forecasted deferred maintenance of $4,644,233 is reasonable and should be allowed in rate base.

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[64] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41 at 38.

[65] For a definition of Customer Advances, see Direct Testimony of Linda C. Bridwell at 27 ("a reduction to rate base to recognize money collected for new mains that are held in an account and refunded to the original customer as new customers tap onto a main").

[66] Application Ex. 37, Sch. B-1 at 2.

[67] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41 at 38.

[68] Application Ex. 37, Sch. B-1 at 2.

[69] Direct Testimony of Linda C. Bridwell at 29.

Deferred Taxes. In its application, Kentucky-American reduces rate base by accumulated deferred income tax of $57,007,044.[70] In its base period update, Kentucky-American revises forecasted deferred income taxes upward by $446,815 to $57,453,859 to reflect the effect of construction slippages.[71] Included in deferred income taxes are items approved in prior rate cases: UPIS, deferred maintenance, and deferred debits.[72] Kentucky-American's calculations are consistent with Statement of Financial Accounting Standards ("SFAS") 109 – Accounting For Income Taxes,[73] a methodology that the Commission has previously accepted.[74]

In its calculation of deferred income taxes, Kentucky-American has taken into account a potentially adverse ruling from the Internal Revenue Service ("IRS") on certain accounting practices. On December 31, 2008, Kentucky-American, as a member of a consolidated group of American Water Works Company ("AWWC") subsidiaries, requested authorization from the IRS to change its accounting method for recording repairs and maintenance. Instead of capitalizing repairs and maintenance costs, the members of the consolidated group sought to deduct these costs in the current tax year. In February 2010, the IRS approved the request and Kentucky-American recognized a tax deduction for costs that previously were capitalized for tax

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[70] Application Ex. 37, Sch. B-6 at 2.

[71] Base Period Update-Revised Ex. 37, Sch. B-6 at 2; Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41 at 83.

[72] Direct Testimony of Scott W. Rungren at 14.

[73] SFAS 109 is "a balance sheet approach to deferred income taxes that requires the deferred income tax provision be shown in total, but also recognizes the regulatory assets and liabilities that will be recovered in rates in future years." *Id.* at 15.

[74] *See, e.g.*, Case No. 2010-00036, Order of Dec. 14, 2010 at 16 – 17.

purposes.[75] The members of the consolidated group, however, believe that the IRS ruling fails to address a critical component of the deduction calculation, that this failure creates uncertainty regarding the deduction, and that they are potentially subject to additional tax liability.

Kentucky-American maintains that, in light of this uncertainty, Financial Accounting Standards Board Interpretation No. 48 ("FIN 48") requires the creation of a liability account to record the amount of deferred taxes that the IRS would likely deny. FIN 48 provides that "[a]n enterprise shall initially recognize the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination."[76] Kentucky-American notes that its experience is common among many utilities and that many of these utilities have taken the same action as Kentucky-American.[77] The FIN 48 liability reduces Kentucky-American's deferred tax liability and thus increases Kentucky-American's rate base.[78]

Kentucky-American began booking the FIN 48 liability in 2009. As of the end of the forecasted test period, Kentucky-American will have booked $3,922,247 to this liability account.[79]

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[75] Price Waterhouse Coopers, *Kentucky-American Water Co. Financial Statements as of and for the years ended December 31, 2008 and December 31, 2009* (Mar. 25, 2010) at 17 - 18, available at Case No. 2010-00036, Kentucky-American's Response to the AG's Second Request for Information, Item 85 at 20-21 (filed May 24, 2010).

[76] FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (June 2006) ¶ 6.

[77] VR 06/04/2013; 16:18:30 - 16:18:50.

[78] *Id.* Item 13(b). AG Witness Stephen M. Rackers testified that the FIN 48 account increases Kentucky-American's revenue requirement by approximately $400,000. Direct Testimony of Stephen M. Rackers at 2.

[79] Kentucky-American's Response to AG's Second Request for Information, Item 13(a). For a year-by-year listing of Kentucky-American's FIN 48 liability level, see Kentucky-American's Responses to Hearing Data Requests, Item 11 (filed June 20, 2013).

This case is not the first occasion in which the Commission has examined the reasonableness of Kentucky-American's establishment of the FIN 48 liability account. In Case No. 2010-00036 in which we approved Kentucky-American's accounting treatment, we stated:

> Kentucky-American determined that some uncertainty exists regarding the legality of the deduction related to the change in accounting methods. No party challenges the reasonableness of this determination or the appropriateness of establishing a reserve in the event of an adverse IRS ruling. Kentucky-American's action, moreover, is consistent with FIN 48. If the IRS ultimately allows the deduction or the statute of limitations expires without a challenge to the deduction, ratepayers and shareholders will benefit from the tax deferral. If the IRS disallows Kentucky-American's deduction, Kentucky-American has stated that it will not seek recovery for interest and penalties imposed by the IRS and the ratepayers will not be negatively affected.[80]

In the same Order, we rejected the AG's proposals that the Commission (1) increase Kentucky-American's accumulated deferred income taxes by the FIN 48 liability and recognize the benefit with an interest amount for the FIN 48 reserve that is recorded above the line; or (2) require Kentucky-American to record the interest below the line in tandem with the creation of a regulatory asset.

In the present proceeding, the AG urges the Commission to reconsider that decision. AG Witness Rackers recommends that Kentucky-American's accumulated deferred income taxes be increased by the FIN 48 liability and, should Kentucky-American receive an adverse ruling from the IRS, it be permitted to recover any interest payments from ratepayers.[81] In the alternative, he recommends that the FIN 48 liability be excluded from accumulated deferred income tax, that the future potential annual

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[80] Case No. 2010-00036, Order of Dec. 14, 2010 at 20.

[81] Testimony of Stephen M. Rackers at 6.

interest cost associated with the FIN 48 reserves be included in the cost of service in this case, and that a true-up and any recovery or refund of interest costs be performed in subsequent rate case proceeding.[82]

Our review of the record does not indicate any significant change since our decision in Case No. 2010-00036. The IRS has yet to provide definitive guidance, and therefore, the uncertainty related to the deductions still exists. No party in this proceeding has challenged the reasonableness of the establishment of the FIN 48 reserve.[83] Ratepayers will benefit if the IRS allows the deductions or the statute of limitations expires. Kentucky-American continues to represent that it will not seek rate recovery of the interest from its ratepayers if the IRS disallows a portion of the deduction.[84] The AG has offered no new argument or reasoning to support of his position.

Given the lack of any significant change and the absence of any new argument in this matter, we decline to depart from the position that we established in Case No. 2010-00036 and we find that accumulated deferred income taxes should be $57,007,044.

Deferred Debits. In its application, Kentucky-American requests that rate base be increased by $1,536,404 to include the unamortized balance of the deferred debits.[85] The Commission finds that this level is reasonable and should be allowed in rate base.

Other Rate Base Elements. In Case No. 2004-00103, the Commission reduced rate base for contract retentions, unclaimed extension deposit refunds, retirement work

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[82] *Id.* at 7.

[83] *See, e.g.*, Testimony of Stephen M. Rackers at 4.

[84] Kentucky-American Brief at 14.

[85] Application Ex. 37, Sch. B-1 at 2; Direct Testimony of Linda C. Bridwell at 30.

in progress, deferred compensation and accrued pensions.[86] Kentucky-American calculates a rate base increase of $650,081, consistent with the Commission's decision in that case. The Commission finds that Kentucky-American's calculation of other rate base elements is accurate and increases Kentucky-American's rate base by $650,081.

Summary. Based on the adjustments discussed above, the Commission has determined the company's net investment rate base to be as shown in Table I.

Table I

Rate Base Component	Application Forecasted 13-Month Average Rate Base	Commission's Adjustments	Commission Forecasted 13-Month Average Rate Base
Utility Plant at Original Cost	$ 627,540,378	$ 2,298,760	$ 629,839,138
Accumulated Depreciation	(136,601,885)	(31,332)	(136,633,217)
Net Utility Plant in Service	490,938,493	2,267,428	493,205,921
CWIP	6,851,268	(554,089)	6,297,179
Working Capital Allowance	3,946,000	(1,540,000)	2,406,000
Other Working Capital	727,081		727,081
CIAC	(52,238,690)	(813,001)	(53,051,691)
Customer Advances	(13,997,843)	(179,147)	(14,176,990)
Deferred Income Taxes	(57,007,044)	(446,815)	(57,453,859)
Deferred Investment Tax Credits	(55,276)		(55,276)
Deferred Maintenance	4,644,233		4,644,233
Deferred Debits	1,536,404		1,536,404
Other Rate Base Elements	650,081		650,081
Net Original Cost Rate Base	$ 385,994,707	$ (1,265,624)	$ 384,729,083

Income Statement

For the base period, Kentucky-American reports operating revenues and expenses of $87,282,760 and $60,961,773, respectively.[87] It proposes several adjustments to revenues and expenses to reflect the anticipated operating conditions during the forecasted period, resulting in forecasted operating revenues and expenses

[86] Case No. 2004-00103, Order of Feb. 28, 2005 at 38.

[87] Application Ex. 37, Sch. C-1.

of $84,157,833 and $59,977,919, respectively.[88] The Commission accepts Kentucky-American's forecasted operating revenues and expenses with the following exceptions:

Water Revenues. Kentucky-American proposes to decrease its base period water revenues of $84,830,506 by $2,998,368 to $81,832,138. Kentucky-American's billing analysis reflects the actual billing determinants for the base period. Kentucky-American has adjusted these determinants to include customer growth through the forecasted test year and adjusted residential, commercial and Other Public Authority classes for declining usage trends for the forecasted test year.[89]

- Change in Revenue Normalization Method. Kentucky-American proposes an adjustment to normalized usage for residential, commercial and Other Public Authority ("OPA") customers. It has modified the methodology that it previously used to calculate this adjustment. In prior cases, it used a statistical weather normalization model that was based upon actual and historical meteorological data and other known predictor variables to predict customer use or sales levels. In the present case, Kentucky-American has employed a usage-normalization approach.

Under the usage-normalization approach, Kentucky-American calculated customer base usage by reviewing monthly water sales during the winter months (December through April) for each year in the period from 2003 to 2012.[90] Due to the low amount of outdoor water usage in these months, Kentucky-American regards these months as reflecting base, non-discretionary usage.[91] Studying the usage in these

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[88] *Id.*

[89] Testimony of Linda C. Bridwell at 7.

[90] *Id.* at 34.

[91] *Id.*

months, Kentucky-American Witness Linda Bridwell testified, allowed the utility to see the underlying trends in base usage.[92]

To calculate usage per customer, Kentucky-American performed a four-step calculation. First, it recorded monthly sales data and then divided monthly sales by the number of customers to yield an average usage per customer. Next, Kentucky-American calculated winter consumption for residential and OPA customers, expressed in gallons per customer per month, for each year during the period. For commercial customers, Kentucky-American made this calculation only for the period from 2008 to 2012. Next, Kentucky-American created a "best-fit" linear regression trend line using the ten-year winter usage data for residential and OPA customers and the five-year winter usage data for commercial customers. Finally, it calculated the portion of consumption that is constant throughout the year as opposed to the amount of increased usage that occurs during summer usage period. It added the ten-year average non-base usage to the base use trend to produce the total trend.[93]

Kentucky-American asserts that this methodology produces a "weather neutral" result. The methodology reflects the trend in base usage, which is relatively unaffected by weather. As to non-base usage, which is significantly affected by the weather, the methodology uses a ten-year average of summer usage, which "represents the 'most likely' outcome in a given year."[94]

Kentucky-American further asserts that its methodology is more indicative of the factors that affect water usage than an adjustment based solely on weather. It contends

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[92] *Id.*

[93] *Id.* at 34-35.

[94] *Id.* at 36.

that the reduction in water usage universally is due to numerous factors, including conservation, the installation and use of more-efficient plumbing fixtures and appliances, and new plumbing requirements.

Based upon this analysis, Kentucky-American determined that residential usage per customer is declining at a rate of 780 gallons per customer per year, or 2.1 gallons per customer per day; that the commercial usage per customer is declining at a rate of 7,584 gallons per customer per year, or 20.8 gallons per customer per day, and that the other public authority usage per customer is declining at a rate of 49,344 gallons per customer per year, or 135.2 gallons per customer per day.[95] This declining usage is reflected in the adjustments that Kentucky-American had made to base period usage.

The AG opposes the change in methodology and takes issue with the contention that the new approach is more accurate or more reflective of Kentucky-American's customers' usage. He notes that during the course of several ratemaking proceedings that stretch back to the early 1990s, the Commission discussed, scrutinized, and adjusted Kentucky-American's weather normalization model before finally accepting it. He describes Kentucky-American's unilateral action to replace "the approved weather normalization process with a declining use factor" as "a rather large step backward."[96] Noting that the usage normalization approach is based upon AWWC's system usage patterns, the AG argues that the Commission has previously rejected such an approach to be insufficient and has sought an approach based upon the usage characteristics of Kentucky-American's service territory.[97]

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[95] *Id.*

[96] AG Brief at 15.

[97] *Id.*

Using weather information from the National Oceanic and Atmospheric Administration and the Palmer Drought Severity Index, AG Witness Rackers recommended that 2012 residential customer average monthly usage of 4,580 gallons and 2012 commercial customer average monthly usage of 37,200 gallons be used to determine normalized revenue for the test period. Mr. Rackers contends that, as rainfall levels in 2012 were closer to normal levels, the 2012 usage is more indicative of these customers' usage.[98] He further recommended that, instead of calculating OPA usage based upon a monthly average of 212,400 gallons per OPA customer, as Kentucky-American proposes, 229,590 gallons per OPA customer should be used to calculate sales to that customer class.[99] In support of this recommendation, Mr. Rackers notes that Kentucky-American's usage amount was less than that the average OPA customer usage in 2011, a year in which the area experienced extreme rainfall amounts.

Based upon our review of the evidence, the Commission finds that Kentucky-American's proposed adjustment should be denied. We agree that Kentucky-American has failed to properly account for customer usage trends. Although we find support for Kentucky-American's contention that customer usage is declining, we find insufficient evidence to support the severe decline in usage that Kentucky-American claims. We are of the opinion that Kentucky-American's methodology does not adequately consider the effect of weather and that, especially as it relates to commercial customer usage, is not based upon a sufficient period of time to establish reliable usage trends. The Commission further finds that the usage amounts that AG Witness Rackers proposes

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[98] Testimony of Stephen M. Rackers at 23.

[99] *Id.* at 24.

are reasonable and should be used to calculate the normalized forecasted usage for residential, commercial, and OPA customers.

- Customer Counts. AG Witness Rackers testified that Kentucky-American used incorrect customer counts in its calculation of revenues from Industrial Customers, OPA, and Other Wholesale Customers. Mr. Rackers stated that Kentucky-American erred in using 21 customers in its annualized calculations for the Industrial Customer classification and should have used 24 customers instead.[100] He further contended that Kentucky-American erred in using 531 OPA customers, not 533 that Kentucky-American used.[101] Finally, he contended that Kentucky-American incorrectly used 12 wholesale customers to calculate revenues from wholesale customers, instead of 13 customers.[102]

Kentucky-American disputes Mr. Rackers's contentions. As to the missing industrial customers, Kentucky-American reviewed the usage of the customers in the industrial customer class and found that three customers historically used little or no water.[103] As they had little or no usage, Kentucky-American removed these customers from its customer counts.

As to its count of wholesale customers, Kentucky-American asserts that the missing wholesale customer had limited water purchases during the period and its purchases were included in the purchases of the other 12 wholesale customers. In the forecasted period, Kentucky-American took into account the 12 forecasted purchasers In contrast, Mr. Rackers used the average yearly amount purchased for the 12

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100 *Id.* at 23.

101 *Id.* at 24.

102 *Id.*

103 Rebuttal Testimony of Linda C. Bridwell at 6.

customers and multiplied this average yearly amount by his 13 customers. This action results in the overstatement of revenues for this customer classification.[104]

As to the OPA Customer classification, Kentucky-American stated that it recognized a sharp decline in the number of OPA customers and usage in the last five years and noted that some OPA customers are seasonal customers, causing a fluctuation in usage. Kentucky-American used a ten-year decline in usage per customer to project a more moderate decline and sought to remove the effects of seasonal fluctuation.[105]

Having reviewed the AG's proposed adjustments and finding that Kentucky-American's adjustments more accurately reflect customer count and usage than those that the AG proposes, the Commission denies the AG's proposed adjustments to Kentucky-American's customer counts.

– Imputed Billing Revenue from LFUCG. LFUCG proposes that the Commission impute to Kentucky-American approximately $1.6 million of annual revenue that it asserts Kentucky-American effectively surrendered by terminating its agreement to provide billing services for LFUCG on August 31, 2012.

LFUCG operates a sanitary sewer system that serves Fayette County. Prior to 1995, LFUCG performed its own billing and collection functions. In May 1995, it entered into an agreement with Kentucky-American for collection and billing services. Under this agreement, Kentucky-American billed for LFUCG sanitary sewer service and

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[104] *Id.* at 7.

[105] *Id.*

remitted those receipts to LFUCG.[106] In October 1996, Kentucky-American agreed to provide billing services for LFUCG landfill fees.[107] In 2009, it further agreed to bill and collect LFUCG's water quality fees.[108] For the three-year period ending December 31, 2011, Kentucky-American's average annual revenue for these billing and collection services was $1,406,960.[109] On August 31, 2012, Kentucky-American ceased its provision of billing and collection services for LFUCG.[110]

LFUCG offers several reasons for its proposed adjustment. It suggests that Kentucky-American's decision was unreasonable, as termination of the billing contract resulted in the loss of $1.6 million of annual revenues and produced only $250,000 of annual savings. It further states that Kentucky-American's decision caused significant financial harm to LFUCG by requiring LFUCG to obtain the same services from another vendor at a much higher cost. Finally, it contends that Kentucky-American customers received no recognizable benefit from the termination of the billing agreement.

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[106] Agreement between Lexington-Fayette Urban County Government and Kentucky American Water Company (May 22, 1995) *available at* http://www.psc.ky.gov/tariffs/Water/Districts,%20Associations,%20&%20Privately%20Owned/Kentucky-American%20Water%20Company/Contracts (last visited Oct. 24, 2013).

[107] Agreement between Lexington-Fayette Urban County Government and Kentucky American Water Company (Oct. 31, 1996), *available at* http://www.psc.ky.gov/tariffs/Water/Districts,%20Associations,%20&%20Privately%20Owned/Kentucky-American%20Water%20Company/Contracts/ (last visited Oct. 24, 2013).

[108] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 77 at 1143-1153.

[109] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 76. During this period, Kentucky-American also provided billing and collection services for the city of Sadieville, Treehaven Mobile Home Park, and Verna Hills Neighborhood Association. The average annual revenue from these services during the same period was $3,094.

[110] The 2009 Agreement provided that either party could terminate the agreement on 90 days' prior notice. On July 1, 2011, Kentucky-American informally notified LFUCG of its intent to terminate the agreement. On October 3, 2011, Kentucky-American provided formal notification of the termination of the agreement as of March 31, 2012. *See* Kentucky-American's Response to Commission Staff's Second Request for Information, Item 77 at 1141. At LFUCG's request, Kentucky-American continued providing billing services until August 31, 2012.

Kentucky-American offers several reasons in support of its decision to terminate the agreement. First, termination of the agreement results in annual savings of $254,625. These savings stem primarily from avoiding the need to customize the BT information systems to permit third-party billing services and from the elimination of an employee to handle third-party billing issues.[111] Second, as a result of the elimination of LFUCG charges from Kentucky-American bills, "a greater number of [Kentucky-American] customers are timely paying their bills."[112] Third, Kentucky-American bills are easier to understand, and less customer confusion occurs.[113] Finally, terminating the agreement eliminated the obscured price signals that customers were receiving regarding their efficiency levels. Kentucky-American argues that its inclusion of fees on water bills that are unrelated to water consumption, for example water quality management fee and landfill fee, prevents customers from properly gauging the benefits of Kentucky-American's water efficiency efforts.[114]

We question the appropriateness of LFUCG's proposed adjustment. The practical consequence of the proposed adjustment is to penalize Kentucky-American for not continuing its provision of billing services to LFUCG. The agreement, which LFUCG negotiated and executed, however, clearly allows Kentucky-American to terminate the provision of billing services upon 90 days' notice. LFUCG, furthermore, has provided no

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[111] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 78.

[112] Rebuttal Testimony of Cheryl D. Norton at 5. Ms. Norton testified that, after Kentucky-American discontinued third-party billing, it saw a nearly 37 percent decline in the number of shut-offs and assessed 16 percent fewer late-payment fees than expected. *See also* Kentucky-American's Responses to Hearing Data Requests, Item 4.

[113] *Id.*

[114] *Id.* at 5-6.

support for the proposition that a public water utility has an obligation to provide auxiliary services outside its regulated utility functions to raise revenue for its utility operations. We were unable to find any legal precedent to support such obligation.

Similarly, the Commission is reluctant to afford significant weight to LFUCG's claims of financial harm. Each of the agreements between LFUCG and Kentucky-American regarding billing and collection services was for a specified term. While each agreement was renewable, each agreement also permitted either party to terminate the agreement upon timely notice. By executing these agreements, LFUCG clearly recognized and accepted the possibility that Kentucky-American might exercise its right to terminate the agreement. If LFUCG preferred a longer commitment, then it had the opportunity to negotiate a longer commitment and either chose not to do so or was unwilling to agree to a higher contract price for such commitment.

The Commission finds that the provision of third-party billing services may result in some customer confusion. Kentucky-American customer surveys indicate customer confusion over the services that Kentucky-American provides and its responsibility for the services for which it billed.[115] While Kentucky-American had no role in LFUCG's efforts to address Fayette County's water quality and waste management problems, its provision of billing services for such functions could easily create a contrary impression in the public's mind. The level of customer confusion and its effect on Kentucky-American, however, is difficult to quantify and to balance against the costs of terminating the billing services agreement.

The record provides a confusing picture of the benefits and costs from the termination of the billing services agreement. The termination reduces Kentucky-

[115] Kentucky-American's Response to Hearing Data Requests, Item 5.

American's revenues by $1,619,499,[116] but also reduces Kentucky-American's total revenue requirement by $254,625.[117] This reduction in revenue requirement, however, does not flow through to Kentucky-American's ratepayers. By Kentucky-American's own calculations, the monthly bill of an average Kentucky-American residential customer is $0.90 greater than if the Kentucky-American had continued providing billing services.[118]

This confusion is at least in part due to the lack of accurate cost allocation information. Despite performing third-party billing services for LFUCG since 1995, Kentucky-American has never conducted a thorough cost-of-service study to determine the cost to provide the billing services. It acknowledges the absence of a detailed cost tracking mechanism for the expenses associated with third-party billing services. While a Kentucky-American employee was tasked with managing third-party billing contracts, "other costs to manage third party billing would have been embedded within a variety of functions, including customer service center charges and information technology charges."[119] Rather than allocate the expenses related to the performance of third-party billing and then remove both the revenues and expenses associated from third-party billing for ratemaking purposes, Kentucky-American instead chose to treat its revenues

[116] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 78. VR 06/05/2013; 09:22:14 – 09:23:23.

[117] *Id.*

[118] With the exception of public fire hydrant customers, the average bill for each customer class was lower if Kentucky-American continued to provide the billing services. *See* Kentucky-American's Responses to Hearing Data Requests, Item 13.

[119] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 76.

from third-party billing services as "above the line" and thus avoided a more detailed and specific allocation of costs.[120]

Based upon our review of the record, we find insufficient evidence to support LFUCG's proposed adjustment to revenues. While the Commission is sympathetic to LFUCG's arguments, we lack the legal authority to prevent Kentucky-American from exercising its right under the billing agreements to exit the contract arrangement. We, therefore, deny the proposed adjustment.

Allowance for Funds Used During Construction ("AFUDC"). In its application, Kentucky-American proposes to increase forecasted operating revenues by $491,629[121] to include an allowance for AFUDC. In calculating this forecast, Kentucky-American uses the weighted cost of capital of 8.2 percent.[122] To reflect the effect of slippage on CWIP and the reduction of its requested weighted cost of capital to 8.12 percent,[123] Kentucky-American in its base period update decreased AFUDC by $50,888 to arrive at its revised level of $440,741.[124] Using the 13-month average CWIP available for AFUDC of $5,862,774[125] and the overall rate of return of 7.61 percent, the Commission calculates a forecasted level of AFUDC of $446,157. This action, coupled with

[120] Greater Cincinnati Water Works currently provides billing and collection services for LFUCG. LFUCG selected Greater Cincinnati Water Works after a five-month competitive selection process. Greater Cincinnati Water Works was the total least cost vendor. *See* LFUCG's Response to Kentucky-American's Request for Information, Item 1 (filed May 1, 2013). LFUCG pays $500,000 more to Cincinnati Water Works to provide the same services that Kentucky-American had previously provided. Direct Testimony of William O'Mara at 6. The increased cost for similar services raises questions about the cost allocation practices that Kentucky-American employed.

[121] Application Ex. 37, Sch. C-1.

[122] *Id.* Ex. 37 Sch. J-1.1/J-2.1.

[123] Base Period Update-Revised Ex. 37, Sch. J-1.1/J-2.1.

[124] *Id.* Sch. C-1.

[125] Kentucky-American's Response to Commission Staff's First Request for Information, Item 3(a), W/P-1 at 39; Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41 at 131.

Kentucky-American's revisions, results in an increase to Kentucky-American's revised forecasted operating revenues of $5,416.[126]

Fuel and Power. Having accepted the AG's proposed adjustments to water sales, the Commission finds that a corresponding adjustment to fuel and power expense to reflect the costs incurred to produce the additional water sales is necessary. To properly reflect the impact the increase in water sales will have on forecasted expenses, the AG proposes to increase Kentucky-American's fuel and power forecast by $150,000.[127] To calculate his proposed adjustment, the AG developed a cost factor using Kentucky-American's water sales and electricity costs and applied this factor to his recommended water sales.[128] The Commission finds that fuel and power expense should be increased by $117,061[129] to reflect the effect the Commission adjustment to water sales will have on the fuel and power expense forecast.

Chemicals. A corresponding adjustment to chemical expense to reflect increased costs due to the Commission's adjustment to forecasted sales is also necessary. The AG proposes to increase chemical expense by $70,000.[130] To calculate his adjustment, the AG developed a chemical cost factor and applied this factor to his proposed increase to water sales.[131] The Commission finds the AG's

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[126] $5,862,774 (13-Month Average CWIP Available for AFUDC) x 7.61% (Commission Weighted Cost of Capital) = $446,157.

[127] Direct Testimony of Stephen M. Rackers at 25.

[128] *Id.*

[129] $368,231 (Increase to Forecasted Water Sales) x $0.3179 (Fuel and Power Cost Factor) = $117,061.

[130] Direct Testimony of Stephen M. Rackers at 25.

[131] *Id.*

chemical cost factor is reasonable and has applied it to the increased level of water sales, which produces a chemical expense adjustment of $53,725.[132]

Pension. Kentucky-American records pension expense in accordance with FASB Accounting Standards Codification Topic 715 ("ASC 715"), formerly Statement of Financial Accounting Standards 87.[133] Kentucky-American proposes to decrease its base year pension expense of $1,025,878 by $42,671 to its forecasted level of $983,207.[134] Forecasted pension expense is based on an allocation of AWWC's 2013 and 2014 ASC 715 defined pension expense of $64,500,000 and $55,600,000 respectively. AWWC's monthly pension expense is calculated for the forecasted test year and a 1.99 percent allocation factor is used to arrive at Kentucky-American's gross pension expense of $1,180,236. Kentucky-American multiplies this amount by the reciprocal of its capitalization rate, or 83.31 percent[135] to arrive at its forecasted pension expense of $983,207.[136]

In its base period update, Kentucky-American proposes to decrease forecasted pension expense by $35,902 to reflect Towers Watson's most recent projections.[137] The Commission finds that the proposed adjustment to most current projections is reasonable and that Kentucky-American's forecasted pension expense should be decreased by $35,902 to a revised level of $947,305.

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[132] 368,231 (Increase to Forecasted Water Sales) x $0.1459 (Chemical Cost Factor) = $53,725.

[133] Direct Testimony of Melissa L. Schwarzell at 14.

[134] Application Ex. 37, Sch. C-1; Direct Testimony of Melissa L. Schwarzell at 14.

[135] *Id.* at 11. $6,880,213 (Kentucky-American's Operation and Maintenance Labor) ÷ $8,258,965 (Kentucky-American's Total Gross Labor) = 83.31%.

[136] Direct Testimony of Melissa L. Schwarzell at 11.

[137] Base Period Update Filing-Summary of Forecast Year Revisions at 1; Rebuttal Testimony of Linda C. Bridwell at 4.

Group Insurance. Kentucky-American increased its base year group insurance expense of $1,964,516 by $144,987 to arrive at its forecast expense level of $2,109,504.[138] The forecasted expense comprises two components other post-retirement employee benefit costs ("OPEB"s) and Non-OPEB Group Insurances.[139]

Non-OPEB group insurances include: (1) basic life, short and long term disability, accidental death and disability; (2) voluntary employee beneficiary association ("VEBA"); and (3) health, dental, and vision coverages that Kentucky-American provides its employees.[140] The expense associated with the first category was calculated using the 2012 plan rates and a projected 8 percent premium increase in October 2013.[141] The second category, VEBA, "is a trust to help finance post-retirement benefits of non-pension-eligible employees" with a cost of $500 per non-union employees hired between January 1, 2006 and December 31, 2010.[142] The third category involves a gross Company cost net of employee contributions and is calculated on a position by position basis, according to each actual employee plan selection.[143] This category is based upon 2012 premiums with a projected 8 percent premium increase in October 2013.[144] Kentucky-American combines the three non-OPEB categories for each employee and multiplies each employee's total by each employee's reciprocal

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[138] Kentucky-American's Response to Commission Staff's First Request for Information, Item 3(a), W/P-3 at 31.

[139] Direct Testimony of Melissa L. Schwarzell at 7.

[140] *Id.* at 7-8.

[141] *Id.* at 8.

[142] *Id.* at 9.

[143] *Id.*

[144] *Id.*

capitalization rate to arrive at the forecast non-OPEB group insurance costs of $1,418,443.[145]

Non-union employees hired before January 1, 2005 and union employees hired before January 1, 2010, are eligible for OPEBs upon their retirement, which includes Company sponsored medical, dental and prescription drug benefits.[146] To forecast test year OPEB cost, Kentucky-American starts with the latest estimates of AWWC's 2013 and 2014 post-retirement welfare costs, which are $33.3 million and $30.7 million, respectively.[147] AWWC's monthly OPEB expense is calculated for the forecast test year and a 2.61 percent allocation factor is used to arrive at Kentucky-American's gross OPEB expense of $829,455. Kentucky-American multiplies this amount by the capitalization rate of 83.31 percent to arrive at its forecasted OPEB expense of $691,061.[148]

After filing its application, Kentucky-American proposed to decrease forecasted OPEB expense by $48,149 to reflect Towers Watson's most recent projections and a further reduction of $8,783 to eliminate a duplicated cost.[149] The Commission finds that the proposed adjustments to reflect the most current projections and to eliminate duplicate costs are reasonable and that Kentucky-American's forecasted pension expense should be decreased by $56,932 to a revised level of $2,052,571.

Support Service Fees. American Water Works Service Company ("AWWSC") provides certain support services to Kentucky-American. These support services

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[145] *Id.* at 9-10.

[146] *Id.* at 10.

[147] *Id.*

[148] *Id.*

[149] Rebuttal Testimony of Linda C. Bridwell at 4.

include the use of centralized call centers, water quality testing lab, information technology support, accounts payable and accounts receivable, tax support and insurance, as well as corporate governance.[150]

Kentucky-American has increased base period support service expense of $8,951,414 by $372,820 to its forecasted level of $9,324,234.[151] While Kentucky-American proposes to remove employee incentive compensation of $513,193 from its forecasted expense level,[152] its forecasted test period expense still exceeds base period expense level due primarily to two driving forces. First, labor and labor-related costs are forecasted to increase $382,055, due to merit pay increases in 2013 and 2014 and additional information technology support for BT efforts.[153] Second, maintenance and depreciation expenses are expected to increase by $415,023, due to the BT implementation and to efforts to continue the operations of the old financial systems.[154]

We note that in 2012, AWWSC revised its method for billing for Customer Service Center services. Prior to that year, AWWSC allocated most Customer Service Center costs to Kentucky-American based on the percentage of its customer count to the overall AWWC regulated utility customer count.[155] After it began tracking the calls by operating affiliate and the average call handling time, AWWSC found a

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[150] Direct Testimony of Linda C. Bridwell at 16.

[151] Kentucky-American's Response to Commission Staff's First Request for Information, Item 3(a), W/P-3 at 85.

[152] *Id;* Direct Testimony of Linda C. Bridwell at 16. In previous Kentucky-American rate case proceedings, the Commission had identified several concerns with Kentucky-American's employee incentive compensation plans and had not permitted recovery of such plans' costs to be recovered through rates. *See, e.g.,* Case No. 2010-00036, Order of Dec. 14, 2010 at 29-33.

[153] *Id.* at 18.

[154] *Id.* at 19.

[155] Kentucky-American's Response to Hearing Data Requests, Item 30

disproportionate level of calls and call handling time by state.[156] In 2012 it began directly charging Customer Service Center calls based on the proportionate number of calls and average call handling time.[157]

Kentucky-American reports that presently approximately 63 percent of its call center costs are being direct charged for the amount of call handling, billing and collections costs it incurs at the Customer Service Center. The remaining 37 percent represents overhead components of Customer Service Center functions which are charged to Kentucky-American and its regulated utility affiliates based on the previous allocation method.[158] Based upon Kentucky-American's estimates, the change in methodology has increased the annual cost of the Kentucky-American's use of the Customer Service Center's services by $899,162.[159]

We find no basis to conclude that the change in AWWSC's billing is inconsistent with the provisions of the 1989 agreement between AWWSC and Kentucky-American. This agreement provides that directly billed costs are to be charge based on the employee's hours directly attributable to the affiliate "or other mutually acceptable means of determination."[160] It also provides that all costs incurred in connection with the services provided by AWWSC which can be identified and related to exclusively to

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[156] Direct Testimony of Linda C. Bridwell at 17-18.

[157] *Id.* at 18.

[158] Kentucky-American's Response to Hearing Data Requests, Item 30.

[159] *Id.*

[160] Agreement between American Water Works Service Co. and Kentucky-American Water Co. (Jan. 1, 1989) ¶ 2.2.

Kentucky-American shall be charged to Kentucky-American.[161] AWWSC's new billing practice appears consistent with these provisions.

In summary, the Commission finds that Kentucky-American's forecasted support service fees of $9,324,323 is reasonable and should be accepted for ratemaking purposes.

Miscellaneous Expense. Kentucky-American includes miscellaneous expense of $1,170,548 in forecasted operations.[162] This expense includes, but is not limited to, the following: customer education items; community relations; company dues and memberships; director's fees; hiring costs; injuries and damages; lab supplies; and operating expenses. Kentucky-American has identified $150,250 of this expense as charitable donations that were inadvertently included in forecasted miscellaneous expense[163] and for which it has disclaimed any intent to seek rate recovery. In its base period update, it removed these donations from its forecasted miscellaneous expense.[164] Kentucky-American also removed $62,000 for a low income payment program, which is a form of charitable donation.[165] Kentucky-American's total adjustment to miscellaneous expenses to remove charitable donations is $212,250.[166]

As such donations are not essential to the provision of utility service, the Commission has generally found that charitable contributions should be borne by utility

[161] *Id.* at ¶ 2.3.

[162] Application Ex. 37, Sch. C-2.

[163] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 109.

[164] Base Period Update Filing-Ex. 37, Sch. C-2.

[165] Kentucky-American's Supplemental Response to Commission Staff's Second Request for Information, Item 109 (filed May 15, 2013).

[166] Rebuttal Testimony Linda C. Bridwell at 2.

shareholders.[167] Accordingly, we accept Kentucky-American's proposed reduction to its forecasted miscellaneous expense of $212,250.

Uncollectible Accounts. To calculate its forecasted uncollectible account expense, Kentucky-American applied the three-year average of its net charge-offs to billed revenue for the 12-month periods ending September 31, 2010, September 31, 2011, and September 31, 2012.[168] Kentucky-American applied that ratio to forecasted revenues at present rates to calculate its uncollectible expense forecast of $481,803.[169] By applying the Kentucky-American's uncollectible ratio to the Commission-adjusted increase in water sales, the Commission arrives at its uncollectible account expense adjustment of $10,457.[170]

Depreciation. Kentucky-American includes depreciation expense of $13,121,602 in its forecasted operations.[171] Based on the Commission's treatment of forecasted rate base with regard to slippage, an adjustment has been made to increase forecasted depreciation expense by $19,815.[172]

General Taxes. Kentucky-American includes a forecast of general tax expense of $5,114,771, which includes property taxes of $4,455,772, payroll taxes of $532,600,

[167] Case No. 10481, *Adjustment of Rates of Columbia Gas of Kentucky, Inc.* (Ky. PSC Oct. 6, 1989) at 22-23.

[168] Direct Testimony of Jermaine K. Bates at 3.

[169] *Id.*; Application Ex. 37, Sch. C at 2.

[170] $83,642,642 (Water Sales) + $1,834,066 (Other Operating Revenues) = $85,476,708.
$85,476,708 (Operating Revenues) x 0.5759% (Uncollectible Ratio) = $492,260.
$492,260 (PSC Uncollectible Account) - $481,803 (Utility Uncollectible Account) = $10,457.

[171] Application Ex. 37, Sch. C-1; Kentucky-American's Response to Commission Staff's First Request for Information, Item 3(a), W/P-4 at 2, 20. $11,517,623 (Depreciation) + $1,603,979 (Cost of Removal) = $13,121,602.

[172] Kentucky-American's Response to Commission Staff's Second Request for Information, Item 41 at 84. $11,531,748 (Depreciation-Slippage Adjusted) + $1,609,669 (Removal-Slippage Adjusted) = $13,141,417 (Total-Slippage Adjusted). $13,141,417 - $13,121,602 = $19,815.

Public Service Commission assessment of $123,659, and taxes and licenses of $2,740.[173] The Commission finds that based on our treatment of forecasted rate base with regard to slippage, forecasted property tax expense should be increased by $8,730. We further find that the PSC assessment should be increased by $2,676 to reflect the effect of increased water sales. The total increased adjustment to Kentucky-American's forecasted general tax expense is $11,406.

Interest Synchronization. Kentucky-American proposes a forecasted interest expense of $12,481,618 based on the forecasted capital structure, the weighted cost of debt and the weighted dividend rate on the preferred stock.[174] As shown in Table II, the Commission has recalculated this expense to be $12,503,605 based on the rate base and weighted cost rates found reasonable herein.

Table II

	Weighted Cost Rates	Commission's Rate Base		Interest Synchronization
Short-Term Debt	0.0100%	384,729,083	$	38,473
Long-Term Debt	3.1400%	384,729,083		12,080,493
Preferred Dividend	0.1000%	384,729,083		384,729
Interest Synchronization	3.15%	384,729,083	$	12,503,695

Income Taxes. Kentucky-American includes a forecast of current income tax expense of $4,149,912, which includes state income taxes and federal income taxes of $491,702[175] and $3,658,210,[176] respectively. Adjusting Kentucky-American's income

[173] Kentucky-American's Response to Commission Staff's First Request for Information, Item 3(a), W/P-5 at 2.

[174] Application Ex. 37, Sch. E-1.3.

[175] Kentucky-American's Response to Commission Staff's First Request for Information, Item 3(a), W/P-6 at 5.

[176] *Id.* at 4

tax forecast, the Commission arrives at its current state income tax expense of $572,622 and federal income tax expense of $4,143,811 as shown in Table III.

Table III

	Income Taxes			
	State		Federal	
Taxable Income - Forecast	$	8,195,045	$	10,452,028
Adjustments to Taxable Income:				
Water Sales		1,810,504		1,810,504
Fuel and Power		(117,061)		(117,061)
Chemicals		(53,725)		(53,725)
Pensions		35,902		35,902
Group Insurance		56,932		56,932
Miscellaneous Expenses		212,249		212,249
Uncollectible Accounts		(10,457)		(10,457)
Depreciation		(19,815)		(19,815)
General Taxes		(11,406)		(11,406)
State Income Taxes				(83,919)
Interest Synchronization		206,309		206,309
Temporary Differences - Slippage		(710,775)		(638,081)
Taxable Income - Commission		9,593,702		11,839,460
Multiplied by: Income Tax Rates		6%		35%
Income Taxes - Commission	$	575,622	$	4,143,811

Deferred Income Taxes. Kentucky-American includes a forecast of deferred income tax expense of $3,573,985, which includes state deferred income taxes and federal deferred income taxes of $674,791 and $2,899,194, respectively.[177] The Commission finds that, after adjusting Kentucky-American's income tax forecast for slippage, its forecasted deferred income tax expense should be of $4,078,706.

Summary. As shown in Table IV, the Commission finds that Kentucky-American's forecasted net operating income at present rates is $25,013,042.

[177] Application Ex. 37, Sch. E-1.3 and E-1.4.

Table IV

Account Titles		Application Forecasted Revenues and Expenses		Commission Adjustments		Commission Forecasted Revenues and Expenses
Operating Revenue:						
Water Sales	$	81,832,138	$	1,810,504	$	83,642,642
Other Operating Revenues		1,834,066		0		1,834,066
AFUDC		491,629		4,244		495,873
Total Operating Revenues		84,157,833		1,814,748		85,972,581
Operating Expenses:						
Operation and Maintenance Expenses		33,892,178		(123,840)		33,768,338
Depreciation		13,121,602		19,815		13,141,417
Amortization - UPAA		210,261		0		210,261
Current State Income Tax		491,702		83,919		575,621
Deferred State Income Tax		674,791		38,745		713,536
Current Federal Income Tax		3,658,210		485,601		4,143,811
Deferred Federal Income Tax		2,899,194		465,976		3,365,170
Investment Tax Credit		(84,792)		0		(84,792)
General Taxes		5,114,771		11,406		5,126,177
Total Operating Expenses		59,977,917		981,622		60,959,539
Net Income Available for Common	$	24,179,916	$	833,126	$	25,013,042

Rate of Return

Capital Structure. Kentucky-American's proposed capital structure, which is based on the projected 13-month average balances for the forecasted test period, and the costs assigned to each capital component are shown in Table V.

Table V

Kentucky-American's Application				
Components		Capitalization	Ratio	Assigned Returns
Short-Term Debt	$	7,845,933	2.041%	0.8100%
Long-Term Debt		200,086,655	52.037%	6.1400%
Preferred Stock		4,489,951	1.168%	8.5200%
Common Equity		172,085,833	44.754%	10.9000%
Total Capitalization	$	384,508,372	100.000%	

In its base year update, Kentucky-American revised its forecasted capital structure to reflect: (1) the delay of Kentucky-American's issuance of $8 million of long-term debt from November 2012 to May 15, 2013; (2) the delay of Kentucky-American's issuance of $3 million of long-term debt from May 2013 to November 2013; (3) revisions in interest rates and issuance costs for the projected long-term debt issuance in May 2013, November 2013, and May 2014; (4) revisions in Kentucky-American's projection for the cost of short-term debt; and (5) the weighted average cost of capital to reflect the effect of the other revisions.[178] Kentucky-American's revised forecasted capital structure and assigned cost rates are shown in Table VI.

Table VI

Kentucky-American's Update			
Components	Capitalization	Ratio	Assigned Returns
Short-Term Debt	$ 9,204,650	2.391%	0.5000%
Long-Term Debt	199,241,777	51.748%	6.0600%
Preferred Stock	4,489,938	1.166%	8.5200%
Common Equity	172,085,452	44.695%	10.9000%
Total Capitalization	$ 385,021,817	100.000%	

Although he did not object to Kentucky-American's capital structure, the AG used the capital structure that appears in Table VII to develop his recommended weighted cost-of-capital.[179]

[178] Rebuttal Testimony of Scott W. Rungren at 5.

[179] Direct Testimony of J. Randall Woolridge, Ex. JRW-1.

Table VII

AG's Capital Structure			
Components	Capitalization	Ratio	Assigned Returns
Short-Term Debt	$ 7,845,926	2.040%	0.8100%
Long-Term Debt	200,086,674	52.040%	6.0500%
Preferred Stock	4,489,964	1.170%	8.5200%
Common Equity	172,085,807	44.750%	8.5000%
Total Capitalization	$ 384,508,371	100.000%	

Upon review of the record, the Commission finds that Kentucky-American's revised capital structure accurately projects the test-year capitalization requirements, and should be used to develop the weighted cost-of-capital.

Short-Term and Long-Term Debt. Kentucky-American originally projected short-term and long-term interest rates of 0.81 percent and 6.14 percent, respectively.[180] In its base period update, Kentucky-American revised its original projections of short-term and long-term interest rates to 0.5 percent and 6.06 percent, respectively.[181] The AG proposed short-term and long-term interest rates of 0.5 percent and 6.05 percent, respectively.[182] Upon review of the supporting calculations, the Commission finds that Kentucky-American's revised projections result in a more current projection of the forecasted debt rates and that Kentucky-American's proposed cost of debt is reasonable and should be accepted.

[180] Application Ex. 37, Sch. J-1.1/J-2.1.

[181] Base Period Update Filing-Schedule J-1.1/J-2.1.

[182] Direct Testimony of J. Randall Woolridge at 16 - 17.

Preferred Stock. Kentucky-American proposed an embedded cost of preferred stock of 8.52 percent.[183] No party objected to this forecasted cost rate. We find that the proposed embedded cost of preferred stock is reasonable and should be accepted.

Return on Equity. Kentucky-American recommends a return on equity ("ROE") ranging from 10.4 percent to 11.4 percent and specifically requests an ROE of 10.9 percent based on its discounted cash flow model ("DCF"), the ex ante risk premium method, the ex post risk premium method, and Capital Asset Pricing Model ("CAPM").[184]

To perform its analysis, Kentucky-American Witness Vander Weide employed two comparable risk proxy groups in its analysis. The first proxy group consists of six water companies included in the *Value Line Investment Survey* ("*Value Line*") that: pay dividends; did not decrease dividends during any quarter for the past two years; have an analyst's long-term growth forecast; and are not part of an ongoing merger. All of these water companies have a *Value Line* Safety Rank of at 2 or 3, with 3 being the average of all *Value Line* companies.[185]

Dr. Vander Weide's second proxy group consisted of seven natural gas local distribution companies. Each company is in the natural gas distribution business; paid quarterly dividends over the last two years; had not decreased dividends over the last two years; was not involved in an ongoing merger; and had an available I/B/E/S long-

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[183] Application Ex. 37, Sch. J-1.1/J-2.1.

[184] Direct Testimony of Gary M. VerDouw at 10; Direct Testimony of James H. Vander Weide at 3-4.

[185] Direct Testimony of James H. Vander Weide at 27.

term growth estimate.[186] Each also had a *Value Line* Safety Rank of 1, 2 or 3 and an investment grade bond rating.[187]

Dr. Vander Weide applied a quarterly DCF model to the water and gas proxy groups. He relied upon a comparable group of gas distribution utilities for the ex ante risk premium ROE estimation. He relied upon Standard & Poor's ("S&P") 500 stock portfolio and Moody's A-rated Utility Bonds to derive the ex post risk premium ROE estimation. He conducted a second study using stock data from the S&P Utilities rather than the S&P 500. Although Dr. Vander Weide performed CAPM analyses using both proxy groups, he did not rely upon the CAPM estimations in reaching his recommended ROE. He rejected the CAPM analyses because the average beta coefficient for the proxy companies was significantly below a value of 1 and because of the proxy group of water companies' small market capitalization.[188] As part of his ROE recommendations, Dr. Vander Weide also made adjustments for flotation costs.

AG Witness Woolridge takes issue with several aspects of Kentucky-American's methodology. First, he argues that Dr. Vander Weide's water proxy group is too small to estimate an equity cost rate and that Dr. Vander Weide erred in excluding the three smallest water companies from his proxy group. He also disagrees with the inclusion of NiSource in Dr. Vander Weide's gas proxy group due to its riskier operating and financial profile and its electric operations. Second, he states that Dr. Vander Weide's DCF approach included an excessive adjustment to the dividend yield to reflect

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[186] *Id.* at 30. I/B/E/S, a division of Thomson Reuters, reports analysts' earnings per share ("EPS") growth forecasts for a broad group of companies. The I/B/E/S growth rates are widely circulated in the financial community, include the projections of reputable financial analysts who develop estimates of future EPS growth, are reported on a timely basis to investors, and are widely used by institutional and other investors. *Id.* at 22.

[187] *Id.* at 30.

[188] *Id* at 3 - 4, 45 - 48.

quarterly payment of dividends. Third, Dr. Woolridge asserts that the Kentucky-American study relies exclusively on the forecasted earnings per share ("EPS") growth rates of Wall Street analysts and *Value Line* to compute the equity cost rate, that the long-term earnings growth rates of Wall Street analysts are overly optimistic and upwardly-biased, and that the estimated long-term EPS growth rates of *Value Line* are overstated.

Fourth, Dr. Woolridge notes several problems associated with weighting the DCF results for the water and gas proxy groups by the market capitalization of the companies in computing the average DCF for each group. Fifth, he contends that both the risk premium and CAPM analyses performed by Kentucky-American contain excessive base interest rates and market risk premiums. Sixth, he observes that Dr. Vander Weide ignored his own CAPM equity cost rate results. Seventh, Dr. Woolridge states that flotation cost adjustments to the equity cost rate results are unwarranted.[189] Contending that the utility has failed to identify any actual floatation costs and questioning whether the necessary conditions that support the use of a floatation cost adjustment are present in the current case, Dr. Woolridge challenges the appropriateness of Dr. Vander Weide's use of floatation cost adjustment in his DCF analysis.[190]

Dr. Woolridge conducted his own analysis, applying the DCF model and the CAPM methods to a water proxy group and a gas proxy group and affording primary weight to the results of the DCF analysis. Based upon that analysis, he proposes an

[189] Direct Testimony of J. Randall Woodridge at 58.

[190] *Id.* at 68 - 70.

ROE range from 7.3 percent to 8.6 percent and recommends an awarded ROE of 8.5.[191]

To perform his analysis, Dr. Woolridge uses a proxy group of nine publicly-held water utility companies covered by *Value Line* and *AUS Utility Reports* and a second proxy group of nine natural gas distribution companies covered by the Standard Edition of *Value Line*. The water proxy group received 96 percent of its revenues from regulated water operations; has an 'A' bond rating and a common equity ratio of 46.5 percent; and an earned return on common equity of 9.8 percent. The gas proxy group consists of eight natural gas distribution companies listed as Natural Gas Distribution, Transmission, and/or Integrated Gas Companies in *AUS Utility Reports* and as Natural Gas Utility companies in the *Value Line* Standard Edition and having an investment grade bond rating by Moody's and S&P. The gas proxy group utilities received 69 percent of revenues from regulated gas operations, a common equity ratio of 47.7 percent, and an earned return on common equity of 10.5 percent.[192]

Dr. Woolridge argues that the use of natural gas distribution companies as a proxy for Kentucky-American is appropriate, since the financial data necessary to perform a DCF analysis on the members of the water proxy group, as well as analysts' coverage of water utilities, is limited. He also argues that the return requirements of gas companies and water companies should be similar, as both industries are capital intensive, heavily regulated, and provide essential commodity with rates and rates of return set by state regulatory commissions. Dr. Woolridge acknowledges, however, that

[191] *Id.* at 2.

[192] *Id.* at 14 - 15.

water companies do not face the same risk of substitution that exists for gas distribution companies.[193]

Dr. Woolridge places significant emphasis on current economic conditions and concluded that capital costs for utilities are historically low and are likely to be so for some time.[194] He further states that the investment risk of utilities is very low and that the cost of equity for utilities is among the lowest of all industries in the U.S. as measured by their betas.[195]

In his rebuttal testimony, Dr. Vander Weide addresses the criticism of his analysis and critiques Dr. Woolridge's analysis. Countering criticism of his proxy group selections, he notes that his proxy group of water utilities has a higher S&P bond rating and a slighter higher average *Value Line* safety than AWWC, and that his proxy group of natural gas utilities has a higher average *Value Line* safety rating and slightly higher average S&P bond rating than AWWC.[196]

Dr. Vander Weide rejects criticism of his use of a quarterly DCF model. He testifies that all companies within his proxy groups paid quarterly dividends and noted the same applied for those companies in Dr. Woolridge's proxy group. He further testifies that, as the DCF model is based on the assumption that a company's stock price is equal to the expected future dividends associated with investing in the

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[193] *Id.* at 13 - 14.

[194] *Id.* at 12.

[195] *Id.* at 23 - 24.

[196] Rebuttal Testimony of James Vander Weide at 6 - 7.

company's stock, an annual DCF model cannot be based upon this assumption when dividends are paid quarterly.[197]

Dr. Vander Weide takes exception to Dr. Woolridge's internal growth method. He argues that this method is not only circular, but underestimates the expected growth of his proxy companies by neglecting the possibility that such companies can grow by issuing new equity at prices above book value. He notes that many of the proxy companies are currently engaging in this practice or are expected to do so in the future. This possibility is noteworthy, he asserts, because the water industry is expected to undertake substantial infrastructure investments in the near future and to finance those investments in part through this practice.[198]

As to his use of EPS growth rates in his DCF analysis, Dr. Vander Weide argues that his studies show that stock prices are more highly correlated with analysts' growth rates than with historical or internal growth rates that Dr. Woolridge considered. He states that, if Dr. Woolridge had used the average EPS share growth rates of Yahoo, Reuters, and Zacks in his DCF analysis, his DCF for the water utility proxy group would have been equal to 9.7 percent.[199] He further maintains that correctly using a full year of growth in the analysis would produce a 9.8 percent DCF result.[200] Dr. Vander Weide asserts that the proper application of the DCF model requires that matching of stock prices and investors' growth expectations. Moreover, he argues, historical growth rates are inherently inferior to analysts' forecasts because analysts' forecasts already incorporate all relevant information regarding historical growth rates and also

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[197] *Id.* at 8 - 9.

[198] *Id.* at 11 - 12.

[199] According to Dr. Vander Weide, this result occurs even if a 1/2 g multiplier is used. *Id.* at 13.

[200] *Id.*

incorporate the analysts' knowledge about current conditions and expectations regarding the future. He refers to financial research that strongly supports the conclusion that analysts' growth forecasts are the best proxies for investor growth expectations.[201] Dr. Vander Weide concludes his discussion of the use of analysts' growth forecasts with his findings that analysts' EPS growth forecasts are not optimistic and that they are reasonable proxies for investor growth expectations, while Dr. Woolridge's historical and retention growth rates are not.[202]

Based upon our review of the record, we find that Kentucky-American's proposed ROE should be denied and that an ROE of 9.7 percent will continue to provide Kentucky-American with a fair and reasonable rate of return. In reaching our finding, we have focused upon the water utilities within the proposed proxy group. In Case No. 2010-00036, we found that Kentucky-American's use of natural gas distribution companies as proxies for water utilities to be inappropriate.[203] The water utility group consists of large and small publicly traded water utilities. While Kentucky-American is a relatively small water utility, it is part of a large, multi-state operation that has access to investment capital under conditions that few small water utilities could obtain. Accordingly, we are of the opinion that a proxy group consisting of water utilities is a more accurate indicator of risk and market expectations.

Our finding as to an ROE of 9.7 percent also continues to reflect Kentucky-American's regulatory history, with Kentucky-American's frequency of rate case

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[201] *Id.* at 21.

[202] *Id.* at 25.

[203] Case No. 2010-00036, Order of Dec. 14, 2010 at 70 ("[S]everal of the companies within the natural gas proxy group that Kentucky-American has used engage in exploration, production, transmission, and other non-regulated and non-distribution activities. These activities extend well beyond a distribution function and have greater risk.").

applications since 1992 clearly demonstrating management's focused efforts to minimize regulatory risk and the risk associated with the recovery of capital investments. Kentucky-American has applied for rate adjustments on a more frequent basis than other water utilities within the proxy group, using a forecasted test period with each rate application. Not only does the ability to use a forecasted test period tend to reduce the risk associated with the recovery of capital investments, it is also a mechanism that is unavailable to several of the utilities in Kentucky-American's proxy group and their subsidiaries.[204]

In reaching our finding, we have also excluded any flotation cost adjustment from our analysis and have placed much greater emphasis on the DCF and the CAPM model results of the water utility proxy groups compiled by Kentucky-American and the AG. While recognizing that historic data has some value for use in obtaining estimates, we have given considerable weight to analysts' projections regarding future growth. Finally, in assessing market expectations, we have given considerable weight to present economic conditions.

Weighted Cost of Capital. As shown in Table VIII, applying the rates of 6.06 percent for long-term debt, 8.52 percent for preferred stock, 0.5 percent for short-term debt, and 9.70 percent for common equity to the adjusted capital structure produces an overall cost of capital of 7.59 percent. We find this cost to be reasonable.

[204] *See* Kentucky-American's Response to Commission Staff's Second Request for Information, Item 23 at 2.

Table VIII

Component	Capital Structure	Capital Ratios	Commision Returns	Commission Average Weighted Cost
Short-Term Debt	$ 9,204,650	2.391%	0.5000%	0.01%
Long-Term Debt	199,241,777	51.748%	6.0600%	3.140%
Preferred Stock	4,489,938	1.166%	8.5200%	0.10%
Common Equity	172,085,452	44.695%	9.7000%	4.34%
Total Capitalization	$ 385,021,817	100.000%		7.5900%

Authorized Increase

The Commission finds that Kentucky-American's net operating income for rate-making purposes is $29,200,937. We further find that this level of net operating income requires an increase in forecasted present rate revenues of $6,904,134.[205]

Cost of Service Study/Rate Design

For general water service, Kentucky-American currently charges a monthly service charge and a flat volumetric fee. The service charge is based in part on the customer's meter size. It is intended to recover the cost of customer facilities such as meters and services, and the cost of customer accounting, including billing and collecting and meter reading. The volumetric fee is intended to recover the cost of producing, transporting, and distributing the water.

Kentucky-American included with its application a cost-of-service allocation study that uses the base-extra capacity method.[206] This methodology is widely recognized

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[205]

Net Investment Rate Base	$ 384,729,083
Multiplied by: Rate of Return	x 7.5900%
Operating Income Requirement	$ 29,200,937
Less: Forecasted Net Operating Income	- 25,013,042
Operating Income Deficiency	$ 4,187,895
Multiplied by: Revenue Conversion Factor	x 1.64859300
Increase in Revenue Requirement	$ 6,904,134

[206] Application Ex. 36.

within the water industry as an acceptable methodology for allocating costs.[207] This Commission has previously accepted the use of this methodology for cost allocation and development of water service rates.[208] No party has objected to the findings of the cost-of-service study.

In developing its proposed rates, Kentucky-American chose not to implement fully the cost-of-service study's results. According to the study, Kentucky-American should assess a monthly service charge of $14.86 per month for 5/8-inch meters.[209] Monthly service charges for the larger-sized meters are established by multiplying the meter capacity ratios by the 5/8-inch monthly service charge.[210] Kentucky-American proposes a monthly service charge for 5/8-inch meters of $14.00. While the proposed charge does not completely recover customer costs, it recovers a greater percentage of customer costs than the present customer charge and moves the utility closer to - completely cost-based rates.[211]

CAC proposes a tiered rate design in which the first usage block is charged a lower rate and the remaining usage blocks are charged an increasing amount.[212] It contends that this rate design would benefit all customers, not only those on low or fixed

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[207] American Water Works Association, *Principles of Water Rates, Fees and Charges* (5th Ed. 2000) at 50.

[208] *See, e.g.*, Case No. 2002-00040, *An Investigation Into Butler County Water System, Inc.'s Rate Schedule for Services with Private Fire Protection Facilities* (Ky. PSC Mar. 29, 2005) at 12 ("While several different methods of allocating costs exist, the base-extra capacity method is one of the most widely used methods of allocating costs. It recognizes that the cost of serving customers depends not only on the total volume of water used but also on the rate of use. We have used this methodology in several rate proceedings and have found it an effective methodology.").

[209] Gannett Fleming, Inc., *Cost of Service Allocation Study as of July 31, 2014 and Proposed Customer Rates* (Harrisburg, Pa. Dec. 21, 2012) at 41.

[210] Direct Testimony of Paul R. Herbert at 10.

[211] *Id.* at 9.

[212] Direct Testimony of Jack E. Burch at 13.

incomes. Under this proposal, the initial block's volume would be equal to the minimum amount of life-sustaining water for household needs. The rate for the initial block would be at a free or substantially reduced rate. The rate for remaining usage blocks would progressively increase to reflect the actual cost of water. CAC failed to define the "minimum amount of life-sustaining water for a household" or provide a methodology for making such determination. It also failed to provide any analysis or supporting authority for its assumption that a correlation exists between income levels and water use levels.

Kentucky-American opposes CAC's proposal. Kentucky-American Witness Herbert testified that the CAC rate structure was not cost-based,[213] would provide a subsidy to all customers, including those with higher income levels, and would thus place an increased burden on customers who cannot maintain their water usage within the initial block, such as customers with home gardens or large families.[214] To provide some rate relief to low-income customers, Mr. Herbert recommended that the Customer Charge be discounted to low-income customers, with any lost revenue recovered from the remaining residential customers through an increased customer charge.[215] He also noted that an increasing block rate structure, such as CAC proposes, is mainly found in areas where water supplies are limited or drought conditions frequently occur.[216]

While the Commission agrees with CAC's goal of maintaining or improving the affordability of water service, we find its proposed rate design is neither practical nor suited for a water utility in an area with a plentiful water supply. Moreover, while intended to assist low-income customers, it will negatively affect those low-income

[213] Rebuttal Testimony of Paul Herbert at 4.

[214] *Id.* at 5.

[215] *Id.*

[216] *Id.* at 5.

users who cannot reduce water consumption to the minimum block level. Given the prohibition against unreasonable preferences set forth in KRS 278.170 and the Commission's past rulings that customer income is not a reasonable classification,[217] the proposal for a discounted minimum charge for low-income customers is not currently a viable alternative.

The Commission has used Kentucky-American's cost-of-service study as a guide to develop the rates and charges set forth in the Appendix to this Order. We, however, have not strictly adhered to it, but have instead allocated some costs to volumetric rates rather than the monthly service charge to ensure that Kentucky-American's rates are equitable to all customer classes and send the appropriate price signal. We agree with AG/LFUCG Witness Brian Kalcic that a reduction in the volumetric rate would send the wrong pricing signal to Kentucky-American customers.[218] Recognizing that modifications to the Cost of Service Rates would require a reduction in volumetric rates, we find that maintaining those rates at existing levels is the more reasonable and prudent course of action.

<u>General Water Rates</u>

The rates and charges contained in the Appendix to this Order produce the required revenue requirement based upon the revised forecasted sales. For a residential customer who uses an average of 5,000 gallons per month, these rates will increase his or her monthly bill from $35.40 to $38.95, or approximately 10.03 percent.

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[217] *See, e.g.*, Case No. 2004-00103, Order of Feb. 28, 2005 at 80 - 83.

[218] Direct Testimony of Brian Kalcic at 11 ("a reduction in consumption charges would signal GMS customers that KAW's costs of supplying, treating and delivering 1,000 gallons of water are declining at a time when the Company claims such costs are increasing.").

Under Kentucky-American's proposed rates, the same customer would have seen his or her monthly bill increase 16.47 percent to $41.23.

Other Issues

Distribution System Improvement Charge. Kentucky-American proposes to implement a Distribution System Improvement Charge ("DSIC") to permit it to "accelerate the replacement of its aging infrastructure."[219] The DSIC is intended to encourage increased stockholder investment by eliminating the regulatory lag between the time when Kentucky-American makes an investment in plant and when it recovers the carrying cost in rates. Kentucky-American argues that the regulatory lag between investment and recovery in rates limits the amount of capital the stockholders are willing to make available to fund plant replacement.

The proposed DSIC would allow recovery through a separate billed charge of the cost of capital, depreciation, and property tax associated with qualified investment between rate case proceedings. The investment must be on plant that is non-revenue producing and was not included in rate base in a prior base rate case. The DSIC charge would be established on an annual basis using a 13-month average end-of-month UPIS balances and would reflect qualified plant additions constructed after the conclusion of the forecasted test year in the previous rate case. Qualified UPIS additions would be reduced by the projected UPIS retirements associated with the DSIC additions when calculating depreciation and property tax expense.[220]

An application for a DSIC would be filed 90 days prior to the effective date of each DSIC implementation. Each DSIC would include an annual reconciliation filing

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[219] Testimony of Gary M. Verdouw at 17.

[220] *Id.* at 22.

made not later than 60 days after the conclusion of each DSIC year. Each filing would contain a detailed listing of each qualifying DSIC project completed and placed in service during the immediate preceding year. The filing is subject to Commission review and adjustment. The DSIC would be cumulative and would re-established at zero at the conclusion of the next base rate proceeding at which time the DSIC costs would be included in base rates. The DSIC would be capped at 10 percent of the authorized revenue level established in Kentucky-American's most recent rate proceeding.[221]

Kentucky-American argues that a pressing need exists to replace the distribution infrastructure that has exceeded its life expectancy. It argues that the reliability of its service is dependent upon its ability to replace aging distribution infrastructure.[222] It further states that implementation of the DSIC will permit it to focus upon replacement of mains that are six inches or less in diameter. These mains, it argues, are responsible for the majority of the distribution system leaks and failures.[223]

Kentucky-American contends that the DSIC "has a host of attendant customer protection measures that dispel any suggestion that KAWC is seeking to push through costs without sufficient regulatory oversight."[224] It further contends that the DSIC is a well-accepted regulatory mechanism that has been used in several states to address

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[221] *Id. at 23.* In this case the proposed DSIC would be limited to $9,393,361 [$12,068,431(Kentucky-American's Revised Increase) + $81,865,176 (Revised Revenue from Water Sales) x 10%].

[222] *Id.* at 16.

[223] *Id.* at 19.

[224] Kentucky-American Brief at 24.

defined and significant infrastructure deficiency.[225] It compares the DSIC to the accelerated main replacement programs and gas line trackers the Commission has approved for other utilities.[226]

Kentucky-American explains that currently 82 miles of its six-inch or smaller water mains are 75 years old or older.[227] At the current annual investment rate of $3 million to $5 million, it will take approximately 41 years to replace the identified mains.[228] At the conclusion of this period, there will be an additional 947.77 miles of six-inch or smaller main with lives of greater than 75 years.[229] If a DSIC is approved, Kentucky-American intends to increase the capital available for the main replacement to a range of $5 million to $7 million, which Kentucky-American expects will shorten the replacement period to 16 to 27 years.[230]

The AG opposes the proposed DSIC tariff rider. He contends that the DSIC is ill-advised and unnecessary. The AG argues that Kentucky-American wants a solution for something that is not actually a problem.[231] Noting that since 1992 Kentucky-American has submitted a rate case with a forecasted test period every two years, the AG contends that the frequency of Kentucky-American's rate case applications "demonstrates management's focused efforts to minimize regulatory risk and the risk

[225] Testimony of Gary M. Verdouw at 20 – 21.

[226] Kentucky-American Brief at 117.

[227] Direct Testimony of Lance Williams at 15.

[228] *Id.*

[229] *Id.*

[230] Kentucky-American Response to the Commission Staff's Second Information Request, Item 50.

[231] AG Brief at 8.

associated with the recovery of capital investments."[232] According to the AG, the DSIC offers no material, incremental benefit, and that its approval would throw aside twenty years of effective regulatory oversight.[233]

He points to Kentucky-American's admission that there is no certainty that the DSIC tariff rider will reduce the frequency of base rate filings or that it will result in any short-term savings in operation and maintenance expenses.[234] The AG further argues that Kentucky-American has not identified the specific projects that will be recovered through the DSIC, nor does it have written procedures or policies to rank or prioritize the replacement of aging mains.[235] The AG argues that the DSIC "stands to reverse all of the gains made during the last twenty years in KAWC's capital budgeting and construction practices."[236]

Kentucky-American counters that it has provided details of its infrastructure planning process, identified the amount of its system that has exceeded its useful life, provided its current replacement rates, and identified the number of years it will take to replace 6 inch and less mains that have been in service longer than 75 years.[237] Kentucky-American asserts that it has shown that the replacement rate for its system mains is inadequate and must be accelerated if the problem is to be addressed in a timely fashion.[238]

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[232] *Id.* at 7 - 8.

[233] *Id.* at 8.

[234] Direct Testimony of Stephen M. Rackers at 10.

[235] *Id.* at 8

[236] *Id.*

[237] Kentucky-American Brief at 26.

[238] *Id.*

Kentucky-American argues that the primary purpose of the DSIC tariff rider "is not to produce cost savings or delay rate cases, but to accelerate the needed remediation of aging water utility infrastructure on a proactive and sustained basis."[239] Incident to achieving this goal, are long-term cost reductions that may occur through reduced energy usage, pumping costs, reductions in unaccounted for water loss, reduced main breaks, and fewer customer calls about service interruptions.[240] Kentucky-American contends that its ratepayers will benefit from any of these cost reductions in the long term, and that the DSIC "will permit the Company to reduce the frequency of base rate cases."[241] These benefits are secondary to the principal benefit of Kentucky-American's DSIC.[242]

Kentucky-American is currently investing between $3 million to $5 million annually to replace its six-inch or smaller mains that have been in service 75 years or longer. Kentucky-American estimates that at this rate of investment, it will take 41 years to replace the identified mains. If it is granted a DSIC tariff rider, Kentucky-American will increase its annual investment to a range of $5 million to $7 million and estimates that it will take between 16 and 27 years to replace the mains. The annual replacement rate will increase from the current rate of two miles per year to a range of three miles to five miles.

Based upon our review of the evidence, the Commission finds that the proposed DSIC tariff should be denied. Given the minimal impact of Kentucky-American's increased investment on main replacement, the Commission is of the opinion that the

[239] *Id.*at 27.

[240] *Id.*

[241] *Id.*

[242] *Id.*

effect of the DSIC tariff rider will be marginal. If Kentucky-American continues its current course of submitting rate cases approximately every two years, then its estimated impact of the accelerated replacement of the mains has been overstated. Further, Kentucky-American contradicts itself when it states that mains with a diameter of six inches or less are responsible for the majority of the distribution system leaks and failures,[243] but then claims that DSIC tariff rider will not result in any identifiable cost savings in the near term. Unlike the DSIC tariff rider, the accelerated gas main tariff riders were allowed for safety concerns and the main replacements were for a defined accelerated replacement period.

Purchased Power and Chemical Charge. Kentucky-American proposes to establish a Purchased Power and Chemical Charge ("PPACC") to reflect the incremental changes in purchased power and purchased chemical costs from the level authorized for recovery in a base rate case proceeding.[244] The PPACC would have the following features:

- In a base rate case proceeding, the Commission would establish the appropriate level of purchased power and chemical expenses to be included in base rates.
- Each month this base cost, which is established on a per unit basis (1,000 gallons of water), would be compared to current month actual purchased power and chemical costs.
- Annually, Kentucky-American would file with the Commission a report of its actual purchased power and chemical costs, as well as the reconciliation of any prior period PPACC Rider over or under-recoveries.
- The PPACC would be determined by dividing the cumulative annual incremental increase or decrease in purchased

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243 Rebuttal Testimony of Scott W. Rungren at 10.

244 Direct Testimony of Gary M. Verdouw at 28; Application Ex. 2 at 23.

power and chemical costs, grossed-up for the associated impact of revenue taxes, by projected annual base rate revenue subject to the PPACC Rider.

- The PPACC Rider would be expressed as a percentage and would be applied to the amount billed to each customer. The PPACC Rider amount would be reflected as a separate line item on the bill of each customer.

- The PPACC Rider would be subject to an annual reconciliation to determine the amount of any prior period PPACC Rider over or under-recovery which amount would be deferred and included in the Company's next PPACC for return to or recovery from customers.[245]

Kentucky-American contends that the PPACC is necessary to address the unpredictability and lack of control over purchased power and chemical expenses.[246] It maintains that the combined cost of purchased power and chemicals is the largest non-labor related component of its operations and maintenance expenses[247] and that the cost of purchasing these commodities is generally beyond Kentucky-American's control and their pricing can be volatile.[248]

Kentucky-American's forecasted chemical expense accounts for 5.3 percent of its total forecasted operation and maintenance expenses and 1.85 percent of its total revised revenue requirement.[249] Purchased power expense accounts for 11.22 percent

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[245] Direct Testimony of Gary M. Verdouw at 31 – 31.

[246] *Id.* at 29 – 30.

[247] *Id.* at 30.

[248] *Id.* at 31.

[249] Base Period Update-Ex. 37 Sch. A and Sch. C-1. $1,779,872 (Chemical Expense Forecast) ÷ $33,587,569 (Total Operation and Maintenance Expense Forecast) = 5.3%. $1,779,872 (Chemical Expense Forecast) ÷ $96,208,414 (Revenue Requirement Revised Forecast) = 1.85%. *See also* Kentucky-American's Response to Hearing Data Requests, Item 31 ("chemical expense comprises 5.24% of Kentucky American's total operations and maintenance expenses from the Cost of Service Study ("COSS") and 2.16% of the Total Cost of Service").

of Kentucky-American's total operation and maintenance expenses and 3.92 percent of its total revised revenue requirement.[250]

The AG argues that these expenses do not, separately or combined, warrant deviation from traditional rate-making methodologies.[251] AG Witness Rackers testified that the use of PPACC effectively allows Kentucky-American to engage in single issue ratemaking. He contends that it allows Kentucky-American to receive additional revenue in rates due to an increase in a tracked expense or decrease in tracked revenue without any consideration of whether it would simultaneously be receiving offsetting decreases in expenses or offsetting increases in revenues for those expenses and revenues that are not being tracked.[252]

The AG also asserts that, given Kentucky-American's frequent rate applications, no certain incremental benefit associated with the use of a tariff tracker mechanism exists. He further asserts that the PPACC tracker may actually add regulatory burden and unnecessary complexity.[253] He warns that a tracker may serve as a disincentive for

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[250] Base Period Update-Ex. 37 Sch. A and Sch. C-1. $3,768,292 (Fuel and Power Expense Forecast) ÷ $33,587,569 (Total Operation and Maintenance Expense Forecast) = 11.22%. $3,768,292 (Fuel and Power Expense Forecast) ÷ $96,208,414 (Revenue Requirement Revised Forecast) = 3.92%. *See also* Kentucky-American's Response to Hearing Data Requests, Item 31 ("The purchased power expense comprises 9.16% of total operations and maintenance expenses, and 4.58% of Total Cost of Service.").

[251] AG Brief at 19 - 20.

[252] Direct Testimony of Stephen M. Rackers at 20.

[253] AG Brief at 20.

Kentucky-American to control or to minimize its expenses.[254] The AG concludes that, if Kentucky-American needs a deviation, then the deferred debit methodology is better-suited for this application.[255]

Based upon our review of the record, we find that the proposed PPACC tariff rider should be denied. We do not agree with the premise that chemical and purchased power are totally outside of utility control. A utility may enter into long-term contracts for the purchase of chemicals. It may invest in energy-efficient equipment and take advantage of time-of-day rates to lessen its power costs. Moreover, if it is greatly concerned about its power costs, it can intervene in regulatory proceedings to zealously protect its interest when electric power rate adjustments are sought. As Kentucky-American concedes that its customers' water usage is decreasing, corresponding decreases in chemical and power purchases are also likely.

Finally, given that purchased power and chemical expenses account for a relatively small percentage of total utility expenses, the Commission finds no compelling need for the proposed tariff rider. For Kentucky-American, neither expense is at a level that is comparable to the level of purchased gas expense for a natural gas distribution

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[254] AG Witness Rackers testified:

> [T]he use of a tracker eliminates the inherent incentive a utility has to minimize expenses and maximize revenues between base rate proceedings, which over time works to keep electric rates lower than they otherwise would be. When a utility is allowed to track an expense, it can become indifferent with regard to minimizing that expense since it knows it will not need to file a new base rate case in order to recover any increases in that expense. Similarly, when a utility is allowed to track a revenue, it can become indifferent with regard to maximizing that revenue since it knows that it will not need to file a base rate case in order to recover any shortfall in that revenue.

Direct Testimony of Stephen M. Rackers at 20.

[255] *Id.*

utility or purchased fuel expense for an electric utility. Other state commissions have reached the same conclusion.[256]

Tap Fees. Kentucky-American proposes to increase its tap fees based upon a five-year average of its actual cost of meter installation. Historically, Kentucky-American has used a three-year average to establish this fee, but since its last general rate adjustment application has used a five-year average. It has used the longer period to establish the fee due to the fewer number of connections caused by slower economic growth.[257] We find that the proposed tap fees will yield only enough revenue to pay the expenses incurred in rendering the service, are reasonable and should be approved.

Activation Fee. Kentucky-American proposes to increase its activation fee from $26 to $28. It has analyzed the costs incurred for service runs related to service activation, disconnection and reconnection. These analyses reflect that the current charge does not recover the full cost of the service activity. Ms. Bridwell testified that due to the utility's efforts in integrating technology and driving efficiencies, the costs of service trips have been very flat, but that the proposed adjustment is appropriate to bring the fee closer to the actual costs of providing the service.[258] We find that the proposed activation fee will yield only enough revenue to pay the expenses incurred in rendering the service, is reasonable, and should be approved.

Reconnection Fee. Kentucky-American proposes to increase its reconnection fee from $26 to $56. The proposed revision recognizes that the activity involved with a

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[256] *See, e.g., Re West Virginia-American Water Co.*, 290 PUR4th 125 (W.Va. PSC Apr. 18, 2011) (rejecting a request to establish an investigation into the establishment of a purchased power adjustment clause because purchased power was not a dominant part of the water utility's cost of service).

[257] Direct Testimony of Lance Williams at 2-3.

[258] Direct Testimony of Linda C. Bridwell at 13-14.

reconnection involves two service trips to the customer's premises. The first trip is necessary to disconnect service. The second trip concerns the reconnection of service. In Case No. 2007-00143,[259] when Kentucky-American requested a reconnection fee of $26, it recognized that the fee would not provide for full recovery of the costs to provide the service.[260] The utility now wishes to obtain full recovery of these costs. We find that the proposed reconnection fee will yield only enough revenue to pay the expenses incurred in rendering the service, is reasonable, and should be approved.

Elimination of Afterhours Charges. Kentucky-American proposes to eliminate its Afterhours Activation or Reconnection Fees. As it has streamlined its organization, responsibility for after-hours service activations and reconnections has shifted to senior field services employees who work during the day. In recent years, Kentucky-American has encouraged customers to use after-hours activations or reconnections only on an emergency basis. This action has reduced overtime expense and also reduced the administrative work for Kentucky-American call representatives who processed the requests. In lieu of assessing the charges, Kentucky-American will continue to encourage its customers to use after-hours activations or reconnections only on an emergency basis.[261] No party opposes the proposal. We find that Kentucky-American's proposal is reasonable and should be approved.

Fire Hydrant Charge. Kentucky-American proposes to increase its monthly public fire hydrant charge from $37.84 to $45.30. Noting that the proposal will increase

[259] Case No. 2007-00143, *Adjustment of Rates of Kentucky-American Water Company* (Ky. PSC filed Apr. 30, 2007).

[260] Case No. 2007-00143, Kentucky-American's Response to Commission Staff's First Request for Information, Item 1(a), W/P-2 at 89 (filed May 21, 2007).

[261] *Id.* at 15-16.

its cost by more than $600,000, LFUCG argues that such an increase to a single customer is "excessive and unjust and would result in rate shock to Lexington."[262] It further argues that principles of gradualism require a lower increase. While we differ with LFUCG on the definition of "rate shock" and gradualism, we find that, as a matter of fairness and equity, the increase in fees for private and public fire hydrants should be limited to the same percentage increase as the increase in the average residential customer's bill. This action will limit the increase in LFUCG's total cost for public fire hydrant rentals to approximately $300,000.

Unified Rate Structure/Surcharge for Northern Division Connection Project.

LFUCG states that none of the cost of the Northern Division Connection Project, which will permit Kentucky River Station II to serve as a water source for the Northern Division, should be assigned to Central Division customers. It argues that "the Company asks that the Central Division customers supplement the Northern Division while receiving no tangible benefit."[263] To permit Kentucky-American to recover the cost of the Northern Division Connection Project through rates and to accept LFUCG's position that no costs associated with the Project be recovered from Central Division customers is only possible if the present unified rate structure is abandoned or if a surcharge to recover the Project's costs is imposed solely on Northern Division customers.

Kentucky-American opposes the termination of its unified rate structure and the assessment of a surcharge. It argues that the Commission encouraged the use of a

[262] LFUCG's Brief at 5.

[263] LFUCG Brief at 8.

unified rate structure in Case No. 2005-00206,[264] approved such a pricing structure in Case No. 2007-00143, and has continued to approve such structure in subsequent rate case proceedings. It notes that LFUCG agreed to a unified rate structure in Case No. 2007-00143 as part of a settlement agreement. None of the parties objected to the continued use of a unified rate structure in Kentucky-American's next rate case proceeding.

Kentucky-American further advances the following arguments in support of the unified rate structure: (1) A unified rate structure spreads the cost of capital expenditures across a larger customer base, thereby decreasing the effect of a capital project on each customer; (2) It eliminates the administrative burden of maintaining multiple sets of books and records; (3) It creates economies of scale and maintains more affordable rates for customers by spreading costs over the entire base of customers; (4) It lowers administrative and regulatory costs; (5) It improves financial capital and capital deployment; (6) It achieves rate and revenue stability; and (7) It improves service affordability for very small systems.[265]

Kentucky-American states that its accounting system does not presently provide an accurate and precise allocation of costs between its two divisions and must be modified to permit the maintenance of separate cost records for the two divisions.[266] It asserts that establishing separate and distinct rate schedules for each division that

[264] Case No. 2005-00206, *Verified Joint Application of the City of Owenton and Kentucky-American Water Company for Approval of the Transfer of the Ownership of Water- and Wastewater-Related Assets of the City of Owenton to Kentucky-American Water Company* (Ky. PSC July 22, 2005).

[265] Kentucky-American Brief at 49; *see also* Janice A Beecher, Consolidated Water Rates: Issues and Practices in Single Tariff Pricing (Sept. 1999).

[266] Kentucky-American's Motion for Relief at 2 – 3 (filed Mar. 12, 2013).

accurately reflect the cost of service, therefore, would have to be deferred to Kentucky-American's next rate case proceeding.

As to the use of a surcharge on Northern District customers to recover the Northern Division Connector Project's costs, Kentucky-American argues that a surcharge conflicts with a unified rate structure and is generally inappropriate. It asserts that such a surcharge is contrary to water-industry practice that provides that surcharges should be used to recover costs arising from one-day events or emergencies.[267]

When questioned regarding the elimination of the uniform rate structure, the AG stated that he does not recommend any change to Kentucky-American's unified rate structure.[268] He also does not recommend the use of a surcharge on Northern Division customers to recover Northern Division Connection Project costs.[269]

Based upon our review of the record, we find that Kentucky-American's unified rate structure should remain in place. The Commission has consistently supported the concept of a unified rate structure to encourage consolidation of water systems and to improve the quality of water service in the Commonwealth. Reversal of this policy would discourage further water system consolidation.

Elimination of the unified rate structure is inconsistent with the integration of the Northern and Central Divisions. The two divisions have ceased to be separate water systems. With the construction of the Northern Division Connection Project, the divisions are interconnected and share the same water treatment source. Their

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267 *Id.* at 52.

268 AG's Response to Commission Staff's Request for Information, Item 31.

269 *Id.* Item 30.

administrative, engineering, purchasing and operation functions are merged. These events have rendered moot the questions about the use and appropriateness of a unified rate structure.

We further find that the assessment of a surcharge on Northern Division customers to recover the costs of the Northern Division Connection Project is unwise and unreasonable. It is contrary to the concept of single tariff pricing. As the Northern Division Connection Project will allow for further integration of the two divisions and create cost savings for both divisions through the increased and more efficient use of Kentucky River Station II, its costs should be borne by all Kentucky-American customers.

A separate surcharge, moreover, would likely create a significant hardship for Northern Division customers. If a surcharge on Northern District customers is used to recover the Northern Division Connection Project's costs, a monthly surcharge of $32 must be assessed on each Northern Division customer for the next 30 years. In contrast, recovery of these costs through general rates will result in an increase of approximately $0.84 to the average Kentucky-American residential customer's monthly bill. Under these circumstances, recovery of the costs through general rates is the more reasonable and preferable method and is consistent with our prior directives regarding the consolidation of Kentucky-American's rates.[270]

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[270] *See* Case No. 2004-00103, Order of Feb. 28, 2005 at 75 – 76; Case No. 2005-00206, Order of July 22, 2005 at 6.

Future Water System Acquisitions

LFUCG cautions the Commission to pay close attention to the manner in which the costs of Kentucky-American's system expansions are recovered. It expresses the concern that the Central Division customer base may be used as a funding mechanism for future water system expansions[271]

Kentucky-American's Northern Division perfectly illustrates this concern. In this case, Kentucky-American acquired three small water systems that were experiencing significant operation problems and required infrastructure improvements. Given the small customer base of these acquired water systems, the only economically feasible means of financing these infrastructure improvements was to spread those costs over Kentucky-American's entire customer base. To finance the cost of the improvements only through rates assessed to the acquired systems' customers would have resulted in unaffordable rates for those customers. Instead, Kentucky-American recovered these costs from all of its customers, without regard to whether those customers directly benefited from the infrastructure improvements. Because these costs were spread over a much larger customer base, the increase in customer rates was relatively small.

This practice of cost sharing or cost spreading is not uncommon. For example, the cost of serving customers who are located closer to a water treatment plant is likely less than cost of serving customers who are located farther from treatment plant in the outer reaches of a water utility's service area. This Commission has recognized that differences in customer locations do not necessarily require different rates. The consolidation of costs in a unified pricing structure ensures affordable rates and high quality service for the greatest number of customers.

[271] LFUCG Brief at 8.

Kentucky-American's acquisition of small water systems that are in need of infrastructure improvement presents a critical question: What is the obligation of Kentucky-American's existing customers to finance system improvements to these acquired systems through higher rates for service? The answer depends upon the circumstances of each system acquisition. We recognize, however, that limits exist and that Kentucky-American's existing ratepayers should not be considered a deep pocket that is available in all cases to finance the improvements of acquired small water systems.

Our review of the record of Case No. 2005-00206 indicates this question was not considered. The Commission failed to thoroughly examine the possible consequences of Kentucky-American's acquisition of the Owenton Water System, including the cost of necessary infrastructure improvements and its potential effect on Kentucky-American's rates. As there was no specific statutory requirement for prior Commission review of Kentucky-American's acquisition,[272] the lack of review may be explainable. As the Commission in that proceeding also directed the use of a unified rate structure, the Commission should have at least posed the question.

The Commission finds that in the future a review of any acquisition of a water system by Kentucky-American should be conducted prior to the completion of that acquisition and that such review should address the question of the acquisition's potential effects on rates. In those instances in which Kentucky-American is acquiring a jurisdictional utility, KRS 278.020 currently requires prior Commission approval of the

[272] Case No. 2005-00206, Order of July 22, 2005 at 2 - 3 ("We find, however, no statutory requirement for such approval. KRS 278.020(5) and 278.020(6) require prior Commission approval of the transfer of control or ownership of any "utility." As a city, Owenton is not within the statutory definition of "utility." *See* KRS 278.010(3). KRS 278.020 therefore does not require Commission approval of the proposed transaction.")

acquisition. To meet its statutory obligation of demonstrating that the proposed acquisition is in the public interest, Kentucky-American will be expected to provide a detailed assessment of the costs of serving the acquired system and any necessary or expected service improvements, a plan for financing the cost of such improvements, an estimate of effect on the rates of acquiring system customers, and the benefits that existing system customers will accrue as a result of the acquisition.

As KRS 278.020 does not require Commission approval of Kentucky-American's acquisition of a non-jurisdictional water system, such as a municipal water utility, we nonetheless find that Kentucky-American should notify the Commission of its intent to acquire such systems at least 90 days prior to the proposed acquisition date. This notice will enable the Commission to conduct an inquiry or investigation into the proposed acquisition and its potential effects on existing system ratepayers.

We place Kentucky-American on notice that the consolidation of an acquired system's rates with Kentucky-American's rates should not be presumed. Kentucky-American must demonstrate the appropriateness and reasonableness of consolidating the rates. It should expect to maintain a separate set of records for acquired water systems for a reasonable period of time after the acquisition to enable the Commission to assess the cost of service for the acquired and acquiring systems and to better assist the Commission in determining the appropriateness and reasonableness of a unified/consolidated schedule of rates.

The position that we state today does not represent a departure from past Commission precedent. In Case No. 9283, we declared:

> The record in this case, in Case No. 9360, and in Case No. 9359 indicates that Kentucky-American intends to expand its service area outside the Urban County. The Commission

> commends Kentucky-American for pursuing the goal of serving as a regional water supplier. The Commission encourages Kentucky-American to pursue supply contracts with the adjacent districts as a way of using its excess treatment capacity and as an efficient method of providing basic water service within the region. But as a leader in Kentucky in the development of a regional water supply system, Kentucky-American must also look at the accompanying issues that this objective raises for the Commission. These issues include equity in cost allocation of treatment plant capacity and distribution capacity among service areas. The Commission is also concerned about the appropriate rate design for customer classes outside the Urban County. **Kentucky-American should be aware that the cost allocation and rate design method approved for the Urban County will not automatically be considered appropriate by the Commission for service to other counties.**[273]

Today, we merely affirm that position.

Service to Low-Income Customers

In Case No. 2010-00036, the Commission found that a collaborative effort should be undertaken to study potential regulatory and legislative solutions to the increasing lack of affordability of water service for low-income customers.[274] We directed Kentucky-American to initiate the process by arranging a meeting of the interested parties, to file periodic reports of the group's progress, and to submit a final report of the group's efforts no later than November 1, 2011.

CAC contends that Kentucky-American failed to comply with our directive. It asserts that no effort was undertaken by Kentucky-American to consider the comments and positions of other interested parties.[275] It further asserts that, even after legislation

[273] Case No. 9283, *Notice of Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Oct. 1, 1985) at 14 (emphasis added).

[274] Case No. 2010-00036, Order of Dec. 14, 2010 at 75 – 76.

[275] CAC Brief at 9; VT 06/05/2013; 17:57:18 - 17:57:29.

was developed by the collaborative group, Kentucky-American failed to take the necessary efforts to garner support for the proposed legislation. It requests that Kentucky-American be directed to fund a study for solutions to the water-affordability problem in the Kentucky-American service area and that the Center on Poverty Research at the University of Kentucky conduct the study.

In a similar vein, the AG describes Kentucky-American's efforts as "feeble" and states that the Commission's "directions were not followed."[276] He rejects any suggestion that his office was an impediment to the group's work and states his willingness to work with Kentucky-American and other stakeholders on the issue of affordability.[277]

Kentucky-American insists that it has complied with the letter and the spirit of the Commission's directive. It organized the required meetings, filed required periodic reports, and timely submitted the required final report.[278] It notes that a legislative solution was developed, but that the other stakeholders failed to adequately support the agreed-upon solution. Kentucky-American insists that the most effective and most appropriate solution is a change in existing law to permit water utilities to use rate classifications based upon a customer's income level. It stated that it remained interested in enacting legislation to permit water utilities to assess a reduced meter charge to low-income customers.[279]

Based upon our review of the record, we find that Kentucky-American has complied with the letter of our Order, but not its spirit. For that matter, no collaborative

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276 AG Brief at 27.

277 *Id.*

278 Kentucky-American Brief at 59 – 60.

279 *Id.* at 60 – 61.

member has fully complied with the spirit of Order. Notwithstanding their public posturing, collaborative members made little investment of time or effort in the process. No attempt was made to solicit potential stakeholders from outside this proceeding to expand the view, to explore administrative or ratemaking alternatives, or to seek the assistance of outside governmental or non-governmental organizations to examine the problem. When problems with the process arose, no collaborative member attempted to inform the Commission of the alleged problems or request our intervention. As a result, the collaborative has not met our expectations or produced any meaningful ideas.

While CAC's suggestion to involve the Center on Poverty Research has merit, this Commission lacks the authority to require Kentucky-American to expend its monies to fund an independent study on the issue and cannot grant CAC's requested relief. We find the parties' failure to seek out the Center on Poverty Research's assistance when the collaborative process began to be both unfortunate and indicative of the lack of imagination and initiative that they have displayed throughout the process.

The Commission finds that the collaborative should not continue in its present form. We will continue to evaluate possible forums for exploring this issue, either through a formal proceeding or through some informal process that may include the greater involvement of Commission's Staff. For the time being, however, we will not take any action to continue the collaborative process.

SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Kentucky-American's proposed rates would produce revenues in excess of those found reasonable herein and should be denied.

2. Kentucky-American's proposed DSIC tariff rider and PPACC charge are unreasonable and should be denied.

3. Kentucky-American's proposed non-recurring charges are reasonable and should be approved.

4. The rates in the Appendix to this Order are fair, just, and reasonable and should be charged by Kentucky-American for service rendered on and after July 26, 2013.

5. Kentucky-American should, within 60 days of the date of this Order, refund to its customers with interest all amounts collected from July 26, 2013 through the date of this Order that are in excess of the rates that are set forth in the Appendix to this Order. Interest should be based upon the average of the Three-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release on the date of this Order.

IT IS THEREFORE ORDERED that:

1. Kentucky-American's proposed rates, except for those directly related to non-recurring services, are denied.

2. The rates set forth in the Appendix to this Order are approved for service rendered on and after July 26, 2013.

3. Within 60 days of the date of this Order, Kentucky-American shall refund to its customers with interest all amounts collected for service rendered from July 26, 2013, through the date of this Order that are in excess of the rates that are set forth in the Appendix to this Order.

4. Kentucky-American shall pay interest on the refunded amounts at the average of the Three-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release on the date of this Order. Refunds shall be based on each customer's usage while the proposed rates were in effect and shall be made as a one-time credit to the bills of current customers and by check to customers that have discontinued service since July 26, 2013.

5. Within 75 days of the date of this Order, Kentucky-American shall submit a written report to the Commission in which it describes its efforts to refund all monies collected in excess of the rates that are set forth in the Appendix to this Order.

6. Within 20 days of the date of this Order, Kentucky-American shall file using the Commission's Electronic Tariff Filing System its revised tariff sheets containing the rates approved herein and signed by an officer of the utility authorized to issue tariffs.

7. Any documents filed with the Commission pursuant to Ordering Paragraph 5 shall reference this case number and shall be retained in the utility's general correspondence file.

8. At least 90 days prior to the execution of any agreement to acquire a water system that is not subject to Commission jurisdiction, Kentucky-American shall advise the Commission in writing of the pending transaction, to include the name and location of the water system and a brief description of the transaction.

By the Commission

ENTERED

OCT 25 2013

KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

Executive Director

OCT 2 5 2013

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2012-00520 DATED

The following rates and charges are prescribed for the customers in the area served by Kentucky-American Water Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Meter Charge Rates

Meter Size	
5/8-Inch	$ 12.45
3/4-Inch	18.68
1-Inch	31.13
1 1/2-Inch	62.25
2-Inch	96.60
3-Inch	186.75
4-Inch	311.25
6-Inch	622.50
8-Inch	996.00

Consumption Rates

Customer Category	Rate Per 100 Cubic Feet All Consumption	1,000 Gallons All Consumption
Residential	$3.9647	$5.30040
Commercial	3.6113	4.82800
Industrial	2.9132	3.89470
Municipal & Other Public Authority	3.1754	4.24520
Sales for Resale	3.1486	4.20930

Municipal or Private Fire Protection Service

Service Size	Rate Per Month	Rate Per Annum
2-Inch	$ 8.92	$ 107.04
4-Inch	35.90	430.80
6-Inch	80.74	968.88
8-Inch	143.54	1,722.48
10-Inch	224.34	2,692.08
12-Inch	323.50	3,882.00
14-Inch	439.89	5,278.68
16-Inch	574.42	6,893.04

Rates for Public or Private Fire Service

	Rate Per Month	Rate Per Annum
For each public fire hydrant contracted for or ordered by Urban County, County, State or Federal Governmental Agencies or Institutions	$ 41.60	$ 499.20
For each private fire hydrant contracted for by Industries or Private Institutions	79.77	957.24

Tapping (Connection) Fees

Meter Connection Size	
5/8-Inch	$1078.00
1-Inch	1,576.00
2-Inch	3,563.00
Service larger than 2-Inch	Actual Cost

Nonrecurring Charges

Activation Fee	$28.00
Reconnection Charge	56.00

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