

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF KENTUCKY-AMERICAN WATER COMPANY TO AMEND TARIFF TO REVISE QUALIFIED INFRASTRUCTURE PROGRAM CHARGE)	CASE NO.
)	2022-00032
)	
)	

ORDER

On March 1, 2022, Kentucky-American Water Company (Kentucky-American) filed its third Qualified Infrastructure Program (QIP) Rider (QIP 3) seeking authority to implement a surcharge for recovery of certain capital expenses to replace a portion of its aging water system infrastructure. Kentucky-American proposed an effective date of July 1, 2022. There are no intervenors in this proceeding. Kentucky-American responded to two rounds of discovery. Kentucky-American did not to request a public hearing and instead requested that the matter be decided based on the written record.¹ This matter now stands submitted to the Commission for a decision.

BACKGROUND

In Case No. 2018-00358, Kentucky-American requested approval of a QIP Rider to make incremental capital improvements to replace its aging mains that otherwise would not be replaced in a timely manner.² In that proceeding, Kentucky-American stated that it would prioritize the replacement of cast iron and galvanized steel mains, which

¹ Kentucky-American's Request for Decision Based Upon the Written Record (filed Apr. 28, 2022).

² Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 73–74. According to Kentucky-American, its infrastructure was deteriorating at a faster rate than the replacement rate.

represented 15 percent of the distribution system but accounted for 64.2 percent of annual main breaks.³ Kentucky-American further stated that the QIP would utilize a “systematic replacement plan” with a 25-year replacement cycle, and provided a list of QIP-eligible projects for the first five years.⁴

With the approval of the QIP Rider, the Commission established a filing schedule, calculation methodology, and filing contents. These requirements stated that QIP applications were to be filed on an annual basis on or before April 2, have a 90-day review period that can be extended for good cause, are based on a forecasted test period of July 1 to June 30, and have an annual true-up filing of projected costs and actual costs. However, in Case No. 2021-00090, the Commission found that it required additional time to thoroughly review Kentucky-American’s QIP applications given the number of projects and the need to closely evaluate those projects that are QIP eligible.⁵ Therefore, the filing requirements were updated and Kentucky-American is now required to file all future QIP applications no later than March 1 of each year for the QIP Rider that would be effective on July 1 of that year. The Commission reserves the right to continue any QIP proceeding beyond 120 days for good cause.⁶

³ Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), final Order at 76.

⁴ Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (filed Nov. 28, 2018) Direct Testimony of Brent E. O’Neill (O’Neill Testimony), Exhibit 1 and Exhibit 2 at 12.

⁵ Case No. 2020-00027, *Electronic Application of Kentucky-American Water Company to Amend Tariff for the Establishment of Qualified Infrastructure Program Charge* (Ky. PSC June 17, 2020) at 21.

⁶ Case No. 2020-00027, *Electronic Application of Kentucky-American Water Company to Amend Tariff for the Establishment of Qualified Infrastructure Program Charge* (Ky. PSC June 17, 2020), final Order at 21.

The QIP Rider is based upon a revenue requirement that is the sum of the pre-tax return for qualified additions and removal expenditures, plus the depreciation and property tax for the proposed projects in the forecasted test year. The QIP surcharge percentage is calculated as the amount of the QIP revenue requirement divided by the \$98,880,622 authorized revenue requirement established in Case No. 2018-00358.⁷ The QIP Rider is applied as a percentage to all water revenue, excluding other surcharges or taxes, and is displayed as a separate line item on customer bills. The QIP Rider is reset to zero when the next base rates are approved because the next base rates will include recovery of the annual costs previously recovered through the QIP.

In the first QIP tariff (QIP 1), Case No. 2020-00027, Kentucky-American proposed QIP investment that consisted of 60 percent main replacement projects and 40 percent non-main plant replacement projects which were stand-alone projects and not incidental to main replacement.⁸ In the final Order for Case No. 2020-00027, the Commission emphasized that the primary reason it approved Kentucky-American's QIP was to replace aging water mains that were reaching the end of their service life and were contributing to Kentucky-American's unaccounted-for water loss.⁹ The Commission rejected stand-alone projects for non-main plant replacement, finding that QIP-eligible plant other than

⁷ Direct Testimony of Tricia Sinople (Sinople Testimony) (filed Mar. 1, 2022) at 12.

⁸ Case No. 2020-00027, *Electronic Application of Kentucky-American Water Company to Amend Tariff for the Establishment of Qualified Infrastructure Program Charge* (Ky. PSC June 17, 2020).

⁹ Case No. 2020-00027, *Electronic Application of Kentucky-American Water Company to Amend Tariff for the Establishment of Qualified Infrastructure Program Charge* (Ky. PSC June 17, 2020), Order at 15.

replacement of aging mains “may be included in the QIP only if such plant is replaced incidental to the replacement of aging main.”¹⁰

For Case No. 2021-00090,¹¹ the QIP 2 tariff rider (QIP 2) application, Kentucky-American proposed a strategic capital expenditures plan (SCEP) for QIP 2 that included four budget line items deemed “recurring projects”¹² that were not developed for the QIP 2 specifically, but instead were projects previously identified as part of Kentucky-American’s larger plan to systematically accelerate spending on replacing aging infrastructure.¹³ Based upon its interpretation of the Commission’s intent in Case No. 2020-00027, Kentucky-American accelerated the replacement cycle of its main replacements in QIP 2 from a 25-year cycle to a 20-year cycle.¹⁴ The proposed reduction in the main replacement cycle increased Kentucky-American’s projected main replacement spending from \$7,623,282 in net plant additions approved in Case No. 2020-00027 to \$20,028,974 requested in QIP 2.¹⁵

In the final Order of Case No. 2021-00090 the Commission found that Kentucky-American’s main replacement projects in future QIP applications should be based on a

¹⁰ Case No. 2020-00027, *Electronic Application of Kentucky-American Water Company to Amend Tariff for the Establishment of Qualified Infrastructure Program Charge* (Ky. PSC June 17, 2020), Order at 17.

¹¹ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC Jun. 21, 2021).

¹² Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 3.

¹³ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 3.

¹⁴ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 6.

¹⁵ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 6.

25-year replacement cycle, be limited to annual main replacements of between 10–13 miles and be for QIP projects that are consistent with the amount proposed and approved in Case No. 2018-00358.¹⁶ The Commission directed Kentucky-American to be prepared to explain how each proposed project meets the prioritization matrix and external drivers in its 2022 QIP filing, and demonstrate what efforts Kentucky-American has implemented with contractors, suppliers, local transportation and engineering officials, and other utilities to contain and manage project costs.¹⁷ Additionally, the Commission ordered Kentucky-American to provide any evidence of the steps it has taken to control such costs.¹⁸

Further, in Case No. 2021-00090, the Commission found that Kentucky-American must demonstrate that it is more proactive in planning for and managing construction costs, and relaying accurate data to the Commission, given that costs that are not found to be reasonable cannot be recovered from ratepayers.¹⁹ As one example, limiting the number of contractors inherently leaves open the potential for inflated pricing, especially if requests to bid are offered only to contractors hand-picked by Kentucky-American.²⁰ The Commission requested that in the 2022 QIP filing Kentucky-American should include

¹⁶ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 12.

¹⁷ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 13.

¹⁸ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 17.

¹⁹ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 17.

²⁰ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 17.

what efforts they have implemented with contractors, suppliers, local transportation and engineering officials, and other utilities to contain and manage project costs.²¹

PROPOSED QIP 3

QIP Projects

Kentucky-American proposed expenditures for QIP 3 are limited to the budget line item B: QIP Mains Replaced/Restored²² and these items will be constructed with internal labor or with pre-qualified contractors to whom Kentucky-American submitted requests for proposals.²³ Kentucky-American explained that the projects are based on a 10-13 mile per year replacement rate to meet its 25-year replacement goal.²⁴ Specifically, the investments included in the proposed QIP 3 are intended to replace aging infrastructure that is non-revenue producing.²⁵

Kentucky-American explained it used the same prioritization matrix to identify QIP 3 projects that was used to develop proposed QIP projects in Case Nos. 2018-00358, 2020-00027, and 2021-00090.²⁶ The prioritization matrix criteria includes the amount of water pressure, number of breaks or leaks, main age, main material type, main size, and water quality, and are evaluated along with external drivers, such as customer impact and scheduled paving by other governmental entities, to develop a final project list and

²¹ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC June 21, 2021), Order at 18.

²² Direct Testimony of Krista Citron (Citron Testimony) (filed Mar. 1, 2022) at 4.

²³ Citron Testimony at 10.

²⁴ Citron Testimony at 4.

²⁵ Citron Testimony at 4.

²⁶ Citron Testimony at 7–8.

schedule.²⁷ For its QIP Year 3 projects, Kentucky-American also considered the pavement condition rating from the city of Lexington (LFUCG).²⁸ Kentucky-American stated that the goal of including this factor in its analysis is to identify segments of main located within roadways that are likely to be paved in the near future to better coordinate paving restoration requirements with LFUCG.²⁹

Kentucky-American's proposed QIP 3 classified Budget Line B: QIP Mains Replaced/Restored include the scheduled replacement or improvement of 12.8 miles of existing water mains for a total of 58 projects at a capital cost of \$17,900,000.³⁰ In addition to water mains, the plant replaced in this budget line includes valves, hydrants, and service lines incidental to the main replacement that reached the end of their useful life or cause service problems to adjacent area serviced by the main.³¹

Kentucky-American stated that the majority of replaced mains in this budget line are cast iron and galvanized mains and these mains represent 15.9 percent of the total inventory and 64 percent of all breaks.³² Kentucky-American explained that the break per mile for cast iron main is 1.1 breaks per mile of main compared to ductile iron, which has a break rate of 0.04 breaks per mile of main between January 2012 and December 2016.³³ Kentucky-American asserted that replacing cast iron and galvanized steel water

²⁷ Citron Testimony at 7–8.

²⁸ Citron Testimony at 8.

²⁹ Citron Testimony at 8.

³⁰ Citron Testimony at 5.

³¹ Citron Testimony at 4.

³² Citron Testimony at 6.

³³ Citron Testimony at 6-7.

main infrastructure would result in a direct customer benefit of improved and sustained water quality and ensure reliability of water service to Kentucky-American customers.³⁴

In accordance with the final Order in Case No. 2021-00090, Kentucky- American provided detailed descriptions of how each proposed project included in QIP 3 addresses the aspects of its prioritization matrix in its selection.³⁵ In addition, Kentucky American stated it has expanded its list of bidders for QIP projects by proactively seeking out additional contractors and it has added two new contractors to the pre-qualified list, Further, Kentucky-American stated that it has contacted firms performing work for other American Water subsidiaries to gauge their interest in working for Kentucky-American.³⁶ Additionally, Kentucky-American contacted bidders for other utilities in surrounding areas. Collectively these measures, have resulted in bids from an expanded group of 7-8 contractors compared to 3-4 as in the past six years.³⁷

While Kentucky-American has implemented the construction cost management procedures detailed above, Kentucky-American noted that the issues currently impacting the global supply chain have increased the cost per linear foot of the replacement of mains, as shown below.³⁸

³⁴ Citron Testimony at 7.

³⁵ Citron Testimony, Exhibit 3.

³⁶ Citron Testimony at 10.

³⁷ Citron Testimony at 10.

³⁸ Citron Testimony at 9.

	Cost per Linear Foot	
	Estimated	Completed
QIP Year 1	\$ 230	\$ 265
QIP Year 2	250	265
QIP Year 3	265	-

QIP 2 Rate Base End of Period Values

Kentucky-American pointed to the Commission’s decision in Case No. 2021-00090 directing Kentucky-American to calculate its rate base for a forecasted QIP period on a 13-month average values rather than the “end-of-period” of “terminal” values since the investment in the proposed QIP projects have yet to occur and the exact timing of the QIP investment is uncertain.³⁹ According to Kentucky-American as of July 1, 2022, the effective date of QIP 3, the amount of investment in the QIP 2 main replacement projects will be known precisely and all of the QIP 2 replacement projects will become “used and useful.”⁴⁰ For these reasons Kentucky-American argued that for consistent and sound ratemaking purposes it is appropriate to update the QIP 2 rate base and revenue requirement to reflect “end-of-period” values just as they would be calculated in a general rate case with an historic test year.⁴¹

Based upon its review of the record in this proceeding, the Commission finds that Kentucky-American’s proposal to revise its QIP 2 surcharge rate to reflect forecasted “end-of-period” construction investment is reasonable and should be accepted. However, in Kentucky-American’s 2023 QIP filing, the Commission directs Kentucky-American that its end-of-period update to QIP 3 should reflect the actual construction costs incurred for

³⁹ Sinopole Testimony at 6–7.

⁴⁰ Sinopole Testimony at 7.

⁴¹ Sinopole Testimony at 7.

the QIP 3 projects as of January 31, 2023, and the remaining five months (February 1, 2023-June 30, 2023) of the QIP 3 period should reflect the forecasted construction costs for that period. Additionally, any differences between the forecasted construction costs for the remaining period and what was forecasted in the instant case should be supported by filed testimony.

Reconciling QIP2 Project Spending and Surcharge Collections

Kentucky-American stated that there will be two pieces to its QIP 2 Annual Balancing Adjustment that will be filed no later than 90 days after June 30, 2022, the end of the QIP 2 period.⁴² In Piece 1 of the annual filing, Kentucky-American will compare the forecasted 13-month average rate base and revenue requirement to the 13-month average actuals.⁴³ Any over or under collection that results from Kentucky-American's Piece 1 comparison will be made to the QIP 2 rate that became effective July 1, 2021, to June 30, 2022.⁴⁴ In Piece 2, Kentucky-American will reconcile the authorized "end of period" rate base in QIP 2 to the actual "end of period" rate base, and any resulting differences to the revenue requirement using the "end of period" comparisons will also be made to the QIP rate that became effective July 1, 2022.⁴⁵ Kentucky-American claimed that its Piece 2 comparison ensures that the QIP 2 actual investment will be trued-up in a timely manner and will not allow Kentucky-American to over or under collect based on "end of period" rate base.⁴⁶

⁴² Sinopole Testimony at 8.

⁴³ Sinopole Testimony at 8.

⁴⁴ Sinopole Testimony at 8.

⁴⁵ Sinopole Testimony at 8.

⁴⁶ Sinopole Testimony at 8.

The Commission finds that Kentucky-American's proposed Annual Balancing Adjustment adjustments are reasonable and should be accepted.

QIP Rider Surcharge Amount

Based upon the above findings, the Commission accepts Kentucky-American's proposed 4.61 percent QIP Rider as reasonable and, therefore, is approved.⁴⁷

QIP 3 Projects are Extensions in the Ordinary Course of Business

KRS 278.020(1) requires a utility to obtain a Certificate of Public Convenience of Necessity (CPCN) prior to constructing any new facility that is intended to furnish regulated utility services to the public. However, this statute also provides an exemption from the certificate requirements if the new facility is an ordinary extension of existing systems in the usual course of business.⁴⁸ Commission regulation 807 KAR 5:001, Section 15(3), defines an ordinary extension in the usual course of business as an extension that does not create wasteful duplication of plant or conflict with existing certificates of other utilities operating in the same area and under the jurisdiction of the Commission, and does not involve sufficient capital outlay to materially affect the existing financial condition of the utility or will not result in increased charges to its customers.

Having reviewed the record and being sufficiently advised, the Commission finds that Kentucky-American's proposed QIP 3 projects approved in this Order are replacement projects of ordinary distribution facilities that do not require a CPCN because they would be classified as extensions in the ordinary course of business, and therefore

⁴⁷ 0.97% (QIP 1) + 0.10% (QIP 1 Annual Balancing Adjustment) + 1.07% (QIP 2) + 1.11% (QIP 3) = 3.25% (Total QIP).

⁴⁸ KRS 278.020(1)(a)(2).

exempt from the requirements of a CPCN pursuant to KRS 278.020(1). The QIP projects approved in this Order do not create a wasteful duplication of plant.

IT IS THEREFORE ORDERED that:


1. The QIP Rider of 4.61 percent as proposed by Kentucky-American is fair, just and reasonable, and is approved for service rendered on and after July 1, 2022, through June 30, 2023.

2. Kentucky-American's proposed revision to the calculation of its QIP 2 rate to reflect forecasted "end-of-period" construction investment is approved.

3. Within 20 days of the date of this Order, Kentucky-American shall, using the Commission's electronic Tariff Filing System, file its revised tariffs setting out the rates authorized in this Order and the revised QIP Rider and reflecting they were approved pursuant to this Order.

4. This case is now closed and removed from the Commission's docket.

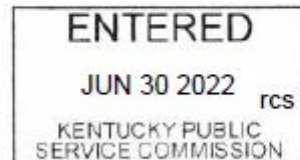
PUBLIC SERVICE COMMISSION



Chairman

Vice Chairman

Commissioner



ATTEST:



Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2022-00032 DATED JUN 30 2022

Line No.	QIP 1 July 2020 - June 2021	QIP 2 July 2021 - June 2022	QIP 3 July 2022 - June 2023	Total QIP
1	\$9,328,645	\$20,050,000	\$8,737,865	\$38,116,510
2	(633,049)	(920,606)	(330,929)	(1,884,585)
3	<u>8,695,596</u>	<u>19,129,394</u>	<u>8,406,936</u>	<u>36,231,925</u>
4				
5	549,261	2,005,000	873,787	3,428,048
6	633,049	920,606	330,929	1,884,585
7	(137,516)			(137,516)
8		(292,680)		(292,680)
9			(128,626)	(128,626)
10	<u>1,044,794</u>	<u>2,632,926</u>	<u>1,076,090</u>	<u>4,753,810</u>
11				
12	9,740,390	21,762,320	9,483,026	40,985,736
13	(1,550,183)			(1,550,183)
14		(1,635,882)		(1,635,882)
15			(1,345,808)	(1,345,808)
16	<u>8,190,207</u>	<u>20,126,438</u>	<u>8,137,218</u>	<u>36,453,863</u>
17	9.28%	9.28%	9.28%	9.28%
18	760,223	1,868,156	755,305	3,383,684
19	137,516			137,516
20		292,680		292,680
21			128,626	128,626
22	120,869	18,819	(4,348)	135,340
23		265,899	(9,565)	256,334
24			230,888	230,888
25				
26	<u>\$1,018,608</u>	<u>\$2,445,553</u>	<u>\$1,100,906</u>	<u>\$4,565,068</u>
27				
28	<u>\$98,880,622</u>	<u>\$98,880,622</u>	<u>\$98,880,622</u>	<u>\$98,880,622</u>
29	<u>1.03%</u>	<u>2.47%</u>	<u>1.11%</u>	<u>4.61%</u>

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