

1 HAS CLAIMED FOR RATE RECOVERY IN THIS CASE.

2 A. As shown on Schedule RJH-28, KAWC has claimed a total amount of \$427,857 for regulatory  
3 expenses in this case, consisting of the following components:

4 1. Continuation of the amortization of the Case No. 95-554 rate case expenses. For the  
5 forecasted period this amortization amount is \$178,739.

6 2. Continuation of the amortization of the Case No. 95-554 depreciation study expenses.  
7 For the forecasted period this amortization amount is \$7,584.

8 3. Continuation of the amortization of the prior Billing and Tariff Group & Cost of Service  
9 study expenses. For the forecasted period this amortization amount is \$42,984.

10 4. Proposed 2-year amortization of the total projected rate case expenses of \$397,100 for  
11 the current case. For the forecasted period this 2-year amortization amount is \$198,550.

12 Q. WHAT IS YOUR OPINION REGARDING THE RATE MAKING TREATMENT THAT  
13 SHOULD BE APPLIED TO THE EXPENSES ASSOCIATED WITH A UTILITY'S  
14 APPLICATION FOR RATE RELIEF IN A GENERAL BASE RATE PROCEEDING?

15 A. It is my opinion that such rate case expenses should be shared between the utility's ratepayers  
16 and shareholders. This sharing concept is based on the premise that both shareholders and  
17 ratepayers benefit from any rate relief generated by a base rate proceeding. The shareholders  
18 benefit because rate relief will either maintain or increase the utility's earnings, thereby  
19 maintaining or enhancing their investment value in the utility. The ratepayers, arguably, benefit  
20 because any required rate relief serves to keep the utility in good financial health and contributes  
21 to the prospect that the utility will continue to provide safe, adequate and reliable water

1 services. It should be noted that there is nothing novel about this sharing concept. For  
2 example, this rate case expense sharing policy has been applied for many years in the State of  
3 New Jersey by the New Jersey Board of Public Utilities. Specifically, the rate making rule  
4 applied by the NJBPU is that the rate case expenses of all of the major New Jersey utilities,  
5 including water utilities, be shared on a 50/50 basis between ratepayers and shareholders.  
6 KAWC should be well aware of this because its sister company, New Jersey-American Water  
7 Company, has long been subject to this 50/50 sharing of its rate case expenses. In fact, in New  
8 Jersey-American's most recent 1995 base rate proceeding, NJBPU Docket No. WR95040165,  
9 New Jersey-American itself requested in its filing that only 50% of its rate case expenses be paid  
10 for by its ratepayers<sup>23</sup>.

11 Q. WHAT IS YOUR UNDERSTANDING OF THE RATE MAKING POLICY CURRENTLY  
12 APPLIED BY THE KENTUCKY PSC REGARDING KAWC'S RATE CASE EXPENSES?

13 A. It is my understanding that the PSC currently allows KAWC to recover all of its rate case  
14 expenses in rates by amortizing such rate case expenses over an appropriate amortization  
15 period, but does not allow the unamortized rate case expense balance in rate base. Presumably,  
16 this is based on the recognition that KAWC's rate cases benefit both ratepayers and  
17 shareholders and, therefore, should in some way be shared between these two stakeholders.  
18 Under the PSC's currently espoused method, this sharing is accomplished by having the  
19 ratepayers pay for the amortization expenses, while having the stockholders absorb the carrying  
20 charges related to the unamortized rate case expense balance.

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<sup>23</sup> NJAWC rate case filing Exhibit P-2, Schedule 17 (witness R.A. Engle), NJBPU Docket No. WR95040165.

1 Q. DO YOU AGREE WITH THIS RATE CASE EXPENSE SHARING METHODOLOGY  
2 CURRENTLY APPLIED BY THE PSC?

3 A. For the reasons expressed earlier, I am in full agreement with the PSC's intent to share  
4 KAWC's rate case expenses between the ratepayers and shareholders. However, with all due  
5 respect, I believe that the PSC's current sharing methodology does not result in appropriate and  
6 equitable sharing percentages between the ratepayers and shareholders. In KAWC's most  
7 recent cases, the PSC has allowed the Company to recover its rate case expenses over a 2-year  
8 period. Because of this very short recovery period, the stockholders share of the rate case  
9 expenses -- through the absorption of the carrying charges on the unamortized balance during  
10 this short two year period -- is very small. Specifically, under the scenario that KAWC's rate  
11 case expenses are amortized in rates over a 2-year period, but the stockholders are not allowed  
12 to earn an assumed overall rate of return of 10% on the unamortized balance, *the ratepayer's*  
13 *share of the rate case expenses is 93% and the stockholder's share is 7%.* The Company has  
14 confirmed this because these sharing percentage were calculated by the Company itself in  
15 response to data request AG 1-89.

16 Q. DO YOU RECOMMEND THAT, STARTING WITH THIS CASE, THE PSC'S CURRENT  
17 RATE CASE EXPENSE SHARING METHODOLOGY BE CHANGED IN ORDER TO  
18 ACCOMPLISH MORE EQUITABLE SHARING PERCENTAGES BETWEEN  
19 RATEPAYERS AND STOCKHOLDERS?

20 A. Yes. I recommend that the PSC's current rate case expense sharing methodology be changed  
21 in this case in such a way that the ratepayers and shareholders will both be paying approximately

1 50% of the rate case expenses. I am making this recommendation not only for the  
2 ratepayer/shareholder benefit reasons previously discussed, but also for another important  
3 reason.

4 Q. WHAT IS THIS OTHER REASON?

5 A. As shown in the response to data request AG 1-161, KAWC's actual rate case expenses have  
6 increased significantly during the past 5 rate cases and are now in the range of \$400,000. While  
7 it is recognized that KAWC's recent use of fully-forecasted test periods has contributed to these  
8 significant rate case expense increases, there should nevertheless be a concern about these ever-  
9 increasing rate case expenses; a concern that, I believe, has previously been expressed by both  
10 the PSC and the AG. It should also be noted that KAWC always ends up requesting that all  
11 of its actual rate case expenses associated with a particular case eventually be recovered in  
12 rates, i.e., even the actual rate case expenses incurred in excess of the rate case expenses  
13 allowed for that same rate case in the prior rate case. This is evident, for example, from filing  
14 Schedule F-6, Page 1. This schedule shows that while the Company's Case No. 95-554 rate  
15 case expense estimate was \$366,000, in retrospect it spent a total actual amount of \$389,982  
16 and the continued amortization expense for Case No. 95-554 requested in the instant  
17 proceeding is based on this higher actual expense level of \$389,982.

18 Because of the particular sharing policy currently applied by the PSC to KAWC's rate  
19 case expenses, one should not be surprised that the Company is willing to spend large amounts  
20 of money to accomplish its rate relief objectives. After all, spending an additional amount of,  
21 let's say, \$30,000 in rate case expenses to exhaustively litigate a rate case issue worth \$100,000

1 would only “cost” KWAC’s shareholders <sup>2</sup>\$3,100 (7% of \$30,000) under the PSC’s current rate ✓  
2 case expense sharing policy. In this example, the Company would have the potential of  
3 “winning” additional rate relief of \$100,000 while also being able to recover \$27,900 of the  
4 additional \$30,000 of rate case expenses spent to pursue this issue.

5 In summary, it is my opinion that the PSC’s current rate case expense sharing  
6 methodology *provides very little incentive for KAWC to minimize, contain or reduce its rate*  
7 *case expenses*. KAWC may be inclined to be more frugal and cost conscious with regard to its  
8 rate case expenses knowing that its shareholders would have to absorb 50% of these expenses  
9 rather than 7%.

10 Q. WHAT SPECIFIC METHODOLOGY DO YOU RECOMMEND TO ACCOMPLISH AN  
11 APPROXIMATE 50/50 SHARING OF THE RATE CASE EXPENSES BETWEEN THE  
12 RATEPAYERS AND KAWC’S SHAREHOLDERS IN THIS CASE?

13 A. Referring to Schedule RJH-28, it should first be noted that I am *not* recommending that the rate  
14 making treatment for the prior regulatory expenses shown on lines 1-4 be changed in this case.  
15 The specific rate making treatment for these items has already been decided and allowed by the  
16 PSC in Case No. 95-554 and changing this treatment now would represent inappropriate  
17 retroactive rate making. Thus, my recommended rate case expense sharing methodology  
18 change should only be applied to the rate case expenses associated with the instant proceeding.

19 I believe that the most accurate way to accomplish an approximate rate case expense  
20 sharing of 50/50 between the ratepayers and shareholders would be to allow 50% of the  
21 Company’s requested rate case amortization expenses, while allowing the unamortized balance

1 of such shared rate case expenses in rate base. There are other ways of achieving this 50/50  
2 sharing concept. For example, the PSC could increase the allowed amortization period while  
3 not including the unamortized balance in rate base in such a way that the end result on a net  
4 present value basis would also represent an approximate 50/50 sharing. However, I believe that  
5 my recommended method would be easier to implement and administer.

6 Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE COMPANY'S  
7 PROPOSED FORECASTED PERIOD RATE BASE AND OPERATING INCOME?

8 A. As shown on Schedule RJH-28, my recommendation increases the Company's proposed  
9 operating income by \$59,205 and average forecasted period rate base by \$148,913.

10 - Postage Billing Expenses

11 Q. PLEASE EXPLAIN THE ISSUE WITH REGARD TO POSTAGE BILLING EXPENSES  
12 IN THIS CASE.

13 A. As is evident from filing workpaper W/P-3-10, Page 1, the Company's projected forecasted  
14 period Customer Accounting expenses (without considering uncollectible expenses) are  
15 significantly higher than the comparable historic actual expense levels. Company witness Bush,  
16 on page 11 of his direct testimony, explains that "virtually all of this increase relates to monthly  
17 meter reading and billing, since only 9 months of the base year includes monthly reading and  
18 billing expenses". A more pinpointed analysis of the data presented in this case indicates that  
19 virtually all of this increase relates to the Company's forecasted period projections for postage

1 billing expenses.

2 Q. COULD YOU DESCRIBE THE ANALYSIS YOU PERFORMED REGARDING THE  
3 COMPANY'S POSTAGE BILLING EXPENSES?

4 A. This analysis is shown in detail on Schedule RJH-29. The first column on this schedule shows  
5 the monthly postage billing expenses from September 1996 through August 1997 that were  
6 projected by KAWC in Case No. 95-554, ranging from \$29,500 to \$30,600 per month. These  
7 monthly expense projections assumed that the impact of monthly reading and billing on postage  
8 billing expenses would start to be experienced in full in September 1996. The second column  
9 shows the monthly expenses from September 1996 through September 1998 projected by the  
10 Company in the current case. As can be seen, the Company's current case projections for the  
11 months of October 1996 through August 1997 are virtually the same as its projections for those  
12 months in Case No. 95-554, i.e., ranging from \$29,500 to \$30,600. The second column also  
13 shows the Company's monthly and total postage billing expense projections for the forecasted  
14 period, i.e., total expenses of \$363,927, averaging about \$30,300 per month. The third column  
15 shows the actual monthly postage billing expenses booked by the Company from September  
16 1996 through April 1997. This data indicates that the full impact on postage billing expenses  
17 from monthly reading and billing did not occur until November 1996. The actual monthly  
18 expenses from November 1996 through April 1997 have consistently been around \$23,000  
19 (averaging \$22,800) and have consistently been lower than the budgeted expenses by about  
20 \$7,000 (variance average of \$7,100).

1 Q. BASED ON THE ANALYSIS SHOWN ON SCHEDULE RJH-29, WHAT LEVEL OF  
2 POSTAGE BILLING EXPENSES DO YOU RECOMMEND FOR THE FORECASTED  
3 PERIOD?

4 A. The Company's projected monthly expenses for the forecasted period are at approximately the  
5 same level as its projected monthly expenses for the period November 1996 through September  
6 1997, i.e., slightly in excess of \$30,000 per month. Since the actual monthly expenses for  
7 November 1996 through April 1997 have consistently been around \$23,000, or approximately  
8 \$7,000 below the budgeted expenses for that same period, I recommend that the average  
9 monthly expenses for the forecasted period be set at \$23,000, for a total recommended  
10 forecasted period expense amount of \$276,000. As shown on Schedule RJH-29, this  
11 recommendation reduces the Company's proposed forecasted period expenses by \$87,927 and  
12 increases the Company's proposed forecasted period operating income by \$52,437.

13 - Bank Service Charges

14 Q. HAVE YOU PERFORMED A SIMILAR ACTUAL-TO-BUDGET VARIANCE ANALYSIS  
15 FOR THE COMPANY'S CLAIMED BANK SERVICE CHARGES IN THIS CASE AS YOU  
16 DID FOR POSTAGE BILLING EXPENSES, AS DESCRIBED IN THE PREVIOUS  
17 SECTION OF THIS TESTIMONY?

18 A. Yes. The Company's projected forecasted period bank service charges represent a substantial  
19 increase over the comparable historic actual expense levels. Company witness Wilkins, on page  
20 4 of her direct testimony, states that this increase is caused by the conversion to monthly billing.



1 Schedule RJH-30 shows the results of a similar actual-to-variance expense analysis regarding  
2 bank service charges as was presented on Schedule RJH-29 regarding postage billing expenses.

3 Q. WHAT IS YOUR RECOMMENDATION BASED ON THE RESULTS OF THE ANALYSIS  
4 SHOWN ON SCHEDULE RJH-30?

5 A. With regard to the actual monthly expenses shown under the third column on Schedule RJH-30,  
6 I have assumed that the full impact of monthly billing on bank service charges did not occur  
7 until November 1996. The average actual monthly bank service charges from November 1996  
8 through March 1997 has been \$4,900. Based on the actual-to-budget expense variances shown  
9 on Schedule RJH-30, and based on the average actual monthly expense experience from  
10 November 1996 through to date, I recommend that the average monthly expenses for the  
11 forecasted period be set at \$5,000, for a total recommended forecasted period expense amount  
12 of \$60,000. Given the actual expense experience to date and the fact that the actual expenses  
13 in almost every month since November 1996 have been below budgeted levels, I believe that  
14 this recommended expense amount is more realistic and reasonable than the Company's  
15 proposed average monthly forecasted period expense level of \$7,405<sup>24</sup>. As shown on Schedule  
16 RJH-30, this recommendation reduces the Company's proposed forecasted period expenses by  
17 \$28,862 and increases the Company's proposed forecasted period operating income by  
18 \$17,213.

19 - Miscellaneous Expense Adjustments

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<sup>24</sup> \$88,862 / 12 = \$7,405.

1 Q. HAVE YOU REVIEWED THE COMPANY'S PROPOSED FORECASTED PERIOD  
2 OPERATING EXPENSES TO DETERMINE WHETHER THEY INCLUDE EXPENSE  
3 ITEMS WHICH, IN YOUR OPINION, SHOULD BE TREATED "BELOW-THE-LINE"  
4 FOR RATE MAKING PURPOSES?

5 A. Yes. Based on my review, I have determined that the Company's forecasted period operating  
6 expenses include a range of expense items which, in my opinion, should not be charged to the  
7 ratepayers. These expense items include the forecasted period expense bookings listed in the  
8 table below:

- 9 1. \$3,800 for Christmas gifts (W/P-3-13, P.1 and AG 1-169b.)
- 10 2. \$3,030 for Lobbying expenses (W/P-3-13, P.1 and AG 1-115: 20% of KAWC's NAWC  
11 dues of \$15,150)
- 12 3. \$3,389 for donations, gifts, award banquet and summer picnic expenses allocated to  
13 KAWC by the Service Company (AG 1-117)
- 14 4. \$14,102 for Employee Recognition expenses (W/P-3-13, P.1 and AG 2-24)
- 15 5. \$5,650 for Community Organization expenses (W/P-3-13, P.1 and AG 1-169c.)
- 16 6. \$2,828 for Service Award expenses (W/P-3-13, P.1)
- 17 7. \$694 for Lafayette Club dues (Schedule D-1, page 15)
- 18 8. \$26,751 for miscellaneous membership expenses, involving chamber of commerce dues,  
19 Bluegrass Tomorrow, and various expenses related to economic development (W/P-3-  
20 13, P.1 and AG 1-169c.)

21 I do not believe that the expense items listed above have anything to do with the provision of  
22 safe, reliable and adequate water service or that they provide a direct benefit to the ratepayers  
23 in some other way. Thus, based on this information alone, I would recommend that these  
24 expense items be excluded from the Company's proposed above-the-line forecasted period  
25 operating expenses. However, I have also reviewed prior Commission rate making policy  
26 regarding these type of expense items in the Company's most recent five base rate cases. This  
27 review indicates that while the PSC has a clear and well-established policy of excluding

1 lobbying expenses, gifts<sup>25</sup>, award banquet expenses and picnic expenses, it has previously  
2 allowed such items as community organization expenses, service awards, Lafayette Club dues  
3 and miscellaneous membership expenses, including Bluegrass Tomorrow, economic  
4 development and chamber of commerce dues.

5 Therefore, *at a minimum*, I recommend that the Company's forecasted period operating  
6 expenses be reduced to remove the lobbying expenses, Christmas gifts and the donations, gifts,  
7 award banquet and summer picnic expenses allocated to KAWC by the Service Company that  
8 are listed as the first three line items in the above table. As shown on Schedule RJH-31, this  
9 recommendation decreases the Company's forecasted period expenses by \$10,219 and increases  
10 the Company's forecasted period operating income by \$6,094. The expense items listed as the  
11 last five line items in the above table should also be removed should the Commission decide to  
12 reconsider its prior rate making treatment for these expense items.

13 - "Miscellaneous Other" and Conservation Expenses

14 Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED "MISCELLANEOUS OTHER" AND  
15 CONSERVATION EXPENSES IN THIS CASE.

16 A. As shown in filing W/P-2-13, Page 1 and response to AG 1-169a., the Company's actual  
17 miscellaneous other expenses for 1993 through 1996 and as projected by KAWC for the  
18 forecasted period are as follows:

19 - 1993 \$ 27,853

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<sup>25</sup> For example, see response to AG 1-169 b.

1	- 1994	\$ 30,254
2	- 1995	\$ 59,491
3	- 1996	\$ 49,519
4	- Forecasted Period	\$179,274

5 As is evident from this data, the Company is proposing to increase its forecasted period  
6 miscellaneous other expenses by a factor of almost 4 x over the actual expense level  
7 experienced in 1996.

8 In response to data request AG 1-170a., the Company described "miscellaneous other"  
9 expenses as follows:

10 "Miscellaneous Other expense is comprised of miscellaneous expenses for which  
11 specific account numbers have not yet been established. It includes such expense  
12 items as customer surveys, the annual Science Fair, various water works events,  
13 LFUCG council and PSC tours and conservation-related programs".

14 From other data presented in this case and the testimony of Company witness Wilkins, page 4,  
15 lines 21-24, it is clear that the majority of the Company's projected miscellaneous other  
16 expenses of \$179,274 for the forecasted period consist of projected conservation expenses.

17 Q. HAVE YOU PERFORMED AN ANALYSIS COMPARING THE COMPANY'S ACTUAL  
18 VERSUS BUDGETED CONSERVATION EXPENSES?

19 A. Yes. The results of this analysis are shown on Schedule RJH-32, page 2 of 2. As shown on  
20 this schedule, the Company's budgeted conservation expenses for the Case No. 95-554 base  
21 period 5/1/95 through 4/30/96 were \$106,454 whereas the actual expenses for this period were  
22 only \$31,502. Thus, the actual conservation expenses were only 29.6% of the budgeted  
23 expenses for this period. Similarly, the Company's budgeted conservation expenses for the  
24 Case No. 95-554 forecasted period portion from 9/1/96 through 3/31/97 were \$66,617 whereas

1 the actual expenses for this period were only \$12,041, or 18.07% of the budgeted expenses.  
2 Finally, for the entire period since the conservation program was implemented, i.e., from 1/1/94  
3 through to date, the budgeted conservation expenses were \$138,802 as compared to a total  
4 actual expense level of only \$49,489, for an actual-to-budget expense ratio of 35.65%.

5 In summary, it is clear from this information that the Company has been rather  
6 unsuccessful in its conservation efforts and, as a result, has been (and still is) spending  
7 considerably less than its budgeted conservation expenses. This was confirmed in the  
8 Company's responses to data requests AG 1-109 and 1-143 in which the Company indicates  
9 that "there has been limited response to the Company's attempt to install retrofit kits" and that  
10 "the programs that were directed at specific customers saw very little response in the pilot  
11 phases and were delayed for further evaluation".

12 Q HAVE YOU ALSO PERFORMED AN ANALYSIS COMPARING THE COMPANY'S  
13 ACTUAL VERSUS BUDGETED "MISCELLANEOUS OTHER" EXPENSES?

14 A. Yes, this analysis is presented on Schedule RJH-32, page 1 of 2. The first column on this  
15 schedule shows the monthly expenses from September 1996 through April 1997 that were  
16 projected by KAWC in Case No. 95-554. The second column shows the monthly expenses  
17 from June 1996 through April 1997 projected by the Company in the current case. The second  
18 column also shows the Company's monthly expense projections for the forecasted period for  
19 a total forecasted period expense amount of \$179,273. The third column shows the actual  
20 monthly expenses booked by the Company from June 1996 through April 1997 and indicates  
21 that the total actual expenses for this period have only been at a level of 61% of the total

1 budgeted expenses for this same period.

2 Q. BASED ON THE ANALYSES SHOWN ON SCHEDULE RJH-32, PAGES 1 AND 2, WHAT  
3 LEVEL OF "MISCELLANEOUS OTHER" EXPENSES DO YOU RECOMMEND FOR  
4 THE FORECASTED PERIOD?

5 A. I recommend that the forecasted period miscellaneous other expenses be set at \$125,000. As  
6 shown on Schedule RJH-32, my recommendation decreases KAWC's proposed forecasted  
7 period expenses by \$54,273 and increases the Company's proposed forecasted period operating  
8 income by \$32,367.

9 Q. WHY ARE YOU RECOMMENDING MISCELLANEOUS OTHER EXPENSES OF  
10 \$125,000 FOR THE FORECASTED PERIOD?

11 A. I do not wish to discourage the Company in its conservation program efforts and it is for that  
12 reason that I recommend the allowance of an amount as high as \$125,000 for the forecasted  
13 period miscellaneous other expenses. While this recommended amount is not as high as what  
14 has been proposed by the Company, it is still more than two and a half times as high as the  
15 actual 1996 expense level of \$49,519.

16 - Customer Deposit Interest

17 Q. WHY HAVE YOU DECREASED THE COMPANY'S PROPOSED OPERATING INCOME  
18 BY \$2,043 AS SHOWN ON SCHEDULE RJH-4, LINE 18?

1 A. I have made this adjustment to be consistent with the previously discussed recommendation to  
2 use customer deposits as a rate base deduction in this case. Based on the recommended  
3 customer deposit rate base deduction and a customer deposit interest rate of 6%, an amount  
4 of \$3,425 for customer deposit interest expense should be moved "above-the-line". As shown  
5 in more detail on Schedule RJH-16, this recommended expense adjustment decreases the  
6 Company's proposed forecasted period operating income by \$2,043.

7 - Depreciation Expenses

8 Q. WHY HAVE YOU INCREASED THE COMPANY'S PROPOSED OPERATING INCOME  
9 BY \$16,167 AS SHOWN ON SCHEDULE RJH-4, LINE 19?

10 A. I have made this adjustment to be consistent with the previously discussed recommendation to  
11 reduce KAWC's proposed forecasted plant in service balance for the so-called slippage factors.  
12 As shown on Schedule RJH-5, lines 4-6, this recommended depreciation expense reduction  
13 adjustment increases the Company's proposed forecasted period operating income by \$16,167.

14 - General Taxes

15 Q. WHY HAVE YOU INCREASED THE COMPANY'S PROPOSED OPERATING INCOME  
16 BY \$10,326 AS SHOWN ON SCHEDULE RJH-4, LINE 20?

17 A. This adjustment represents the combined after-tax operating income impact of my  
18 recommended adjustments to the Company's proposed forecasted period taxes other than

1 income taxes. My specific general tax adjustments are presented in more detail on Schedule  
2 RJH-33. The property tax adjustment shown on line 1 of this schedule is a direct result of (1)  
3 the previously discussed recommended plant in service and CWIP adjustments due to the  
4 application of the slippage factor, and (2) the recommended removal from rate base of the  
5 Louisville pipeline related special budget projects BP 90-13, 90-14 and 92-12. The payroll tax  
6 adjustment is a direct result of the recommended adjustments to the Company's proposed  
7 forecasted period payroll expenses. It should be noted that Schedule RJH-33 does not show  
8 any adjustments to PSC fees that would be required as a result of the recommended operating  
9 revenue adjustments made in this case. This is because such PSC fees adjustments have already  
10 been separately accounted for in the revenue adjustment schedules included in this testimony.

11 - Income Taxes

12 Q. PLEASE EXPLAIN THE ADJUSTMENTS YOU HAVE MADE TO THE COMPANY'S  
13 PROPOSED FORECASTED PERIOD INCOME TAXES.

14 A. As the starting point, I accepted all of the income tax components and amounts proposed by  
15 KAWC for the forecasted period. I then separately reflected the income tax implications of  
16 each of my recommended adjustments to the Company's proposed forecasted period revenues,  
17 expenses and taxes other than income taxes. However, there are still two income tax  
18 adjustments that need to be made, involving interest synchronization and a correction for a tax  
19 calculation error reflected in KAWC's forecasted period income taxes.



1 taxes by \$15,137. Accordingly, I have increased the Company's forecasted period net  
2 operating income by \$15,137, as shown on Schedule RJH-4, line 22.

3 Q. MR. HENKES, DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

4 A. Yes, it does.

5

**SUPPORTING SCHEDULES**

**SCHEDULES RJH-1 THROUGH RJH-34**

**KAWC - CASE NO. 97-034**  
**SUMMARY OF REVENUE REQUIREMENT POSITIONS**

	<u>KAWC</u> (1)	<u>Adjustment</u>	<u>AG</u>	
1. Average Rate Base	\$130,570,800	(\$4,849,251)	\$125,721,549	Sch. RJH-3
2. Rate of Return	<u>9.57%</u>		<u>8.77%</u>	Sch. RJH-2
3. Operating Income Requirement	12,495,626		11,025,780	
4. Forecast Year Operating Income	<u>10,899,642</u>	437,851	<u>11,337,493</u>	Sch. RJH-4
5. Operating Income Deficiency	1,595,984		(311,713)	
6. Revenue Conversion Factor	<u>1.6837199</u>		<u>1.6837199</u>	
7. Revenue Requirement	<u>\$2,687,190</u>	<u>(\$3,212,028)</u>	<u>(\$524,838)</u>	

(1) Schedule A, Page 1

**KAWC - CASE NO. 97-034**  
**SUMMARY OF RATE OF RETURN POSITIONS**

<u>KAWC POSITION (1)</u>	<u>Capital Structure Ratios</u>	<u>Cost Rates</u>	<u>Weighted Cost Rates</u>
Short Term Debt	3.65%	5.70%	0.21%
Long Term Debt	50.75%	8.12%	4.12%
Preferred Stock	5.49%	7.77%	0.43%
Common Equity	<u>40.11%</u>	12.00%	<u>4.81%</u>
Total Capital	<u><u>100.00%</u></u>		<u><u>9.57%</u></u>

<u>AG POSITION (2)</u>	<u>Capital Structure Ratios</u>	<u>Cost Rates</u>	<u>Weighted Cost Rates</u>
Short Term Debt	3.65%	5.70%	0.21%
Long Term Debt	50.75%	8.12%	4.12%
Preferred Stock	5.49%	7.77%	0.43%
Common Equity	<u>40.11%</u>	10.00%	<u>4.01%</u>
Total Capital	<u><u>100.00%</u></u>		<u><u>8.77%</u></u>

(1) Schedule J-1, Page 1

(2) Testimony Mr. Rothschild

**KAWC - CASE NO. 97-034**  
**SUMMARY OF RATE BASE POSITIONS**

	<u>KAWC</u> (1)	<u>Adjustment</u>	<u>AG</u>	
1. Utility Plant in Service	\$192,758,194	(\$1,091,065)	\$191,667,129	Sch. RJH-5
2. Acquisition Adjustment	(5,814)		(5,814)	
3. Accumulated Depreciation	(32,510,781)	15,524	(32,495,257)	Sch. RJH-6
4. Accumulated Amortization	(7,674)		(7,674)	
5. CWIP	6,400,363	(2,569,016)	3,831,347	Sch. RJH-7
6. Cash Working Capital				
- Lead/Lag CWC	986,000	(116,188)	869,812	Sch. RJH-8
- Less: Accrued Pensions		(242,540)	(242,540)	Sch. RJH-9
- Total Net CWC	<u>986,000</u>	<u>(358,727)</u>	<u>627,273</u>	
7. Other Working Capital	406,028	(1,024)	405,004	Sch. RJH-10
8. CIAC	(18,100,645)	5,333	(18,095,312)	Sch. RJH-11
9. Customer Advances	(5,321,568)	283,641	(5,037,927)	Sch. RJH-12
10. Deferred Income Taxes	(18,068,070)	(20,477)	(18,088,547)	Sch. RJH-13
11. Deferred ITC	(179,264)		(179,264)	
12. Deferred Maintenance	3,007,935		3,007,935	
13. Deferred Debits	380,571	(83,502)	297,069	Sch. RJH-14
14. Source of Supply Invest.	969,811	(969,811)	0	
15. Contract Retentions	(144,286)	(29,506)	(173,792)	Sch. RJH-15
16. Customer Deposits		(57,091)	(57,091)	Sch. RJH-16
17. Unclaimed Ext. Dep. Refunds		(74,882)	(74,882)	Sch. RJH-17
18. Unamortized KU Refund		(47,562)	(47,562)	(2)
19. Unamortized Rate Case Exp.		148,913	148,913	Sch. RJH-28
20. Meter Deviation Net Plant Savings		<u>(63,940)</u>	<u>(63,940)</u>	Sch. RJH-18
<b>TOTAL NET RATE BASE</b>	<u><u>\$130,570,800</u></u>	<u><u>(\$4,849,251)</u></u>	<u><u>\$125,721,549</u></u>	

(1) Schedule B-1, Page 2

(2) Response to AG 1-60C

**KAWC - CASE NO. 97-034**  
**SUMMARY OF OPERATING INCOME POSITIONS**

	<u>Impact on Net Income</u>	
1. Forecasted Period Utility Operating Income Proposed By KAWC:	\$10,899,642	(1)
<u>AG Recommended Adjustments:</u>		
2. Adjustment for Impacts of Conservation on Sales	35,910	Sch. RJH-19
3. Monthly OPA Sales Adjustment	4,789	Sch. RJH-20
4. Quarterly OPA Sales Adjustment	5,562	Sch. RJH-21
5. OWU Sales Adjustment	12,570	Sch. RJH-22
6. AFUDC Adjustments	(88,831)	Sch. RJH-7
7. Labor Expense Adjustments	148,648	Sch. RJH-23, p.1
8. Incentive Compensation Expense Adjustment	23,743	Sch. RJH-24
9. Employee Benefit Expense Adjustment	116,881	Sch. RJH-25
10. Fuel and Power Expense Adjustment	52,784	Sch. RJH-26
11. Chemical Expense Adjustment	(8,418)	Sch. RJH-26
12. Current Waste Disposal Expense Adjustment	12,062	Sch. RJH-27
13. Regulatory Expense	59,205	Sch. RJH-28
14. Postage Billing Expense Adjustment	52,437	Sch. RJH-29
15. Bank Service Charges	17,213	Sch. RJH-30
16. Miscellaneous Expense Adjustments	6,094	Sch. RJH-31
17. "Miscellaneous Other" and Conservation Expense Adjustments	32,367	Sch. RJH-32, p.1
18. Customer Deposit Interest	(2,043)	Sch. RJH-16
19. Depreciation Expense Adjustment	16,167	Sch. RJH-5
20. General Taxes Adjustments	10,326	Sch. RJH-33
21. Interest Synchronization Adjustment	(84,750)	Sch. RJH-34
22. Correction for Income Tax Error	15,137	(2)
23. Meter Deviation Depreciation Expense Adjustment	1,161	Sch. RJH-18
24. Forecasted Period Utility Operating Income Recommended By AG:	<u>\$11,337,493</u>	

(1) Schedule C-1, Page 1

(2) Per response to AG 1-46. Taxable income reduction of \$37,503 x composite income tax rate of 40.3625% = income tax reduction (net income increase) of \$15,137.

**KAWC - CASE NO. 97-034**  
**PLANT IN SERVICE AND DEPRECIATION EXPENSE ADJUSTMENT**

**RATE BASE ADJUSTMENT**

1. Forecasted Period Average Plant in Service Proposed By KAWC: \$192,758,194 (1)

**AG Recommended Adjustments:**

2. Impact on Line 1 due to Plant Slippage Factor Adjustment (1,091,065)

3. AG Recommended Forecasted Period Average Plant in Service \$191,667,129 (2)

**DEPRECIATION EXPENSE ADJUSTMENT**

4. Depreciation Expense Adjustment Related to Plant Adjustment (\$27,108) (3)

5. After-Tax Income Factor 59.6375%

6. Impact on Net Income \$16,167

(1) Schedule B-1, Page 2

(2) Response to data request PSC 2-7, page 20. Represents slippage factors of 96.993% (routine) and 84.726% (special budget) based on "Scenario B" of the response to PSC 2-7.

(3) Depreciation expense based on plant adjustment reflecting slippage factors of 96.993% and 84.726% as per response to data request PSC 2-7, page 15 is \$4,416,108. This is \$27,108 less than KAWC's proposed depreciation expense of \$4,443,216.

**KAWC - CASE NO. 97-034  
ACCUMULATED DEPRECIATION**

1. Forecasted Period Average Acc. Depr. Proposed By KAWC:	(\$32,510,781)	(1)
<u>AG Recommended Adjustments:</u>		
2. Impact on Line 1 due to Plant Slippage Factor Adjustment	<u>15,524</u>	
3. AG Recommended Forecasted Period Average Acc. Depr.	<u><u>(\$32,495,257)</u></u>	(2)

(1) Schedule B-1, Page 2

(2) Response to data request PSC 2-7, page 20. Represents slippage factors of 96.993% (routine) and 84.726% (special budget) based on "Scenario B" of the response to PSC 2-7.



**KAWC - CASE NO. 97-034  
CWIP AND AFUDC**

<u>CWIP</u>	<u>KAWC</u>	<u>Adjustment</u>	<u>AG</u>
1. Average Forecasted Period CWIP	<u>\$6,400,363</u> (1)	<u>(\$2,569,016)</u>	<u>\$3,831,347</u> (2)

AFUDC

1. Forecasted Period AFUDC	<u>\$392,478</u> (3)	(\$148,952)	<u>\$243,526</u> (2)
2. After-Tax Income Factor		<u>59.6375%</u>	
3. Impact on Net Income		<u>(\$88,831)</u>	

(1) Schedule B-1, Page 2

(2) Average forecasted period CWIP adjusted for slippage factors:	\$5,726,786	(4)
Remove CWIP related to BP 90-13, 90-14 and 92-12.	<u>(1,895,439)</u>	(5)
Remaining CWIP balance:	<u>\$3,831,347</u>	
Remaining CWIP balance - AFUDC accruing:	\$2,776,807	(5)
AG-recommended overall rate of return:	<u>8.77%</u>	Sch. RJH-2
Recommended AFUDC:	<u>\$243,526</u>	

(3) Schedule D-1, Page 1

(4) Response to data request PSC 2-7, page 20 Represents slippage factors of 96.993% (routine) and 84.726% (special budget) based on "Scenario B" of the response to PSC 2-7.

(5) Per response to data request AG 2-18S.

**KAWC - CASE NO. 97-034**  
**CASH WORKING CAPITAL REQUIREMENT**

	<u>CWC</u> <u>Requirement</u>	
1. KAWC's Proposed Lead/Lag Study CWC:	\$986,000	(1)
<u>AG Recommended Adjustments:</u>		
2. Revenue Lag of 35.84 Days vs. KAWC's Proposed 35.88 Days:		
- KAWC's proposed average daily operating funds	\$95,614	
- Difference between 35.8 <del>8</del> and 35.80 days	<u>(0.04)</u>	✓
	(3,825)	(2)
3. Remove Deferred Income Tax from Lead/Lag Analysis:		
- (\$815,052 / 365 days) x 35.84 revenue lag days	(80,031)	
4. Remove Depreciation Expenses Associated With Plant Funded By Customer Advances of \$75,869 (AG 1-28):		
- (\$75,869 / 365 days) x 35.84 revenue lag days	(7,450)	
5. Remove \$37,503 of Amortizations (AG 2-7) From Lead/Lag Analysis:		
- (\$37,503 / 365 days) x 35.84 revenue lag days	(3,682)	
6. Remove Pension Expenses From Lead/Lag Analysis (AG 1-33):		
- (\$215,902 / 365 days) x 35.84 revenue lag days	<u>(21,200)</u>	
7. Total Recommended Lead/Lag CWC Requirement	<u><u>\$869,812</u></u>	

(1) Filing Schedule B-5.2, Page 4

(2) Response to AG 2-5

**KAWC - CASE NO. 97-034  
ACCRUED PENSION RESERVES**

Average Balance 1994	<u><u>\$126,592</u></u>
Average Balance 1995	<u><u>\$74,785</u></u>
Average Balance 1996	<u><u>\$75,038</u></u>
Actual Balance 1/97	\$120,596
Actual Balance 2/97	\$131,163
Actual Balance 3/97	\$141,767

Projected for Forecast Period:

9/97	\$191,135
10/97	199,702
11/97	208,270
12/97	216,837
1/98	225,405
2/98	233,972
3/98	242,540
4/98	251,107
5/98	259,675
6/98	268,242
7/98	276,810
8/98	285,377
9/98	<u>293,945</u>
Average Balance	<u><u>\$242,540</u></u>

SOURCE: Response to data request AG 2-2. Balances exclude accrued pension expenses related to \$655,365 write-off ordered by PSC in Case No. 92-452. Balances are also stated net of associated prepaid deferred income taxes.

**KAWC - CASE NO. 97-034  
OTHER WORKING CAPITAL**

Sch. RJH-10

<u>Month</u>	<u>Amount</u>
	(1)
3/95	\$371,832
4/95	373,592
5/95	330,353
6/95	400,150
7/95	382,921
8/95	371,840
9/95	369,685
10/95	355,379
11/95	449,255
12/95	326,388
1/96	374,559
2/96	364,977
3/96	494,724
4/96	353,453
5/96	399,683
6/96	368,070
7/96	495,752
8/96	600,023
9/96	230,758
10/96	416,268
11/96	404,459
12/96	375,365
1/97	571,436
2/97	407,690
3/97	536,497
24-Month Average 3/95-3/97	<u>\$405,004</u>

(1) W/P-1-7, Page 1; response to PSC 1-26 (prior case); response to AG 2-4

**KAWC - CASE NO. 97-034**  
**CONTRIBUTIONS IN AID OF CONSTRUCTION**

1. Forecasted Period Average CIAC Proposed By KAWC:	(\$18,100,645)	(1)
<u>AG Recommended Adjustments:</u>		
2. Impact on Line 1 due to Plant Slippage Factor Adjustment	<u>5,333</u>	
3. AG Recommended Forecasted Period Average CIAC	<u><u>(\$18,095,312)</u></u>	(2)

(1) Schedule B-1, Page 2

(2) Response to data request PSC 2-7, page 20 Represents slippage factors of 96.993% (routine) and 84.726% (special budget) based on "Scenario B" of the response to PSC 2-7

**KAWC - CASE NO. 97-034  
CUSTOMER ADVANCES**

1. Forecasted Period Average Cust. Adv. Proposed By KAWC:	(\$5,321,568)	(1)
<u>AG Recommended Adjustments:</u>		
2. Impact on Line 1 due to Plant Slippage Factor Adjustment	<u>283,641</u>	
3. AG Recommended Forecasted Period Average Cust. Adv.	<u><u>(\$5,037,927)</u></u>	(2)

(1) Schedule B-1, Page 2

(2) Response to data request PSC 2-7, page 20 Represents slippage factors of 96.993% (routine) and 84.726% (special budget) based on "Scenario B" of the response to PSC 2-7.

**KAWC - CASE NO. 97-034**  
**ACCUMULATED DEFERRED INCOME TAXES**

1. Forecasted Period Average ADIT Proposed By KAWC:	(\$18,068,070)	(1)
<u>AG Recommended Adjustments:</u>		
2. Impact on Line 1 due to Plant Slippage Factor Adjustment	5,925	(2)
3. ADIT Increase Related to Rate Base Inclusion of Unamortized Current Case Rate Case Expenses	(60,105)	(3)
4. ADIT Decrease Related to Rate Base Exclusion of AMR Study Deferred Debit	33,703	(4)
5. AG Recommended Forecasted Period Average Acc. Depr.	(\$18,088,547)	

(1) Schedule B-1, Page 2

(2) Response to data request PSC 2-7, page 20 Represents slippage factors of 96.993% (routine) and 84.726% (special budget) based on "Scenario B" of the response to PSC 2-7. \$18,068,070 less \$18,062,145 = \$5,925.

(3) Rate base addition for unamortized current case rate case expenses.	\$148,913	Sch. RJH-3
Composite state and federal income tax rate.	<u>40.3625%</u>	
Increase in accumulated deferred income taxes.	<u>\$60,105</u>	
(4) Rate base deduction for AMR deferred debit removal:	\$83,502	Sch. RJH-14
Composite state and federal income tax rate.	<u>40.3625%</u>	
Increase in accumulated deferred income taxes:	<u>\$33,703</u>	

**KAWC - CASE NO. 97-034  
DEFERRED DEBITS**

Sch. RJH-14

1. Forecasted Period Average Def. Debits Proposed By KAWC:	<b>\$380,571</b>	(1)
<u>AG Recommended Adjustments:</u>		
2. Remove Deferred Debit Related to AMR Study	<u>(83,502)</u>	(2)
3. Forecasted Period Average Def. Debits Recommended by AG:	<u><b>\$297,069</b></u>	

(1) Schedule B-1, Page 2

(2) W/P-1-12, Page 1



**KAWC - CASE NO. 97-034  
CONTRACT RETENTIONS**

<u>Month</u>	<u>Amount</u>
	(1)
3/95	\$111,354
4/95	72,208
5/95	65,950
6/95	45,451
7/95	141,806
8/95	114,290
9/95	109,241
10/95	139,617
11/95	169,613
12/95	176,434
1/96	188,812
2/96	165,936
3/96	105,818
4/96	94,467
5/96	193,066
6/96	209,381
7/96	269,197
8/96	245,891
9/96	283,861
10/96	205,130
11/96	228,757
12/96	279,505
1/97	249,192
2/97	233,303
3/97	246,513
24-Month Average 3/95-3/97	<u>\$173,792</u>

(1) W/P-1-13, Page 1 and response to AG 2-4

**KAWC - CASE NO. 97-034  
CUSTOMER DEPOSITS AND RELATED INTEREST**

<u>Month</u>	<u>Amount</u> (1)		
3/95	\$56,274		
4/95	57,454		
5/95	57,535		
6/95	58,716		
7/95	58,360		
8/95	56,308		
9/95	55,738		
10/95	56,002		
11/95	55,090		
12/95	55,097		
1/96	55,017		
2/96	55,360		
3/96	58,891		
4/96	58,898		
5/96	59,998		
6/96	57,513		
7/96	57,535		
8/96	57,492		
9/96	56,174		
10/96	58,055		
11/96	56,090		
12/96	56,808		
1/97	57,425		
2/97	57,461		
3/97	57,988		
24-Month Average 3/95-3/97	<u>\$57,091</u>	<u>CD Int. Rate</u> 6%	<u>Cust. Dep. Interest</u> \$3,425
After-Tax Income Factor:			<u>59.6375%</u>
Impact on Net Income:			<u>(\$2,043)</u>

(1) Responses to PSC 1-25, page 4 (current case), PSC 1-26, page 3 (prior case) and AG 2-4

**KAWC - CASE NO. 97-034**  
**UNCLAIMED EXTENSION DEPOSIT REFUNDS**

Average Balance 1994          \$72,856     (1)

Average Balance 1995          \$73,861     (1)

Month	Amount
	(2)
3/95	\$73,121
4/95	73,121
5/95	73,121
6/95	73,121
7/95	73,121
8/95	72,969
9/95	73,574
10/95	72,994
11/95	72,994
12/95	81,951
1/96	73,449
2/96	75,568
3/96	74,509
4/96	74,509
5/96	76,523
6/96	75,821
7/96	75,821
8/96	75,821
9/96	75,821
10/96	76,881
11/96	75,750
12/96	72,069
1/97	75,750
2/97	76,810
3/97	76,856
24-Month Average 3/95-3/97	<u>    \$74,882    </u>

(1) Response to data request AG 2-1

(2) Responses to PSC 1-25, page 2 (current case), PSC 1-26, page 2 (prior case) and AG 2-1

**KAWC - CASE NO. 97-034**  
**METER DEVIATION NET PLANT AND DEPRECIATION EXPENSE ADJUSTMENTS**

<u>NET PLANT SAVINGS</u>	<u>1997</u> (1)	<u>1998</u> (1)	<u>Forecasted Period</u>
1. Projected Capital Savings as a Result of Not Having to Purchase Meters if KAWC's Meter Deviation Application in Case 96-569 is Approved by PSC	\$113,466	\$135,280	
2. Forecasted Period Ratios	<u>3/12</u>	<u>9/12</u>	
3. Forecasted Period Plant Savings	\$28,367	\$101,460	\$129,827
4. Average Forecasted Period Plant Savings			<u>12</u> \$64,913
4. Forecasted Period Depreciation Reserve Reduction			<u>(974)</u> (2)
5. Average Forecasted Period Net Plant Savings			<u><u>\$63,940</u></u>
 <u>DEPRECIATION EXPENSE SAVINGS</u>			
6. Line 4 x estimated composite meter depreciation rate of 3% (3)			\$1,947
7. After-Tax Income Factor			<u>59.6375%</u>
8. Impact on Income			<u><u>\$1,161</u></u>

(1) Response to PSC Information Request No. 8 in Case No. 96-569

(2) Line 6 divided by 2.

(3) Filing W/P-4-1, Page 1

**KAWC - CASE NO. 97-034**  
**ADJUSTMENT FOR CONSERVATION IMPACTS ON SALES**

	<u>Residential</u>	<u>Comm. Quart.</u>	<u>Industrial</u>
1. Sales Loss (000 gallons) Due to Conservation Proposed by KAWC	22,000	14,666	25,666
2. Sales Loss (000 gallons) Due to Conservation Recommended by AG	<u>11,000 (1)</u>	<u>7,333 (1)</u>	<u>5,015 (2)</u>
3. Recommended Add-Back to KAWC's Proposed Forecasted Period Sales (000 gallons)	11,000	7,333	20,651
4. Current Rate per 000 gallons	<u>\$2.01145</u>	<u>\$1.89809</u>	<u>\$1.51996</u>
5. Recommended Gross Revenue Increase	\$22,126	\$13,919	\$31,389
6. Associated Expense Increase (L3 x \$.17809) (3)	(\$1,959)	(\$1,306)	(\$3,678)
7. Associated Increase in Uncollectibles and PSC Fees (L5 x .41115%) (4)	<u>(\$91)</u>	<u>(\$57)</u>	<u>(\$129)</u>
8. Net Revenue Increase Before Income Tax	\$20,076	\$12,556	\$27,582
9. After-Tax Income Factor	<u>59.6375%</u>	<u>59.6375%</u>	<u>59.6375%</u>
10. Impact on Income	\$11,973	\$7,488	\$16,449
11. Total of Line 10			<u><u>\$35,910</u></u>

(1) AG recommends 50% of KAWC's proposed conservation impacts on residential and commercial sales

(2) - Actual 1995 sales (000 gallons) for 14 Forecasted Period industrial customers.	978,781	AG 1-148
- Actual 1996 sales (000 gallons) for 14 Forecasted Period industrial customers.	982,013	AG 1-148
- Forecasted Period sales projected by KAWC for 14 industrial customers - Unadjusted:	987,028	
Adjustment for conservation impact on sales projected by KAWC:	<u>(25,666)</u>	
Forecasted Period sales projected by KAWC - Adjusted for projected conservation impact:	961,362	

- AG recommended Forecasted Period industrial sales.

Reduce KAWC's projected unadjusted Forecasted Period sales of 987,028 by 5,015 to equalize to the actual 1996 sales of 982,013

(3) Response to AG 1-143 Represents associated increases in fuel/power, chemical and waste disposal expenses

(4) Filing Schedule H, Page 1

**KAWC - CASE NO. 97-034**  
**MONTHLY OPA SALES ADJUSTMENT**

1. Forecasted Period Revenue Increase for Monthly OPA Sales Based on KWAC's Calculation Revisions for Weather Normalization	\$9,125	(1)
2. Associated Expense Increase	(1,057)	(1)
3. Associated Increase in Uncollectibles and PSC Fees (L1x .41115%)	<u>(38)</u>	
4. Net Revenue Increase Before Income Tax	8,030	
5. After-Tax Income Factor	<u>59.6375%</u>	
6. Impact on Income	<u><u>\$4,789</u></u>	

(1) Response to data request AG 2-16

**KAWC - CASE NO. 97-034  
QUARTERLY OPA SALES ADJUSTMENT**

	<u>KAWC</u>	<u>Adjustment</u>	<u>AG</u>
<u>Average Sales/Customer (000 gallons)</u>			
1990	Not Used		135.4386
1991	107.8193		107.8193
1992	110.7512		110.7512
1993	112.6256		112.6256
1994	Not Used		122.1915
1995	102.8867		102.8867
1996	Not Used		118.9383
1. Average Sales/Customer For:			
- 1991, 1992, 1993 and 1995	109.3838 *		
- 1990 through 1996			116.5087 *
2. Number of Bills	<u>818</u>		<u>818</u>
3. Total Projected Forecasted Period Sales	89,476	5,828	95,304
4. Current Tariff Rate per 1000 gallons	<u>\$1.81825</u>	<u>\$1.81825</u>	<u>\$1.81825</u>
5. Projected Forecasted Period Revenues	<u>\$162,690</u>	\$10,597	<u>\$173,287</u>
6. Associated Expense Increase L3 x \$.2106 **)		(1,227)	
7. Associated Increase in Uncollectibles and PSC Fees (L5x .41115%)		<u>(44)</u>	
8. Net Revenue Increase Before Income Tax		9,326	
9. After-Tax Income Factor		<u>59.6375%</u>	
10. Impact on Income		<u>\$5,562</u>	

\* Weighted by number of bills

\*\* Per response to data request AG 2-16a(5): cost per thousand gallons is \$.2106.

Sources for this schedule: Response to data request AG 2-16 and filing W/P-2-1, page 33.

**KAWC - CASE NO. 97-034  
OWU SALES ADJUSTMENT**

Actual Sales For OWU Customer Spears (CCF)

1992	67,416
1993	62,868
1994	52,955
1995	47,276
1996	65,744

	<u>KAWC</u>	<u>Adjustment</u>	<u>AG</u>
1. Projected Forecasted Period Sales (CCF)			
- Based on 1995 Actual Sales	47,276		
- Based on 1996 Actual Sales			65,744
2. Conversion Factor CCF to 000 gallons	<u>0.75</u>		<u>0.75</u>
3. Projected Forecasted Period Sales in 000 gallons	35,457	13,851	49,308
4. Current Tariff Rate per 1000 gallons	<u>\$1.73944</u>	<u>\$1.73944</u>	<u>\$1.73944</u>
5. Projected Forecasted Period Revenues	<u>\$61,675</u>	<u>\$24,093</u>	<u>\$85,768</u>
6. Associated Expense Increase L3 x \$ 2106 *		(2,917)	
7. Associated Increase in Uncollectibles and PSC Fees (L5x .41115%)		<u>(99)</u>	
8. Net Revenue Increase Before Income Tax		21,077	
9. After-Tax Income Factor		<u>59.6375%</u>	
10. Impact on Income		<u>\$12,570</u>	

\* Per response to data request AG 2-16a(5): cost per thousand gallons is \$2106.

Sources for this schedule. Response to data request AG 1-174 and filing W/P-2-1, page 39.



**KAWC - CASE NO. 97-034**  
**SUMMARY OF LABOR EXPENSE ADJUSTMENTS**

1. Total Forecasted Period O&M Payroll Proposed by KAWC	<u>\$5,119,861</u>	(1)
<u>AG Recommended Adjustments:</u>		
2. O&M Ratio Adjustment	(\$53,472)	Sch. RJH-23, p.2
3. Retirement of Two Employees Not Reflected by KAWC	(58,851)	Sch. RJH-23, p.3
4. Additional Level of Employees Adjustment	<u>(136,929)</u>	Sch. RJH-23, p.4
5. Total AG Recommended Labor O&M Adjustments	(249,252)	
6. After-Tax Income Factor	<u>59.6375%</u>	
7. Impact on Net Income	<u>\$148,648</u>	

<b>SUMMARY CHECK OF REASONABLENESS</b>			
	<u>O&amp;M Payroll</u>	<u>Contr. Labor</u>	<u>Total</u>
	(2)	(3)	
1995	\$4,451,430	\$82,775	\$4,534,205
1996	\$4,522,170	\$205,830	\$4,728,000
<u>Forecasted Period.</u>			
KAWC Proposed	\$5,119,861	\$156,897	\$5,276,758
AG Adjustments	(\$249,252)		(\$249,252)
AG Recommended	<u>\$4,870,609</u>	<u>\$156,897</u>	<u>\$5,027,506</u>

(1) Schedule C-2, P.1  
(2) Schedule RJH-23, p.2 and above  
(3) Schedule RJH-23, p.5

**KAWC - CASE NO. 97-034  
LABOR O&M RATIO ADJUSTMENT**

	<u>KAWC</u> (1)	<u>Adjustment</u>	<u>AG</u>
1. Total Payroll Costs	\$5,870,671		\$5,870,671
2. O&M Ratio	<u>87.21%</u>		<u>86.30%</u> (2)
3. O&M Payroll Expense	<u>\$5,119,861</u>	<u>(\$53,472)</u>	<u>\$5,066,389</u>

(1) Schedule G-2, Page 1

(2) Per Schedule G-2, Page 1

	<u>Total Payroll Cost</u>	<u>O&amp;M Payroll Cost</u>	<u>O&amp;M Ratio</u>
1992	\$4,927,797	\$4,309,797	87.46%
1993	\$4,936,673	\$4,289,072	86.88%
1994	\$5,136,326	\$4,490,611	87.43%
1995	\$5,200,441	\$4,451,430	85.60%
1996	\$5,309,543	\$4,522,170	85.17%
5-Year Average 92-96			86.51%
3-Year Average 94-96			86.07%
Mid-point of 5-Yr. and 3-Yr Averages			<u>86.30%</u>
KAWC's projected payroll O&M ratios, shown in filing Exhibit No. 22			
- for 1997			86.27%
- for 1998			86.27%
- for 1999			86.27%

**KAWC - CASE NO. 97-034  
ADJUSTMENT FOR TWO EMPLOYEE RETIREMENTS**

O&M Payroll Reductions For:

1. Office Supervisor Retirement	(\$41,094)	(1)
2. Distr. Superint. Retirement	<u>(17,757)</u>	(1)
3. Total O&M Payroll Reduction	<u><u>(\$58,851)</u></u>	

(1) Response to AG 1-69c

**KAWC - CASE NO. 97-034**  
**ADJUSTMENT FOR ADDITIONAL EMPLOYEE REDUCTIONS**

1. Additional Level of Employees Adjustment	(4)	Sch. RJH-23, p 5
2. Average O&M Payroll per Employee	<u>\$34,232</u>	(1)
3. O&M Payroll Expense Adjustment	<u><u>(\$136,929)</u></u>	

(1) KAWC's proposed O&M payroll expense	\$5,119,861
AG's adjustment for O&M ratio	<u>(53,472)</u>
Adjusted O&M payroll expense	\$5,066,389
KAWC's proposed number of employees	<u>148</u>
Adjusted O&M payroll per average employee	<u><u>\$34,232</u></u>

EMPLOYEE LEVEL ANALYSIS

Level of Employees			
	Budgeted (1)	Actual (2)	Actual vs. Budgeted
1992 Avg	155	140	(15)
1993 Avg	147	143	(4)
1994 Avg.	144	146	2
1995 Avg.	142	140	(2)
1996 Avg	145	140	(5)
5-Year Avg.		4	(5)

	Case 95-554 Employee Level Forecast			Actual Level of Employees		
	Incr. Monthly Mtr. Reading	Other	Total	Incr. Monthly Mtr. Reading	Other	Total
9/96	7	143	150	6	134	140
10/96	7	143	150	6	135	141
11/96	7	143	150	6	137	143
12/96	7	143	150	6	137	143
1/97	7	143	150	6	133	139
2/97	7	143	150	6	133	139
3/97	7	143	150	6	135	141
4/97	7	143	150	6	137	143
Monthly Average			150	6	135	141
- KAWC's Proposed Projection For Forecasted Period				7	141	148
- AG's Reflection of 2 Retirements in 1997 and 1998 (separately adjusted)					(2)	(2)
- AG's Additional Employee Reduction Adjustment					(4)	(4)
- AG's Recommended Projection For Forecasted Period				7	135	142

TOTAL PAYROLL AND CONTRACT LABOR COST ANALYSIS

	Payroll	Contr. Labor	Total
<b>1992</b>			
Actual	\$4,927,797	\$37,106	\$4,964,903
Budget	\$5,098,977	\$28,104	\$5,127,081
Act. vs Budet			(\$162,178)
<b>1993</b>			
Actual	\$4,936,673	\$16,548	\$4,953,221
Budget	\$5,048,945	\$19,920	\$5,068,865
Act. vs Budet			(\$115,644)
<b>1994</b>			
Actual	\$5,136,326	\$39,189	\$5,175,515
Budget	\$5,106,813	\$0	\$5,106,813
Act. vs Budet			\$68,702
<b>1995</b>			
Actual	\$5,200,441	\$82,775	\$5,283,216
Budget	\$5,264,379	\$27,000	\$5,291,379
Act. vs Budet			(\$8,163)
<b>1996</b>			
Actual	\$5,309,543	\$205,830	\$5,515,373
Budget	\$5,504,276	\$156,192	\$5,660,468
Act. vs Budet			(\$145,095)
Average Actual vs. Budget Variance			(\$72,476)
<b>Forecasted Period</b>			
Projected by KAWC	\$5,870,671	\$156,897	\$6,027,568

**KAWC - CASE NO. 97-034  
INCENTIVE COMPENSATION**

1. Direct KAWC Incentive Compensation Expenses Included in the Forecasted Period	\$15,870	(1)
2. Service Company Incentive Compensation Expenses Allocated to KAWC Included in the Forecasted Period	<u>63,756</u>	(2)
3. Total Incentive Compensation Expenses	79,626	
4. Sharing of Incentive Compensation Expenses Between Ratepayers and Stockholders at 50/50	(39,813)	
5. After-Tax Income Factor	<u>59.6375%</u>	
6. Impact on Net Income	<u>\$23,743</u>	

(1) Schedule D-1, Page 7

(2) Response to AG 1-77

**KAWC - CASE NO. 97-034  
EMPLOYEE BENEFIT EXPENSE ADJUSTMENT**

<u>O&amp;M Expenses For:</u>	<u>KAWC</u> (1)	<u>Adjustment</u>	<u>AG</u>	
1. Pensions	<u>\$215,902</u>	(\$40,088)	<u>\$175,814</u>	(2)
2. Group Insurance:				
- OPEB	\$546,563	(\$88,895)	\$457,668	(3)
- Health and Other	<u>638,066</u>		<u>638,066</u>	
- Total Group Insurance	<u>\$1,184,629</u>			
3. 401(k)	<u>\$75,517</u>	7,218	<u>\$82,735</u>	(4)
4. Adjustment for Payroll Overhead Related to Two Employee Retirements		(22,310)	(22,310)	(5)
5. Adjustment for Payroll Overhead Related to Additional Employee Reductions		<u>(51,910)</u>	<u>(51,910)</u>	(6)
6. Total O&M Expense Adjustment		(195,985)		
7. After-Tax Income Factor		<u>59.6375%</u>		
8. Impact on Income		<u>\$116,881</u>		
 (1) Filing Schedule C-2				
(2) Response to AG 1-163				
(3) Per response to AG 1-84				
- KAWC's updated FAS106 Cost Study based on 141 active employees		\$497,995	AG 1-84, p. 1 of 3	
- Ratio of AG recommended employees of 142 to 141 employees		<u>1.00792</u>		
- Updated FAS106 Cost Study based on 142 active employees		501,939		
- KAWC's proposed O&M ratio		<u>0.9118</u>	1 - .0882	
- Recommended updated FAS106 O&M expense		<u>\$457,668</u>		
(4) Response to AG 1-167				
(5) Per response to AG 1-69				
Employee Retirements:				
- Office Supervisor Salary Savings		(\$41,094)		
- Distr. Superintendent Salary Savings		<u>(17,757)</u>		
- Total Salary Savings		(58,851)		
- Payroll Overhead Factor		<u>0.3791</u>		
- Payroll Overhead Savings		<u>(\$22,310)</u>		
(6) Adjustment for additional employee reductions - payroll impact:				
Payroll overhead factor		<u>0.3791</u>	Sch. RJH-23, p.4 AG 1-69	
Payroll overhead adjustment		<u>(\$51,910)</u>		

**KAWC - CASE NO. 97-034**  
**FUEL/POWER AND CHEMICAL EXPENSES**

FUEL AND POWER EXPENSE

	Actual	Budget	Actual vs. Budget	Actual vs. Budget
	(1)	(1)	(1)	
1987	\$1,719,531	\$1,861,401	(\$141,870)	0.924
1988	1,619,524	1,674,755	(55,231)	0.967
1989	1,444,139	1,760,366	(316,227)	0.820
1990	1,470,148	1,619,476	(149,328)	0.908
1991	1,499,275	1,544,665	(45,390)	0.971
1992	1,381,739	1,480,242	(98,503)	0.933
1993	1,464,620	1,355,735	108,885	1.080
1994	1,513,706	1,767,834	(254,128)	0.856
1995	1,575,065	1,567,758	7,307	1.005
1996	1,485,005	1,545,524	(60,519)	0.961
1. 10-Yr. Avg				<u>0.943</u>
2. KAWC Proposed Fuel and Power Expense				<u>\$1,552,762</u>
3. Recommended Expense Adjustment (1-.943) x \$1,552,762 =				(\$88,507)
4. After-Tax Income Factor				<u>59.6375%</u>
5. Impact on Net Income				<u><u>\$52,784</u></u>

CHEMICAL EXPENSE

6. Increase in KAWC's Proposed Expense due to Formula Correction	\$14,115 (2)
7. After-Tax Income Factor	<u>59.6375%</u>
8. Impact on Net Income	<u><u>(\$8,418)</u></u>

\* Response to AG 1-62 (Updated 5/21/97): For the more recent 12-month period 5/96-4/97, the actual fuel and power expenses were \$1,403,530 as compared to the budgeted expenses of \$1,544,501 for that same 12-month period as projected by KAWC in Case No. 95-554. This represents an actual-to-budgeted expense ratio of 90.87%.

For the first 4 months in 1997, the actual expenses were \$394,302, or 86.04% of the budgeted expenses of \$458,296 for that same 4-month period.

(1) Response to AG 1-61

(2) Response to AG 1-63



**KAWC - CASE NO. 97-034**  
**CURRENT WASTE DISPOSAL EXPENSE - ACCOUNT 643.3**

	<u>Actual</u>	<u>Case 95-554 Projections</u>	<u>Actual vs. Projections</u>
		(3)	(3)
1993	\$44,720	(1)	
1994	\$33,730	(1)	
1995	\$37,773	(1)	
1996	\$34,926	(2)	
9/96	\$2,737	\$3,000	(\$263)
10/96	2,537	3,200	(663)
11/96	2,368	3,400	(1,032)
12/96	2,854	3,400	(546)
1/97	3,151	3,900	(749)
2/97	2,885	3,900	(1,015)
3/97	5,088	3,900	1,188
7-mos. Total	<u>\$21,620</u>	<u>\$24,700</u>	<u>(\$3,080)</u>
7-mos. Annual	\$37,057		

1 KAWC's Proposed Forecasted Period Expense	\$70,225	(1)
2 AG Recommended Forecasted Period Expense	<u>50,000</u>	
3 Recommended Exp. Adjustment	(20,225)	
4 After-Tax Income Factor	<u>59.6375%</u>	
5 Impact on Net Income	<u><u>\$12,062</u></u>	

(1) Filing W/P-3-4, Page 2

(2) Response to data request PSC 1-5

(3) Response to AG 1-51 (Updated 5/21/97)

**KAWC - CASE NO. 97-034  
REGULATORY EXPENSE**

<u>EXPENSE IMPACT</u>	<u>KAWC</u> (1)	<u>Adjustment</u>	<u>AG</u>
<u>Amortization of Previously Allowed Regulatory Expense:</u>			
1. Case 95-554 Rate Case Expense	\$178,739		\$178,739
2. Depreciation Study Expense	7,584		7,584
3. BAT & COS Expense	<u>42,984</u>		<u>42,984</u>
4. Sub-Total	<u>229,307</u>		<u>229,307</u>
<u>Amortization of Current Case Expense:</u>			
5. 2-Year Amortization	198,550		198,550
Less: 50% Sharing			<u>(99,275)</u>
Net Amortization Expense	<u>198,550</u>	<u>(99,275)</u>	<u>99,275</u>
<u>Total Regulatory Expense (L4 + L5)</u>	<u>\$427,857</u>	(\$99,275)	<u>\$328,582</u>
After-Tax Income Factor		<u>59.6375%</u>	
7. Impact on Net Income		<u>\$59,205</u>	

RATE BASE IMPACT

- Current Case Expense Unamortized Starting Balance (Shared at 50%)	\$198,550
- Forecasted Period Amortization	<u>(99,275)</u>
- Unamortized Ending Balance at 9/30/98	99,275
- Forecasted Period Average Unamortized Balance [(\$198,550 + \$99,275) / 2]	<u>\$148,913</u>

(1) Schedule C-2, Page 1 and W/P-3-8, Page 1

**KAWC - CASE NO. 97-034  
POSTAGE BILLING EXPENSES**

	Case 95-554 Projections	Current Case Projections	Actual	Actual vs. Current Case Projections
	(1)	(1)	(1)	
9/96	\$29,548	\$9,504	\$10,065	\$561
10/96	29,648	29,565	16,371	(13,194)
11/96	29,674	29,589	22,324	(7,265)
12/96	29,704	29,622	23,199	(6,423)
1/97	29,966	29,966	22,416	(7,550)
2/97	29,982	29,982	23,368	(6,614)
3/97	30,153	30,153	22,329	(7,824)
4/97	30,095	30,095	23,347	(6,748)
5/97	30,331	30,331		
6/97	30,367	30,367		
7/97	30,399	30,399		
8/97	30,619	30,619		
9/97		30,445		
Forecast Period				
10/97		30,537		
11/97		30,526		
12/97		30,507		
1/98		29,966		
2/98		29,982		
3/98		30,153		
4/98		30,095		
5/98		30,331		
6/98		30,367		
7/98		30,399		
8/98		30,619		
9/98		30,445		
1. Total Proposed by KAWC		\$363,927		
2. AG Recommended		<u>276,000</u>		Monthly average expense of \$23,000 x 12
3. Expense Adjustment		(87,927)		
4. After-Tax Income Factor		<u>59.6375%</u>		
5. Impact on Net Income		<u><u>\$52,437</u></u>		

(1) Responses to AG 1-164 and AG 2-23

**KAWC - CASE NO. 97-034  
BANK SERVICE CHARGES**

	<u>Case 95-554 Projections</u>	<u>Current Case Projections</u>	<u>Actual</u>
	(1)	(1)	(1)
9/96	\$5,932		\$1,615
10/96	6,157		2,501
11/96	6,400		4,685
12/96	5,967	2,622	7,532
1/97	6,230	5,916	4,510
2/97	6,470	6,156	3,801
3/97	6,030	5,762	4,111
4/97	6,241	5,954	
5/97	6,491	6,186	
6/97	6,041	5,813	
7/97	6,255	5,966	
8/97	6,512	6,190	
9/97		6,213	
Forecast Period			
10/97		6,238	
11/97		6,202	
12/97		6,182	
1/98		7,701	
2/98		7,946	
3/98		7,544	
4/98		7,740	
5/98		7,977	
6/98		7,596	
7/98		7,752	
8/98		7,981	
9/98		<u>8,003</u>	
1. Total Proposed by KAWC		<b>\$88,862</b>	
2. AG Recommended		<u>60,000</u>	Monthly average expense of \$5,000* x 12
3. Expense Adjustment		(28,862)	
4. After-Tax Income Factor		<u>59.6375%</u>	
5. Impact on Net Income		<u><u>\$17,213</u></u>	

\* Conversion to monthly billing started in September 1996. Assumed that full impact not effective until November 1996 (similar to what is shown for the actual expenses for Postage Billing on Schedule RJH-29). Average actual bank service charges from November 1996 through to date is approximately \$4,800. Used recommended average monthly charge of \$5,000.

(1) Responses to AG 1-166 and AG 2-22

**KAWC - CASE NO. 97-034**  
**MISCELLANEOUS EXPENSE ADJUSTMENTS**

1. Remove Lobbying Expenses (at 20% of NAWC Dues)	(\$3,030)	(1)
2. Remove Employee Christmas Gifts	(3,800)	(2)
3. Remove Donation, Gifts and Awards Banquet and Summer Picnic Expenses Allocated to KAWC by the Service Company	<u>(3,389)</u>	(3)
4. Total Expense Removal	(10,219)	
5. After-Tax Income Factor	<u>59.6375%</u>	
6. Impact on Net Income	<u><u>\$6,094</u></u>	

(1) Per AG 1-115 and 1-116. Forecasted period NAWC dues of \$15,150 x 20% = ~~\$3~~\$3,030

(2) AG 1-169b

(3) Per AG 1-117:

- Donations	\$55
- Gifts, award banquets	3,075
- Summer picnics	<u>259</u>
	<u><u>\$3,389</u></u>

**KAWC - CASE NO. 97-034**  
**"MISCELLANEOUS OTHER" EXPENSES**

	<u>Case 95-554</u> <u>Projections</u> (1)	<u>Current Case</u> <u>Projections</u> (1)	<u>Actual</u> (1)	<u>Actual vs.</u> <u>Current Case</u> <u>Projections</u>
6/96		\$14,804	\$3,817	
7/96		7,349	2,126	
8/96		13,680	1,802	
9/96	\$8,538	9,205	2,519	
10/96	5,261	5,634	1,883	
11/96	7,132	7,082	2,286	
12/96	5,135	5,057	2,040	
1/97	15,358	10,800	3,605	
2/97	19,023	11,235	14,552	
3/97	16,025	6,340	10,828	
4/97	14,193	9,800	16,289	
		<u>100,986</u>	<u>61,747</u>	61.14%
Forecast Period				
10/97		9,651		
11/97		10,331		
12/97		9,051		
1/98		18,638		
2/98		19,573		
3/98		14,167		
4/98		17,945		
5/98		15,774		
6/98		21,788		
7/98		13,522		
8/98		13,208		
9/98		<u>15,625</u>		
1. Total Proposed by KAWC		\$179,273		
2. AG Recommended		<u>125,000</u>		
3. Expense Adjustment		(54,273)		
4. After-Tax Income Factor		<u>59.6375%</u>		
5. Impact on Net Income		<u><u>\$32,367</u></u>		

(1) Response to AG 1-170 (Updated 5/21/97)

**KAWC - CASE NO. 97-034**  
**ANALYSIS OF MISCELLANEOUS OTHER AND CONSERVATION EXPENSES**

Response to AG 1-170a. : Miscellaneous Other expense (\$179,274) is comprised of miscellaneous expenses for which specific account numbers have not yet been established. It includes such expense items as customer surveys, the annual Science Fair, various water works events , LFUCG council and PSC tours and conservation-related programs.

Miscellaneous Other Expenses:

1993 - Actual	\$27,853	W/P-2-13, P.1
1994 - Actual	\$30,254	W/P-2-13, P.1
1995 - Actual	\$59,491	W/P-2-13, P.1
1996 - Actual	\$49,519	AG 1-169a.
Forecasted Period Proj.	\$179,274	W/P-2-13, P.1

CONSERVATION EXPENSE ANALYSIS

	Budgeted	Actual	Actual vs. Budgeted	% Actual of Budgeted
- Case 95-554 Base Period Conservation Expenses from 5/1/95 - 4/30/96 (1):	\$106,454	\$31,502	(\$74,952)	29.59%
- Case 95-554 Forc. Period Conservation Expenses from 9/1/96 - 3/31/97 (1):	\$66,617	\$12,041	(\$54,576)	18.07%
- Total Conservation Expenses Since Implementation on 1/1/94 Through to Date (2):	\$138,802	\$49,489	(\$89,313)	35.65%

(1) Response to AG 1-108

(2) Response to AG 1-107

**KAWC - CASE NO. 97-034  
GENERAL TAXES**

<u>General Taxes</u>	<u>KAWC</u> (1)	<u>Adjustment</u>	<u>AG</u>
1. Property	\$1,116,886	(\$13,167) (2)	\$1,103,719
2. Gross Receipts/Sales	50,783	(3)	50,783
3. Payroll	397,136	(4,148) (4)	392,988
4. Miscellaneous	9,960		9,960
5. Total	<u>\$1,574,765</u>	<u>(\$17,315)</u>	<u>\$1,557,450</u>
6. After-Tax Income Factor		<u>59.6375%</u>	
7. Impact on Net Income		<u>\$10,326</u>	

(1) Schedule C-2, Page 1

(2) Property taxes based on plant and CWIP adjustments reflecting slippage factors of 96.993% and 84.726% as per response to PSC 2-7, page 15 are \$1,110,314. This is \$6,572 less than KAWC's proposed property taxes of \$1,116,886: (\$6,572)

Additional recommended property tax reduction due to removal of BP 90-13, BP 90-14 and BP 92-12:

(\$1,895,439)	Sch. RJH-7
50.0000%	
<u>0.6959%</u>	
<u>(6,595)</u>	
<u>(\$13,167)</u>	

(3) PSC fee adjustments associated with AG's revenue adjustments are separately reflected on the revenue adjustment schedules.

(4) O&M labor expense adjustment: Sch. RJH-23, p.1, L.2 \*  
 Ratio O&M payroll to O&M labor 7.7568% (5)  
(\$4,148)

(5) Schedule G-2, Page1: \$397,136 / \$5,119,861

\* The payroll tax reductions associated with the AG's two other O&M labor adjustments on Sch. RJH-23, p.1, L.3 and 4 were already separately accounted for in the payroll overhead adjustments on lines 4 and 5 of Employee Benefit Expense Adjustment Sch. RJH-25



**KAWC - CASE NO. 97-034**  
**INTEREST SYNCHRONIZATION ADJUSTMENT**

	<u>KAWC</u> (1)	<u>Adjustment</u>	<u>AG</u>	
1. Rate Base	\$130,570,800		\$125,721,549	Sch. RJH-3
2. Weighted Cost of Debt	<u>4.33%</u>		<u>4.33%</u>	Sch. RJH-2
3. Pro Forma Interest	\$5,653,716	(209,973)	\$5,443,743	
4. Composite State and Federal Income Tax Rate		<u>40.3625%</u>		
5. Impact on Net Income		<u><u>(\$84,750)</u></u>		

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of: )  
 )  
NOTICE OF ADJUSTMENT OF THE RATES ) Case No. 2000-120  
OF KENTUCKY-AMERICAN WATER COMPANY )  
EFFECTIVE ON AND AFTER MAY 29, 2000 )

DIRECT TESTIMONY OF ROBERT J. HENKES  
ON BEHALF OF THE OFFICE OF RATE INTERVENTION OF THE  
ATTORNEY GENERAL FOR THE COMMONWEALTH OF KENTUCKY

JULY 28, 2000

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Kentucky-American Water Company  
Case No. 2000-120  
Direct Testimony of Robert J. Henkes

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APPENDIX I: Prior Regulatory Experience of Robert J. Henkes

SUPPORTING SCHEDULES: Schedules RJH-1 Through RJH-22

I. STATEMENT OF QUALIFICATIONS

Q. WOULD YOU STATE YOUR NAME AND ADDRESS?

A. My name is Robert J. Henkes and my business address is 7 Sunset Road, Old Greenwich, Connecticut 06870.

Q. WHAT IS YOUR PRESENT OCCUPATION?

A. I am a principal and founder of the firm of Henkes Consulting, which is a financial management consulting firm specializing in utility regulation.

Q. WHAT IS YOUR REGULATORY EXPERIENCE?

A. I have prepared and/or presented numerous testimonies in rate proceedings involving electric, gas, telephone and water companies in a number of jurisdictions including Arkansas, Delaware, District of Columbia, Georgia, Kentucky, Maryland, New Jersey, New Mexico, Ohio, Pennsylvania, Vermont, the U.S. Virgin Islands and before the Federal Energy Regulatory Commission ("FERC").

A complete listing of jurisdictions and rate proceedings in which I have been involved is provided in Appendix I supplementing this direct testimony.

Q. WHAT OTHER PROFESSIONAL EXPERIENCE HAVE YOU HAD?

A. Prior to my current position, I was a principal of The Georgetown Consulting Group, Inc. for the last 20 years, during which I performed the same type of consulting services as I am currently rendering through Henkes Consulting. Prior to my association with the Georgetown Consulting Group, Inc.,

I was employed by the American Can Company as Manager of Financial Controls. Before joining the American Can Company, I was employed by the Management Consulting Division of Touche Ross & Co. for six years. At Touche Ross, my experience, in addition to regulatory work, included numerous projects in a wide variety of financial areas including cash flow projections, bonding feasibility, capital and profit forecasting, and the design and implementation of accounting and budgetary reporting and control systems.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I hold a Bachelor degree in Management Science, received from the University of Utrecht, The Netherlands in 1966; a Bachelor degree in Marketing, received from the University of Puget Sound in 1971; and an MBA degree in Finance, received from Michigan State University in 1973. I have also completed the CPA program of the New York University Graduate School of Business.

II. SCOPE AND PURPOSE OF TESTIMONY

Q. WHAT IS THE SCOPE AND PURPOSE OF THIS TESTIMONY?

A. I was engaged by the Office of Rate Intervention of the Attorney General of Kentucky ("AG") to conduct a review and analysis and present testimony regarding the petition of Kentucky-American Water Company ("KAWC" or "the Company") for an increase in its rates for water service.

The purpose of this testimony is to present to the Kentucky Public Service Commission ("PSC" or "the Commission") the appropriate rate base and pro forma operating income as well as the appropriate revenue requirement for the Company in this proceeding.

In the determination of my recommended rate base, pro forma operating income and revenue requirement, I have relied on and incorporated the recommendations of AG witness Dr. Carl Weaver concerning the appropriate capital structure, capital cost rates, and overall rate of return for the Company in this proceeding. I have also relied on the recommendations made by AG witness Scott Rubin regarding the rate treatment for KAWC's Boonesboro sewer operations in this case.

In developing this testimony, I have reviewed and analyzed the Company's petition; testimonies, exhibits, workpapers and filing requirements; responses to interrogatories and other relevant financial documents and data.

III. SUMMARY OF FINDINGS AND CONCLUSIONS

Q. MR. HENKES, PLEASE SUMMARIZE YOUR FINDINGS AND CONCLUSIONS IN THIS CASE.

A. The findings and conclusions reached by me in this case are as follows:

1. The appropriate pro forma forecasted period rate base amounts to \$137,150,631, which is \$5,276,880 lower than KAWC's proposed pro forma rate base of \$142,427,511 (see Schedule RJH-3).
2. The appropriate pro forma forecasted period operating income amounts to \$11,575,330, which is \$914,189 higher than KAWC's proposed pro forma operating income of \$10,661,141 (see Schedule RJH-4).
3. The appropriate overall rate of return is 8.716%, incorporating a return on equity rate of 10.25%, the mid-point of Dr. Weaver's recommended return on equity range of 9.75% to 10.75%. This compares to KAWC's proposed overall rate of return of 9.58%, incorporating a proposed return on equity rate of 12.00% (see Schedule RJH-2).
4. The appropriate revenue conversion factor to be used for rate making purposes in this case is 1.6874450 (see Schedule RJH-1).



5. The combination of the aforementioned four rate making components indicate an appropriate rate increase for KAWC in this proceeding of \$638,950. This is \$4,395,399 lower than KAWC's proposed rate increase of \$5,034,349 (see Schedule RJH-1).

IV. ACCOUNTING ISSUES

**A. CAPITAL STRUCTURE AND OVERALL RATE OF RETURN**

Q. PLEASE DESCRIBE THE CAPITAL STRUCTURE AND OVERALL RATE OF RETURN RECOMMENDED BY THE AG IN THIS PROCEEDING.

A. In determining the recommended capital structure, I took Dr. Weaver's recommended capital structure as the starting point and then adjusted this capital structure for the plant slippage factor. This is shown in footnote 2 of Schedule RJH-2. As documented in footnote 5 of Schedule RJH-2, I have reflected the plant slippage factor adjustment by reducing Dr. Weaver's recommended short-term and long-term debt balances by the same dollar amounts as reflected by the Company in its response to PSC 2-5. Next, I applied Dr. Weaver's recommended capital costs rates to this adjusted capital structure. For the return on equity, I used the mid-point of Dr. Weaver's recommended return on equity range of 9.75% to 10.75%. As shown on Schedule RJH-2, the resulting recommended overall rate of return is 8.716%.

**B. RATE BASE**

Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED AND YOUR RECOMMENDED PRO FORMA NET RATE BASE LEVELS FOR THE FORECASTED PERIOD IN THIS CASE.

A. The Company's proposed pro forma rate base of \$142,427,511 is summarized by specific rate base component on Schedule RJH-3. With the exception of cash working capital, other working capital and Other Rate Base Elements, all of the Company's proposed rate base components are based on projected 13-month average balances for the forecasted period December 1, 2000 through November 30, 2001. The Company's proposed cash working capital requirement is based on a detailed lead/lag study, the proposed other working capital balance represents the actual 13-month average balance for the twelve-month period ended February 29, 2000, and the Other Rate Base Elements are essentially based on the 24-month average balance during the 24-month period ended February 29, 2000.

As shown on Schedule RJH-3, I have recommended a large number of rate base adjustments with the effect of reducing the Company's proposed rate base by a total amount of \$5,276,880 to a recommended rate base level of \$137,150,631. Each of the recommended rate base adjustments are explained and quantified in more detail in the supporting rate base schedules referenced on Schedule RJH-3 and will be discussed in detail in the subsequent sections of this testimony.

- Utility Plant in Service

Q. HOW DID THE COMPANY DERIVE ITS PROPOSED AVERAGE FORECASTED PERIOD UTILITY PLANT IN SERVICE RATE BASE COMPONENT?

A. The Company derived its proposed average forecasted period utility plant in service investment level by taking the actual plant balance as of January 31, 2000 as the starting point and then adding to this balance the projected plant additions from its construction budget for the months of February 2000 through November 2001 and subtracting from this balance the projected plant retirements for this same time period. The Company then calculated the 13-month average of the projected plant balances for the forecasted period in this case, December 2000 - November 2001.

Q. IS IT IMPORTANT THAT THE PROPOSED PLANT IN SERVICE PROJECTIONS BE REVIEWED FOR ACCURACY IN SETTING THE RATES FOR THIS COMPANY?

A. Yes. Since the Company has chosen to base this rate filing on a fully-forecasted test period, it is particularly important to conduct analyses to verify whether the Company's projections are reasonably on target. Since the non-Company parties in this proceeding do not have access to all of the details and assumptions underlying the Company's construction budget and the projected closings to plant of the numerous construction projects, the only way for these parties to verify the accuracy of the Company's projections is to perform an historic analysis to determine how the Company's past projections have compared to actual results.

Q. HAS INFORMATION REGARDING SUCH A COMPARATIVE ANALYSIS BEEN PROVIDED TO THE PARTIES IN THIS CASE?

A. Yes. In response to data request PSC 1-10 and further confirmed in response to data request PSC 2-5, the Company provided information showing, in total and separately for the "routine" and "special budget" construction projects, a comparison of actual versus originally budgeted results for each of the 10 years from 1990 through 1999. This information indicates that, on average for each of the 10 years in the analysis period, the Company's actual routine construction has been at 97.23% of the budgeted routine construction and the Company's actual special budget construction has been at 74.87% of the budgeted special budget construction. These actual-to-budget ratios are referred to as the "slippage factors."

Q. DO YOU BELIEVE THAT THE PREVIOUSLY DISCUSSED PLANT SLIPPAGE FACTORS ARE CONSERVATIVE?

A. Yes. The actual annual construction data in the comparative analysis in PSC 1-10 includes carry-overs of construction expenditures from prior years.<sup>1</sup> These actual construction carry-overs from prior years are reflected in the comparative analysis without any corresponding budgeted construction expenditures because the Company does not carry over its budgeted construction expenditures. For example, the year 1999 includes the following actual expenditures for which there are no corresponding budgeted construction expenditures:

- BP 96-02	\$135,093
- BP 96-17	\$ 63,600
- BP 96-18	\$294,890

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<sup>1</sup> See response to PSC 1-6

- BP 98-03                   \$ 32,406
- BP 98-06                   \$ 9,393

Thus, while these construction expenditures are being reflected as “actual in excess of budgeted expenditures” in the comparative analysis – thereby reducing the plant slippage factors –, in reality they represent construction expenditures which were not completed during the year the Company had budgeted for and should have the opposite effect on the plant slippage factor analysis. For this reason, I believe that the previously described plant slippage factors are to be considered conservative.

Q. IS THERE OTHER INFORMATION AVAILABLE SHOWING THAT THE COMPANY'S ACTUAL CONSTRUCTION HAS CONSISTENTLY BEEN BEHIND SCHEDULE?

A. Yes, this information is shown in the response to AG 1-85. The data in this response indicates that of the total 124 budget projects completed from 1987 through 1999 as many as 75, or 65%, were completed behind schedule. For 1999, the most recent year for which data are available, all 9 budget projects were completed behind schedule.

Q. WHAT IS YOUR RECOMMENDATION BASED ON THE AFOREMENTIONED INFORMATION?

A. The aforementioned information indicates that the Company has generally overprojected its construction expenditures during the most recent 10 years and has continued to do so as recent as in Case No. 97-034. Based on this information, I recommend that the Company's proposed

average forecasted period plant in service balance be reduced to reflect the (conservative) plant slippage factors of 97.23% and 74.87% experienced by the Company for routine and special budget construction during the 10-year period 1990 - 1999. As shown on line 2 of Schedule RJH-5, my recommended slippage factor adjustment reduces the Company's proposed average forecasted period plant in service balance by \$1,254,550.

Q. HAVE YOU MADE ANOTHER ADJUSTMENT TO THE COMPANY'S PROPOSED FORECASTED PERIOD AVERAGE PLANT IN SERVICE BALANCE?

A. Yes. I have removed from the Company's proposed plant in service balance the Boonesboro sewer operations plant amount of \$50,835. The reasons for this are discussed in the next section of this testimony.

- Boonesboro Sewer Operations

Q. WHAT IS THE ISSUE WITH REGARD TO THE BOONESBORO SEWER OPERATIONS IN THIS PROCEEDING?

A. The Company has included all of the rate base investments, revenues, expenses and taxes from its sewer operations in determining the revenue requirement and rates for its water operations. Mr. Rubin, the AG's cost of service and rate design expert, has informed me that all aspects of the Company's sewer operations should be removed from the revenue requirement in this case. I have done this in the schedules attached to this testimony.

Q. COULD YOU BRIEFLY DESCRIBE WHERE IN YOUR TESTIMONY SCHEDULES YOU HAVE MADE THESE SEWER OPERATIONS ADJUSTMENTS?

A. Yes. With regard to rate base, I have removed (1) the sewer plant in service of \$50,835, as shown on Schedule RJH-5, line 3; (2) the sewer depreciation reserve of \$35,830, as shown on Schedule RJH-6, line 3; and (3) the unamortized Rockwell sewer study balance in deferred debits, as shown on Schedule RJH-10, line 14. With regard to revenues, expenses and taxes, I have removed: (1) the sewer depreciation expenses of \$2,544 on Schedule RJH-5, line 6; (2) the Rockwell sewer study amortization expenses of \$1,396 on Schedule RJH-10, line 14, and (3) the sewer revenues of \$28,376, O&M expenses of \$79,023 and property taxes of \$357, as shown on Schedule RJH-19.

- Boonesboro Acquisition Adjustment

Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF THE BOONESBORO ACQUISITION ADJUSTMENT.

A. This adjustment stems from KAWC's acquisition of all water and sewer facilities of the Boonesboro Water Association, Inc. ("Boonesboro") that was approved by the Commission on October 16, 1997 in Case No. 97-320. KAWC paid a premium of \$35,812 in excess of the net book value of the net assets acquired from Boonesboro. In paragraph 50 of the PSC Order in Case No. 97-320, the Commission allowed KAWC to give recognition to this premium as a plant acquisition adjustment:



50. Upon completion of the proposed transfer, Kentucky-American will record a Utility Plant Acquisition Adjustment of \$35,812.

It should be noted here that the recording of this acquisition adjustment was allowed for book purposes only. The PSC made no ruling in its Case 97-320 regarding the rate making treatment of this plant acquisition adjustment.

Q. WHY IS IT THAT THE COMPANY IN THE CURRENT CASE IS CLAIMING A BOONESBORO PLANT ACQUISITION ADJUSTMENT OF \$184,568 RATHER THAN THE AMOUNT OF \$35,812 THAT THE PSC ALLOWED KAWC TO RECORD FOR BOOK PURPOSES IN CASE NO. 97-320?

A. The claimed acquisition adjustment amount of \$184,568 includes not only the \$35,812 acquisition premium allowed for book purposes by the PSC in Case No. 97-320, it also includes the following other expenditures made by KAWC in connection with the Boonesboro acquisition:

- Legal expenses	\$ 87,230
- Company labor	\$ 46,350
- Other expenses	<u>\$ 17,188</u>
Total	\$150,768

Q. WAS THE BOOKING OF THESE ADDITIONAL ACQUISITION ADJUSTMENT COSTS OF \$150,768 PREVIOUSLY ALLOWED BY SPECIFIC COMMISSION ORDER AS WAS THE CASE FOR THE \$35,812 ACQUISITION PREMIUM?

A. No. The PSC never previously authorized the booking of the additional Boonesboro acquisition adjustment amount of \$150,768 which the Company, apparently on its own, has added to the \$35,812 that was authorized by the PSC in Case No. 97-320.

Q. PLEASE EXPLAIN THE PURPOSE OF THE ADDITIONAL \$150,768 BOOKED AS PART OF THE BOONESBORO ACQUISITION ADJUSTMENT BY KAWC.

A. Page 14, lines 10 - 12 of Mr. Bush's testimony states that,

We have incurred additional costs related to the costs of acquisition, including Company labor and legal costs necessary to acquire approval and litigate ongoing wastewater issues. (emphasis supplied)

The response to AG 1-82 further confirms that the Company labor amount of \$46,350 represents the labor of employees on KAWC's own payroll.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL TO GIVE RATE RECOGNITION TO THESE ADDITIONAL BOONESBORO ACQUISITION ADJUSTMENT COSTS OF \$150,768?

A. No, I do not. There are various reasons why this proposal should be rejected by the Commission in this case.

Let us first consider the Company labor, legal and other costs expended by the Company to litigate ongoing wastewater issues. Since these costs are related to the Company's sewer operations, they should not even be considered in this water rate case for KAWC. Perhaps even more importantly, the Company has acknowledged in its response to AG 1-82 D that if, currently and in the future, the Company incurs legal, Company labor and other expenses to litigate ongoing wastewater issues, the Company would *expense* such costs when incurred rather than capitalize or defer such costs. Similarly, the Company should have *expensed* the Company labor, legal and other

costs associated with the litigation of ongoing wastewater issues when these costs were incurred rather than deferring and amortizing these costs as part of the Boonesboro plant acquisition adjustment.

Furthermore, it should be recognized that the Company labor expenses of \$46,350 that are included in the acquisition adjustment do not represent incremental out-of-pocket expenses to the Company. The Company's rates that were in effect when this acquisition took place included Company labor expense allowances for 150 Company employees. The Company did not hire additional employees to implement this acquisition. Rather, some of the Company's then-existing employees<sup>2</sup> simply devoted more attention to this matter and less attention to other matters without adding a single dime to KAWC's overall labor expenses. Thus, the Company's rates in the period during and after the acquisition already fully reimbursed KAWC for the \$46,350 Company labor costs that the Company has now included in the Boonesboro acquisition adjustment and is proposing to charge to the ratepayers again through the 10-year acquisition amortization adjustment.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THESE ADDITIONAL BOONESBORO ACQUISITION ADJUSTMENT COSTS OF \$150,768 BASED ON THE FOREGOING INFORMATION?

A. Based on the previously discussed findings and conclusions, I recommend that these additional

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<sup>2</sup> In fact, during the time that the acquisition was negotiated and approved in 1997, the Company's actual employees ranged between 140 and 148 employees while the Company's rates at that time included a rate allowance for 150 employees.

Boonesboro Acquisition Adjustment costs not be recognized for rate making purposes in this case.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE \$35,812 ACQUISITION PREMIUM? \*

A. First, in the response to AG 2-1, KAWC confirmed that this acquisition premium amount was adjusted to \$33,800 in December 1999 to reflect the final purchased assets at 12/31/1998. I recommend that this remaining acquisition adjustment amount of \$33,800 also be removed for rate making purposes in this case because I do not believe that the Boonesboro acquisition has provided any significant benefits to the current customers of KAWC.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATIONS ON THE COMPANY'S PROPOSED FORECASTED PERIOD RATE BASE AND AFTER-TAX INCOME?

A. My recommendations reduce the Company's proposed rate base by \$175,340 (see Schedule RJH-3, line 2) and increase the Company's proposed after-tax income by \$18,456 (see Schedule RJH-4, line 14).

- Accumulated Depreciation

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENTS TO THE COMPANY'S PROPOSED AVERAGE FORECASTED PERIOD ACCUMULATED DEPRECIATION RESERVE BALANCE.

- A. As shown on Schedule RJH-6, \$35,194 of my recommended accumulated depreciation reserve adjustments is a direct result of my recommendation to adjust the Company's proposed forecasted plant in service balance and associated forecasted period depreciation expenses for the plant slippage factors discussed previously in this testimony. In addition, I have removed from the Company's proposed depreciation reserve the accumulated depreciation reserve amount of \$35,830 associated with the Boonesboro sewer operations for the reasons discussed in a prior section of this testimony.

- CWIP And AFUDC

- Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO THE COMPANY'S PROPOSED AVERAGE FORECASTED PERIOD CONSTRUCTION WORK IN PROGRESS ("CWIP") BALANCE.

- A. As shown in more detail on Schedule RJH-7, lines 1 - 3, my recommended CWIP balance adjustment is a direct result of the plant slippage factor adjustment. As calculated by the Company in its response to PSC 2-5, the application of the 10-year average plant slippage factor in this case reduces the Company's proposed CWIP balance by \$491,000.

- Q. CAN YOU NOW DESCRIBE WHAT PORTION OF THE COMPANY'S PROPOSED AVERAGE FORECASTED PERIOD CWIP BALANCE REPRESENTS AFUDC BEARING CWIP (AS OPPOSED TO NON-AFUDC BEARING CWIP) AND HOW THE COMPANY DERIVED ITS PROPOSED PRO FORMA AFUDC INCOME LEVEL?

A. Yes. It should first be noted that the Company's AFUDC rate used for rate making purposes in this case is 13.336%, representing its proposed overall rate of return of 9.58%, increased by the tax gross-up for the equity portion of this 9.58% rate of return number.<sup>3</sup> As explained on page 30, lines 7 - 12 of Mr. Grubb's testimony, the Company started using such a tax grossed-up AFUDC rate after its adoption of FAS109.

Since the Company's proposed pro forma AFUDC income in this case is \$338,018 and the applicable AFUDC rate is 13.336%, it can be derived that the AFUDC-bearing portion of the Company's total forecasted period CWIP balance amounts to  $\$338,018 / 13.336\%$ , or \$2,534,585 (see Schedule RJH-7, page 2, line 3).

In summary, the Company's proposed forecasted period AFUDC income of \$338,018 is derived by applying KAWC's "overall rate of return with equity tax gross-up" of 13.336% to KAWC's proposed forecasted period average AFUDC-bearing CWIP balance of \$2,534,585.

Q. WHAT ARE THE COMPONENTS OF THE COMPANY'S PROPOSED NON-AFUDC-BEARING CWIP BALANCE IN THIS CASE?

A. Since the Company's proposed forecasted period total CWIP balance amounts to \$5,454,134 and the AFUDC-bearing portion of this total CWIP balance amounts to \$2,534,585, this leaves a proposed balance of \$2,919,549 for non-AFUDC-bearing CWIP (see Schedule RJH-7, page 2, line 5). The components of this non-AFUDC-bearing CWIP are \$2,000,162 for the capitalized

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<sup>3</sup> The detailed calculations underlying this tax grossed-up AFUDC rate of 13.336% are shown in footnote 1 of Schedule RJH-7, page 2 of 2.

design costs of the Bluegrass Water Project ("BWP") and \$919,387 for all other non-AFUDC-bearing CWIP.

Q. IN THIS PROCEEDING, THE COMPANY HAS PROPOSED TO CHANGE FROM AN AFUDC RETURN TO A CURRENT RETURN ON THE CAPITALIZED BWP DESIGN COSTS. COULD YOU COMMENT ON THIS?

A. Yes. As described on page 4 of Mr. Bush's testimony, the \$2,000,162 of BWP design costs represent "source of supply costs associated with the potential for increased withdrawals from the Kentucky River including studies, investigations, surveys, evaluations and monitoring." As shown in more detail on W/P 4-1, page 13 of 16, these "source of supply" costs essentially consist of the costs related to the BP 90-13 Aquatic Study; BP 90-14 HARZA Study; PSC 93-434 Investigation; previously accrued AFUDC; and certain water quality monitoring and mediation process activities. Rather than continuing to accrue AFUDC on this source of supply related CWIP, the Company now wishes to cease accruing AFUDC and, instead, include this CWIP in rate base for a current return.

In this regard, Mr. Bush states on page 5, lines 23 - 25 of his testimony:

Using a 9% discount rate, our requested rate alternative [rate base inclusion for a current return] has a better present value than the continued booking of AFUDC with the costs ultimately being included in rate base upon completion of a solution to the source of supply deficit.

I disagree with the Company's proposed approach regarding this \$2,000,162 CWIP level. These expenditures are clearly and directly related to the source of supply issue and KAWC's responsibility to implement a solution to eliminate its supply deficit. The PSC has consistently ruled

in KAWC's prior rate cases that these very same source of supply expenditures could not receive rate recognition until completion of the related solution to the Company's source of supply deficit.

I see no reasons why the Commission should change this rate making policy in the current case.

Q. DO YOU HAVE ANY COMMENTS REGARDING THE ABOVE-REFERENCED NET PRESENT VALUE ANALYSIS MENTIONED ON PAGE 5 OF MR. BUSH'S TESTIMONY?

A. Yes. Mr. Bush's analysis assumes that the AFUDC accruals on the \$2,000,162 CWIP balance are based on an AFUDC accrual rate of 9.58%, the Company's requested overall rate of return in this case. However, for the net present value discount rate the Company used a lower rate of 9% rather than the same assumed overall rate of return on 9.58%. Once this is corrected for -- i.e., equalizing the NPV discount rate to the overall rate of return of 9.58% --, the net present value benefit of Mr. Bush's preferred rate making alternative over the alternative of continuing the accrual of AFUDC is very little. Specifically, the revised analysis shows that there is a \$38,000 net present value benefit for the entire 50 year period in Mr. Bush's analysis. This equates to an almost meaningless annual benefit of \$760 in Mr. Bush's 50-year analysis.

Q. BASED ON THE FOREGOING FINDINGS AND CONCLUSIONS, WHAT IS YOUR RECOMMENDED AFUDC-BEARING CWIP LEVEL AND THE ASSOCIATED RECOMMENDED AFUDC INCOME LEVEL TO BE USED FOR RATE MAKING PURPOSES IN THIS CASE?

A. My recommendations are shown on Schedule RJH-7, page 1 of 2. As discussed previously, the



recommended average forecasted period CWIP level after the adjustment for the plant slippage factor is \$4,963,029 (line 3). Next, I removed the non-AFUDC-bearing CWIP balance of \$834,777, as shown on line 4. This non-AFUDC-bearing CWIP represents the Company's proposed "Other" non-AFUDC-bearing CWIP of \$919,387<sup>4</sup>, adjusted for the plant slippage factor for which the calculations are shown in footnote 2. The resulting remaining recommended AFUDC-bearing CWIP balance amounts to \$4,128,252.

The AG's recommended AFUDC rate is 11.997%, representing the AG's recommended overall rate of return of 8.716%, increased by the tax gross-up for the equity portion of this 8.716% rate of return number.<sup>5</sup> Applying this recommended AFUDC rate to the recommended AFUDC-bearing CWIP balance indicates a recommended annual AFUDC income level of \$495,263 (line 7).

Finally, comparing this recommended pro forma AFUDC income level of \$495,263 to the Company's proposed pro forma AFUDC income of \$338,018 and applying the after-tax income factor of 59.6375% indicates that the Company's proposed net income should be increased by \$93,777 (line 11).

- Cash Working Capital

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<sup>4</sup> This does not include the \$2,000,162 for the BWP-Design CWIP.

<sup>5</sup> The detailed calculations underlying this tax grossed-up AFUDC rate of 11.997% are shown in footnote 3 of Schedule RJH-7, page 1 of 2.

Q. PLEASE SUMMARIZE YOUR UNDERSTANDING OF THE COMPANY'S PROPOSED CASH WORKING CAPITAL CLAIM IN THIS CASE.

A. The Company has proposed a total cash working capital ("CWC") requirement of \$1,176,000 in this case based on the results of a detailed lead/lag study. Virtually the entire CWC requirement amount is caused by the inclusion (with a 0 payment lag) in the Company's lead/lag study of (1) non-cash expense items such as depreciation expenses and deferred taxes; and (2) the return on equity component (Net Income). I do not agree that depreciation expenses and deferred taxes should be included in a lead/lag study with a 0 payment lag because such expenses do not require a cash outlay in the lead/lag study period. Neither do I agree with the proposition that the entire return on equity be included in the lead/lag study with a 0 payment lag based on the assumption that the stockholder is entitled to his return at the exact time that service is rendered. The simple fact is that the stockholder receives his return through common dividend payments and any gain in the Company's stock. This is the mechanism by which the common shareholder is compensated in the real world, and this mechanism would suggest a payment lag significantly higher than 0 days.

However, based on my review of prior PSC Orders involving KAWC, I understand that the PSC has consistently allowed depreciation expenses, deferred taxes and the return on equity in the lead/lag study with a 0 payment lag for purposes of determining the Company's CWC requirement.

In recognition of this and in an attempt to limit the issues in this case, I have chosen to accept the Company's proposed lead/lag study methodology for determining the appropriate cash working capital in this proceeding.

Q. DO YOU RECOMMEND AN ADJUSTMENT TO THE COMPANY'S PROPOSED CASH WORKING CAPITAL?

A. Yes. As confirmed in its response to AG 1-101, the Company's proposed overall weighted revenue collection lag of 36.63 days should be corrected down to 35.80 days. This correction reduces the Company's proposed cash working capital by approximately \$91,000, as confirmed by KAWC in its response to AG 1-205 (1). I have reflected this recommended cash working capital adjustment on Schedule RJH-3, line 6.

- Other Working Capital

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO THE COMPANY'S PROPOSED AVERAGE FORECASTED PERIOD OTHER WORKING CAPITAL BALANCE.

A. The Company has proposed to add to its forecasted period rate base an average projected balance for other working capital which it has assumed to be equivalent to the actual 13-month average plant materials and chemical stock balance for the period ending February 29, 2000. Consistent with the PSC's approved rate making treatment for other working capital in Case No. 97-034, I recommend that the forecasted period other working capital balance be based on the average for the most recent 24 months for which actual other working capital balances are available at the time of this testimony preparation. The response to AG 1-90 shows that this results in a recommended forecasted period other working capital balance of \$445,679, representing the average balance for the 24-month period

ending May 31, 2000. My recommendation is also consistent with the Company's proposal to determine most of the balances making up the Other Rate Base Elements based on the average of the most recent 24-month period available at the time the Company prepared its filing. My recommendation is reflected on Schedule RJH-3, line 7.

- Contributions In Aid of Construction (CIAC)

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENT TO THE COMPANY'S PROPOSED AVERAGE FORECASTED PERIOD CIAC BALANCE.

A. As shown on Schedule RJH-8, the recommended CIAC balance adjustment is a direct result of the plant slippage factor adjustment. As calculated by the Company in its response to PSC 2-5, the application of the 10-year average plant slippage factor in this case reduces the Company's proposed CIAC balance by \$13,323.

- Customer Advances

Q. DO YOU HAVE ANY COMMENTS REGARDING THE APPROPRIATE CUSTOMER ADVANCES BALANCE TO BE INCLUDED FOR RATE MAKING PURPOSES IN THIS CASE?

A. Yes. In KAWC's prior cases, the Company adjusted its customer advances balance for the same plant slippage factor as was used for adjusting its plant in service, depreciation reserve, CIAC and

ADIT balances. However, in the instant proceeding the Company for the first time introduced two new slippage factors related to customer advances in its overall plant slippage factor revenue requirement analysis in the response to PSC 2-5. In this regard, the Company stated in its response to PSC 2-5:

In order to respond to this data request [PSC 2-5], KAWC revised the spreadsheet files shown below. KAWC used the slippage factors requested above and also used slippage factors 93.73% for Customer Advance receipts and 107.86% for Customer Advance refunds. (emphasis supplied)

These newly introduced Customer Advances slippage factors should not be used to determine the pro forma Customer Advances balance in this case. First, other than the two sentences referenced above, the Company provided no explanations, justifications, calculations or workpapers in support of the two new Customer Advances slippage factors. Second, the Commission has historically applied the same slippage factors it used for plant in service to the Company's proposed depreciation reserve, CIAC, Customer Advances, and ADIT balances. It would be inconsistent and inappropriate to now give separate recognition to (unsubstantiated) Customer Advances slippage factors. Why not then develop and reflect separate CIAC and ADIT slippage factors? In summary, the Company's proposed approach is an inappropriate and inconsistent attempt to skew the slippage factor revenue requirement analysis methodology previously adopted by the PSC to its own advantage.

Q. WHAT IS THE IMPACT OF THE COMPANY'S CALCULATED CUSTOMER ADVANCES SLIPPAGE FACTORS ON ITS PROPOSED PRO FORMA CUSTOMER ADVANCES BALANCE IN RATE BASE?

A. Not surprisingly, the application of these newly introduced slippage factors results in quite a large

reduction of \$569,712<sup>6</sup> in the Company's proposed pro forma Customer Advances balance.

Q. DID YOU REQUEST THE COMPANY TO REDO ITS PLANT SLIPPAGE FACTOR REVENUE REQUIREMENT ANALYSIS IN THE RESPONSE TO PSC 2-5 WITHOUT THE SEPARATE CUSTOMER ADVANCES SLIPPAGE FACTORS?

A. Yes, I made this request in AG 2-5, however, KAWC did not perform this requested analysis.

Q. WHAT LEVEL OF PRO FORMA CUSTOMER ADVANCES HAVE YOU REFLECTED AT THIS TIME BASED ON THE FOREGOING INFORMATION?

A. As previously discussed, at this time I do not know what the pro forma Customer Advances balance is after the application of the recommended plant slippage factors described in the prior "Utility Plant in Service" section of this testimony. Therefore, until the time that the Company can provide this plant slippage factor impact on Customer Advances (supported with detailed calculations and workpapers), I have reflected the Company's proposed unadjusted forecasted period Customer Advances balance of \$12,411,002, as shown on Schedule RJH-3, line 9.

- Deferred Income Taxes

Q. PLEASE EXPLAIN YOUR RECOMMENDED ADJUSTMENTS TO THE COMPANY'S PROPOSED AVERAGE FORECASTED PERIOD DEFERRED INCOME TAX BALANCE.

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<sup>6</sup> Per response to PSC 2-5: \$12,411,002 - \$11,841,290 = \$569,712.

- A. As shown on Schedule RJH-13, the first of my recommended deferred income tax balance adjustments is a direct result of the plant slippage factor adjustment. As calculated by the Company in its response to PSC 2-5, the application of the 10-year average plant slippage factor in this case increases the Company's proposed ADIT balance by \$8,491.

The next five recommended deferred income tax balance adjustments are a direct result of my recommendations to remove from the Company's proposed rate base the unamortized KRS II, KRS Residuals Project, BWP Pipeline and Community Education cost balances.

The final recommended deferred income tax adjustment is a direct result of my recommendation to remove a portion of the Company's proposed deferred debit balances from rate base.

- Deferred Debits

Q. HAVE YOU REVIEWED THE RATE BASE BALANCES AND ASSOCIATED AMORTIZATION EXPENSES REGARDING ALL OF THE DEFERRED DEBIT ITEMS PROPOSED BY THE COMPANY IN THIS CASE?

- A. Yes, these Company-proposed balances and associated amortization expenses are listed in the first column on Schedule RJH-10. As denoted on this schedule, the deferred debits items and associated amortization expenses on lines 1 - 4 represent deferred debits for which the PSC allowed rate treatment in KAWC's prior rate cases. The deferred debit items and associated amortization expenses on lines 5 - 10 represent deferred debits for which the PSC has previously allowed full rate treatment when similar deferred costs were involved. The remaining deferred debits and associated

amortization expenses represent new items for which the PSC has not previously issued any rate making rulings.

Q. WHICH OF THE KAWC-PROPOSED DEFERRED DEBIT BALANCES AND ASSOCIATED AMORTIZATION EXPENSES LISTED ON SCHEDULE RJH-10 DO YOU NOT OPPOSE IN THIS CASE?

A. I have not taken exception to the Company's proposed rate base deferred debit balances and associated amortization expenses listed on lines 1 through 9 of Schedule RJH-10. Since these concern deferred debit items which have either been accorded rate treatment in KAWC's prior rate cases or for which similar costs have previously been allowed rate treatment by the PSC, I have chosen not to challenge them in this case.

Q. WHY DO YOU RECOMMEND NO RATE TREATMENT IN THIS CASE FOR A PORTION OF THE DEFERRED ACQUISITION EXPENSE, AS SHOWN ON SCHEDULE RJH-10, LINE 10?

A. The Company's proposed rate base deferred debit amount of \$32,088 is for its terminated efforts to acquire East Clark County Water District, Georgetown Municipal Water System and Logan and Todd County Systems. In past KAWC proceedings, the PSC has allowed rate base and amortization expense treatment for such failed acquisition cost deferrals. The terminated acquisition cost deferrals of approximately \$17,000 associated with the Georgetown Municipal Water System



("GMWSS") were incurred and deferred by KAWC from 1/95 through 2/97.<sup>7</sup> The unamortized rate base deferred debit balance for these deferred GMWSS costs claimed by KAWC in the current case are \$14,190 with associated forecasted period amortization expenses of \$5,676. These GMWSS costs should be removed from this case, as shown on line 10 of Schedule RJH-10. I am making this recommendation because the current Case No. 97-034 rates have already recovered these deferred GMWSS costs. W/P 3-13, page 4 of 4 and the response to AG 1-168 in Case No. 97-034 clearly show that in that case the Company was allowed an annual amortization of \$5,640 to amortize these very same terminated GMWSS acquisition costs over a 3-year period. Since the rates from Case No. 97-034 became effective on 10/1/97 and will stay in effect until 12/1/00, these deferred GMWSS costs will have been more than fully amortized through the Case No. 97-034 rates.

Q. WHY DO YOU RECOMMEND TOTAL DISALLOWANCE FOR THE ROCKWELL SEWER STUDY DEFERRED DEBIT AND THE ASSOCIATED AMORTIZATION EXPENSES, AS SHOWN ON LINE 14 OF SCHEDULE RJH-10?

A. The reason for this has been discussed by me in the earlier "Boonesboro Sewer Operations" section of this testimony.

Q. WHY DO YOU RECOMMEND TOTAL DISALLOWANCE FOR THE COST CONTAINMENT PROGRAM AND REORGANIZATION RELATED DEFERRED DEBITS

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<sup>7</sup> See response to PSC 2-43

AND ASSOCIATED AMORTIZATION EXPENSES, AS SHOWN ON LINES 11 AND 15 OF SCHEDULE RJH-10?

- A. In short, I am recommending this because the costs associated with the implementations of the Cost Containment Program and Reorganization are more than offset by the associated program cost savings experienced (and to be experienced) from inception of the Cost Containment Program and Reorganization until 12/1/00, the rate effective date of the current case.

Q. COULD YOU PROVIDE MORE DETAILS IN SUPPORT OF THIS CONCLUSION?

- A. Yes. As described on page 16 of Mr. Grubb's testimony and further detailed in the response to AG 1-105, the implementation of the Cost Containment Program involves a one-time cost of approximately \$24,000 incurred in 1998 which the Company has deferred on its books and is now proposing to charge to the ratepayers over a 3-year amortization period starting on 12/1/00. The response to AG 1-105 also points out that (1) shortly after the implementation of this Cost Containment Program in April 1998 the Company began realizing cost savings from this Program, and (2) the total actual cost savings resulting from this Program amount to \$52,841 as of May 31, 2000. However, while the Company has deferred the retroactive \$24,000 implementation cost of this Program and is proposing to charge this deferred cost to the ratepayers on a prospective basis, it has not similarly proposed to defer all of the retroactive savings from this Program and credit these deferred cost savings to the ratepayers on a prospective basis in this case. This is an unreasonable proposition. The one-time Program implementation cost of \$24,000 has been more than paid for by the substantially larger amount of associated cost savings resulting from this very same Program that

were not recognized in the Case 97-034 rates.

Q. WHAT ABOUT THE REORGANIZATION RELATED DEFERRED DEBIT ITEM?

A. As described on page 18 of Mr. Grubb's testimony and further detailed in the responses to AG 1-116 and 1-118, the total deferred reorganization costs claimed by the Company amounts to \$197,363, consisting of \$47,099 for the PeopleTech study and \$150,264 for the relocation costs of two former KAWC employees to the newly formed Southeast Regional Office. While these reorganization costs were incurred sometime in 1998, the Company deferred them on its books and is now proposing to charge them to the ratepayers over a 3-year amortization period starting on 12/1/00. As described on page 19, lines 7 - 12 of Mr. Grubb's testimony and further detailed on Exhibit EJG-3, page 7 of 8, the Company's latest updated version of the PeopleTech Study "...shows that the savings [from the reorganization] would be \$129,083 in year 1 and \$318,493 in year 2 and beyond....." The response to AG 1-117 confirms that the reorganization "...was completed by June 1998 when the last employee position in the reorganization was filled." Thus, if one assumes "year 1" of the reorganization to be the 12-month period ended June 1999 and "year 2 and beyond" the 17-month period July 1999 to December 1, 2000, this means that the reorganization cost savings based on the Company's own updated study results will amount to approximately \$580,000<sup>8</sup> by the time that the rates from the current case will become effective.

Similar to the Cost Containment Program costs, while the Company has deferred the

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<sup>8</sup> \$129,000 for Year 1 and \$451,000 (17/12 x \$318,493) for Year 2 and beyond = \$580,000.

retroactive \$197,363 implementation cost of the Reorganization and is proposing to charge this deferred cost to the ratepayers on a prospective basis, it has not similarly proposed to defer the retroactive savings of \$580,000 from this same Reorganization and credit these deferred cost savings to the ratepayers on a prospective basis in this case. This asymmetrical rate proposal should not be allowed in this case. The one-time Reorganization implementation cost of \$197,363 has been more than paid for by the substantially larger amount of associated cost savings resulting from this same Reorganization that were not recognized in the Case 97-034 rates.

Q. WHY DO YOU RECOMMEND TOTAL DISALLOWANCE FOR THE DEFERRED LEGAL/SETTLEMENT, DEFERRED RELOCATION, AND EASEMENT ENCROACHMENT DEFERRED DEBIT ITEMS AND THEIR ASSOCIATED AMORTIZATION EXPENSES, AS SHOWN ON LINES 17, 18 AND 19 OF SCHEDULE RJH-10?

A. The deferred litigation and settlement costs involve the costs incurred by the Company in two discrimination suits brought by two of KAWC's former employees, which suits were eventually resolved by settlement. As confirmed in the response to AG 2-19, the total deferred cost amount of \$193,056 consists of \$64,392 for actual settlement payments made by KAWC, \$127,143 in legal fees, and \$1,521 for deferred Company labor. The Company has proposed to charge these deferred costs to the ratepayers over a 5-year period starting on 12/1/00 and receive a return on the unamortized balance through rate base inclusion. These deferred costs should not receive any rate recognition for several reasons. First, I believe that the ratepayers should not be forced to pay for settlement awards and legal fees associated with lawsuits in which the Company is accused of illegal

business practices. These kind of expenses should properly be the responsibility of KAWC's stockholders who are being reimbursed for these types of business risk in their authorized return on equity. Second, while Mr. Bush spends two full pages in his testimony<sup>9</sup> in an attempt to convince the Commission that these deferred costs for some reason benefit the ratepayers, I do not think these costs have anything to do with the provision of safe, adequate and reliable water service. In my opinion, it is quite far-fetched to reason that these costs provide benefits to the ratepayers.

Q. WHAT ABOUT THE DEFERRED RELOCATION COSTS?

A. In February and September 1999, the Company incurred \$52,073 associated with the relocation of two management employees. The Company has deferred these costs and is proposing to amortize these costs to the ratepayers over a 3-year period and receive a rate base return on the unamortized balance. I do not believe that these deferred relocation costs should receive any rate recognition in this case. In AG 1-106, the Company was asked how many other management relocations it had experienced during the 10-year period 1989 - 1999. The response to this question indicates that KAWC experienced one management relocation in 1992 (Scott Thompson), one management relocation in 1994 (Roy Mundy) and then the two 1999 management relocations that are at issue in

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<sup>9</sup> Testimony of Mr. Bush, pages 12 and 13

the instant proceeding<sup>10</sup>. The response to PSC-41 also indicates that the Company expensed (rather than deferred) the aforementioned management relocation costs incurred in 1992 and 1994.

In summary, it is my opinion that the deferred relocation costs of \$52,073 at issue in this case represent non-recurring costs that should have been expensed when incurred by the Company in 1999. Had the Company done so, this would no longer have been an issue in this case.

*! Q&E: relocation costs not allowed for ratemaking purposes*

Q. WHAT ABOUT THE DEFERRED EASEMENT ENCROACHMENT COSTS?

A. As described on page 17 of Mr. Grubb's testimony and further detailed in the response to AG 1-114, these costs concern \$19,177 of expenditures made and deferred by the Company between 1991 and 1995 as a result of an investigation of various easement encroachments on Company property. In response to AG 1-114 C, the Company states that it does not project to have any similar easement encroachment costs for at least the next three years. I do not believe that there should be any rate recognition for these deferred costs in this case. These concern costs that were incurred by the Company between 1991 and 1995, a period 5 to 10 years prior to the forecasted period in this case. The Company never asked for rate recognition of these deferred costs in its two prior rate cases, Case Nos. 95-554 and 97-034, and I am quite puzzled why the Company picked the instant case to now charge the ratepayers for these very "old" deferred costs. In summary, I recommend that no rate recognition be granted to these deferred costs as they represent non-recurring items that were

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<sup>10</sup> While the response also lists the 1998 relocations of Messrs. Grubb and Rowe to the Southeast Regional Office, these costs were considered part of the Reorganization deferred debit in this case.

incurred more than 5 to 10 years before the forecasted period in this case and could have been, but were never, requested for rate treatment by KAWC in its prior two rate cases.

Q. COULD YOU NOW EXPLAIN YOUR RECOMMENDATIONS FOR THE PARTIAL RATE RECOGNITION FOR THE DEFERRED Y2K COSTS, DEFERRED GIS STUDY COSTS AND DEFERRED KRS AUTOMATION STUDY?

A. Yes. Each of these deferred debit items represent fairly recent costs incurred and deferred by KAWC that will benefit both the ratepayers and the stockholders alike. In accordance with previously applied PSC rate making policy, I therefore recommend that these deferred costs be shared between the Company's ratepayers and stockholders. To accomplish this sharing objective, the PSC has always allowed amortization rate treatment without inclusion of the unamortized deferred debit balance in rate base. I recommend the same type of rate treatment for the deferred Y2K, GIS study and KRS automation study costs in this case.

Q. COULD YOU NOW SUMMARIZE THE IMPACT OF ALL OF THE PREVIOUSLY DISCUSSED DEFERRED DEBIT RECOMMENDATIONS ON THE COMPANY'S PROPOSED FORECASTED PERIOD RATE BASE AND AFTER-TAX INCOME?

A. Yes. As shown on Schedule RJH-10, lines 20 and 22, my recommendations reduce the Company's proposed rate base by \$620,501 and increase the Company's after-tax income by \$85,438.

- KRS II Costs

Q. COULD YOU BRIEFLY SUMMARIZE THE BACKGROUND OF THE KRS II COSTS AND THE COMPANY'S PROPOSAL REGARDING THESE COSTS IN THE CURRENT CASE?

A. Yes. The deferred KRS II costs at issue in this case concern expenditures associated with the design of Kentucky River Station II that were incurred by the Company prior to August 1990. The entire expenditure for the design of KRS II amounted to approximately \$1.5 million. In Case No. 89-348, the project was considered inappropriate and the Company requested rate treatment for \$1 million of the total project costs of \$1.5 million. The PSC allowed rate recovery of this \$1 million over a 5-year amortization period, however, with no rate recovery on the unamortized balance. It was also decided at that time that a portion of that total design project could potentially be utilized in the design of an expansion of the Richmond Road Station, depending on the resolution of the source of supply issue. This design cost portion is the deferred cost balance of \$507,245 at issue in the current case. However, as described on page 11 of Ms. Bridwell's testimony, ".....Revised regulations and improved technology have made it unlikely that this design will ever be used no matter what facility is constructed". For this reason, the Company in this case is requesting that this remaining KRS II deferred costs balance of \$507,245 be amortized in rates over a 5-year amortization period with rate base treatment on the unamortized balance. The Company believes that it is justified in requesting rate base treatment on the unamortized costs balance in this case because its stockholders have already carried this deferred cost balance since 1990.

Q. HAVE YOU TAKEN EXCEPTION TO THE COMPANY'S PROPOSAL TO AMORTIZE



THESE DEFERRED COSTS OVER A 5-YEAR AMORTIZATION PERIOD IN THIS CASE?

A. No, I have not. I have accepted the Company's amortization proposal because it is consistent with the amortization treatment granted by the PSC in Case No. 89-348 for the initial \$1 million portion of this total design project.

Q. DO YOU AGREE WITH THE COMPANY'S POSITION THAT THE UNAMORTIZED BALANCE OF THIS DEFERRED COST AMOUNT SHOULD BE INCLUDED IN RATE BASE BECAUSE THE KAWC STOCKHOLDERS HAVE ALREADY CARRIED THIS DEFERRED COSTS BALANCE SINCE 1990?

A. No, I do not. I believe that the most relevant viewpoint to take in this matter is that it is now a certainty that this deferred cost amount of \$507,000 represents an abandoned project that will never provide any benefits to the KAWC ratepayers. Given these facts, I believe it would be highly inappropriate to include this abandoned project in rate base for a current return to the stockholders of KAWC. The Company should not be allowed to earn a profit (through the return on equity component in its overall rate of return) on an abandoned project that has no value to the ratepayers and is not used and useful in KAWC's current and future provision of water services.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE COMPANY'S PROPOSED FORECAST PERIOD RATE BASE?

A. As shown on Schedule RJH-3, line 15, my recommendation reduces the Company's rate base by \$456,521.

- KRS Residual Project Costs

Q. PLEASE BRIEFLY DESCRIBE THE COMPANY'S RATE PROPOSAL WITH REGARD TO THE DEFERRED KRS RESIDUAL PROJECT COSTS.

A. The Company has spent \$624,258 on preliminary investigation and actual design costs associated with future KRS Residuals Handling Facilities. On page 10, lines 27 - 28 of her testimony, Ms. Bridwell states with regard to these future KRS Residuals Handling Facilities that, ".....It is anticipated that these facilities as designed will not be needed for at least 10 years." The Company further states with regard to the preliminary investigation and design costs associated with these facilities in its response to PSC 2-33:

Because it is uncertain that the facilities as designed will ever be built, even after ten years, Kentucky-American considers these efforts to be abandoned. (emphasis supplied)

Because the Company has now declared these deferred preliminary investigation and actual project design costs to be an abandoned project, it has requested immediate rate recovery for this project in this case through a 5-year rate amortization with rate base treatment on the unamortized balance.

Q. DO YOU AGREE WITH THE COMPANY'S RATE PROPOSAL FOR THIS PROJECT IN THIS CASE?

A. No, I do not. First, I do not agree with the Company's proposal to include the unamortized balance of this abandoned project in rate base. Similar to the arguments made by me regarding the

abandoned KRS II project cost balance in the prior section of this testimony, the Company should not be allowed to earn a return – including a profit element in the form of the return on equity rate – on an abandoned project that has no value to the ratepayers and is not used and useful in the Company's current and future provision of water services.

Second, while I agree with the Company that it be allowed rate amortization of the full deferred cost balance of \$624,528, I recommend the use of a 10-year amortization period rather than the 5-year amortization period proposed by KAWC. If these deferred costs had become part of a residuals handling facility, the recovery period for these costs would have been a lot longer than 5 years or even 10 years. For that reason, I conservatively recommend a 10-year amortization period.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE COMPANY'S PROPOSED FORECAST PERIOD RATE BASE AND AFTER-TAX INCOME?

A. As shown on Schedule RJH-3, line 16, my recommendation reduces the Company's rate base by \$561,834. Schedule RJH-20, lines 4-8 shows that my recommendation also increases the Company's forecasted period after-tax income by \$37,227.

- BWP Pipeline Costs

Q. PLEASE BRIEFLY DESCRIBE THE COMPANY'S RATE PROPOSAL WITH REGARD TO THE DEFERRED COSTS RELATED TO THE LOUISVILLE PIPELINE, NOW REFERRED TO AS THE BLUEGRASS WATER PROJECT ("BWP") PIPELINE.

A. Since 1992 KAWC has spent approximately \$3.5 million on the design and development of a proposed pipeline to bring treated water from the Louisville Water Company to the KAWC service area in order to address the water supply deficit in the Company's service territory. However, this project has now been abandoned in favor of obtaining additional water supply from the Kentucky River. In this case, the Company is proposing to recover this \$3.5 million investment by amortizing these deferred costs over a 10-year period with rate base treatment on the unamortized balance.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL WITH REGARD TO THIS LARGE ISSUE?

A. No, I do not. Similar to the previously discussed KRS II and KRS Residuals projects, this BWP pipeline represents an abandoned project. The Company made this abundantly clear in its response to PSC 2-30 where it was asked why it is appropriate to request immediate recovery of the pipeline cost in this proceeding instead of deferring the costs until the supply deficit problem is resolved:

Kentucky-American has abandoned its pursuit of the pipeline as the solution to the source of supply and treatment capacity deficits.

The fact that this project has now been abandoned means that it is no longer used and useful and will never provide benefits to the ratepayers. The Company has already removed from the total BWP pipeline project costs those deferred costs that *are* still considered used and useful and of benefit to the ratepayers. These are the deferred costs of approximately \$2 million now included in the CWIP account that the Company has categorized as "source of supply costs", including the costs of source of supply studies, investigations, evaluations and monitoring. As discussed in the prior "CWIP and

AFUDC" section of this testimony, I have recommended that these source of supply costs be included in CWIP with offsetting AFUDC income in this case. As I explained in the previous testimony sections regarding the KRS II and KRS Residual projects, it would be inappropriate and represent poor rate making policy to include the costs associated with abandoned projects in rate base and allow KAWC to earn a current return -- including a profit -- on a project that is of no benefit to the ratepayers and will never be used and useful in the Company's provision of water services.

In summary, based on the aforementioned findings and conclusions, I recommend that this abandoned project cost balance be excluded from rate base.

Q. WHAT ABOUT THE COMPANY'S PROPOSAL TO AMORTIZE THESE DEFERRED BWP PIPELINE COSTS IN RATES OVER A 10-YEAR AMORTIZATION PERIOD?

A. The response to PSC 3-16 states that the Company considered 5-, 10-, 15-, 20-, 25- and 50-year recovery periods and that it evaluated such considerations as, for example, the total revenue requirement and the impact on both current and future ratepayers. This same response also confirms that if the BWP pipeline had been constructed and placed in service, the recovery period would have been 70 years.

While I do not take exception to the Company's proposal to amortize these abandoned costs in its rates, I do not agree with the Company's proposed amortization period. Given the size of this \$3.5 million abandoned project cost and the fact that the alternative to abandoning this project would have meant a 70-year cost recovery period, I believe that the 10-year amortization period chosen

by KAWC is too short. Rather, based on all of the aforementioned facts, I recommend the use of a 20-year amortization period.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE COMPANY'S PROPOSED FORECAST PERIOD RATE BASE AND AFTER-TAX INCOME?

A. As shown on Schedule RJH-3, line 17, my recommendation reduces the Company's rate base by \$3,358,227. Schedule RJH-21, lines 1-5 shows that my recommendation also increases the Company's forecasted period after-tax income by \$105,408.

- Community Education Costs

Q. PLEASE BRIEFLY DESCRIBE THE COMPANY'S PROPOSAL WITH REGARD TO ITS DEFERRED COMMUNITY EDUCATION COSTS IN THIS CASE.

A. The Company has spent a total of \$684,870 in – what it refers to as – Community Education costs in the process of addressing the water supply deficit problem in its service area. Most, if not all, of these costs were incurred during the time that the BWP pipeline was fully “alive” and was aggressively being promoted by KAWC as the most desirable solution to its water supply problem. Now that the Company has declared the BWP pipeline an abandoned project and is proposing to recover the deferred pipeline costs in its rates in this case, the Company has also decided in this proceeding to seek rate recovery for the related Community Education costs. However, the Company is not seeking rate recovery for the entire \$684,870 deferred cost balance. Rather, it is treating \$182,517

of the total deferred cost balance below-the-line in this case, and is proposing a 5-year rate amortization and rate base treatment for the unamortized balance for the remaining \$502,353 of this total deferred cost balance.

Q. WHY IS THE COMPANY NOT SEEKING RATE RECOVERY FOR THE ENTIRE DEFERRED COST BALANCE?

A. As explained by the Company in its response to PSC 3-5, the Company decided that the cost portion for which it is not seeking rate recovery could be considered “political advertising” because one of the purposes of these costs was the promotion of the BWP pipeline as the solution to the water supply shortage. With regard to the deferred Community Education cost balance for which KAWC seeks rate recovery, the Company claims that these costs are purely related to water conservation.

Q. WHAT IS THE RELEVANT STANDARD IN KENTUCKY RATE MAKING WITH REGARD TO POLITICAL ADVERTISING?

A. As defined in 807 KAR 5:016, Section 4(2)(a), political advertising is intended to influence “public opinion with respect to legislative, administrative, or electoral matters, or with respect to any controversial issue of public importance” (emphasis supplied).

Q. DOES THE COMPANY BELIEVE THAT THE BWP PIPELINE REPRESENTS A “CONTROVERSIAL ISSUE OF PUBLIC IMPORTANCE”?

A. No, not judged by its response to AG 2-31 in which the Company was asked whether it agreed that the pipeline, when it was still being considered by KAWC, represented a controversial issue of public

importance:

No. In KAWC's opinion a limited number of individuals and entities were vocally opposed to the pipeline for self-serving interests. Most of the public was unaware that a significant water supply deficit existed. KAWC felt compelled to attempt to educate the public about the water supply deficit because of the gravity of the consequences of a drought of record.

However, in its response to AG 1-132, the Company states that, "...the company recognizes that the controversy that arose regarding this effort could lead some parties to consider this effort to be political advertising." Furthermore, Mr. Mundy more than implies on page 12 of his testimony that the controversial nature of the BWP pipeline was an important consideration for the Company to opt out of this solution to the water supply problem:

However, the potential of litigation relative to the Bluegrass Water Project should it have been approved by the PSC was high, being noted publicly on many occasions by opponents of the project.

Q. HAS THE PSC PREVIOUSLY RULED THAT THE BWP PROJECT IS A CONTROVERSIAL ISSUE OF PUBLIC IMPORTANCE?

A. Yes. On pages 16 and 17 of the PSC's Order in Case No. 97-034, the Commission stated with regard to the BWP pipeline project:

The Commission finds that Kentucky-American's proposed Ohio River pipeline is a controversial issue of public importance. Therefore any costs that are incurred to influence public opinion or to educate the executive and legislative branches of government on this issue appears to fall squarely within prohibition of 807 KAR 5:016.

The Commission places Kentucky-American on notice that such costs will not be allowed for rate-making purposes.



Q. HAVE YOU ATTEMPTED TO PERFORM A DETAILED REVIEW AND ANALYSIS OF THE DEFERRED COST BALANCE OF \$684,870 IN ORDER TO IDENTIFY THE EXACT NATURE AND PURPOSE OF THE COST ELEMENTS MAKING UP THIS COST BALANCE?

A. Yes. In AG 1-132 I requested the Company to provide "a detailed breakout and detailed descriptions of the nature and purpose for each expense type and category making up the total amount of \$684,870". In response, the Company simply referred to its response to LFUCG Item 16. However, this response does not provide the detailed descriptions of the nature and purpose for each expense type and category that was requested by me.

Next, I issued AG 2-30 in which I requested the Company again to provide a detailed description of the nature and purpose for each of the expense types and categories making up the total cost balance of \$684,870. In response to this request, the Company referred me to LFUCG Item 16, page 3 of 42. However, this page does not provide the requested information. It indeed lists 11 line items with dollar amounts adding to the total cost balance at issue in this case, however, there is no meaningful cost breakout and there are no detailed descriptions of the nature and purpose of the cost categories. For example, the largest cost components on this page 3 consist of \$253,895 with the explanation "1998 transferred expenditures" and \$265,962 with the explanation "consultants".

Next, I reviewed the Company's response to PSC 3-5 where the Company was similarly requested to provide detailed descriptions of each cost element making up the \$684,870. While not entirely clear, it appears from this response that the total Community Education cost balance of

\$684,870 consists of two campaigns, one campaign with a claimed focus on conservation and the other campaign with a claimed focus on “heightening customer awareness of a potential shortage of water supply.” The Company then apparently separated out those campaign expenditures that were directly related to the BWP pipeline, for a total amount of \$182,517, and considered all remaining campaign expenditures to be purely conservation related.

Q. ARE THESE REMAINING COMMUNITY EDUCATION COSTS OF \$502,353 CONSIDERED TO BE NORMAL ONGOING CONSERVATION RELATED COSTS?

A. No. If they were, the Company would have expensed (rather than deferred) these costs when they were incurred, similar to what it does for the other conservation related expenses that are included in the forecasted period O&M expenses. For example, filing Schedule F-4 shows that the forecasted period expenses includes approximately \$136,000 worth of O&M expenses for conservation and institutional advertising<sup>11</sup>. Rather, I believe that these deferred costs represent extraordinary non-recurring costs that would not have been incurred absent the BWP pipeline controversy or the broader issue of the Company's source of supply deficit.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THE DEFERRED COMMUNITY EDUCATION COSTS OF \$502,353 FOR WHICH THE COMPANY IS REQUESTING RATE TREATMENT IN THIS CASE?

A. Based on all of the foregoing information, I do not believe that the Company has made a convincing

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<sup>11</sup> The AG has not opposed the inclusion of these advertising expenses in this case.