

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Adjustment of Rates of Kentucky-)
American Water Company)

Case No. 2004-00103

ATTORNEY GENERAL'S RESPONSE TO
KENTUCKY-AMERICAN WATER COMPANY'S
AMENDED PETITION FOR REHEARING

The Attorney General tenders his response to the Kentucky-American Water Company's (KAWC) Amended Petition for Rehearing. A party seeking relief through rehearing must establish the necessity for a modification to or change in the prior result, and the mere identification of a different outcome or methodology does not establish necessity.¹ Further, in opposing a request for rehearing, the Attorney General submits that he may argue any ground in support of upholding a correct result in the initial order by this Commission.² In the present case, the Commission should deny the Amended Petition.

A. Deferred Debits for Security Costs

The Attorney General objects to Kentucky-American's practice of isolating expenses from a prior period without any corresponding consideration of other factors from that period and then placing those items in a forward-looking test period. This Commission noted its concern with Kentucky-American's use of

¹ See *In the Matter of: An Investigation of the Sources of Supply and Future Demand of Kentucky-American Water Company*, Case No. 93-434, Order (on rehearing), 25 April 1995, pages 3 and 4.

² Case No. 93-434; see, for comparison with, *Jarvis v. Commonwealth*, 960 S.W.2d 466, 469 (Ky. 1988)(reviewing court will uphold correct result notwithstanding previous court's reasoning); *Newman v. Newman*, 451 S.W.2d 417, 420 (Ky. 1970)(even if trial court takes action for wrong reason, if action is proper on any other grounds result must stand).

deferrals in Case No. 2000-00120, the Company's most recent rate case.

Specifically, the Commission stated the following:

The Commission does not agree with Kentucky-American's proposed rate treatment of the aforementioned expenses included as other deferred debits and the deferred acquisition adjustment. **The Commission finds that these deferrals are contrary to the forecasted test period methodology, may constitute retroactive ratemaking or single-issue ratemaking, and should therefore be eliminated from forecasted operations entirely.** (emphasis in bold)³

The Attorney General continues to believe that the Commission's prior finding on this point is correct. Kentucky-American's philosophy regarding deferrals is contrary to the use of a forward-looking test period.⁴ Hence, the Petition for Rehearing should be denied.

With regard to the deferral relating to security costs, an additional factor merits discussion. Kentucky-American was aware of the mandate to "formally apply for Commission approval before accruing an expense as a regulatory asset."⁵ Rather than formally applying for the creation of a regulatory asset in the aftermath of "9/11," the Company sought the establishment of a surcharge. There is no express statutory authority for such a surcharge, and, in any case, the

³ *In the Matter of: Application of Kentucky-American Water Company to Increase its Rates*, Case No. 2000-00120, Order, 27 November 2000, pages 21 and 22.

⁴ The plain language of the Commission's 27 November 2000 order indicates that the immateriality of the items was a separate and independent consideration that also provided adequate grounds to eliminate a deferral.

⁵ Case No. 2000-00120, Order, 27 November 2000, page 23.

Company agreed to withdraw this request as a condition of the RWE acquisition approval process.

Hence, Kentucky-American did not seek the creation of a regulatory asset for these costs. Instead, it sought recover via a surcharge. As noted, Kentucky-American voluntarily withdrew the surcharge application in seeking approval of the RWE acquisition. By its actions, it has long-since waived any claim for deferral treatment of security costs incurred prior to the withdrawal of the surcharge application by its election to pursue and then withdraw its request for recovery through an alternative regulatory mechanism.⁶

Kentucky-American did not submit any request, formal or informal, for the creation of a regulatory asset for deferred security costs until approximately two years had past and after KAWC had elected to pursue an alternative regulatory treatment for the costs which was, with Kentucky-American's acceptance, withdrawn as a condition of the RWE acquisition approval.

Allowing recovery of the deferred costs after such a delay will remove any incentive Kentucky-American may have for seeking a timely creation of a regulatory asset in that Kentucky-American will suffer no consequence for waiting for, roughly, two years to advise the Commission of its desire for a regulatory asset (and having waived its claim for recovery by withdrawing its

⁶ Candidly, this theory may not cover the entire amount of the deferral amount for this item. Nonetheless, there are alternative grounds for denying the remainder.

request for recovery of these costs in a separate proceeding) and thereafter waiting until the eve of its filing of a rate case before filing a formal application.

B. Deferred Debits for Shared Services Center and Customer Call Center

The Attorney General incorporates the pertinent sections from his prior argument as well as the arguments on this point set out in his briefs and testimony. Further, while Kentucky-American may have been able to provide information about its costs, it did not meet its burden of proof regarding the reasonableness of or need the deferred costs. The Commission's ability to assess the credibility and persuasiveness of Kentucky-American's evidence is a matter within the Commission's sound discretion. The Commission's Order reaches the correct result. Accordingly, the Petition for Rehearing should be denied.

C. Consolidated Tax Adjustment

Kentucky-American's desire is to set its revenue requirement to collect money from its Kentucky ratepayers in order to send that money to its parent for a tax bill as if Kentucky-American filed its taxes on a stand-alone basis. In fact, it does not file its taxes on a stand-alone basis but rather files as part of a consolidated group. The filing of a consolidated return allows the group to take advantage of tax losses experienced by other member companies who file as part of the same consolidated tax group in determining tax liability. For Kentucky-American, the result is an effective tax rate that is lower than it otherwise would be had KAWC filed its taxes on a stand-alone basis.

The ratepayers of Kentucky-American may be properly required to pay for the legitimate expense of the provision of reasonable water service. If Kentucky-American actually filed its taxes on a "stand-alone" basis rather than as part of a consolidated tax group, there would be no issue. KAWC does, however, file as part of a consolidated group and the calculation of its revenue requirement as if it did not do so results in a windfall to the Company from rates that are higher than necessary because Kentucky-American's effective tax rate is, in reality, lower than it otherwise would be if it filed on a stand-alone basis.

There is no error of fact or law in the Commission's decision on this point. The Commission should deny the Petition for Rehearing. While Kentucky-American rattles the sabre of "serious jurisdictional and confiscatory issues,"⁷ neither issue is present.

Three other jurisdictions in which American subsidiaries operate apply consolidated income tax adjustments for ratemaking purposes. There is no prohibition against this Commission likewise adopting an adjustment that reflects the reality of the condition in which Kentucky-American finds itself in the aftermath of the creation of Thames Water Aqua US Holdings, Inc. ("TWUS"), and the approval of its request to become part of the TWUS consolidated tax group.⁸

⁷ KAWC Amended Petition for Rehearing, page 2.

⁸ See also, TE Vol. IV, page 48.

Additionally, there is no confiscation in an action by the Commission to afford the Kentucky ratepayers the benefit of savings that result from Kentucky-American's inclusion in the TWUS consolidated group.⁹ Further, when a company files a consolidated income tax return, it foregoes the ability to use tax loss carryforwards to offset taxable income in subsequent years.¹⁰ Thus, "consolidated income taxes do not result in any confiscation of tax benefits because these benefits do not exist to a tax loss company if that company files its tax return as part of a consolidated income tax group."¹¹

WHEREFORE, the Attorney General respectfully requests this Commission deny KAWC's Amended Petition for Rehearing.

Respectfully submitted,

GREGORY D. STUMBO
ATTORNEY GENERAL



Dennis G. Howard II
David Edward Spenard
Assistant Attorneys General
1024 Capital Center Drive, Suite 200
Frankfort, Kentucky 40601-8204
502-696-5453
502-573-8315 (facsimile)

⁹ See also, TE Vol. IV, pages 48, 49.

¹⁰ See 5 November 2004 pre-filed Surrebuttal Testimony of Andrea C. Crane, page 5.

¹¹ 5 November 2004 pre-filed Surrebuttal Testimony of Andrea C. Crane, page 5.

Submission of Filing in Paper Medium

Per Instructions 3 and 13 of the Commission's 27 May 2004 Order, Counsel submits for filing, by hand delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601, the original and one copy in paper medium of the document. 29 March 2005 is the date for the filing in paper medium.


Assistant Attorney General

Certificate of Service

Per Instructions 4, 8 (d), and 12 of the May 27th Order, Counsel certifies service of a true and correct photocopy of the document by mailing the photocopies, first class postage prepaid, to the other parties of record on 28 March 2005.

The following are the other parties of record: David Jeffrey Barberie, Leslye M. Bowman, Lexington-Fayette Urban County Government, Department of Law, 200 East Main Street, Lexington, Kentucky 40507; Coleman D. Bush, Kentucky-American Water Company, 2300 Richmond Road, Lexington, Kentucky 40502; Joe F. Childers, 201 West Short Street, Suite 310, Lexington, Kentucky 40507; Roy L. Ferrell, West Virginia American Water Company, 1600 Pennsylvania Avenue, Charleston, West Virginia 25302; Lindsey W. Ingram III, Stoll, Keenon & Park, LLP, 300 West Vine Street, Suite 2100, Lexington, Kentucky 40507-1801; Lindsey W. Ingram, Jr., Stoll, Keenon & Park, LLP, 300 West Vine

Street, Suite 2100, Lexington, Kentucky 40507-1801; Michael A. Miller, West Virginia American Water Company, 1600 Pennsylvania Avenue, Charleston, West Virginia, 25302; Jon Parker, 201 W. Short Street, Suite 310, Lexington, Kentucky 40507; Bluegrass FLOW, Inc., c/o Foster Ockerman, Jr., 200 N. Upper Street, Lexington, Kentucky 40507; and Roy W. Mundy II, Kentucky-American Water Company 2300 Richmond Road, Lexington, Kentucky 40502.

David Lee Spivey
Assistant Attorney General

Certification Regarding Electronic Filing

Counsel certifies that he has (per Instructions 3 and 8 (b) of the May 27th Order) submitted one copy of the document in electronic medium. Pursuant to Instructions 8 (a) and 8 (c) of the May 27th Order, he certifies that the electronic version of the filing is a true and accurate copy of the document filed in paper medium and that he has, by electronic mail, notified the Commission and the other parties that the electronic version of the filing has been transmitted to the Commission. 28 March 2005 is the date of filing in electronic medium.

David Lee Spivey
Assistant Attorney General