

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY-AMERICAN )  
WATER COMPANY FOR AN ADJUSTMENT OF ) CASE NO. 2010-00036  
RATES SUPPORTED BY A FULLY )  
FORECASTED TEST YEAR )

COMMISSION STAFF'S FIRST SET OF INFORMATION REQUESTS  
TO THE ATTORNEY GENERAL

Pursuant to 807 KAR 5:001, Commission Staff requests that the Attorney General ("AG") file with the Commission no later than July 9, 2010 the original, one paper copy, and an electronic copy of the information requested below. Responses to requests for information shall be appropriately bound, tabbed, and indexed. Each response shall include the name of the witness responsible for responding to the questions related to the information provided.

Each response shall be answered under oath or, for representatives of a public or private corporation or a partnership or association or a governmental agency, be accompanied by a signed certification of the preparer or the person supervising the preparation of the response on behalf of the entity that the response is true and accurate to the best of that person's knowledge, information, and belief formed after a reasonable inquiry.

The AG shall make timely amendment to any prior response if it obtains information which indicates that the response was incorrect when made or, though correct when made, is now incorrect in any material respect. For any request to which

the AG fails or refuses to furnish all or part of the requested information, it shall provide a written explanation of the specific grounds for its failure to completely and precisely respond.

Careful attention shall be given to copied material to ensure that it is legible. When the requested information has been previously provided in this proceeding in the requested format, reference may be made to the specific location of that information in responding to this request. When applicable, the requested information shall be separately provided for total company operations and jurisdictional operations.

1. In all previous proceedings in which Kentucky-American applied for a general rate adjustment using a fully forecasted test period, the Commission found that “slippage” adjustments were appropriate to account for the effect of capital construction budget variances for the 10 years prior to the forecasted period.

a. State whether the AG agrees with the use of slippage adjustments in general adjustment rate proceedings in which a fully forecasted test period is used.

b. Refer to Kentucky-American’s Response to Commission Staff’s Second Information Request, item 36. State whether the AG agrees with the slippage adjustments set forth in that response.

c. Explain why the AG witnesses have not proposed slippage adjustments or otherwise included such adjustments in their recommendations.

2. AG witness Ralph C. Smith proposes to eliminate Construction Work In Progress (“CWIP”) from Kentucky-American’s forecasted rate base and to remove the

Allowance for Funds Used During Construction ("AFUDC") from forecasted operating revenues.<sup>1</sup>

a. State whether Mr. Smith is aware that the Commission has previously allowed Kentucky-American to include CWIP in rate base but offset the return by including AFUDC in operating revenues.

b. State whether Mr. Smith agrees with the statement below:

Generally, regulated utilities recognize the carrying costs of construction in rates through one of two methods: inclusion of CWIP in rate base or accrual of Allowance for Funds Used During Construction ("AFUDC"). This Commission has, in previous Kentucky-American rate proceedings, applied a hybrid approach that combines these two methods. This approach allows Kentucky-American to include all CWIP in rate base while accruing AFUDC on projects taking longer than 30 days to complete. Under this approach, AFUDC revenue is reported "above the line." This approach eliminates the effects of including AFUDC bearing CWIP in rate base. It further allows Kentucky-American to accrue AFUDC as part of an asset's cost where appropriate and to earn a return on CWIP where AFUDC is not accrued.

We are not persuaded by the AG's argument that customers paying the rates approved in this case may never receive service from CWIP included in rate base. Effectively, the only CWIP upon which Kentucky-American will earn a return is that which will be completed and placed into service within 30 days of its construction start date.<sup>2</sup>

c. If Mr. Smith does not agree with the statement set forth in item 2(b), explain why.

d. List the events or changing conditions that have occurred since the issuance of the Commission's Order of February 28, 2005 in Case No. 2004-00103 that

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<sup>1</sup> Direct Testimony of Ralph C. Smith at 10-16 and 32 (filed June 11, 2010).

<sup>2</sup> Case No. 2004-00103, Adjustment of Rates of Kentucky-American Water Company (Ky. PSC Feb. 28, 2005) at 11.

would require the Commission to reconsider and modify its position on CWIP and AFUDC as expressed in that Order.

3. State the net revenue requirement effect of Mr. Smith's proposal to exclude CWIP from rate base and to remove AFUDC from operating revenues.

4. In his direct testimony, Mr. Smith discusses a "Major Tax Accounting Change" for the method of accounting for repairs and maintenance.<sup>3</sup>

a. Provide a detailed description of the referenced change.

b. Explain how this change affects the calculation of deferred income taxes.

5. At page 25 of his direct testimony, Mr. Smith states that he is "aware of this issue, involving a major change to a utility's tax accounting method, being raised in some recent electric utility rate cases." For each of the cases to which Mr. Smith is referring:

a. State the state utility regulatory commission before which the case was brought, the case style and case number, and the name of electric utility involved; and

b. Provide a copy of all orders from the utility regulatory commission proceeding in which the accounting change was discussed.

6. At page 15 of his direct testimony, Mr. Smith states that "[i]t is not appropriate to include CWIP in rate base, particularly as the projects may result in additional revenues or cost savings which have not been reflected in the future test year ended September 30, 2011."

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<sup>3</sup> Direct Testimony of Ralph C. Smith at 21 - 27.

a. Identify all construction projects that are included in CWIP that will definitely result in additional revenues and provide the calculation of the expected additional revenues that will occur as a result of the identified project(s).

b. Identify all construction projects that are included in CWIP that will definitely result in cost savings and provide the calculation of the expected cost savings that will occur as a result of the identified project(s).

7. Explain why, as the Commission has permitted a cash return on CWIP for the jurisdictional electric and gas utilities, it should not afford the same ratemaking treatment to Kentucky-American.

8. State whether Mr. Smith believes that the use of the 1/8 formula approach to calculate Kentucky-American's cash working capital is a reasonable alternative to the use of a cash working capital study. Explain.

9. State whether Mr. Smith agrees with the following statement: "To demonstrate that the inclusion of forecasted business development costs are reasonable and appropriately included in Kentucky-American's regulated operations, Kentucky-American must document and separate forecasted management fees from those that are directly assignable and those that are allocated."<sup>4</sup> Explain.

10. a. List all state utility regulatory commissions that have adopted consolidated income tax adjustments for ratemaking purposes.

b. Provide a copy of all orders from the state utility regulatory commissions listed in the response to item 10(a) in which the commission has addressed the use of consolidated income tax adjustments for rate-making purposes.

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<sup>4</sup> See Case No. 2004-00103, Order of Feb. 28, 2005 at 53.

11. a. List all state utility regulatory commissions that have rejected or denied consolidated income tax adjustments for rate-making purposes.

b. Provide a copy of all orders from the state utility regulatory commissions listed in the response to item 11(a) in which the commission has addressed the use of consolidated income tax adjustments for rate-making purposes.

12. In Case No. 2004-00103, the Commission accepted the AG's proposal to adjust Kentucky-American's forecasted current and deferred income tax expenses to reflect the use of a consolidated tax return because it had previously held that the savings resulting from the filing of a consolidated tax filing was a merger benefit, subject to allocation.<sup>5</sup> Explain why, as Kentucky-American is no longer an affiliate of either Thames Water Aqua Holdings, Thames Water Aqua US Holdings, Inc., or RWE Aktiengesellschaft, a consolidated income tax adjustment is reasonable and appropriate.

13. Refer to Direct Testimony of Ralph C. Smith at 29-32. State whether Mr. Smith's proposed consolidated income tax adjustment conforms to the federal income tax normalization requirements. Explain.

14. Refer to Direct Testimony of Dr. J. Randall Woolridge at 17. Provide a copy of the case study to which Dr. Woolridge refers in footnote 2.

15. Refer to Direct Testimony of Dr. J. Randall Woolridge, Exhibit\_JRW-4 at 2. For each company in Panels A and B, provide the most recent company profiles as published in *Value Line Investment Survey*.

16. Refer to Direct Testimony of Dr. J. Randall Woolridge, Exhibit JRW-10 at 2. Provide the calculations used to derive in the dividend yields for Panels A and B.

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<sup>5</sup> Id. at 65-66.

Indicate whether stock prices used in the calculations were highs, lows, means, or medians.

17. Refer to Direct Testimony of Dr. J. Randall Woolridge at 34-35 and Exhibit\_JRW-10 at 3-5.

a. Explain why blending the median values of ten- and five-year averages produces a meaningful estimate of growth rates.

b. Explain why blending projected estimates of earnings, dividends, and book value growth rates into a single number provides a meaningful estimate of growth rates.

18. Refer to Direct Testimony of Dr. J. Randall Woolridge at 47-48 and Exhibit\_JRW-11 at 6.

a. Provide a copy of each study listed in the Exhibit on page 6.

b. Explain why it is appropriate to use geometric means in calculating equity risk premiums in the context of this case

c. Explain why averaging geometric and arithmetic means produces a meaningful estimate in the context of this case.

d. State whether the most recent Ibbotson SBBI yearbook contains any discussion of estimating and using the ex ante approaches or a discussion comparing the ex ante and historical approaches to calculating risk premiums. If yes, provide a copy of those sections of the yearbook in which those discussions appear.

19. Refer to Direct Testimony of Dr. J. Randall Woolridge, Exhibit\_JRW-11 at 11. Provide a copy of the Table "Kentucky-American Water Company - CAPM - Real S&P 500 ESP Growth Rate" in Excel spreadsheet form with all formulas intact and unprotected.

20. Table 1, which is appended to this Request, reflects annual depreciation expense for the Kentucky River Station II facilities based upon the current estimated construction costs using the depreciation rates contained in a net present-value analysis that Kentucky-American submitted in Case No. 2007-00134<sup>6</sup> and those in a depreciation study that Kentucky-American has presented in this proceeding.

a. State whether Mr. Smith agrees with the calculations set forth in Table 1. If no, explain why not.

b. State the weight, if any, that should be given to the depreciation rates used in Case No. 2007-00134 in assessing the appropriateness and reasonableness of Kentucky-American's proposal to use the remaining life depreciation rates for the existing plant to calculate the depreciation expense for the new Kentucky River Station II facilities. Explain.



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Jeff Derouen  
Executive Director  
Public Service Commission  
P.O. Box 615  
Frankfort, KY 40602

DATED: JUN 25 2010

cc: Parties of Record

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<sup>6</sup> Case No. 2007-00134, The Application of Kentucky-American Water Company for a Certificate of Convenience and Necessity Authorizing the Construction of Kentucky River Station II, Associated Facilities and Transmission Main. Response filed Dec. 10, 2007.



APPENDIX

APPENDIX TO COMMISSION STAFF'S FIRST SET OF INFORMATION  
REQUESTS TO THE ATTORNEY GENERAL IN CASE NO. 2010-00036  
DATED JUN 25 2010

Table 1					
Depreciation Group	Case No. 2007-00134			Revised W/P4-1	
	Est. Cost	Dep. Rate	Dep. Exp.	Dep. Rate	Dep. Exp.
Lake, River and Other Intakes	\$ 5,648,952	2.29%	\$ 129,361	2.05%	\$ 115,804
<u>Raw Water Pumping Station:</u>					
Structure	\$ 13,819,059	1.94%	268,090	2.85%	393,843
Electric Pumping Equipment	\$ 2,239,867	2.45%	54,877	2.25%	50,397
Supply Mains	\$ 657,044	1.82%	11,958	2.20%	14,455
<u>Water Treatment Plant</u>					
Structure	\$ 36,152,863	1.91%	690,520	2.95%	1,066,509
Equipment	\$ 18,659,215	2.21%	412,369	2.51%	468,346
Electric Pumping Equipment	\$ 3,286,961	2.45%	80,531	2.25%	73,957
Finished Water Main	\$ 67,551,898	1.66%	1,121,362	1.66%	1,121,362
Transmission Storage	\$ 2,325,750	2.25%	52,329	2.03%	47,213
<u>Transmission Water Pumping Station</u>					
Structure	\$ 5,989,814	1.94%	116,202	2.85%	170,710
Electric Pumping Equipment	\$ 2,299,447	2.45%	56,336	2.25%	51,738
Totals			\$2,993,935		\$3,574,334

SOURCES:

1. Case No. 2007-00134, Kentucky-American Response to Hearing Data Requests, item 15 (filed Dec. 10, 2007).
2. Kentucky-American's Response to Commission Staff's Second Set of Information Requests, item 44 (filed Apr. 30, 2010).
3. Kentucky-American's Response to Commission Staff's Third Set of Information Requests, item 6 (filed May 28, 2010).