

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY-AMERICAN)
WATER COMPANY FOR AN ADJUSTMENT OF) CASE NO. 2012-00520
RATES SUPPORTED BY A FULLY FORECASTED)
TEST YEAR)

**LEXINGTON-FAYETTE
URBAN COUNTY GOVERNMENT'S BRIEF**

Comes now the Lexington-Fayette Urban County Government ("Lexington"), by counsel, in accordance with the procedural schedule, and submits this Brief in support of its positions in this action.

Lexington, the Kentucky Attorney General (the "Attorney General") and the Community Action Council for Lexington-Fayette, Bourbon, Harrison and Nicholas Counties, Inc. ("Community Action") were granted full intervenor status.

Each of the intervenors filed testimony in this matter, and a two day hearing concluded on June 5, 2013. Lexington is generally in agreement with the positions and arguments made by the Attorney General in this matter, and adopts and incorporates the same herein except to the extent that they otherwise conflict with this Brief.

This case involves Kentucky-American Water Company's ("KAW", or the "company") attempt to obtain a rate increase in excess of \$12 million per year and more than 14.5%. [Application, Statement and Notice (and Exhibits referenced therein)]. This would increase the average residential water bill by more than \$60 per year (most of which is an increase to the "flat fee" General

Meter Service Charge), and the public fire hydrant rate by almost 20%, with most of this significant increase (more than \$600,000 per year) borne by a single customer, Lexington. [Application, par. 11; Response to Question No. 8 of Lexington's First Set of Data Requests].

As further argued below, the Public Service Commission (the "Commission") should deny the application and instead provide the company with the lowest possible rate increase allowed by law. Additionally, the Commission should: (1) ensure that the concept of gradualism is built into any public fire hydrant rate increase given the customer impact to Lexington and its citizens, (2) deny any recovery of KAWC's Business Transformation costs and any revenues lost from KAWC's unilateral decision to end its billing relationship with Lexington, (3) deny recovery of the costs associated with the Owenton pipeline decision, (4) deny KAW's attempt to add in a Distribution System Infrastructure Charge and a Purchased Power and Chemical Charge, and (5) put measures in place to ensure that the Central Division customer base will not be used as the financial means to expand the operations of the company beyond its current service territory.¹

¹ Lexington also notes that it is not generally opposed to the arguments forwarded by CAC in this matter. The issue of affordability for low-income customers needs to be addressed. However, with respect to this particular case, Lexington believes that a significant reduction in the scope of the proposed General Meter Service Charge (and as proposed by Attorney General/Lexington witness Brian Kalcic), which would benefit all residential customers, is more realistically achievable.

I. KAW's Application Should Be Denied

Based upon the record in this case and the applicable law, KAW is not entitled to the rate increase it seeks. The burden of proof in this matter is on the company, and the Commission is not required to grant KAW its requested increase. See e.g., KRS 278.190(3); Citizens Telephone Co. v. Public Service Commission, 247 S.W.2d 510 (Ky. App. 1952).

Although KAW is allowed a "fair, just and reasonable rate", the company's requested increase in this case does not meet that standard. KRS 278.030. Instead, KAW should be granted the lowest possible increase that allows it to operate successfully, maintain its financial integrity, attract capital, and compensate its investors for the risks assumed. See Commonwealth of Kentucky ex rel. Stephens v. South Central Bell Telephone, 545 S.W.2d 927 (Ky. 1976); Citizens Telephone Co. at 511.²

The Commission should adopt the testimony of joint Attorney General/Lexington witnesses Stephen M. Rackers and Dr. J. Randall Woolridge regarding revenues to which the company may be entitled. More specifically, the Commission should adopt the revenue adjustments proposed by Mr. Rackers and the Return on Equity (ROE) of 8.5%, as testified to by Dr. Woolridge. [See e.g., Direct Testimony of Stephen M. Rackers at pp. 2-7; 15-19 and 22-26; Direct Testimony of Dr. J. Randall Woolridge at p. 2]. Additionally, it should ensure

² See also Lexington-Fayette Urban County Government Resolution No. 295-2013.

that the General Meter Service Charge is not increased at the level proposed by the company. [See Direct Testimony of Brian Kalcic at pp. 10-12].

The result of the proposed rate increase on all customers (especially residential and public fire hydrant customers) is significant. The Commission should carefully review every aspect of this case to make sure that the company only obtains the least relief necessary under the law. This is clearly not the full amount requested by KAW. At **most** the requested increase should be no more than the \$2.485 million, or less than 3%, as suggested by Witnesses Rackers and Kalcic. [Direct Testimony of Stephen M. Rackers; Direct Testimony of Brian Kalcic, page 8].³

II. The Commission Should Limit the Magnitude of the Proposed Public Fire Hydrant Rate

Lexington currently pays more than \$3.1 million per year in public fire hydrant tariffs. [Exhibit No. 36; Exhibit No. 37, Schedule M; Response to Question No. 8 of Lexington's First Set of Data Requests]. KAW proposes, based upon its cost of service study, that the public fire hydrant tariff increase almost 20%, which will impact Lexington by more than \$600,000 per year. While joint Attorney General/Lexington witness Brian Kalcic was generally in agreement with the methodology used in KAW's Cost of Service Study, he specifically cautioned that the principals of rate gradualism and customer impact should be considered in the event that the revenue requirements of witness Rackers were not adopted

³ The issue of whether any of the company's Business Transformation costs should be borne by the customers must also be decided by the Commission, and any reduction would serve to further reduce the revenues to which KAW would be entitled.

by the Commission. [Testimony of Brian Kalcic 06-05-13; 16:50:28-51:35; 17:09:20-17:10:38]. Clearly an increase of \$600,000 per year and nearly 20% to a single customer is excessive and unjust and would result in rate shock to Lexington. Therefore, it should not be adopted by the Commission.

III. Lexington and its Citizens Should Not Bear the Cost of KAW's decision to Terminate Billing Services

There is sufficient evidence in the record to support a determination that none of the costs of the KAW's Business Transformation program should be borne by the customers.⁴ There is no evidence that any KAW-level analysis or determination was made as to the program, or that it was otherwise a reasonably and prudently incurred expense as to other alternatives that may have been considered. [See Attorney General's Response to Commission Staff's Request for Information Responses No.'s 19, 20, and 22].

However, even if the Commission determines some level of these costs should be passed onto the ratepayers, this should still not result in the customers bearing the cost of KAW's unilateral decision to end billing services. Depending upon which evidence is to be trusted, either this decision was made outside of Kentucky without any real consideration as to the local impact, or it was callously made at the local level. This misguided decision resulted in more than \$1.3 million in annual lost revenues without any regard to the consequences to Lexington and the majority of KAW's customers. In essence, KAW walked away

⁴ Perhaps better stated, there is not a KAW-specific basis in the record to support these costs.

from \$1.6 million in revenue to save around \$250,000. [Public Service Commission Staff Hearing Exhibit No. 3].

This decision caused Lexington significant financial harm which will ultimately be paid for by the citizens of Lexington, who also comprise the bulk of the company's customer base. [Direct Testimony William O'Mara, pp. 4-7]. For example, Lexington is already paying more than \$500,000 per year for the same services KAW was providing, and these costs will eventually be borne by KAW's Lexington customers. [Id.].

As indicated by Mr. Rackers, KAWC's customers should be compensated for the lost billing revenue through a credit towards the cost of Business Transformation or some other offset. [Attorney General's Response to Commission Staff's Request for Information No. 23].

Rather than acting as a good corporate citizen, or seeking to minimize rates, the company (or perhaps American Water Works)⁵ unilaterally decided to discontinue billing with no regard to the negative impact to Lexington or the ratepayers. The local justification for this decision, which involved no objective analysis or criteria, was that it avoided billing confusion, allowed for a modest amount of customers (around 300) to avoid shutoffs, and alleviated some late payments. [See e.g., Rebuttal Testimony of Cheryl Norton D. Norton page 13,

⁵ According to KAW witness David Baker, all of the American Water Works companies were ultimately instructed to exit these types of agreements in December 2011, although this was apparently being discussed in early 2011 and encouraged by no later than August 1st. [See Hearing Testimony of David Baker, 06-04-13, 09:32:37-10:18:00, Public Service Commission Staff Hearing Exhibit No.'s 1 and 2]. Ms. Norton seemed to testify that the decision to terminate these services was made by her.

line 5 – page 14, line 6; Testimony of Melissa Schwarzell, 06-05-13, 09:44:30-09:45:56]. It also saved approximately \$250,000 a year. In return, KAW gave up more than \$1.6 million a year for which it now wants to be compensated through an increase in rates at an amount of \$.90 per month for each of its more than 100,000 residential customers. [Public Service Commission Staff Hearing Exhibit No. 3].

No attempt was made to avoid any alleged customer confusion over the billing.⁶ In fact, the current billing arrangement is likely to be even less transparent to customers, as their sewer fees are directly related to the amount of water that they use and they now receive that bill separately from their water bill. See Chapter 16, Article VI, Lexington-Fayette Urban County Government Code of Ordinances. This was not a good business decision, it was not in the interest of the ratepayers, and it should not be rewarded by the Commission.⁷ See e.g., Citizens Telephone Co. v. Public Service Commission, 247 S.W.2d 510 (holding that the Public Service Commission is not required to accept the expert opinion testimony of a utility company's witnesses).

⁶ The bill in use at the time the decision was made clearly indicates which fees belong to the LFUCG. [See Lexington-Fayette Urban County Government Hearing Exhibit No. 1].

⁷ Given the company's stance regarding decreased water usage trends it also begs the question of whether the decision to focus on core business should be translated to mean that KAW is actively encouraging its customers to use as much water as possible.

IV. Customers Should Not Pay for the Owenton Pipeline

Simply put, KAW is required to demonstrate that its actions related to Owenton were reasonable and prudent and that any costs and expenses were prudently incurred. The costs related to the Northern Division Connection Project (“NDCP”) were not reasonably and prudently incurred and should not be borne by the ratepayers. KAW should have disclosed its plan to utilize KRS II for the benefit of Owenton at the time KRS II was being considered by the Commission. The NDCP does not benefit the Central Division and in certain circumstances may harm it.⁸ In this case, which only includes a portion of the proposed costs for the project, the Company asks that the Central Division customers supplement the Northern Division while receiving no tangible benefit. [KAW’s Response to Commission Staff’s Third Request for Information No. 10].

Moreover, the Commission needs to pay particularly close attention to this issue, as it is likely to serve as the precedent for KAW to claim that the Central Division customer base should be used as the funding mechanism for future expansions by the water company.

V. The Proposed Distribution System Infrastructure and Purchased Power and Chemical Charges should be Denied

KAW has failed to demonstrate why its newly proposed Distribution System Infrastructure (DSIC) and Purchased Power and Chemical Charges should be allowed. Both of these charges do not exist today and would result in regular increases to water rates without going through a full rate case. In sum,

⁸ It is still not clear what impact NDCP will have on the Central Division in the event of a significant drought.

there is no shown benefit to customers for either proposal. (See Direct Testimony of Stephen M. Rackers, pp. 7-15; 19-21).

In the event that the Commission allows a DSIC, the recommendations proposed by Mr. Rackers as to its structure should be adopted. [Rackers Direct Testimony at pp. 14-15].

VI. The Company Should Not Be allowed to Pay for Future Expansions on the Backs of its Central Division Customers

According to KAW, free of its previous billing obligations and the resultant “obscure price signals” its customers were receiving, the company can now focus its attention on its “core business” - selling water. [See e.g., Rebuttal Testimony of Cheryl D. Norton, page 6, lines 12 through 18]. As a result, Lexington has a heightened concern that its ratepayers will continue to be used to pay for the continued expansion of the company, even though this will reduce the water available to its citizens, increase its rates, and result in no tangible benefit. This is particularly the case given the vagueness of KAW’s plans for future use of KRS II water. [See Cheryl D. Norton, 06-04-13, 11:02:45-11:04:23; 11:20:20-11:23; 12:47:20-12:49:48; KAW’s Responses to LFUCG’s First Request for Information No.’s 6 and 29].⁹

Regardless of how the Commission rules on the NDCP, KRS II is a potential water source and can be used as a platform for expansion. And in order to save the acquired utility(s) and KAW’s shareholders from bearing the

⁹ Even if KRS II water is not used, it is clear that KAW plans to pay for future expansions by having the Central Division customers pay for them.

costs of acquisition, the company will seek to spread them across the Central Division.¹⁰

V. CONCLUSION

KAW's requested increase is too much, and is not supported by the evidence. For all of the reasons stated above, KAW is not entitled to a rate increase in the amount sought, nor should the allocation of any rate increase be unfairly borne by the residential or public fire hydrant customers. Therefore, Lexington respectfully requests that the Commission deny KAW's Application and grant Lexington all of the relief that it has specified above.

Respectfully submitted,

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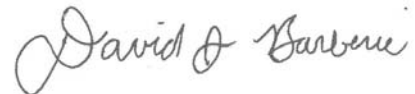


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¹⁰ In making its argument that the Northern Division Customers have borne the expenses of KRS II along with the Central Division, KAW fails to mention the significant reduction in rates these customers were given when unified rates were implemented.

NOTICE AND CERTIFICATION

Pursuant to the Commission's December 17, 2012 Order of Procedure, the Lexington-Fayette Urban County Government undersigned counsel certifies that: (a) the electronically filed documents are a true and accurate copy of each paper document which has been mailed on this date for filing with the Commission, (b) the electronic version of the filing has been transmitted to the Commission, (c) because no party has been excused from participating electronically no paper copies were mailed, and (d) the parties of record have been served electronically.



BY: _____

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