

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

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

**DIRECT TESTIMONY OF BRIAN KALCIC
ON BEHALF OF THE
OFFICE OF THE ATTORNEY GENERAL
AND
LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT**

APRIL 3, 2013

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APPENDIX – Qualifications of Brian Kalcic

1

I. QUALIFICATIONS AND OVERVIEW

2 **Q. Please state your name and business address.**

3 A. Brian Kalcic, 225 S. Meramec Avenue, Suite 720, St. Louis, Missouri 63105.

4

5 **Q. What is your occupation?**

6 A. I am an economist and consultant in the field of public utility regulation, and
7 principal of Excel Consulting. My qualifications are described in the Appendix to
8 this testimony.

9

10 **Q. On whose behalf are you testifying in this case?**

11 A. I am testifying on behalf of the Office of the Attorney General (“AG”) and the
12 Lexington-Fayette Urban County Government (“LFUCG”).

13

14 **Q. What is the subject of your testimony?**

15 A. I will review the class cost-of-service study (“COSS”) and proposed rate design
16 filed by Kentucky-American Water Company (“KAW” or “Company”), and
17 sponsor an appropriate rate design that reflects AG-LFUCG witness Stephen
18 Rackers’ recommended revenue requirement increase of \$2.485 million.

19 In addition, I will comment on the Company’s proposed increases to its
20 miscellaneous service charges.

21

22 **Q. How is your testimony organized?**

Direct Testimony of Brian Kalcic

1 A. My direct testimony is organized as follows. Section I of my testimony contains
2 my qualifications and an overview of my testimony. Section II reviews the
3 Company's cost-of-service study. Section III presents my recommended class
4 revenue allocation and rate design. Finally, Section IV addresses KAW's proposed
5 miscellaneous service charges.

6

7 **Q. Please summarize your recommendations.**

8 A. Based upon my review of the Company filing and interrogatory responses, I
9 recommend that the Kentucky Public Service Commission ("Commission"):

10

- 11 • adopt my recommended class revenue allocation, which moves all of the
12 Company's rate classes closer to their respective cost-based revenue levels;
- 13
- 14 • implement my recommended rate design, which incorporates non-uniform
15 increases to KAW's fixed service charges and consumption charges; and;
- 16
- 17 • approve the Company's proposed increase to its Activation Fee.

18

19 The specific details associated with my recommendations are discussed below.

20

1 **II. COST-OF-SERVICE STUDY**

2

3 **Q. Mr. Kalcic, what type of cost-of-service study did KAW perform for this**
4 **proceeding?**

5 A. Company witness Paul R. Herbert sponsored a class cost-of-service analysis
6 (included in Exhibit No. 36) for the Company's consolidation water operations
7 utilizing the Base Extra-Capacity ("BEC") cost methodology.

8

9 **Q. Please summarize the major components of the BEC cost methodology.**

10 A. In general, the BEC methodology consists of two major steps. First, the utility's
11 system-wide revenue requirement is *classified* into functional cost categories (i.e.,
12 base, extra capacity, customer and fire protection). Second, each functional cost
13 category is *allocated* to rate classes in accordance with a factor that reflects relative
14 cost responsibility.

15 The BEC classification and allocation steps combine to produce a measure
16 of total cost of service, by rate class. By comparing allocated cost responsibility to
17 actual revenue levels, one can determine whether a given rate class is contributing
18 above or below its cost-of-service indications.

19

20 **Q. What rate classes are included in the Company's cost study?**

21 A. The study allocates functionalized costs to following rate classes: a) Residential; b)
22 Commercial; c) Industrial; d) Other Public Authorities ("Public"); e) Sales for
23 Resale ("Resale"); f) Private Fire Protection; and g) Public Fire Protection.

1 **Q. Is KAW's cost-of-service methodology consistent with that employed in the**
2 **Company's most recent base rate proceeding?**

3 A. Yes, it is.¹

4
5 **Q. Mr. Kalcic, do you recommend any changes to the Company's BEC cost**
6 **methodology?**

7 A. No. Based on my review, I conclude that the Company's COSS reflects an
8 appropriate application of the BEC cost methodology, as applied to KAW's system,
9 and that no changes in methodology are warranted at this time.

10

11 **Q. What does the Company's cost study indicate with respect to the relative**
12 **contribution toward allocated costs of its existing rate classes?**

13 A. As discussed in more detail below, the Company's COSS indicates that the
14 Commercial, Public, Resale and Private Fire Protection classes are, by varying
15 degrees, subsidizing the remaining classes on KAW's system.

16

17 **Q. Have you utilized the Company's class cost of service results as a guide in**
18 **preparing your recommended class revenue allocation and rate design?**

19 A. Yes, I have. My rate structure recommendations are discussed in the next section
20 of my testimony.

21

¹ See the Company's response to AG-I-40.

1 **III. REVENUE ALLOCATION & RATE DESIGN**

2

3 **Q. Mr. Kalcic, how does KAW propose to recover its requested revenue increase**
4 **in this proceeding?**

5 A. Schedule BK-1 summarizes the Company's proposed class revenue allocation. As
6 shown on lines 1-7 of Schedule BK-1, the Company's proposed revenue increases
7 range from 2.5% (for Resale) to 19.8% (for Industrial). The proposed overall
8 increase in sales revenue is 14.6% (per line 8).

9

10 **Q. How did Mr. Herbert arrive at the proposed revenue allocation shown in**
11 **Schedule BK-1?**

12 A. On page 9 of his direct testimony, Mr. Herbert states that KAW management
13 established the following guidelines to assist with the development of the
14 Company's revenue allocation and rate design proposals: 1) maintain KAW's
15 existing single-tariff pricing rate structure; 2) increase service (or customer) charges
16 to recover a greater percentage of customer-related costs; and 3) adjust class
17 revenues so as to move all rate classes toward their indicted cost of service.

18

19 **Q. Does Mr. Herbert indicate whether the Company's proposed class revenue**
20 **allocation is successful in moving all classes closer to cost?**

21 A. Yes, in as much as Mr. Herbert claims that the Company's proposed rate design
22 complies with *all* of the above guidelines.

23

1 **Q. Have you undertaken any analysis to determine whether or not KAW's**
2 **proposed class revenue allocation is, in fact, moving all rate classes toward**
3 **their indicate cost of service?**

4 A. Yes. In order to determine the degree of movement toward class cost of service, I
5 have prepared Schedule BK-2, which shows class revenue subsidies under the
6 Company's current and proposed revenue requirement levels.

7
8 **Q. Why is information about class subsidies relevant?**

9 A. By definition, if a class is not paying exactly its full cost of service, it is either: a)
10 receiving a subsidy (i.e., paying too little); or b) providing a subsidy (i.e., paying
11 too much). In order to determine whether or not a class is moving toward cost of
12 service, one must ascertain whether the class' present subsidy is growing or
13 shrinking at proposed rates. If its present subsidy is growing at proposed rates, the
14 class is moving in the wrong direction (i.e., away from cost of service).
15 Conversely, if its present subsidy is shrinking at proposed rates, the class is moving
16 closer to cost of service.

17 In short, the proper yardstick for measuring the degree of movement toward
18 cost of service is the change in the absolute level of class subsidies at present and
19 proposed rates.

20
21 **Q. Please describe Schedule BK-2.**

22 A. Schedule BK-2 consists of two pages. Page 1 of Schedule BK-2 reports class
23 revenue subsidies, at both present and proposed rates, based on the Company's filed

1 COSS. These class subsidies are derived in columns 3 and 6, respectively, of page
2 2 of Schedule BK-2, by subtracting class cost of service from class rate revenues, at
3 present and Company proposed rates. The subsidy calculation provides a dollar
4 measure of the difference between actual class revenues and those revenue levels
5 that, if attained, would produce rates of return for each class of 6.26% at present
6 rates, and 8.20% at proposed rates.²

7

8 **Q Mr. Kalcic, what does page 1 of Schedule BK-2 indicate with respect to class**
9 **cross-subsidization and the Company's proposed class revenue allocation?**

10 A. Since the Commercial, Public, Resale and Private Fire Protection classes exhibit
11 positive subsidies at present rates, one may conclude that these classes are
12 providing subsidies to the remaining classes (i.e., Residential, Industrial and Public
13 Fire Protection) on KAW's system. At the same time, page 1 of Schedule BK-2
14 shows that the (absolute) magnitude of the proposed subsidies of all classes are
15 smaller than their respective subsidy level at present rates. As such, I find that
16 KAW's proposed class revenue allocation is cost-based, i.e., it moves *all* classes
17 closer to their respective cost of service.

18

19 **Q. Are you sponsoring a recommended class revenue allocation in this**
20 **proceeding?**

² See KAW's Exhibit 37, Schedule A, at line 25 for KAW's proposed rate of return of 8.20%. Per line 18, the Company's operating income at present rates for the FY ended 7/31/2014 is \$24.180 million. Dividing \$24.180 million by KAW's claimed rate base of \$385.995 million (line 24) produces a claimed present rate of return of 6.26%.

1 A. Yes, I am. My recommended class revenue allocation is shown in Schedule BK-3.

2

3 **Q. How did you derive the revenue allocation shown in Schedule BK-3?**

4 A. Mr. Rackers is recommending an overall revenue increase of \$2.485 million, which
5 equates to: 1) a system average increase in total revenue of 2.9%, per line 10 of
6 Schedule BK-3; and 2) a system average increase in sales revenue of 2.5%, per line
7 8 of Schedule BK-3. My recommended class revenue adjustments are shown in
8 lines 1-7 of Schedule BK-3, and are generally designed to mirror the relative class
9 increases proposed by KAW (in order to be consistent with the results of the
10 Company's COSS).³

11

12 **Q. Mr. Kalcic, please describe the Company's existing rate structure for general**
13 **metered service ("GMS") customers.**

14 A. At the present time, KAW provides service to all metered service customers (i.e.,
15 Residential, Commercial, Industrial, Public and Resale) via its Service
16 Classification No. 1 ("Rate SC-1") rate schedule. All GMS customers are billed:
17 1) a fixed monthly service charge; and 2) a flat rate consumption or usage charge
18 (per 1000 gallons of usage). Rate SC-1 contains one set of service charges
19 (applicable to all GMS classes), and a separate consumption charge for each class.

20

³ Compare column 5 of Schedule BK-1 with column 5 of Schedule BK-3.

1 **Q. Do all GMS customers within a given customer class (e.g., Residential) pay the**
2 **same rates for water service?**

3 A. Yes, they do.
4

5 **Q. Is KAW proposing any changes to its existing GMS rate structure in this**
6 **proceeding?**

7 A. No. The Company is proposing to maintain its single-tariff pricing rate structure.
8

9 **Q. Mr. Kalcic, have you developed rates to implement your recommended class**
10 **revenue allocation?**

11 A. Yes, I have. Schedule BK-4 presents my recommended rate design and proof of
12 revenue.
13

14 **Q. Are you recommending any changes to KAW's existing GMS rate structure in**
15 **this case?**

16 A. No, I am not.
17

18 **Q. Please describe Schedule BK-4.**

19 A. Schedule BK-4 consists of six pages. The present and recommended class revenue
20 levels shown in Schedule BK-4 are derived by multiplying individual class billing
21 determinants by present and recommended rates, respectively. My recommended
22 class billing determinants reflect the pro forma revenue adjustments sponsored by

1 Mr. Rackers, and produce total pro forma sales revenues at present rates of \$84.084
2 million, as shown on line 8 of Schedule BK-3.

3

4 **Q. How did you determine your recommended GMS service charges shown on**
5 **pages 1-5 of Schedule BK-4?**

6 A. Service charges should be limited to the recovery of customer-related costs, such as
7 the costs associated with meters and service lines, along with meter reading, billing
8 and collection expense. Schedule F of KAW Exhibit 36 shows that the total
9 customer costs associated with taking service through a 5/8" meter is \$14.86 per
10 month, at the Company's claimed revenue requirement level. Since the Company's
11 current 5/8" service charge is \$8.90 per month, the cost-of-service evidence in this
12 case indicates that KAW's service charges are below cost, i.e., fail to recover 100%
13 of KAW's claimed customer related costs. Accordingly, in order to move KAW's
14 service charges closer to cost of service, I find that the percentage increase
15 applicable to GMS service charges should be greater than the percentage increase
16 applicable to GMS consumption charges.

17

18 **Q. Do you agree with KAW's proposal to increase GMS service charges 57.3%, as**
19 **shown on Schedule G of KAW Exhibit 36?**

20 A. No, I do not.

21

22 **Q. Why not?**

Direct Testimony of Brian Kalcic

1 A. First, the 5/8” service charge cost benchmark of \$14.86 that is used in the
2 development of KAW’s proposed service charge levels is based on the Company’s
3 claimed revenue requirement level, not the recommended revenue requirement
4 sponsored by Mr. Rackers.

5 Second, even assuming for purposes of argument that a revised service
6 charge cost benchmark analysis (at Mr. Rackers’ recommended revenue
7 requirement level) produced a cost-based 5/8” service charge of (at least) \$14.00
8 per month, it would *not* be feasible to apply a 57.3% increase to GMS customer
9 charges when the overall increases to the GMS classes range from only 0.7% to
10 3.4%.⁴ Doing so would necessitate *decreasing* all of KAW’s existing GMS
11 consumption charges, which would send an improper price signal to GMS
12 customers. More specifically, a reduction in consumption charges would signal
13 GMS customers that KAW’s costs of supplying, treating and delivering 1,000
14 gallons of water are declining at a time when the Company claims such costs are
15 increasing.

16 **Q. What is your recommended percentage increase to GMS service charges?**

17 A. I recommend a 10.7% increase to all GMS service charges, which represents the
18 maximum service charge increase that may be implemented without causing a
19 decrease in one or more GMS consumption charges.
20

⁴ See Schedule BK-3, at column 4, lines 1-5.

1 **Q. How did you determine your recommended consumption charge for each GMS**
2 **rate class?**

3 A. In each instance, I set the applicable GMS consumption charge at the residual level
4 necessary to achieve my recommended class revenue level (shown in column 2 of
5 Schedule BK-3), given the level of my recommended GMS service charges.

6

7 **Q. Have you prepared a summary of your recommended GMS tariff charges?**

8 A. Yes, in Schedule BK-5.

9

10 **Q. Mr. Kalcic, how did you develop your recommended rates for the Private Fire**
11 **protection class?**

12 A. As shown on page 6 of Schedule BK-4, I assigned a uniform increase of 1.7% to all
13 Private Fire Protection tariff charges.

14

15 **Q. How did you develop your recommended hydrant rate for the Public Fire**
16 **Protection class of \$39.14 per month, as shown on page 6 of Schedule BK-4?**

17 A. Consistent with my recommended Public Fire Protection class increase of 3.4%
18 shown in Schedule BK-3, I applied a 3.4% increase to KAW's existing public
19 hydrant charge of \$37.84 per month.

20

21 **Q. Does your recommended rate design reflect an increase to any of the**
22 **Company's current miscellaneous service charges?**

1 A. Yes. As shown on line 9 of Schedule BK-3, my recommended rate design
2 incorporates an increase in Other Revenues (i.e., certain miscellaneous service
3 charges) of \$346,149, which acts as an offset to the increase required from sales
4 customers (line 8).

5 I discuss the Company's proposed miscellaneous service charges in the
6 following section of my testimony.

7

8 **IV. MISCELLANEOUS SERVICE CHARGES**

9

10 **Q. Is KAW proposing to increase any Miscellaneous Service Charges in this**
11 **proceeding?**

12 A. Yes. The Company is proposing to increase its: 1) Tapping Fees (see Fifth Revised
13 Sheet No. 52.1); 2) Reconnection Charge (see Third Revised Sheet No. 56); and 3)
14 Activation Fee for new accounts (see Second Revised Sheet No. 58.3).

15

16 **Q. What is the basis for the Company's proposed increase in Tapping Fees?**

17 A. KAW is proposing to increase Tapping Fees from 0.4% to 31.9%, based on a five-
18 year average of the actual cost of installing new services.

19

20 **Q. Is KAW's methodology for setting Tapping Fees the same as approved in the**
21 **Company's last base rate case?**

22 A. Yes, it is.

23

1 **Q. Has the Company reflected an increase in Tapping Fee revenue in its filing, as**
2 **a consequence of increasing Tapping Fees?**

3 A. Not explicitly. As shown on line 9 of Schedule BK-1, the Company has
4 incorporated an increase in Other Water Revenues of \$346,149 in its filing.
5 However, the proposed Activation Fee increase (\$46,989) and the proposed
6 Reconnection Charge increase (\$299,160) account for 100% of the proposed
7 increase in Other Water Revenues.

8

9 **Q. Do you oppose the Company's proposed increase in Tapping Fees?**

10 A. No, I do not. However, one would expect an increase in Tapping Fees to produce
11 an increase in Tapping Fee revenues. Therefore, I recommend that KAW explain in
12 rebuttal: a) how an increase in Tapping Fee revenues are reflected in its filing; or,
13 in the alternative b) how the Company accounts for Tapping Fee-related costs and
14 revenues in its filing.

15

16 **Q. What is the Company's proposed increase in the Reconnection Charge?**

17 A. The Company is proposing to increase the Reconnection charge from \$26 to \$56, or
18 115.4%.

19

20 **Q. Has KAW provided cost support for its proposed Reconnection Charge**
21 **increase?**

22 A. Yes. The Company's average cost to process an order to reconnect service is
23 \$28.29 (including travel time). Since an order to reconnect service involves one

1 service call to disconnect service and one service call to reconnect service, the
2 Company's total cost to reconnect a customer is two times \$28.29 or \$56.58.

3

4 **Q. Is the Company's proposed Reconnection charge appropriate?**

5 A. Strictly from a cost perspective, it is an appropriate charge. However, from a
6 customer impact perspective, an increase of 115.4% may be deemed excessive.

7

8 **Q. Are you recommending a smaller increase to the Company's proposed**
9 **Reconnection Charge?**

10 A. No. As previously discussed, my recommended rate design reflects an increase in
11 Reconnection Charge revenue of \$299,160. However, to the extent that the
12 Commission determines that KAW's proposed Reconnection Charge increase is
13 excessive, I would recommend that any foregone Reconnection Charge revenues be
14 recovered from the Company's customer classes in proportion to the recommended
15 increases shown in column 3 of Schedule BK-3.

16

17 **Q. What is the Company's proposed increase in the Activation Fee?**

18 A. The Company is proposing to increase the Activation Fee from \$26 to \$28, or 7.7%,
19 based on an average cost to process an order (including reading the customer's
20 meter) of \$28.29.

21

22 **Q. Do you find the Company's proposed increase in the Activation Fee**
23 **appropriate?**

Direct Testimony of Brian Kalcic

1 A. Yes, I do.

2

3 **Q. Does this conclude your direct testimony?**

4 A. Yes.

SCHEDULES BK-1 THROUGH BK-5

APPENDIX

APPENDIX

Qualifications of Brian Kalcic

Mr. Kalcic graduated from Benedictine University with a Bachelor of Arts degree in Economics in December 1974. In May 1977 he received a Master of Arts degree in Economics from Washington University, St. Louis. In addition, he has completed all course requirements at Washington University for a Ph.D. in Economics.

From 1977 to 1982, Mr. Kalcic taught courses in economics at both Washington University and Webster University, including Microeconomic and Macroeconomic Theory, Labor Economics and Public Finance.

During 1980 and 1981, Mr. Kalcic was a consultant to the Equal Employment Opportunity Commission, St. Louis District Office. His responsibilities included data collection and organization, statistical analysis and trial testimony.

From 1982 to 1996, Mr. Kalcic was employed by the firm of Cook, Eisdorfer & Associates, Inc. During that time, he participated in the analysis of electric, gas and water utility rate case filings. His primary responsibilities included cost-of-service and economic analysis, model building, and statistical analysis.

In March 1996, Mr. Kalcic founded Excel Consulting, a consulting practice that offers business and regulatory analysis.

Mr. Kalcic has previously testified before the state regulatory commissions of Delaware, Kansas, Kentucky, Maine, Massachusetts, Minnesota, Missouri, New Jersey, New York, Ohio, Oregon, Pennsylvania, and Texas, and also before the Bonneville Power Administration.