

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:)
)
THE APPLICATION OF KENTUCKY-AMERICAN) CASE NO. 2018-00358
WATER COMPANY FOR AN ADJUSTMENT OF)
RATES)

**KENTUCKY-AMERICAN WATER COMPANY’S
DATA REQUESTS TO ATTORNEY GENERAL AND LFUCG**

In accordance with the Public Service Commission’s (“Commission”) December 5, 2018 Order, Kentucky-American Water Company (“KAW”) propounds the following data requests upon the Attorney General of Kentucky (“AG”) and the Lexington-Fayette Urban County Government (“LFUCG”). Due to the fact that the AG and LFUCG have jointly sponsored the testimony of Lane Kollen and Richard Baudino, KAW propounds these data requests in the same joint fashion. AG and LFUCG shall respond to these requests in accordance with the provisions of the Commission’s December 5, 2018 Order and the instructions set forth below.

INSTRUCTIONS

1. In producing documents and things responsive to these requests, AG and LFUCG (collectively, “you”) shall respond in accordance with the requirements set forth in the Commission’s December 5, 2018 Order and the production shall be organized and labeled to correspond with the data requests to which they are responsive, regardless of whether these documents and things are possessed directly by you or by your present or past agents, employees, companies, licensees, representatives, investigators, or attorneys.

2. If the attorney-client privilege or work product immunity is asserted as to any document or thing, or if any document or thing is not produced in full, produce the document or

thing to the extent the request for production is not objected to, and, in so doing, state the following:

- (a) the specific ground(s) for not producing the document or thing in full;
- (b) the basis for such a claim of privilege or immunity and the facts supporting that basis; and
- (c) fully identify the information or material contained within the document or thing for which such privilege or immunity is asserted, including as applicable, the name of any document or thing; its date; the name, address and job title of each author or other person involved in its preparation, each addressee and each person to whom a copy of the document or thing has been sent or received; and the general nature of the document or thing (e.g., memoranda, letter).

3. Where an objection is made to a request, state all grounds upon which your objection is based.

4. If, after exercising due diligence, you are unable to determine the existence of any documents or things falling within a specific request, you shall so state in your written response.

5. With respect to each of the following requests, you shall identify and/or produce all documents which are known to you or which can be located or discovered by you through diligent effort on your part, including, but not limited to, all documents which are in your business, personnel, and/or personal files or those of your present or past employees or contained or stored within a computer in your possession or those of your present or past representatives, attorneys, or accountants, or accessible to you or your present and past employees, or its representatives, attorneys, or accountants.

6. Whenever used herein, the singular shall be deemed to include the plural and the plural shall be deemed to include the singular and the disjunctive shall be deemed to include the conjunctive and the conjunctive shall be deemed to include the disjunctive so as to elicit all information potentially responsive to the request for production.

REQUESTS

1. Please provide copies of all testimony prepared by Mr. Baudino for the last 5 years on the cost of capital.
2. Please provide a summary of Mr. Baudino's recommendations for each case where he has provided testimony on the cost of capital over the past five years. In this summary please include:
 - (a) Date filed
 - (b) Docket
 - (c) Company
 - (d) Mr. Baudino's recommended ROE
 - (e) Mr. Baudino's recommended capital structure
 - (f) Authorized ROE
 - (g) Authorized capital structure
3. Please provide all exhibits, workpapers and source documents in native format. All Excel files should be working spreadsheets with working formulas.
4. Referencing page 11 of Mr. Baudino's testimony at lines 8-16, does monetary policy have a lagged effect on the economy? If not, please explain.
5. Referencing page 11 of Mr. Baudino's testimony at lines 8-16. Please provide support references to all support relied on by Mr. Baudino (from financial analysts or other sources) for the proposition that the yield on long-term treasury bonds is forecasted to remain constant.
6. Referencing page 17 of Mr. Baudino's testimony at lines 29-33, please explain the basis for Mr. Baudino's claim that KAW is less risky than the proxy group where he testifies that 50 -58 percent of the proxy group uses a future test year and KAW also uses a future year.

7. Referencing page 18 of Mr. Baudino's testimony at lines 1-13. Did Mr. Baudino conduct any analysis that compares the level of capital investments that were made in 2017-2018 to KAW's projected capital expenditures? If so, please provide the analysis including all supporting documentation and electronic copies of the analysis with working formulas. Please explain whether or not the amount of capital investment that was made would have an effect on the earned ROE, and, if so, the basis for, and calculation of, that effect.
8. Referencing page 18 of Mr. Baudino's testimony at lines 1-13. Please explain with specificity, the basis of Mr. Baudino's conclusion that the absence of QIP does not increase KAW's risk relative to the proxy group.
9. Referencing Mr. Baudino's testimony at pages 30 line 18 through 31 line 20.
 - (a) Has Mr. Baudino conducted any analysis that determines the amount of investment risk that is described by Beta? If so, please provide the analysis including all supporting documentation and electronic copies of the analysis with working formulas.
 - (b) Has Mr. Baudino reviewed any studies that support his conclusion that estimating the return on the market is nearly impossible and that the limitations on this analysis affect the usefulness of market return estimates? If so, please provide all supporting research. If not, please explain if this is just Mr. Baudino's opinion or if it has been substantiated through analysis. If it has, please provide all such analysis including supporting workpapers.
 - (c) Considering the cases that Mr. Baudino has provided testimony in over the last five years, please indicate what index was relied on by Mr. Baudino in each proceeding to estimate the risk-free rate.
 - (d) Please provide the support for Mr. Baudino's statement on p. 31 that in the CAPM it is prudent to use a wide variety of data to estimate investor-required returns. Is it prudent to use a wide variety of data in all ROE estimation models or just the CAPM? What would be the expected result of any model if a wide variety of data is relied on? Is the range of results that comes from using a wide variety of assumptions a reason to invalidate the model, or just the assumptions used to specify the model? Please explain the response.
 - (e) Is it reasonable to expect that the analyst developing the ROE estimation model would carefully select the data that is used in the analysis in order to ensure that the results are reliable? If you disagree, please explain why?
 - (f) Please explain how the calculation of the DCF model would not vary considerably based on an analyst's choice of inputs such as the proxy group and growth rate selection.
10. Referencing Page 32 of Mr. Baudino's testimony at lines 1-7, please provide the data relied on from the Value Line Investment Analyzer to calculate the market return used in Exhibit RAB-7.

11. Referencing Exhibits (RAB-6) and (RAB-7). Please explain why Mr. Baudino relied on earnings and book value growth rates to estimate the return on the market that is used in his CAPM analysis but relied on projected dividend and earnings growth rates in his DCF analysis.
12. Referencing Mr. Baudino's testimony at page 32, lines 15-17. Did Mr. Baudino include negative growth rates in the median growth rate calculation used to estimate the market return in his CAPM analysis? If so, please explain how this is consistent with the Constant Growth DCF model that was used to calculate the market return.
13. Referencing Page 33 of Mr. Baudino's testimony line 8, please provide the historical market return that includes 2018.
14. Referencing Page 33 of Mr. Baudino's testimony at lines 13-20. Did Mr. Baudino consider the effects of other anomalous events on the long-term historical market return? Specifically has Mr. Baudino considered the effect of the negative return on the market that occurred in 2008 on the overall market return? If so, please explain how this negative return influenced the overall market return and risk premium. If not, please explain why it would be reasonable to assume that this event would be likely in the future but not the growth in P/E ratios that occurred from 1980-2001.
15. Referencing Page 33 of Mr. Baudino's testimony at lines 13-20.
 - (a) Does Mr. Baudino agree that the P/E ratios for the companies included in the Combined Utility Proxy Group are currently at historically high levels as shown in Figure 4 on page 20 of Ms. Bulkley's testimony?
 - (b) If yes, why is it appropriate to rely on the DCF estimates of companies with P/E ratios that are not expected to be sustained in near-term when it is not appropriate to include a period of high P/E ratios in Duff and Phelps's estimate of the historical market risk premium?
 - (c) Is it important to consider the impact that the current level of P/E ratios is having on the DCF results considering the cost of equity is being estimated for the future period when KAWC's rates will be in effect? If not, please explain.
16. Referencing Mr. Baudino's testimony at page 35, table 3 and lines 7-9. Please explain why Mr. Baudino believes that the average results are reasonable results in a DCF analysis that relies on the proxy companies but the average is not the appropriate measure of central tendency when calculating the growth rate over thousands of observations in the market return calculation performed by Mr. Baudino.
17. Referencing Mr. Baudino's testimony at page 35, table 3. Does Mr. Baudino believe that the results of the CAPM using the historical market return are reasonable estimates of the cost of equity? Please explain the answer fully.
18. Referencing Mr. Baudino's testimony at page 35, lines 7-8. Does Mr. Baudino believe that KAWC has average risk when compared to the combined utility proxy group? If so,

please provide the analysis used to support Mr. Baudino's conclusion including all supporting documentation and electronic copies of the analysis with working formulas.

19. Referencing Mr. Baudino's testimony at page 42, lines 11-12. Does Mr. Baudino disagree that it is appropriate to evaluate the relative risk of the proxy group versus the risk of the subject company in estimating the appropriate ROE? Please explain this answer fully.
20. Referencing Mr. Baudino's testimony at page 46, lines 1-10. Mr. Baudino states that investors ability and willingness to pay for a stock is reflected in current prices. However, in the current proceeding, is the objective to estimate the cost of equity for KAWC as of the present or the future period when rates will be in effect? If it is the future period, is it Mr. Baudino's opinion that current stock prices will prevail when KAWC's rate will be in effect?
21. Referencing page 47, lines 8-10 of Mr. Baudino's testimony. Please explain why Mr. Baudino believes that it is inappropriate to rely on projected interest rates in the CAPM.
22. Referencing Mr. Baudino's testimony at page 49, line 7. Is Mr. Baudino aware of any estimates of the expected growth rate on the market that are published by analysts? If so, please provide all such estimates.
23. At page 23, commencing on line 13, Mr. Kollen states "[t]he APP incentive compensation is primarily based on financial performance metrics."
 - (a) Does Mr. Kollen agree that there are no performance compensation payments made if adjusted earnings per share falls below 90% of target?
 - (b) If the financial metrics exceed 100% of target are customers asked to assume any payments made for the achievement of more than 100% of the financial metric?
24. At page 23, commencing on line 16, Mr. Kollen states that "[t]he APP incentive payments are weighted 50% on EPS and 50% on other factors."
 - (a) Please state Mr. Kollen's understanding of every "other factor" on which APP performance based pay is made.
 - (b) Please explain, with particularity Mr. Kollen's understanding of how the non EPS measures are factored into the employee's APP payment.
25. Has Mr. Kollen ever been employed in the field of employee compensation? If so, describe with particularity when, with whom and what his duties entailed.
26. Has Mr. Kollen ever performed a survey of employee compensation practices in the utility industry?
27. Has Mr. Kollen ever performed a survey of employee compensation practices for businesses generally?

28. Has Mr. Kollen investigated employee compensation practices to know if incentive compensation is common in the utility industry? If, so please provide the particular investigations made and the results obtained. Provide all studies related to the above that are in Mr. Kollen's possession.
29. Has Mr. Kollen investigated employee compensation practices to know if incentive compensation is common in business, generally, If so, please provide the particular investigations made and the results obtained. Provide all studies related to such compensation practices that are in Mr. Kollen's possession.
30. On Exhibit LK-1, page 3 of 36, Mr. Kollen provides a listing of "Industrial Companies and Groups" to which he has provided services. For the companies listed under that category, how many of those companies provide incentive compensation to their employees?
31. On Exhibit LK-1, page 4 of 36, Mr. Kollen provides a listing of "Utilities" to which he has provided services. For the companies listed under that category, how many of those companies provide incentive compensation to their employees?
32. Beginning on page 5 of Exhibit LK-1, Mr. Kollen provides a list of testimony he has filed before various regulatory commissions,
 - (a) Has Mr. Kollen ever recommended recovery of incentive compensation expense for an investor owned utility or authority? If so, provide copies of the relevant testimony?
 - (b) Has Mr. Kollen ever recommended denial of recovery of incentive compensation expense for a utility that was rejected by a utility regulatory commission? If so, provide copies of his testimony and a reference to the relevant order.
33. Does Mr. Kollen believe that a utility's wage and salary expense is subject to the standard of reasonableness, just like any other utility expense? If not, why not?
34. What test does Mr. Kollen believe appropriate to measure the reasonableness of a utility's wage and salary expense?
35. If a utility pays wages and salaries that are measured to be at or below the median wages and salaries paid by contemporaneous utilities, is that not determinative of reasonableness? If not, why not?
36. If a utility pays wages and salaries that are measured to be at or below the median wages and salaries paid by similarly situated businesses, is that not determinative of reasonableness? If not, why not?
37. Has Mr. Kollen undertaken any review or analysis to determine if the overall salary expense for the Company, including APP, is reasonable when measured against other Kentucky utilities?

38. Has Mr. Kollen undertaken any review or analysis to determine if the overall salary expense for the Company, including APP, is reasonable when measured against other Kentucky businesses?
39. Is it Mr. Kollen's belief that Kentucky American should not pay any performance based compensation but should compensate its employees entirely by means of base wages and salaries?
40. If Kentucky American were to compensate its employees based entirely on base wages and salaries, would those expenses be deemed just, reasonable and fully compensable to the Company if they were at, or below the median salaries and wages for similarly situated companies?
41. Is the retention of well-trained, dedicated employees a benefit to the customers of a business?
42. Does Mr. Kollen agree that the Company Long-Term Performance Plan ("LTPP") provides a mechanism that aids in the retention of employees by requiring continued employment in order for an employee to avail him or herself of the benefits of the LTPP? If not, why not?
43. On page 24, commencing on line 13, Mr.Kollen states "the achievement of the target metrics tied to financial performance benefits shareholders to the detriment of customers in rate proceedings such as this." Please explain precisely how the achievement of financial target metrics operates to the detriment of KAWC customers. Be specific in tying the achievement of financial targets to customer detriments.
44. Does Mr. Kollen believe that an efficiently run utility is in the interest of customers? If not, why not?
45. Does Mr. Kollen believe that a safety conscious utility is in the interest of customers? If not, why not?
46. Does Mr. Kollen believe that an environmentally compliant utility is in the interest of customers? If not, why not?
47. Does Mr. Kollen believe that a utility that complies with water quality measures is in the interest of customers? If not, why not?
48. Does Mr. Kollen believe that a utility focused on improving customer satisfaction is in the interest of customers? If not, why not?
49. Does Mr. Kollen believe that a financially healthy utility is in the interest of customers? If not, why not?
50. Mr. Kollen testifies at page 26, line 11 to a belief that "[i]ncentive compensation incurred to incentivize AWWC financial performance also provides the Company's executives,

managers, and employees a direct incentive to seek greater and more frequent rate increases from customers...”

- (a) Does Mr. Kollen agree that, notwithstanding the disallowance of the APP, KAWC employees, were still paid wages and salaries that included the APP?
- (b) Prior to this rate filing, when was the Company’s last base rate filing?
- (c) Does Mr. Kollen have any evidence that the Company’s rate filing schedule was based on the existence of the APP or other performance based compensation?

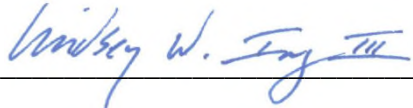
51. At page 26, Mr. Kollen argues that “there is an inherent conflict between achieving lower rates for customers on the one hand and achieving greater financial performance for shareholders and greater incentive compensation for executives, managers, and other employees on the other hand.”

- (a) Is Mr. Kollen aware of the *Hope* case. *FPC v. Hope Nat. Gas Co.*, 320 U.S. 591 (1944).
- (b) Does not the *Hope* case state that “[t]he rate-making process under the Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests.”

Dated: March 29, 2019

Respectfully submitted,

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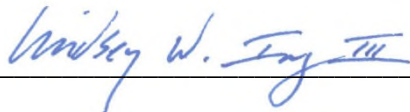
BY: 

Attorneys for Kentucky-American Water Company

CERTIFICATE

This certifies that Kentucky-American Water Company's electronic filing is a true and accurate copy of the documents to be filed in paper medium; that the electronic filing has been transmitted to the Commission on March 29, 2019; that a paper copy of the filing will be delivered to the Commission within two business days of the electronic filing; and that no party has been excused from participation by electronic means.

STOLL KEENON OGDEN PLLC

By 

Attorneys for Kentucky-American Water Company