

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

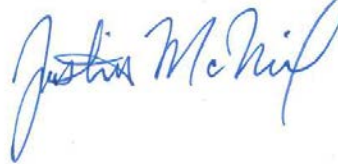
ELECTRONIC APPLICATION OF)
KENTUCKY-AMERICAN WATER) CASE NO. 2018-00358
COMPANY FOR AN ADJUSTMENT)
OF RATES)

**ATTORNEY GENERAL AND LEXINGTON-FAYETTE URBAN COUNTY
GOVERNMENT'S RESPONSES TO DATA REQUESTS FROM KENTUCKY-
AMERICAN WATER COMPANY**

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (“Attorney General”), and Lexington-Fayette Urban County Government (“LFUCG”), by and through counsel, submits the following responses to data requests from Kentucky-American Water Company (“KAW”) in the above-styled matter.

Respectfully submitted,

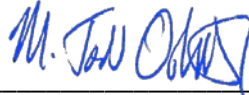
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Electronic Application of Kentucky-American Water Company For An Adjustment of Rates
Attorney General and LFUCG's Responses to KAW Data Requests
Case No. 2018-00358

And



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The Attorney General and LFUCG object to instruction paragraph number 1 of KAW's propounded data requests, insofar as the instruction contemplates or expects the parties to produce materials that are not within their current possession, nor directly related to this proceeding. The instruction states that "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." Present agents, or any of the other listed designations, of the parties who are not directly involved in this matter should not be expected to produce materials. Likewise, past agents, or any of the other listed designations, who are not directly involved in this matter should not be expected to produce materials. Any request made with such an expectation would be overly broad in scope and time, and compliance with it would be unduly burdensome and costly to the parties. Such an expectation would be calculated to annoy and harass the parties.

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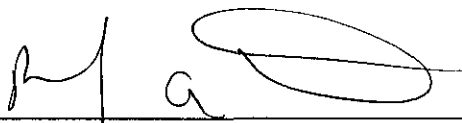
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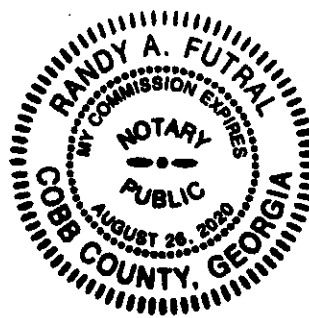
COUNTY OF FULTON)

LANE KOLLEN, being duly sworn, deposes and states: that the attached is his sworn testimony and that the statements contained are true and correct to the best of his knowledge, information and belief.


Lane Kollen

Sworn to and subscribed before me on this
12th day of April 2019.


Notary Public

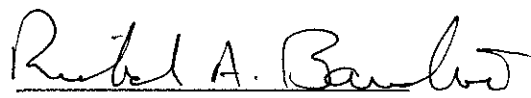


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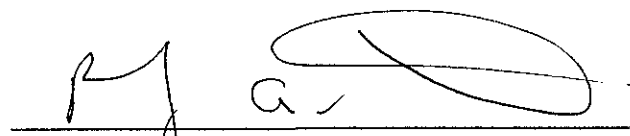
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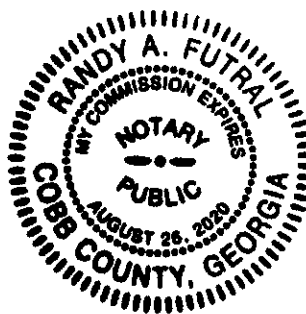
RICHARD A. BAUDINO, being duly sworn, deposes and states: that the attached is his sworn testimony and that the statements contained are true and correct to the best of his knowledge, information and belief.


Richard A. Baudino

Sworn to and subscribed before me on this
12th day of April 2019.



Notary Public



Electronic Application of Kentucky-American Water Company For An Adjustment of Rates
Attorney General and LFUCG's Responses to KAW Data Requests
Case No. 2018-00358

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 1

Please provide copies of all testimony prepared by Mr. Baudino for the last 5 years on the cost of capital.

RESPONSE:

Refer to the separately filed testimonies.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino / Counsel as to Objection

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QUESTION No. 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

RESPONSE:

Objection. This request is overly broad and unduly burdensome. The information sought by this request is in the public domain, the location of which has been equally available to Kentucky-American Water since the filing of intervenor testimony. Counsel for Kentucky-American Water can just as easily access the requested information as counsel for the Attorney General and LFUCG. Notwithstanding this objection, refer to Exhibit ___(RAB-1) for a listing of cases, docket and case numbers, date and month of filing of Mr. Baudino's testimony. Further, refer to the copies of testimony provided in response to Question 1 for Mr. Baudino's recommended ROE and capital structure, although Mr. Baudino may not have addressed capital structure in all cases. For the authorized ROE and capital structure in those cases, refer to the Commission web sites for the Commission Orders.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino / Lane Kollen / Counsel as to Objection

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QUESTION No. 3

Please provide all exhibits, workpapers and source documents in native format. All Excel files should be working spreadsheets with working formulas.

RESPONSE:

Objection. The question is overly broad and unduly burdensome, as it provides no specific reference or limit. The question is further objectionable in that it fails to provide any reference to the testimony filed with the Commission in this matter, insofar as it actually relates to said testimony. Without any reference, limit or relevant basis, the request is nonsensical as it is provided for the purpose of harassment. Without waiving these objections, and assuming the question is in reference to the direct testimonies of Messrs. Baudino and Kollen, refer to the attached spreadsheets, work papers, and source documents of Mr. Baudino. Mr. Kollen provided all exhibits, workpapers, and source documents along with his Direct Testimony. Note that Mr. Baudino did not include the Value Line reports he used due to copyright restrictions. Mr. Baudino also did not include the pages he cited from *New Regulatory Finance* due to copyright restrictions. This book is available from Public Utility Reports, Inc. Mr. Baudino did not include the pages cited from *A Random Walk Down Wall Street* due to copyright restrictions. This book is available for purchase on Amazon.com. For the material cited in footnotes 1, 3, and 4, the links in the footnotes may be used to access this material. For the Commission Order cited in footnote 22, refer to the Kentucky Public Service Commission's web site.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

Yes, monetary policy tends to have a lagged effect on economic activity.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

Mr. Baudino did not put forward "the proposition that the yield on long-term treasury bonds is forecasted to remain constant". The statement contained in this question is not what Mr. Baudino testified to on page 11, lines 8-16 of his Direct Testimony. It is Mr. Baudino's position that current interest rates are the best indicators of investor expectations and that utility regulators should not raise ROEs based on forecasted long-term interest rates that may or may not occur.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

The basis for this statement is that not all of the companies in the proxy groups use future test years. If all the companies in the proxy groups used future test years, then the groups would likely be comparable in risk to KAW, other things being equal. Mr. Baudino pointed out that with respect to the use of a future test year, KAW is "slightly less risky" than the Combined Utility Proxy Group ("CUPG").

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino / Counsel as to Objection

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QUESTION No. 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.

RESPONSE:

Mr. Baudino did not conduct a formal analysis, as implied by this question, but did review KAW's historical and projected capital expenditures while developing his analysis, testimony, and recommended ROE.

Objection. The following portion of the request is uncertain, ambiguous, or confusing, and it is unclear what information is being sought:

"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."

Notwithstanding this objection, as a general proposition, between rate cases the amount of capital investment could affect the actual earned ROE, as would the Company's ability to control and manage its expenses, growth in revenues, and so on. For purposes of this case, the Company's future test year enables the Company to seek inclusion of capital investments through June 30, 2020. To the extent KAW's infrastructure and capital spending through June 30, 2020 exceed the historical 2017 and 2018 spending amounts, that additional investment will be captured in this rate proceeding.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

Mr. Baudino explained his position regarding risk and the QIP with sufficient specificity on the cited page 18, lines 1-13. This position is further bolstered by Mr. Baudino's discussion of how the use of a future test year mitigates risk for KAW.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino / Counsel as to Objections

Page 1 of 3

QUESTION No. 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.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino / Counsel as to Objections

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RESPONSE:

- a. Mr. Baudino did not perform such an analysis. This type of analysis is not required for use of the CAPM in regulatory proceedings, as Mr. Baudino accepted Value Line's betas for use in his version of the CAPM.
- b. The difficulty of accurately estimating the "market return" portion of the CAPM was described by Dr. Malkiel in the passage cited in footnote 19 of Mr. Baudino's Direct Testimony. On page 222, Dr. Malkiel wrote:

Second, as Professor Richard Roll of UCLA has argued, we must keep in mind that it is very difficult (indeed probably impossible) to measure beta with any degree of precision. The S&P 500 Index is not "the market". The Total Stock Market contains many thousands of additional stocks in the United States and thousands more in foreign countries. Moreover, the total market includes bonds, real estate, commodities, and assets of all sorts, including one of the most important assets any of us has - the human capital built up by education, work, and life experiences. Depending on exactly how you measure the "market", you can obtain very different beta values.

In Chapter 8, pages 189-190 of *Principles of Corporate Finance*, Eighth Edition, by Franklin Allen, Stewart C. Myers, and Richard A. Brealey, the authors wrote the following:

How about the market risk premium? As we pointed out in the last chapter, we can't measure $r_m - r_f$ with precision. From past evidence, it appears to be 7.6%, although many economists and financial managers would forecast a lower figure.

- c. In recent cases, Mr. Baudino has consistently used the six-month average of the 30-year Treasury Bond and the 5-year Treasury note to estimate the risk free rate of return. Mr. Baudino switched from his prior use of the 20-year Treasury bond in past cases, although this switch made little difference in the CAPM results. Please refer to the copies of testimony Mr. Baudino provided in response to Question 1 for specific information on the risk free rate used by Mr. Baudino.
- d. The statement referred to in part (d) was based on the difficulty of accurately measuring the market return portion of the CAPM. Refer to Mr. Baudino's response to part (b) for further support. Mr. Baudino used a reasonably wide variety of data in estimating the market return for his CAPM analyses, which included both forward-looking and historical market risk premium estimates.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino / Counsel as to Objections

Page 3 of 3

With respect to the following questions:

Is it prudent to use a wide variety of data in all ROE estimation models or just the CAPM?

Objection. This question is overly broad and unduly burdensome. Notwithstanding this objection, the prudence of using "a wide variety of data in all ROE estimate models" depends upon the ROE estimation models and the variety of data being used. Mr. Baudino cannot provide a more detailed response without knowing more about "the variety of data" used in the various models and the models to which that data would be applied.

What would be the expected result of any model if a wide variety of data is relied on?

Objection. This question is overly broad, vague, and unduly burdensome. Without more specificity, the request cannot be answered with clarity. Notwithstanding this objection, again, the answer would depend on the "wide variety of data" and the model to which that data is applied.

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?

See the response to the prior question.

- e. It is "reasonable to expect" that an ROE analyst would go through a careful selection process. However, this process may not necessarily lead to a reasonable result in every case. This is certainly the situation with the CAPM results presented by Ms. Bulkley, as described by Mr. Baudino in his Direct Testimony. Mr. Baudino described in detail beginning on page 38 why Ms. Bulkley's excessively high CAPM results should be rejected.
- f. Objection. The question as posed is highly speculative, vague, and overly broad and, as such, cannot be answered with clarity. Mr. Baudino is unable to speculate on "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" without additional information as to the choice of the companies in the group and the growth rates selected.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

Refer to the spreadsheets and work papers provided in response to Question 3.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

One of the assumptions underlying the DCF model is that earnings, book value, and dividends grow together at the same rate over the long run. Mr. Baudino did not include dividend growth in the calculation because many of the Value Line companies do not pay dividends or have dividend growth projections. Thus, Mr. Baudino included forecasted earnings and book value growth.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

No.

Electronic Application of Kentucky-American Water Company For An Adjustment of Rates
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WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 13

Referencing Page 33 of Mr. Baudino's testimony line 8, please provide the historical market return that includes 2018.

RESPONSE:

Mr. Baudino does not have the requested data.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

Regarding Mr. Baudino's testimony on page 33, lines 13-20, the data was taken from the study by Ibbotson and Chen and the adjusted historical market risk premium of 6.04% is based on their calculations and the number presented in the *2018 SBI Yearbook*. Mr. Baudino did not perform any other analysis associated with this number.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

- a. Yes.
- b. The question in part (b) does not accurately reflect Mr. Baudino's position on the DCF model or on his presentation of the Duff and Phelps adjusted market risk premium. With respect to the adjusted risk premium presented on page 33, lines 13 - 20, Mr. Baudino presented this as an alternative calculation of the historical risk premium analysis he presented in Exhibit ___(RAB-8). Mr. Baudino did not base his ROE recommendation on this number or opine on its appropriateness in the current economic environment. Regarding Ms. Bulkley's forecasted P/E ratios in her Table 4, the Commission should not adjust its allowed ROE for KAW upward based on forecasted P/E ratios that may or may not come to pass. The current stock prices that are driving current P/E ratios for the CUPG are the best measure of investor return requirements for the companies in that proxy group and they reflect the low interest rate environment in today's economy as well as the relative safety of the regulated water industry generally.
- c. Refer to the response to (b) above.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

Mr. Baudino explained why the average for Value Line's data set was not a good measure of central tendency on page 32, lines 10 - 20. In addition, Mr. Baudino considered the median results of his DCF analyses on page 35, Table 3, and based his ROE recommendation on the midpoint of the DCF range for the CUPG.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

No. It is Mr. Baudino's opinion that the CAPM results using historical risk premiums are producing unreasonably low values at this time and does not recommend them in this proceeding.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

Yes, it is Mr. Baudino's opinion that KAW is reasonably comparable in risk to the CUPG. Please refer to the discussion and analysis in Mr. Baudino's Direct Testimony at: page 14, line 10 through page 18, line 13; page 23, line 13 through page 24, line 3; page 36, lines 6 through 16; page 36, line 19 through page 37, line 13.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

As a general matter, the answer here is yes. Although it is difficult to assess whether the subject company has precisely the same risk as a proxy group of companies, the analyst should perform a review to determine whether the subject company is reasonably comparable in risk to the proxy group as a whole.

Mr. Baudino's Direct Testimony at page 42, lines 11-12, addressed the specific issue of revenue decoupling, a rate mechanism that KAW did not request be implemented in this proceeding. The lack of such a request should not be a basis for a higher allowed ROE for KAW. If KAW believed that the volatility of its revenues required a revenue decoupling or rate stabilization mechanism, then it could have requested one in this case. Neither KAW nor Ms. Bulkley provided any analysis that the Company's volumetric risk is a problem that requires mitigation through revenue decoupling or rate stabilization.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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?

RESPONSE:

It is not Mr. Baudino's opinion that current stock prices will prevail when KAW's rates are in effect. It is Mr. Baudino's opinion that current stock prices are the best indicator we have of investor expectations and preferences with respect to the value of the common stock of the companies in the proxy groups. Current stock prices, therefore, are the values that should be used in estimating the DCF model in this proceeding. The resulting ROE from Mr. Baudino's analysis can then be applied to the cost of capital for the future test year and implemented for the period in which rates are in effect. We cannot accurately forecast stock prices that will prevail when rates become effective in this case, any more than we can accurately forecast the interest rates that will be in effect at that time.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

Mr. Baudino discussed why regulators should not rely on forecasted interest rates in Section II of his Direct Testimony. Specifically, please refer to pages 10 - 11 of Mr. Baudino's Direct Testimony. Further, Mr. Baudino clearly set forth further reasoning for not using forecasted interest rates on page 47, line 8 through page 48, line 15.

WITNESS/RESPONDENT RESPONSIBLE:

Richard Baudino

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QUESTION No. 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.

RESPONSE:

Mr. Baudino's Direct Testimony, page 49, lines 8 through 10, does not reference "the expected growth rate on the market." This section of Mr. Baudino's testimony refers to the excessively high market return estimate provided by Ms. Bulkley and compares her estimate of 15.19% to Mr. Baudino's market return estimates. Mr. Baudino provided forecasted earnings and book value growth estimates from Value Line's Statistical Summary. Mr. Baudino does not know the "market" to which this question refers since it is not specified or defined.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 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?

RESPONSE:

- a. Yes.
- b. The Company requests recovery of the APP expense from customers based on achieving 100% of the target metrics.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

Page 1 of 1

QUESTION No. 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.

RESPONSE:

- a. The other factors are described in the APP itself. Those written factors speak for themselves.
- b. The applicability of the other factors is described in the APP itself. Those factors speak for themselves.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 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.

RESPONSE:

Yes. Mr. Kollen holds ownership interests in numerous businesses and is responsible in whole or part for employee compensation in those businesses.

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QUESTION No. 26

Has Mr. Kollen ever performed a survey of employee compensation practices in the utility industry?

RESPONSE:

No.

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QUESTION No. 27

Has Mr. Kollen ever performed a survey of employee compensation practices for businesses generally?

RESPONSE:

No.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen / Counsel as to Objection

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QUESTION No. 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.

RESPONSE:

Objection. The request for Mr. Kollen to provide other utility compensation studies that he may have reviewed in other utility rate proceedings is unduly burdensome and not reasonably calculated to provide relevant information in this proceeding. Notwithstanding this objection, Mr. Kollen is aware that incentive compensation is common in the utility industry based on his review of numerous utility rate filings during his career.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen / Counsel as to Objection

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QUESTION No. 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.

RESPONSE:

Objection. The request for Mr. Kollen to provide "business" compensation studies that he may have reviewed outside of rate proceedings is unduly burdensome and not reasonably calculated to provide relevant information in this rate proceeding. Notwithstanding this objection, Mr. Kollen is aware that incentive compensation is common in business, generally.

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QUESTION No. 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?

RESPONSE:

Mr. Kollen has not performed any investigations of such practices in order to answer the question as portrayed.

WITNESS/RESPONDENT RESPONSIBLE:

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QUESTION No. 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?

RESPONSE:

Mr. Kollen has not reviewed the compensation practices of the industrial groups and companies listed on his Exhibit___(LK-1).

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 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.

RESPONSE:

- a. Generally, Mr. Kollen has recommended disallowances of incentive compensation expense when tied to measures of financial performance. To the best of his recollection, Mr. Kollen has not addressed or recommended disallowances of other incentive compensation expense, except in one or more jurisdictions where the Commission historically disallowed certain other incentive compensation expense.
- b. Mr. Kollen has not performed and does not have a comparison of his recommendations and those that were adopted by the regulator in each case in which he filed testimony. The testimonies and the orders in those proceedings are publicly available and can be researched by the Company.

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QUESTION No. 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?

RESPONSE:

Yes.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 34

What test does Mr. Kollen believe appropriate to measure the reasonableness of a utility's wage and salary expense?

RESPONSE:

The reasonableness of the compensation expense for ratemaking purposes depends on many factors, including the basis for the forecast, assuming a forecast test year; the allocation among capital, expense, and other; the components of the expense, including payroll (labor) expense, benefits expense, and incentive compensation expense; and the components of the incentive compensation expense.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen / Counsel as to Objection

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QUESTION No. 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?

RESPONSE:

Objection. The request neither provides a reference to testimony nor identifies a particular witness it is directed toward, and is otherwise vague. Notwithstanding the objection, refer to the response to Item 34. Mr. Kollen cannot provide a more detailed response without further detail regarding the basis for the comparison and the methodology employed for the comparison.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen / Counsel as to Objection

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QUESTION No. 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?

RESPONSE:

Objection. The request neither provides a reference to testimony nor identifies a particular witness it is directed toward, and is otherwise vague. Notwithstanding this objection, refer to the response to Item 34. Mr. Kollen cannot provide a more detailed response without further detail regarding the basis for the comparison and the methodology employed for the comparison.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 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?

RESPONSE:

Mr. Kollen has not performed an independent study.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 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?

RESPONSE:

Mr. Kollen has not performed an independent study.

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QUESTION No. 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?

RESPONSE:

No.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 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?

RESPONSE:

Not necessarily. Refer to the response to Item 34.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 41

Is the retention of well-trained, dedicated employees a benefit to the customers of a business?

RESPONSE:

Objection. The request neither provides a reference to testimony nor identifies a particular witness it is directed toward, and is otherwise overly broad in scope. Notwithstanding this objection, yes.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 42

Does Mr. Kollen agree that the Company Long-Term Performance Plan ("LTTP") 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 LTTP? If not, why not?

RESPONSE:

Mr. Kollen understands that this is an objective of the LTTP. Mr. Kollen has not performed an analysis of whether the LTTP is effective in achieving this objective or whether that objective can be assessed in isolation from other factors that may influence employee's decisions.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 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.

RESPONSE:

Refer to Mr. Kollen's testimony at 23-27.

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QUESTION No. 44

Does Mr. Kollen believe that an efficiently run utility is in the interest of customers? If not, why not?

RESPONSE:

Yes.

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QUESTION No. 45

Does Mr. Kollen believe that a safety conscious utility is in the interest of customers? If not, why not?

RESPONSE:

Yes.

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QUESTION No. 46

Does Mr. Kollen believe that an environmentally compliant utility is in the interest of customers?
If not, why not?

RESPONSE:

Yes.

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QUESTION No. 47

Does Mr. Kollen believe that a utility that complies with water quality measures is in the interest of customers? If not, why not?

RESPONSE:

Yes.

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QUESTION No. 48

Does Mr. Kollen believe that a utility focused on improving customer satisfaction is in the interest of customers? If not, why not?

RESPONSE:

Yes.

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QUESTION No. 49

Does Mr. Kollen believe that a financially healthy utility is in the interest of customers? If not, why not?

RESPONSE:

Yes.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen / Counsel as to Objection

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QUESTION No. 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?

RESPONSE:

- a. Yes.
- b. Objection. That date is a matter of public record and already within the factual knowledge of the Company. Notwithstanding this objection, Mr. Kollen is aware that the last base rate filing was on January 29, 2016 in Case No. 2015-00418.
- c. Yes. The revenue requirement in the Company’s rate filing included APP expense, which was denied by the Commission.

WITNESS/RESPONDENT RESPONSIBLE:

Lane Kollen

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QUESTION No. 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.”

RESPONSE:

- a. Yes.
- b. Yes. Mr. Kollen agrees with that assessment.