

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

---

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

---

Kentucky-American Water Company seeks to increase its rates to unreasonable levels. Specifically, it seeks to increase annual revenues by \$18,606,798 or 21%, such that its annual revenue will exceed \$100,000,000. Equally unreasonable, KAWC desires to implement a Qualified Infrastructure Program that is unnecessary. In order to highlight some deficiencies in KAWC's filing, Lexington-Fayette Urban County Government respectfully submits this brief.

**INTRODUCTION**

In its Application filed with the Commission on November 28, 2018, Kentucky-American Water Company ("KAWC") sought approval of an increase in its annual revenues of \$19,865,003. Following its Base Period Update, KAWC's requested annual increase was revised to \$18,471,247. The average residential customer in Lexington would pay more than \$80 per year based on KAWC's request.

Included within this request is KAWC's assertion that it is entitled to a 10.8% return on equity ("ROE"). This is vastly higher than the recent ROEs authorized by this Commission that

range from 9.65% to 9.725%.<sup>1</sup> In addition, KAWC’s actual ROEs raise significant questions as to why KAWC needs such a large—or even any—increase in rates. During the first quarter of 2018, KAWC earned an ROE in excess of 10.9%, and during the first quarter of 2019, KAWC earned an ROE around 8.9%.<sup>2</sup>

Lexington-Fayette County Government (“LFUCG”) and the Attorney General (“AG”) have been granted full intervenor status in this matter. Following discovery, both intervenors filed joint testimony of two witnesses. A two-day hearing was conducted on May 13 and 14, 2019.

The purpose of this brief is not to repeat arguments previously presented in testimony. Accordingly, LFUCG adopts and incorporates each of the positions presented by its witnesses, Lane Kollen and Richard Baudino. These witnesses’ sophisticated positions on complex topics ranging from return on equity to employee compensation have been well stated.

LFUCG also generally agrees with the positions and arguments made by the Attorney General in this matter, and adopts and incorporates those arguments except to the extent that they otherwise conflict with this brief.<sup>3</sup> With this general background in mind, LFUCG presents the following argument.

## ANALYSIS

### **I. The Commission should reject KAWC’s Qualified Infrastructure Program because KAWC’s justifications for the program are not supported by the record, are vague, unproven, and without analytical support.**

KAWC is rolling out its fourth attempt since 2012 seeking approval of an infrastructure surcharge, which it now terms “Qualified Infrastructure Plan” or QIP. With strong opposition

---

<sup>1</sup> See, e.g., *Atmos Energy*, Case No. 2018-00281 (Ky. PSC May 7, 2019).

<sup>2</sup> KAWC Response to PSC Staff Post-hearing Data Request at Item 5.

<sup>3</sup> LFUCG acknowledges that it may have unique or nuanced perspectives on certain issues such as cost of service, rate design, and acquisitions.

presented, the Commission rejected one prior attempt for a similar mechanism,<sup>4</sup> KAWC agreed to settlement of the rate case without the surcharge in another case,<sup>5</sup> and it withdrew a third attempt merely two years ago.<sup>6</sup>

Now, KAWC has tweaked its proposal hoping to gain support. KRS 278.190(3) clearly places the burden on the applicant KAWC: “At any hearing involving the rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility . . . .” Despite slight modifications from prior proposals, KAWC still cannot satisfy its burden of proof.

**A. American Water will fund projects that customers need regardless of whether there is a QIP.**

In his rebuttal testimony, KAWC’s President Nick Rowe mentions “discretionary capital” at least nine times as the justification for QIP. Other KAWC rebuttal witnesses justify QIP by mentioning discretionary capital at least 22 times.

Typical is the following testimony:

With Kentucky-American being among the last . . . without a mechanism to achieve timely recovery of its investment in accelerated infrastructure replacement, it is at a significant disadvantage to attract discretionary capital allocations . . . .<sup>7</sup>

Like an echo chamber, KAWC’s witnesses cite each other’s testimony about “discretionary capital.” For example, Melissa Schwartzell cites to Nick Rowe to support her own assertion and

---

<sup>4</sup> *Kentucky-American Water Company*, Case No. 2012-00520 at 57 (Ky. PSC Oct. 25, 2012). The Commission rejected the DSIC (Distribution System Infrastructure Charge), which was justified in part by the need to “encourage increased stockholder investment.” The Commission noted that the filing of rate cases about every 2 years minimizes the need for such a surcharge. *Id.* at 62.

<sup>5</sup> *Kentucky-American Water Company*, Case No. 2015-00418 (Ky. PSC Aug. 23, 2016).

<sup>6</sup> *Kentucky-American Water Company*, Case No. 2017-00313 (Ky. PSC Aug. 27, 2017).

<sup>7</sup> Rebuttal testimony of Nick O. Rowe (“Rowe Rebuttal”) at 4 (filed Ky. PSC April 30, 2019).

states: “[I]t is at a significant disadvantage to attract discretionary allocations from American Water as compared to its affiliates.”<sup>8</sup>

These tautological statements are self-serving. Worse yet, KAWC fails to provide substance to support these statements that suggest that the utility will not receive necessary capital without QIP.

In fact, Rowe’s own testimony demonstrates that KAWC does not need a QIP to attract necessary capital. In responding to questions by Vice Chairman Cicero, Rowe discussed how priorities factored into American Water’s funding decisions. Using the Kentucky River Station II water treatment plant as an example, Rowe explained:

At that time, it was a priority for Kentucky. That would have been a priority for American Water, which would have trumped anything else because there was a need for water supply. . . . So that was a priority for American Water. And they were going to make sure that we got the funding for that.<sup>9</sup>

Rowe further emphasized that projects that are deemed to be priorities are “going to be done if that’s what’s needed for the customers. That’s going to be the first priority for American Water.”<sup>10</sup> In addition, he stated that “priorities would be the same whether there is a QIP or not.”<sup>11</sup>

On this point, Rowe’s testimony is clear: KAWC does not need a QIP in order to receive capital from American Water if the project is “what’s needed for customers.” He explains that American Water will put the needs of its customers as its first priority, regardless of whether the subsidiary has an infrastructure replacement program. The only reason KAWC wants the QIP is

---

<sup>8</sup> Rebuttal testimony of Melissa L. Schwarzell (“Schwarzell Rebuttal”) at 18, 19 (filed Ky. PSC April 30, 2019).

<sup>9</sup> VR: 5/13/19; 9:47:30

<sup>10</sup> *Id.* at 9:48:10.

<sup>11</sup> *Id.* at 9:48:57-9:49:00.

because KAWC wants “an opportunity to attract additional capital.”<sup>12</sup> And it goes without saying that when KAWC attracts additional capital, KAWC’s shareholders benefit.

**B. KAWC fails to provide a detailed and specific description of discretionary capital.**

In contrast to the clear point that American Water will fund projects that are needed by the customer, the record is vague as to what exactly discretionary capital is. KAWC has not provided a concise definition of discretionary capital, how KAWC can specifically achieve such an allocation, or even when KAWC has received it in the past or been denied it. On questioning to clarify discretionary capital, Rowe stated the following about it:<sup>13</sup>

- The \$160 million capital spent by KAWC since the prior case did not include discretionary capital.
- KAWC receives discretionary capital from AWWC as a result of Rowe’s lobbying efforts with AWWC, which is an important priority of Rowe’s position.
- Discretionary means unspent/excess capital.
- When discretionary capital becomes available, Rowe gets a call and is told there is discretionary capital and then he lobbies for it.
- There may be a pot of other capital that is not discretionary beyond excess capital but Rowe did not know for sure.
- Rowe is not told in advance by AWWC how much discretionary capital there is or will be.
- The last time Rowe received a call from AWWC was in 2018 but KAWC was not allocated any discretionary capital.
- Rowe did not remember how much, but he receives a call for discretionary capital a couple times a year.
- Rowe is not aware of any metric to let him know how this discretionary capital is assigned.

In post-hearing data responses, KAWC attempts to clarify the confusion sowed by Rowe’s hearing testimony as to what discretionary capital means and how much of it does

---

<sup>12</sup> *Id.* at 9:49:15-9:49:20.

<sup>13</sup> *Id.* at 10:50, *et seq.*

KAWC get.<sup>14</sup> But this leads to further confusion. For example, in the responses, KAWC states that over half of the \$6 billion invested is discretionary and the largest category is with renewal investments. But this does not appear consistent with Rowe’s testimony that discretionary capital is excess or unspent capital. The written responses also identify a “secondary” category of investment funds that may become available. This category appears to be more consistent with Rowe’s suggestion of discretionary capital being excess. But Rowe did not mention that KAWC never received any of these funds, even though the written response indicates that the utility has not received any.

This illustrates that the “discretionary capital” concept is vague at best. Some ambiguity is undoubtedly the result of American Water’s priority to the needs of its customers. According to Rowe, American Water will fund these “first priority” projects regardless of whether the subsidiary has a QIP-like mechanism.<sup>15</sup> But, until KAWC can establish a clear record on what discretionary capital is and explain why it must attract discretionary capital in order to serve the needs of its customers, the QIP must be rejected.

**C. There is no justification to support KAWC’s theory of the relationship between QIP approval and discretionary capital or improvement of water loss.**

In addition to the vague record on the exact nature of discretionary capital, there is no analysis connecting discretionary capital with QIP or water loss. The absence of detailed analysis establishing a relationship between these issues is revealing. In contrast, KAWC presented detailed economic analysis about ROE by economist Ann E. Bulkley,<sup>16</sup> detailed regression analysis about weather normalization and usage by the AWWC Leader of Revenue

---

<sup>14</sup> See KAWC Response to PSC Staff’s Post-Hearing Data Request at 11.

<sup>15</sup> *Id.* at 9:48:57-9:49:00.

<sup>16</sup> Direct Testimony of Ann E. Bulkley (“Bulkley Direct”) (filed Ky. PSC November 28, 2018).

Analytics, Gregory P. Roach,<sup>17</sup> and complicated economic analysis of compensation comparisons.<sup>18</sup> But despite detailed economic analysis on the other issues, no such analysis on these alleged connections with discretionary capital exists.

Bulkley, who performed a very detailed (but flawed) ROE analysis, admits that she did not perform an analysis of the relationship between ROE and the infrastructure surcharge.<sup>19</sup> Instead, she merely attaches a listing of utilities (including AWWC utilities such as KAWC) indicating whether they have an infrastructure replacement surcharge, future test year, and decoupling.<sup>20</sup> When asked whether she performed an analysis between discretionary capital and whether they had a QIP-like surcharge mechanism, Bulkley said she did not perform that analysis and did not know how it could be done from outside the company.<sup>21</sup> KAWC, thus, chose not to provide an analysis to support its vague connection that discretionary capital supports QIP.

KAWC also seeks to justify the QIP mechanism as a tool to help reduce non-revenue water.<sup>22</sup> This excuse for the QIP is likewise not tenable because KAWC's own evidence contradicts this assertion. KAWC has identified the water loss percentage for its affiliates.<sup>23</sup> It has also indicated that all of its affiliates except for Maryland and California (and Kentucky) have an infrastructure surcharge.<sup>24</sup> If KAWC was correct that QIP mechanisms support reduction of water loss percentages, the water loss percentages would be lower in the surcharge jurisdictions. But it is not. For 2018, the average water loss for non-surcharge affiliates is

---

<sup>17</sup> Direct Testimony of Gregory P. Roach ("Roach Direct") (filed Ky. PSC November 28, 2018).

<sup>18</sup> See e.g., confidential exhibit to Direct Testimony of Robert V. Mustich ("Mustich Direct") (filed Ky. PSC November 28, 2018).

<sup>19</sup> VR: 5/13/19; 4:01:47

<sup>20</sup> Bulkley Direct at AEB-11.

<sup>21</sup> VR: 5/13/19; 4:02:20.

<sup>22</sup> Rebuttal Testimony of Brent F. O'Neill ("O'Neill Rebuttal") at 16 (filed Ky. PSC April 30, 2019).

<sup>23</sup> KAWC Response to PSC Staff's Post-Hearing Data Request, Item 12 at 2, 3.

<sup>24</sup> Bulkley Direct at AEB-11.

13.06% and, for those with a surcharge, it is 21.94%. Simple arithmetic points out the fallacy of this argument that QIP will reduce water loss.

Moreover, KAWC's argument that the QIP is necessary to replace dilapidated infrastructure, which will reduce water loss, is completely inconsistent with its acquisition strategy. Midway Mayor Grayson Vandegrift indicated that KAWC has offered to acquire the City of Midway's water and sewer utilities that are forecasted to need up to \$20 million in repairs over the next 20 years.<sup>25</sup> Mayor Vandegrift then asks a poignant question: "why would a company that needs more money to fix infrastructure also want to purchase some that they know to be ready for investment?" There is no reasonable answer to that question. It evidences the fact that KAWC does not need a QIP.

KAWC fails to demonstrate that QIP mechanisms reduce water loss. It has not provided any economic analysis to connect discretionary capital and QIP. And even the concept of discretionary capital is so elusive that KAWC has not properly defined, measured, or quantified it. But, above all else, KAWC President Nick Rowe's testimony clearly demonstrates that KAWC will receive funding for projects that customers need, regardless of whether QIP is approved. KAWC has failed to meet its burden that QIP is reasonable, and therefore, the QIP proposal must be rejected.

**II. KAWC's test-year production costs should be reduced based on KAWC's unaccounted-for water loss percentage exceeding 15 percent.**

KAWC's most recent non-revenue water report shows non-revenue water at 20.9%.<sup>26</sup> 807 KAR 5:066, Section 6(3) clearly provides that a utility's unaccounted-for water shall not exceed 15 percent. The Commission has focused on this standard and is "placing greater

---

<sup>25</sup> Letter from Grayson Vandegrift, Mayor of the City of Midway, to the Public Service Commission, Public Comments (submitted May 13, 2019).

<sup>26</sup> LFUCG Hearing Exhibit 1, page 2 of NRW Status Report, 1 May 2019, attached to the "Ordering Paragraph 9 Report" filed in Case No. 2007-00134. Also see Response to LFUCG 1-48.



emphasis on monitoring utilities that consistently exceed the 15 percent unaccounted-for water loss threshold.”<sup>27</sup> Through this objective, the Commission has consistently reduced the revenue requirement of non-profit water utilities by the amount of variable costs that reflect an amount above that 15-percent mark.<sup>28</sup> It would be illogical to have a different and lower standard for investor-owned utilities. If the Commission does not reduce KAWC’s variable expenses to reflect KAWC’s unaccounted-for water loss above 15 percent, the Commission would be departing from its consistent, uniform application of Section 6(3).

**A. KAWC has not properly requested that an alternate level of water loss percentage be deemed reasonable.**

The regulation prohibiting rate recovery for excess water loss provides that “[u]pon application by a utility in a rate case filing or by separate filing, or upon motion by the Commission, an alternative level of reasonable unaccounted-for water loss may be established by the Commission.”<sup>29</sup> Although KAWC asserts that its request for an alternate level of unaccounted-for water loss is buried in its revenue-requirement calculations, KAWC never applied for an alternate level of unaccounted-for water loss. There is no mention of this request anywhere in KAWC’s application. Rather, it is first mentioned in rebuttal testimony by Brent

---

<sup>27</sup> *In re Electronic Investigation into Excessive Water Loss by Kentucky’s Jurisdictional Water Utilities*, (“Water loss investigation”) Case No. 2019-00041 at 1 (Ky. PSC Mar. 12, 2019).

<sup>28</sup> *See, e.g., South Hopkins Water Dist.*, Case No. 2018-00387 at 2 (Ky. PSC April 16, 2019) (reducing test-year expenses to account for the utility’s 17.69-percent excess water loss); *Elkhorn Water Dist.*, Case No. 2018-00145 at 2 (Ky. PSC April 2, 2019) (reducing test-year expenses to account for the utility’s 1.03-percent excess water loss); *Western Lewis-Rectorville Water and Gas District*, Case No. 2018-00321 at 2 (Ky. PSC. Mar. 20, 2019) (reducing test-year expenses to account for the utility’s 11.38-percent excess water loss); *North McLean Water Dist.*, Case No. 2018-00260 at 2 (Ky. PSC Dec. 20, 2018)(reducing test-year expenses to account for the utility’s 6.31-percent excess water loss); *West Carroll Water Dist.*, Case No. 2017-00244 at 2 (Ky. PSC Apr. 24, 2018) (reducing test-year expenses to account for the utility’s 17.33-percent excess water loss); *Jonathan Creek Water District*, Case No. 2017-00323 at 2 (Ky. PSC Dec. 21, 2017)(reducing test-year expenses to account for the utility’s 6.55-percent excess water loss); *Cannonsburg Water Dist.*, Case No. 2011-00217 at 5 n.12 (reducing the water district’s revenue requirement \$233,625, which would reflect more than 10% of its total annual revenue).

<sup>29</sup> 807 KAR 5:066, Section 6(3).

O'Neill, which was filed after multiple rounds of discovery and the filing of Intervenors' testimony.

The Commission addressed a similar situation in a wholesale rate case involving the City of Danville.<sup>30</sup> In that case, Danville responded to Commission Staff's Information Request that it sought to recover rate case expenses from its wholesale customers.<sup>31</sup> The Commission rejected Danville's request to recover rate case expense from its wholesale customers, finding that Danville failed to move to amend its application to request recovery of rate case expenses and that it failed to provide notice to its customers.<sup>32</sup> In fact, 807 KAR 5:001, Section 4(5) permits an application to be amended on a party's motion and if good cause is shown.

Because KAWC never applied to increase the reasonable level of unaccounted-for water loss above the 15-percent requirement found in 807 KAR 5:066 and because KAWC never sought to amend its application in this case to include such a request, nor provided proper notice, the Commission should reject any such request at this time.

**B. Even if KAWC properly requested for a deviation from the 15-percent regulatory standard for water loss, the Commission should nonetheless deny recovery of expenses related to excess water loss.**

If the Commission, in spite of the improper presentation of the issue by KAWC, decides to adjudicate the water loss matter, the outcome should be the same: no recovery. The burden on KAWC is clear: "A utility proposing an alternative level shall have the burden of demonstrating that the alternative level is more reasonable than the level prescribed in this section."<sup>33</sup> KAWC has failed to meet its burden.

---

<sup>30</sup> See *City of Danville*, Case No. 2014-00392 (Ky. PSC August 13, 2015).

<sup>31</sup> *Id.* at 6.

<sup>32</sup> *Id.*

<sup>33</sup> 807 KAR 5:066, Section 6(3) (emphasis added).

An alternate level of reasonable unaccounted-for water loss should not be awarded to KAWC because it has a long history of water loss and an equally long history of inadequately addressing increasing water loss. In conjunction with the approval of the CPCN for the construction of the KRS II project and in response to concerns raised about leaks, the Commission ordered that KAWC retain a qualified consultant to develop a “leak-mitigation and demand management plan consistent with the best practices of the water industry.”<sup>34</sup>

The Commission also ordered KAWC to file a monthly report that “provides the status of its water conservation, leak-mitigation and demand-side management plan and the effects that the implementation of such a plan has had on water usage.”<sup>35</sup>

A copy of the May 1, 2019 water loss report demonstrates how little useful information is provided by KAWC as to what it is doing about water loss.<sup>36</sup> The report merely states that at the time of the study by Gannett Fleming (“GF”) in 2009, the Company’s 12-month non-revenue water was 13.7% and that it has now climbed to 20.9%.<sup>37</sup> No other significant information is provided. The report merely updates the most recent water loss from month to month and clearly is not complying with the Commission’s order regarding the monthly report contents.

One can only speculate as to why the NRW loss has steadily increased since the GF study. Is it because of a lack of priority? Is it because KAWC emphasized construction of a new capital project (KRS II) to the detriment of leak detection? Is it because since the date of the GF study, KAWC has embarked on an acquisition spree by taking over North Middletown, Millersburg and the East Rockcastle systems, to the detriment of existing water loss problems?

---

<sup>34</sup> *Kentucky-American Water Company* (“KRS II”), Case 2007-00134 at 89 (Ky. PSC Apr. 25, 2008).

<sup>35</sup> *Id.*

<sup>36</sup> Attorney General’s Hearing Exhibit 7.

<sup>37</sup> *Id.*

Whatever the reason for KAWC's steadily increasing water loss, the record demonstrates that KAWC's answer is not to initiate comprehensive analysis followed by action, but instead it is to build and construct so as to increase its rate base. KAWC built the KRS II project beginning in 2008 in spite of water loss concerns resulting in GF Study and its solution today is to further bolster its rate base.

There is no comprehensive plan to address the water loss problem for KAWC's entire system. In contrast, KAWC has a written plan to address the Southern Division,<sup>38</sup> but none for the system-wide problem. The only response KAWC seems to provide is that it has a plan already, i.e., the GF report.<sup>39</sup> If true, KAWC should have recognized long before now that merely following that report is not a reliable solution.<sup>40</sup>

In addition, Brent O'Neill's testimony is vague at best as to what the company is doing now to solve it. Because of inconsistent testimony, it is unclear as to whether the QIP was even proposed to address KAWC's leak problem. This is the fourth iteration of the infrastructure rider proposed by KAWC in the last decade, each of which has been rejected or withdrawn previously. KAWC's expenses related to production costs should be reduced to reflect the 15-percent water loss standard.

**C. KAWC's test-year expenses should be reduced by \$435,847 to reflect the 15-percent water loss standard**

KAWC attempted to calculate the appropriate adjustment to account for its excessive water loss. KAWC's calculation that the reduction should be \$315,743 fails to consider several

---

<sup>38</sup> See LFUCG Hearing Exhibit 1 (Exhibit to the Motion to Dismiss filed April 2, 2019 by KAWC in Water Loss Investigation, Case 2019-00041).

<sup>39</sup> VR: 5/13/19; 1:50:00. For the first time in response to the PSC PHDR 19 we learn that a task force has identified eight tasks to learn about water loss. However, the tasks are still not even identified because there is no real effort to stop the leaks. The real effort is to try to obtain approval of a surcharge.

<sup>40</sup> KAWC used Brent O'Neill as the witness who adopted the water loss testimony of Kevin Rogers. Rogers left KAWC shortly after filing Responses to the last round of requests to KAWC.

factors.<sup>41</sup> First and foremost, KAWC's self-reported unaccounted-for water loss in 2018 was 19.95 percent.<sup>42</sup> Although the forecasted test-year predicts 19.37 percent, KAWC has not demonstrated that there will be a reduction in unaccounted-for water. In fact, recent trends suggest otherwise. KAWC's unaccounted-for water loss has increased in eight of the past nine years. Therefore, the Commission should use the 2018 actual unaccounted-for water loss percentage.

KAWC admits that it did not include purchased water or waste disposal in its revenue-requirement reduction.<sup>43</sup> The most reliable figure on KAWC's excess expenses comes from Commission Staff, which estimated that the excess cost of purchased water was \$57,153 as a result of the line loss in the Southern Division.<sup>44</sup> At a minimum, this amount should be included within the calculation of the reduction to test-year expenses. In addition, KAWC estimated \$407,483 in expenses for waste disposal,<sup>45</sup> which should likewise be included in the calculation. Accordingly, here is the appropriate calculation:

---

<sup>41</sup> See KAWC Response to the Attorney General's Post-Hearing Data Requests at Item 4.

<sup>42</sup> See KAWC Response to the Attorney General's Second Request for Information at Item 39.

<sup>43</sup> See KAWC Response to the Attorney General's Post-Hearing Data Requests at Item 4.

<sup>44</sup> LFUCG Hearing Exhibit 1.

<sup>45</sup> W/P 3-5.

Forecast Unaccounted for Water	19.95%
Threshold	15.00%
Unaccounted for Water Variance	<u>-4.95%</u>
Forecast Chemical Expense	\$2,786,126
Forecast Fuel & Power Expense	4,358,389
Waste Disposal Expense	407,483
Total	<u>\$7,551,998</u>
Unaccounted for Water Variance	-4.95%
Total Fuel Power & Chemical	<u>-\$373,824</u>
Purchased Water - Southern Division	-\$57,153
Total Chemical, Fuel, Power & Water	-\$430,977
Expense Gross Up	1.0113
<b>Total Fuel Power &amp; Chemical</b>	<u><b>-\$435,847</b></u>

Based on the foregoing analysis, KAWC’s test year expenses should be reduced by \$435,847 as a result of this adjustment.

**III. Expenses incurred by KAWC to AWWSC should be disallowed.**

KAWC and American Water Works Service Company, Inc. (“AWWSC”) entered into a contract dated January 1, 1989 (“Contract”) that governs their relationship. Pursuant to the Contract, KAWC pays AWWSC approximately \$1,000,000 per month comprised of direct costs, costs allocated to KAWC based on the number of KAWC customers, and a calculated proportion of AWWSC’s overhead costs.<sup>46</sup> KAWC pays these invoices monthly in advance by paying an estimate for the current month and a true-up for previous month’s costs. Because the justification given by KAWC witness Patrick Bayrenbruch does not satisfy the Commission’s requirements established in previous Commission cases, these expenses should be denied.

<sup>46</sup> KAWC Response to PSC Staff 1-23.

Further, KAWC is not entitled to a presumption of reasonableness for its service company expenses because of the lack of independence.

**A. The Commission previously established the requirements to justify recovery of a service company's costs.**

The Commission has clearly defined the requirements which must be followed in order to enable a company to recover service company's expenses.<sup>47</sup> First, the burden to establish the reasonableness of the utility's proposed expenses is on the applicant. Management decisions are presumed to be reasonable unless it is not an arms-length transaction, in which case the presumption does not follow. In the present case, there is no arms-length relationship and therefore no presumption of reasonableness.

First, KAWC President Nick Rowe is also on the board of AWWSC, and therefore has a built-in conflict of interest. Second, the Contract does not allow KAWC the right to contest the charges; it merely has the obligation to pay in advance. Moreover, there is no evidence that KAWC has even disputed one single charge. In fact, KAWC admits, "There is no documentation that specifically authorizes KAWC to contest or object to costs that are billed to it by AWWSC."<sup>48</sup>

AWWSC's billing procedure is not conducive to local review. AWWSC sends an electronic bill to KAWC on the first of the month and the payment is made via a journal entry via SAP on the tenth. The payment is actually for an estimated amount for the current month prior to all services being rendered. Estimated costs are trued-up the following month. This process can result in significant overpayments by KAWC. For example, the April billing statement shows that KAWC had been overcharged \$467,061.83, nearly a 50% overpayment.

---

<sup>47</sup> *Water Service Corp. of Kentucky s*, Case No. 2010-00476 at 1 (Ky. PSC Nov. 23, 2011 "WSKY I").

<sup>48</sup> KAWC Response to LFUCG Post-Hearing Data Request, Item 12.

This process hardly establishes independence. Therefore, the presumption of reasonableness does not follow.

**B. The Commission determined that Baryenbruch’s study was not reasonable in a previous case and should likewise be found to be not reasonable in this case.**

KAWC attempts to support its service company charges through the testimony and study of Patrick Baryenbruch. Baryenbruch provided a similar study for another water utility in a previous rate case.<sup>49</sup> In both cases, Baryenbruch’s studies compared electric and gas utilities, but did not include water utilities. His comparisons of professional rates such as attorneys, involved over 100 cities but none from Kentucky.

In that previous case, the Commission agreed “with the AG’s criticism of Mr. Bayenbruch’s study as failing to involve similar type and sized utilities and, therefore, decline to afford it any weight.”<sup>50</sup> When asked in effect why he and KAWC ignored the Commisison’s prior holding and performed “essentially” the identical study that was rejected as in *Water Service I*,<sup>51</sup> Bayrenbruch simply stated that he disagreed with the Commission.<sup>52</sup>

Bayrenbruch tried to pass his flawed methodology again on the PSC. As in *WSKY I*, the study should not be given any weight, and the service company expenses should be denied.

**IV. Expenses incurred from the Chemical Complex should be disallowed.**

Kentucky-American Water Company (“KAWC”) seeks to recover expenses it has already incurred and will be incurring related to the Richmond Road Station and the Kentucky River I Station Chemical Complexes (“Chemical Complex”) including but not limited to depreciation expense and a return on the Chemical Complex’s capital investment. KAWC did

---

<sup>49</sup> See *WSKY I* at 11-12.

<sup>50</sup> *Water Service I* at pp. 11-12; see also *Water Service Corp. of Kentucky*, Case No. 2013-00237 at 17 (Ky. PSC July 24, 2014) (“In that preceding, the Commission declined to give *WSKY*’s study any weight, finding that it failed to involve utilities of similar type and size.”).

<sup>51</sup> VR: 5/13/19; 6:46:30 PM.

<sup>52</sup> *Id.* at 6:47:50 PM.



not seek a Certificate of Public Convenience and Necessity (“CPCN”) and therefore is not entitled to a presumption of reasonableness.<sup>53</sup> Instead, the Commission in this proceeding must make a separate and independent finding that the \$19,000,000 expense incurred arising from the Chemical Complex is reasonable.<sup>54</sup> Evidence to support such a finding does not exist in the record and, therefore, these expenses should be disallowed.

**A. KAWC did not obtain a CPCN for the Chemical Complex, and therefore, it is not entitled to a presumption of reasonableness.**

KAWC elected not to seek a CPCN notwithstanding the fact that this nearly \$20,000,000 construction project constitutes approximately 3.3% of KAWC’s net plant. KAWC’s net plant is \$567,115,299<sup>55</sup> and the total cost of the chemical projects \$19,000,002<sup>56</sup> or approximately 3.3% of net plant.

The Commission previously placed Atmos Energy Corporation (“Atmos”) on notice in Case No. 2018-0028 that it would require a show cause proceeding to determine if penalties should be assessed, if Atmos constructed facilities not in the ordinary course of business without a CPCN.<sup>57</sup> The Commission applied the “2% rule” to determine if the projects were in the ordinary course of business<sup>58</sup> and thus not required to the presumption.

Accordingly, KAWC should have applied for a CPCN because the Chemical Complex in fact exceeds 2% of net plant. Nonetheless, KAWC first argues that a CPCN was not required. It claims that, “[s]ince the project was a replacement of the existing chemical process and not a change in the way that the company treated the water at the facility and was considered a part of

---

<sup>53</sup> See *Northern Kentucky Water Dist.*, Case No. 2000-00481 (Ky. PSC Oct. 8, 2001)( “If the Commission has issued a Certificate for the construction of a utility facility, that facility and its associated expenses are presumed to be reasonable.”)

<sup>54</sup> *Id.*

<sup>55</sup> Application, Exhibit 37, Schedule K-1, page 2 of 4.

<sup>56</sup> Direct Testimony of Brent E. O’Neill (“O’Neill Direct”) at 15 (filed Ky. PSC November 28, 2018).

<sup>57</sup> *Atmos Energy Corp.*, Case No. 2018-00281, at 56-57 (Ky. PSC May 7, 2019).

<sup>58</sup> *Id.* at p. 57.

normal business for the company,” no CPCN is required.<sup>59</sup> However, KAWC’s understanding of “normal business” may not be the same as the regulatory standard of “ordinary course of business.” Additionally, it is unclear as to why the replacement of an existing chemical process does not constitute a change in the way that the company treated the water at the facility. Finally, KAWC alleges that these are two separate projects and not one; therefore, it passes the 2% rule.<sup>60</sup> The projects, however, are identical. Although at two different stations in the same county, the projects were bid together and analyzed together.<sup>61</sup> It is one project and therefore KAWC should have sought a CPCN. Because it did not seek a CPCN, KAWC is not entitled to a presumption of reasonableness in this proceeding.

**B. There is not sufficient evidence in the record to support the reasonableness of expenses related to the Chemical Complex.**

There is scant evidence to support the need and absence of wasteful duplication for these expenses. No “cost benefit analysis” was performed on the entire project. The only cost benefit analysis performed was on the evaluation of the chemicals themselves, not whether new processes were needed.<sup>62</sup> In addition, no federal or state regulation or law requires that the Chemical Complex be modified. KAWC has not been cited by any government agency for non-compliance with regulations relating to purification of the water or storage of chemicals. Moreover, the evidence presented was inconsistent, such as when attempting to justify projects at KRS I and Richmond Road, the KAWC witness O’Neill talked about the danger to employees

---

<sup>59</sup> KAWC Response to LFUCG 1-69(h)(m).

<sup>60</sup> In Response to PSC 2-5, KAWC argues without support that there is a 5% rule. As noted above, merely six days before the hearing in this case, the Commission re-affirmed the validity of the 2% rule to measure the materiality of the project.

<sup>61</sup> See, e.g., *Barker v. East Kentucky Power Coop.*, Case No. 2013-00291 (Ky. PSC July 6, 2015)(finding that similar projects must be considered “in totality and not individually” for purposes of considering whether a CPCN should be granted and finding that the “construction comprised one project, and there is no basis for reviewing each individual deviation in isolation”).

<sup>62</sup> Response to AG 1-77(c) and 5/13/19 Hearing VR 1:30:50 PM.

with the existing gas processes,<sup>63</sup> yet that same rationale was not mentioned to describe why the change was not included when KRS II recently was constructed. In fact, chlorine gas is still used at the newer KRS II.<sup>64</sup>

KAWC mentioned a concern for the security of the chemicals, but no federal requirement mandates this change.<sup>65</sup> Instead, there is the general concern expressed in an article in a footnote to witness O'Neill's response to a data request. The article is dated after the project had been sent to bid and therefore could not have been used to support KAWC's decision.<sup>66</sup>

Additionally, KAWC asserts that the age of the facilities forced its decision. KRS I is 61 years old and "critical improvements will be needed to maintain the capacity and reliability of the facility."<sup>67</sup> Likewise, the Richmond Road station is approaching 100 years old and although Mr. O'Neill cited the Commission's analysis in 2015 to justify expenditures requested then,<sup>68</sup> no similar analysis was performed in this case as to whether it makes financial sense to continue making expensive repairs to the Richmond Road Station. In fact, no cost benefit analysis was performed of the capital expenditures themselves.<sup>69</sup>

Therefore, these expenses incurred related to the Chemical Complex should be disallowed because no CPCN was requested, and no complete cost benefit analysis was performed to establish reasonableness.

---

<sup>63</sup> VR: 5/13/19; 1:35:10 PM.

<sup>64</sup> *Id.* at 1:46:30 PM

<sup>65</sup> *Id.* at 1:41:30 PM, 1:44:25 PM

<sup>66</sup> 5 *Id.* at VR 1:36:45 PM and fn1 to Response to AG 2-26.

<sup>67</sup> KAWC Response to AG 1-77(a).

<sup>68</sup> VR: 5/13/19; 1:45:20 PM.

<sup>69</sup> KAWC Response to AG 1-77(c); VR: 5/13/19; 1:30:50 PM.

**V. KAWC's purchased power expense should be reduced to reflect the Commission's final order in the Kentucky Utilities rate case.**

In its application, KAW forecasted purchased power expense based on the full increase proposed by Kentucky Utilities in KU's rate case application.<sup>70</sup> LFUCG and AG witness Lane Kollen recommended decreasing the forecasted power expense to reflect the proposed stipulation in the KU rate case.<sup>71</sup> As a part of its base period update, KAW agreed to Kollen's change and reduced the revenue requirement by \$97,027.<sup>72</sup> The final order in the KU rate case, however, reduced KU's revenue requirement \$2.47 million below the proposed stipulation's \$58.35 million revenue requirement.<sup>73</sup> Accordingly, KAWC's purchased power expense should be reduced by an additional 4.233%.<sup>74</sup>

**VI. KAWC's recoverable rate case expense should be reduced to \$94,287.**

KAWC included an estimated \$1,230,559 of rate case expense, which the utility proposed to amortize over 36 months for a total increase of \$410,186 to its annual revenue requirement.<sup>75</sup> KAWC indicates that its actual rate case expense through the filing of the post-hearing data responses is only \$843,097.<sup>76</sup>

In prior decisions, the Commission has based its allowed rate-case-expense amortization on the actual rate case expenses, not estimated expenses.<sup>77</sup> Therefore, it is only appropriate to allow a utility to recover *actual*, reasonable rate-case expenses, as opposed to estimated expenses.<sup>78</sup>

---

<sup>70</sup> Rogers Direct Testimony at 28 and WP-3-2 Fuel and Power Exhibit.xlsx.

<sup>71</sup> Kollen Direct Testimony at 31.

<sup>72</sup> See Base Period Update and Schwartzell Rebuttal Testimony at 2.

<sup>73</sup> *Kentucky Utils.* Case No. 2018-00294 at 11, 17 (Ky. PSC Apr. 30, 2019)

<sup>74</sup>  $\$2.47\text{M} / \$58.35\text{M} = 4.233\%$

<sup>75</sup> KAWC Response to LFUCG Post-Hearing Data Request 5 at 2.

<sup>76</sup> *Id.*

<sup>77</sup> *Delta Natural Gas Co.*, Case No. 2004-00067 at 11 (Ky. PSC Nov. 10, 2004).

<sup>78</sup> *E. Kentucky Power Coop.*, Case No. 2010-00167 at 18 (Ky. PSC Jan. 14, 2011).

In addition, the Commission requires utilities to demonstrate that rate case expenses are reasonable and related to the rate case. Accordingly, on numerous occasions, the Commission has required a utility to file unredacted copies of rate-case expenses to ensure that the Commission can confirm that the associated expenses are directly related to the rate case.

For example, Louisville Gas & Electric Company (“LG&E”) filed invoices for legal services that were redacted to protect attorney-client privilege and a subsequent affidavit from counsel indicating that all the redacted services were related to the rate case.<sup>79</sup> The Commission identified the governing standard by stating, “when a utility seeks to recover an expenditure in its rates, the Commission is obligated to review the nature of that expenditure to verify that it is just and reasonable.”<sup>80</sup> It then explained, “we are unable to determine from the evidence of record the nature of certain legal services performed and whether those services were related to this rate case.”<sup>81</sup> As a result, the Commission disallowed \$18,929 in actual rate case expense because of the redacted invoices.

The Commission expressed similar concerns when reviewing rate case expense incurred by Big Rivers Electric Cooperative. On a petition for rehearing, the Commission explicitly stated:

The Commission also notes that Big Rivers, as the applicant in this case, bears the burden of proof, and had it not filed unredacted copies of its legal invoices, none of those expenses would have been included for recovery in rates. In future rate cases, any request for recovery of rate case expenses must be supported by unredacted copies of invoices.<sup>82</sup>

---

<sup>79</sup> *Louisville Gas & Elec. Co.*, Case No. 2003-00433 at 39-40 (Ky. PSC June 30, 2004).

<sup>80</sup> *Id.* at 40.

<sup>81</sup> *Id.*

<sup>82</sup> *Big Rivers Elec. Coop.*, Case No. 2011-00036 at 6 (Jan. 29, 2013).

In the present case, KAWC has not filed any invoices or other documentation that support the reasonableness of the legal expenses as required<sup>83</sup> and was requested.<sup>84</sup> Instead, KAWC filed a single page listing the monthly total amount due for legal services.<sup>85</sup> This is the equivalent of providing a totally redacted invoice. There is no information to support the reasonableness of those expenses as the Commission has previously required. The Commission should, therefore, disallow the rate case expense for legal services.

Further, KAWC's recovery of rate case expense should not include internal labor and support services. As articulated by Lane Kollen, KAWC's request to include these costs as rate case expense "is not justified and is inconsistent with the exclusion of internal labor costs by other utilities seeking recovery of rate case expenses in recent base rate case proceedings."<sup>86</sup> Moreover, KAWC did not provide information to allow the Commission to determine whether the services performed were related to the rate case. The only information provided by KAWC to support these charges is a spreadsheet with employees' hours recorded and associated costs.<sup>87</sup> Consistent with the treatment of legal expenses, these internal labor and support services should also be disallowed for inclusion in actual rate case expense.

---

<sup>83</sup> See *id.*; *Louisville Gas & Elec. Co.*, Case No. 2003-00433 at 39-40.

<sup>84</sup> See LFUCG Post Hearing Data Request, Item 5(b).

<sup>85</sup> See KAWC Response to LFUCG Post Hearing Data Request, Item 5(b) at 33-42.

<sup>86</sup> Kollen Direct Testimony at 43.

<sup>87</sup> *Id.* at 5.

Line Number	Service	Consultant	2018 Rate Case Expense Estimate	Actual Invoices through May 17, 2019	Evidence-supported Actual Expense
1	Rate of Return	Concentric Energy Advisors	\$86,000	\$43,542	\$43,542
3	Cost of Service	Gannett Fleming	50,000	23,833	23,833
5	Legal	Stoll Keenon Ogden	562,500	319,459	
7	Compensation Study	Robert Mustich	85,000	106,162	106,162
9	Support Services Study	Patrick Baryenbruch	55,000	35,558	35,558
11	Rate Case Preparation	Support Services	312,141	256,694	
13	Customer Notice		48,000	53,580	53,580
13	Miscellaneous Expense		16,000	4,269	4,269
15	Depreciation Study - unamortized balance		15,918		15,918
17	Total Rate Case Expense (Prior to Amortization)		\$1,230,559	\$843,097	\$282,862
19	Annual Rate Case Expense Amortized Over 36 Months		\$410,186		\$94,287

Based on the previously described adjustments to eliminate legal and rate case preparation expenses that KAWC has not sufficiently supported, KAWC should be permitted to recover \$94,287 in annual revenues for rate case expenses. This is a decrease of \$315,899 in annual expenses from KAWC’s as-filed position.

**VII. KAWC’s Base Period Update to increase revenue requirement by \$311,014 for taxes on CIAC should be rejected.**

In its Base Period Update, KAWC proposed increasing its revenue requirement by \$311,014 to reflect a change that it would no longer propose to recover taxes on Contributions in Aid of Construction (“CIAC”).<sup>88</sup> Commission Staff’s discovery requests in which it referenced Administrative Case No. 313 served as the catalyst for KAWC’s change in position.<sup>89</sup> In that case, the Commission reviewed significant amounts of information in order to analyze “the materiality of the contributions to a company, that company’s ability to absorb any additional corresponding tax liability that may occur as a result of the contribution, and its impact on the company’s customers.”<sup>90</sup> KAWC has not provided any analysis related to these topics, including the impact to KAWC customers. In addition, the parties’ ability to investigate KAWC’s position

<sup>88</sup> \$276,440 + \$ 34,574 = \$311,014.

<sup>89</sup> KAWC Post-Hearing Brief at 60.

<sup>90</sup> *The Effects of the Tax Reform Act of 1986 on Contributions in Aid of Construction and Customer Advance*, Administrative Case No. 313, Interim Order at 13 (Ky. PSC Apr. 15, 1988).

was severely hampered by KAWC's late change, which occurred after discovery related to KAWC's application and after Intervenor testimony was filed.

Because there has been no analysis provided on the impact on customers, KAWC's late change to the "no gross up" method should be rejected and the proposed increase in revenue requirement of \$311,014 should be eliminated. Those costs should be borne by the cost causer (e.g., individual providing the contribution) or KAWC's shareholders until KAWC provides information and analysis in a new case to confirm circumstances are similar now as they were in 1988 when the order in Administrative Case No. 313 was issued.

**VIII. KAWC's request to include an acquisition adjustment for North Middletown should be denied.**

KAWC proposed a Utility Plant Acquisition Adjustment ("UPAA") associated with its North Middletown acquisition of \$225,195.<sup>91</sup> This was revised upward to \$229,290 in the Base Period Update.<sup>92</sup> KAWC asserts that the Commission should approve the acquisition adjustment either under the Commission's standard "Delta test" or under a fair-market-value method proposed in Schwartzel's testimony.<sup>93</sup> This Commission has never approved the fair-market-value method. In addition, several bills have been introduced in the General Assembly over the past few years that would have authorized a fair-market-value methodology, but each of those bills failed to be enacted.<sup>94</sup> Accordingly, the Commission should explicitly reject the fair-market-value method proposed by KAWC and continue to consider the reasonableness of the adjustment under the Delta test.

---

<sup>91</sup> Schwartzel Direct Testimony at 21-22; KAWC Filing Exhibit 37, Schedule B-1, Page 2 of 2.

<sup>92</sup> Base Period Update, Exhibit 37, Schedule B-1, Page 2 of 2.

<sup>93</sup> See KAWC's Post-Hearing Brief at 59.

<sup>94</sup> See, e.g., 2019 SB 163; 2018 SB 399.



The acquisition adjustment fails to meet the standards set forth in the Delta test. In the Commission's 1985 decision involving Delta Natural Gas Company,<sup>95</sup> the Commission articulated five factors to assist in the determination of whether an acquiring utility should be able to recover an acquisition adjustment. The following list are the factors to be considered: (1) whether the purchase price was established upon arm's-length negotiation; (2) whether the initial investment plus the cost of restoring the facilities to required standards will not adversely impact the overall costs and rates of the existing and new customers; (3) whether operational economies can be achieved through the acquisition; (4) whether the purchase price of the utility and non-utility property can be clearly identified; and (5) whether the purchase will result in overall benefits in the financial and service aspects of the utility's operation.

The application of these factors to the North Middletown acquisition demonstrates that the Delta standards are not satisfied. First, although KAWC's acquisition of the City of North Middletown's system may be between a willing buyer and willing seller, there is more to consider on whether the purchase price was established through an arm's-length negotiation. In these situations, the buyer and seller have a common interest. The municipality selling the system can use the extra funds to build parks, renovate buildings, or raise salaries. The investor-owned acquirer can put the acquisition cost into rate base and, therefore, earn more profits. Because both municipal seller and investor-owned purchaser have incentive to drive the cost of the purchase price up, it should not be considered an arm's length transaction.

Second, KAWC has not demonstrated that the initial investment plus the cost of restoring the facilities to required standards will not adversely impact the overall costs and rates of the existing and new customers. Evidence presented in this case demonstrates that KAWC does not

---

<sup>95</sup> *Delta Natural Gas Co.*, Case No. 9059, (Ky. PSC Sept. 11, 1985).

perform sufficient evaluation of a system that it is acquiring to determine what the cost of restoring the facilities to required standards would be.

For example, when acquiring the Eastern Rockcastle Water Association's system, KAWC believed that it could significantly reduce that isolated system's approximate 50% water loss by replacing meters.<sup>96</sup> No quantifiable evidence has been presented to demonstrate that the water loss was positively impacted by the replacement of a majority of meters in that system.<sup>97</sup> KAWC admits that it "does not know all the cause of NRW [Non-revenue water]," but that the main driver is continued leakage on aging infrastructure and unidentified leaks.<sup>98</sup> KAWC has since produced a list of six tasks designed to reduce water loss, but that list does not identify or estimate the costs to replace aging infrastructure and repair leaks.<sup>99</sup> KAWC has never identified the cost of restoring the Eastern Rockcastle facilities to required standards.

It appears that KAWC has taken the same approach with the North Middletown system. It admitted that (prior to acquisition) it had "no insight into the hydraulic conditions within the system."<sup>100</sup> KAWC also stated that it had "not identified any significant expenditures necessary" for the North Middletown system.<sup>101</sup> In fact, prior to acquisition, KAWC had not done its own calculation for the North Middletown system's unaccounted-for water loss.<sup>102</sup> Likewise, after acquisition, KAWC still does not have adequate information to provide a calculation for the system's unaccounted-for water loss.<sup>103</sup>

---

<sup>96</sup> See KAWC Response to LFUCG 2-23

<sup>97</sup> See *id.*

<sup>98</sup> *Id.*

<sup>99</sup> See LFUCG Hearing Exhibit 1 (Letter from Kevin Rogers to Erin Donges dated Mar. 18, 2019 and attached "Scope of 2019 NRW Reduction Activities").

<sup>100</sup> KAWC Response to PSC Staff 2-72.

<sup>101</sup> KAWC Response to PSC Staff 3-49(a); KAWC's Response to LFUCG 1-84(e).

<sup>102</sup> KAWC Response to to LFUCG 1-87.

<sup>103</sup> KAWC Response to LFUCG Post-Hearing Data Request 1.

KAWC has not provided information on the condition of the North Middletown system. The only improvements that KAWC plans for the system in 2019 cost \$150,000 to install new meters and SCADA communication equipment so that the North Middletown system can be integrated into KAWC's operations.<sup>104</sup> There is no reason to believe that these expenses were needed but for KAWC's acquisition of the system. Moreover, KAWC may end up in the same position with its North Middletown system as it is with the Eastern Rockcastle system; after KAWC operates the system more, it may need a 6-task list for the North Middletown system to provide safe and reliable water.<sup>105</sup> Accordingly, KAWC has not demonstrated that the initial investment plus the cost of restoring the facilities to required standards will not adversely impact the overall costs and rates of the existing and new customers.

Third, it is not clear whether operational economies will be achieved through the acquisition. KAWC apparently hired one additional full-time employee through the North Middletown acquisition.<sup>106</sup> It now states that it is actively recruiting an additional employee who will split time between North Middletown and Eastern Rockcastle to address water loss.<sup>107</sup> With the addition of employees for North Middletown's system, it is unlikely that operational economies will be achieved through the acquisition.

Fourth, there does not appear to be an overall benefit to KAWC in financial and service aspect of KAWC's operations. Most notably, KAWC has not identified any specific cost savings for KAWC resulting from the acquisition. Although the acquisition will result in more

---

<sup>104</sup> KAWC Response to PSC Staff 3-49(a); KAWC's Response to LFUCG 1-84(e).

<sup>105</sup> See LFUCG Hearing Exhibit 1.

<sup>106</sup> KAWC Response to PSC Staff 3-49(b).

<sup>107</sup> See LFUCG Hearing Exhibit 1; VR: 5/13/19; 2:14:00-2:14:30.

customers to pay utility expenses, it appears that the cost to provide service in North Middletown is higher than the rest of the system.<sup>108</sup>

Ratepayers should not be required to pay higher rates attributable to the premium paid for other systems. Because KAWC's acquisition of North Middletown's system does not meet the standards set forth in the Commission's "Delta test,"<sup>109</sup> KAWC should not be allowed to recover its requested premium for the acquisition.

**IX. KAWC's proposal to unify rates with Eastern Rockcastle and North Middletown should be rejected.**

Following the acquisitions of the Eastern Rockcastle and North Middletown systems, KAWC adopted the volumetric rates of those systems. KAWC proposes to unify those rates with the rest of its system. But KAWC has failed to adhere to the Commission's previous directive when proposing the unified rates in this case.

In KAWC's Case No. 2012-00520, the Commission aptly stated "that Kentucky-American's existing ratepayers should not be considered a deep pocket that is available in all cases to finance the improvements of acquired small water systems."<sup>110</sup> Accordingly, the Commission put KAWC on notice that future unified rates for acquired systems "should not be presumed."<sup>111</sup> In the present case, however, KAWC presumed that unified rates would be accepted.<sup>112</sup>

To support its position, KAWC argues that the rate reduction to Eastern Rockcastle and North Middletown customers will have minimal effect on other customers when the rates are

---

<sup>108</sup> KAWC's Response to PSC Staff 2-72 ("purchase price of the system and the cost of its operation are almost entirely funded by the system's present rate revenue, with only a \$16 thousand deficiency at the Company's requested rate of return").

<sup>109</sup> KAWC states that there is no non-utility property conveyed in the transaction. It is therefore a non-issue in this analysis.

<sup>110</sup> *Kentucky-American Water Co.*, Case No. 2012-00520 at 73 (Ky. PSC Oct. 25, 2013).

<sup>111</sup> *Id.* at 74.

<sup>112</sup> See KAWC Response to AG 2-36 ("The Company did not request separate cost of service results for Eastern Rockcastle and North Middletown because the Company planned to propose single tariff treatment.")

unified. Specifically, KAWC suggests that other customers will be required to pay only an additional \$0.07 and \$0.006 per month than what they would otherwise pay if rates are not merged.

This calculation, however, is misleading. KAWC calculates these increases based on the deficiency between the present rate revenue for those systems in comparison to the revenue necessary to achieve KAWC's requested rate of return. The rates and unified rate structure proposed by KAWC would result in a decrease of revenues from the Eastern Rockcastle and North Middletown systems when compared to the present rate revenue. Accordingly, the deficiency between the proposed rate revenue for those systems in comparison to the revenue necessary to achieve KAWC's requested rate of return is greater than what KAWC calculated.

For example, KAWC calculated the revenue requirement for the Eastern Rockcastle system to be \$542,404 and calculated the test-year revenue at proposed rates to be \$244,435. The deficiency of \$297,969 determined from the proposed rate revenue is far greater than the \$192,855 determined from the present rates.

These calculations, moreover, do not include the full cost to serve these new acquisitions. In a previous case, the Commission directed KAWC "to maintain a separate set of records for acquired water systems for a reasonable period of time after the acquisition to enable the Commission to assess the cost of service for the acquired and acquiring systems and to better assist the Commission in determining the appropriateness and reasonableness of a unified/consolidated schedule of rates."<sup>113</sup> KAWC has still not determined what specific repairs must be made to the Eastern Rockcastle system in order to reduce its water loss to a reasonable percentage.<sup>114</sup> In addition, KAWC did not even maintain reliable and necessary records to

---

<sup>113</sup> *Kentucky-American Water Co.*, Case No. 2012-00520 at 74.

<sup>114</sup> *See* Section VII *supra*.

determine the cost to serve. KAWC admits, “Since the close of the Eastern Rockcastle acquisition, KAW has not segregated all of the Other Water Used activities for that portion of our system.”<sup>115</sup> Without knowing what those specific expenses will be, it is impossible to determine what the impact will be to customers.

LFUCG acknowledges that the negative impact to all other customers for unifying the rates is likely to be relatively small because of the scale of the systems. But that does not prevent the reasonableness of rates paid by existing customers to suffer “death by a thousand cuts.” Legacy customers must endure increased costs each time KAWC acquires a new system with high O&M expenses and massive infrastructure needs. Even if the impact to residential customers may be pennies for acquisition of a small system, those pennies turn into quarters and eventually dollars when KAWC acquires multiple systems (such as North Middletown, Eastern Rockcastle, Millersburg, Owenton, Tri-Village, and Elk Lake). And if KAWC acquires a large system or even several small systems in the future with relatively high cost of service, such as the City of Midway,<sup>116</sup> the impact to legacy customers will be significant.

Ultimately, KAWC proposal to unify rates would result in a decrease of revenue received from the Eastern Rockcastle system by 24.59% and from the North Middletown system by 12.21% from KAWC’s proposed rates.<sup>117</sup> If the Commission approves the unified rates and approves rates lower than what KAWC proposes, the difference in present-rate revenue and approved-rate revenue will be an even larger percentage than these percentages calculated by KAWC. By decreasing the rates in those locations while increasing rates to all other customers, KAWC is effectively socializing the higher costs to serve those newly acquired systems.

---

<sup>115</sup> See KAWC Response to LFUCG Post-Hearing Data Request at 2

<sup>116</sup> See Letter from Grayson Vandegrift, Mayor of the City of Midway, to the Public Service Commission, Public Comments (submitted May 13, 2019).

<sup>117</sup> KAWC Base Period Update, Exhibit 37, Schedule M-2.

As a result, the Commission should deny KAWC's proposal to unify rates and increase present rates based on a uniform percentage within each customer class regardless of location. This proposal would allow KAWC to operate these systems for a period of time and determine what additional infrastructure costs are necessary. In the next rate case, KAWC can present better information to support its position that it is appropriate to unify the rates in these newly acquired systems, as it was directed to do in Case No. 2012-00520. Alternatively, the Commission could direct KAWC to maintain the present rates in North Middletown and Eastern Rockcastle because those rates will produce higher revenues from those systems thereby reducing the revenue requirement in comparison to a unified rate structure.

### CONCLUSION

KAWC's proposed rates, QIP, and unified rate structure are unfair, unjust, unreasonable, and unnecessary. Accordingly, LFUCG respectfully requests that the Commission deny KAWC's proposals.

Respectfully submitted,



---

STURGILL, TURNER, BARKER & MOLONEY, PLLC  
James W. Gardner  
M. Todd Osterloh  
333 W. Vine Street, Suite 1500  
Lexington, Kentucky 40507  
Telephone No.: (859) 255-8581  
Facsimile No.: (859) 231-0851  
jgardner@sturgillturner.com  
tosterloh@sturgillturner.com

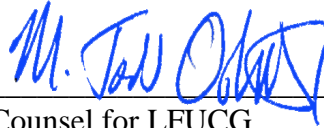
and

David J. Barberie, Managing Attorney  
Department of Law  
200 East Main Street  
Lexington, Kentucky 40507  
(859) 258-3500  
dbarberi@lexingtonky.gov

*Attorneys for Lexington-Fayette Urban County  
Government*

CERTIFICATE OF SERVICE

In accordance with 807 KAR 5:001, Section 8, I certify that the June 11, 2019, electronic filing of this document is a true and accurate copy of the same document being filed in paper medium; that the electronic filing will be transmitted to the Commission on June 11, 2019; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that an original paper medium of the Notice of Filing will be delivered to the Commission within two business days.



---

Counsel for LFUCG

x:\wdox\clients\65512\0005\pleading\01124415.docx