REASONS FOR APPLICATION

(In the space below list all reasons why the Applicant requires a rate adjustment. Describe any event or occurrence of significance that may affect the Applicant's present or future financial condition, including but not limited to excessive water line losses, regulatory changes, major repairs, planned construction, and increases in wholesale water costs.)

Please see attached.

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In November 2014, Kentucky-American Water Company ("KAWC") filed for an increase in sewer rates and rates were approved and implemented in July 2015. The only two areas included in the July 2015 increase were Owenton and Rockwell Village, which included less than 750 customers. KAWC has not requested a rate increase for either of these sewer systems since the July 2015 increase was approved. In July 2014, the Kentucky Public Service Commission approved sewer rates for the City of Millersburg following KAWC's acquisition of the water and sewer assets. KAWC did not propose any changes to those rates as part of the November 2014 sewer rate increase filing. The City of Millersburg's sewer rates have not been changed in over seven years.

Since KAWC's last sewer rate increase was implemented more than six years ago, KAWC has acquired two additional sewer systems: Ridgewood Subdivision in Franklin County and the City of North Middletown. Since acquiring Ridgewood subdivision in October 2016, KAWC has not requested an increase for Ridgewood's sewer rates, but rather decreased rates from what Ridgewood customers were paying prior to the acquisition. Since acquiring the City of North Middletown, KAWC has not requested a rate increase.

In the last five years, KAWC's sewer operations have operated at a loss. This is clearly demonstrated in the annual reports filed with the Kentucky Public Service Commission. A rate increase is needed to reduce the current shortfall in revenues for KAWC's sewer operations. A rate increase is further necessary in order to attract the capital necessary to properly maintain the system and provide further needed capital improvements. KAWC plans to complete a comprehensive planning study for all sewer system areas to determine a long-range capital plan. In addition, KAWC plans to complete SCADA for all sewer systems. KAWC completed the Owenton wastewater lagoon liner project in June 2020.

Based on the principle of gradualism, KAWC is proposing a four-step rate increase. The implementation of phased-in measure increases is consistent with prior Kentucky Public Service Commission orders. KAWC is proposing a 24.1% increase to become effective June 1, 2022, a second increase of 24.6% to become effective June 1, 2023, a third increase of 24.9% to become effective June 1, 2024, and a 25.0% increase to become effective June 1, 2025. Although these four increases will not afford KAWC with revenues that will fully recover the costs of current operating expenses and capital costs attributed to its sewer operations, the proposed increases are designed to reduce the amount of loss while providing gradual rate increases to customers.

In preparing the application, KAWC chose to only propose minor adjustments to the calendar year 2020 test period to maintain simplicity in this filing, as well as to minimize the increase. Despite increases experienced by KAWC in both expenses and depreciation, adjustments were only made to include amounts pulled out of KAWC's most recent water rate case for the allocation of management's salaries and benefits, service company, and general and workers compensation insurance expenses. The only other adjustment made was for regulatory expense related to the sewer case filing, with the estimated expense being amortized over four years. To ensure fair and proper allocation for the change in the federal tax rate from 35% to 21% in December 2017 and the pass-back of the Excess Accumulated Depreciation Income Tax ("EADIT"), KAWC included a grossed-up revenue requirement reduction of $29,150 per year to account for the EADIT pass-back to sewer customers. This adjustment accounts for the variance in the Revenue Requirement Calculation - Operating Method (ARF Form 1 - Attachment RR-OR) on the Provision for State and Federal Income Taxes line of $30,421.29 versus the calculation of the tax gross-up factor in the bottom section of $59,571.55.

In an additional effort to minimize the rate increase, KAWC chose to not adjust the 2020 revenues from sales at present rates of $716,829, as presented in KAWC's 2020 Commission report. Using the adjusted 2020 billing determinants, current revenues would be $684,919. This accounts for the $31,910 difference in current revenues in the bill analysis file and the revenue requirement file. Because of this difference, the revenue requirement file shows an increase of 130.97% and using the bill analysis revenue of $684,919, produces an increase of 141.4%.

KAWC is proposing to unify and consolidate its current five district rate design into a statewide unified and consolidated tariff pricing rate design in the final phase of the four-year rate phase-in. The four-year period provides a gradual approach that eases the impact of consolidation on customers. Consolidated tariff pricing allows for the use of a unified or single set of sewer rates for the same service rendered by a single sewer company across multiple systems regardless of the customer's location. Some of the benefits of consolidated pricing include incentives to purchase small under-performing sewer utilities, the promotion of state economic development goals, improved affordability for all customers, and lower administrative and regulatory costs.

Consolidated tariff pricing creates benefits in the long run for all customers because typically, the customers who are paying lower than average prices do so because of aged, and therefore, depreciated investment. Over time, the utility will need to invest in all regions of the system. Consolidated tariff pricing mitigates the effect of lumpy investment for all customers while promoting a standard quality of service for the entire system.

Utility customer rates are dependent on the total expenses, rate base of the utility and the volume of utility sales. Changes in rate base, particularly as the result of the Clean Water Act, have a significant potential for adversely impacting the rates for certain areas within a utility system. The ability to absorb the cost of such projects over a larger customer base is a compelling argument in support of rate consolidation. Capital programs will never be uniform in the several operating areas, even over 5 to 10 years, but over the long run all areas will need specific investment. The cost of specific programs should be shared by all customers rather than burdening those of the affected areas when investment in that area is needed. By spreading the cost of these investments over a larger base, consolidated tariff pricing stabilizes rates for all customers over time.

Simplifying rate structures also leads to lower administrative costs as utilities can more easily help consumers who have questions, lowers the cost of billing and collections, and reduces the regulatory cost of separate filings within a single rate proceeding. To keep regulatory costs and the customer increase to a minimum in this filing, KAWC has chosen not to do a cost-of-service study.

To help ensure the increases were fair and equitable for all areas and to minimize large swings, the phase-in was designed to try to keep the monthly increase around the same percentage for each area for an average residential customer. Evidence of this can be found in the average bill impact table on page three of the customer notification. Since a cost-of-service study was not completed and those customers that have a meter larger than one inch typically have a higher cost of service allocation, KAWC is proposing a higher minimum bill for those customers with a meter larger than one inch. Most of these are commercial, industrial, and other public authority customers who typically have higher usage. To help offset the increased fixed charge for these customers, the proposed rates include declining usage blocks.

Another item to note is item 15c from ARF-Form 1, which asks if the applicant has attached an amortization schedule for each outstanding evidence of indebtedness. KAWC has selected N/A as KAWC doesn't have any sinking fund debt that would require annual or semi-annual principal payments. KAWC makes only annual interest payments on outstanding bonds. All bonds are payable upon the maturity date.