

**KENTUCKY-AMERICAN WATER COMPANY**  
**CASE NO. 2022-00032**  
**COMMISSION STAFF'S SECOND REQUEST FOR INFORMATION**

---

**Witness: Tricia Sinopole**

1. The Commission has approved pipeline replacement tariff riders similar to Kentucky-American's QIP rider for the gas utilities subject to its jurisdiction that reflects a 13-month average forecasts. Cite any Pipeline Replacement Program (PRP) or similar tariff rider where the Commission has allowed the true-up to terminal values as proposed by Kentucky-American, if any.

**Response:**

The ratemaking and true-up approach KAW proposes in this proceeding is substantively and effectively *identical* to the 13-month average rate base approaches the Commission has required and routinely approves for gas utility PRP riders. The only difference between the KAW approach and that of the gas utilities is one of presentation, not a substantive difference. Therefore, *every* PRP the Commission has approved effectively provides the true-up to terminal values KAW is proposing.

To see why this is true, consider that when a gas utility files for an annual update to its PRP based on a 13-month average of forecasted mechanism rate base, the first data point in the 13-month average is necessarily a true-up to terminal values (mostly actual, partially forecasted) for the 12-month PRP rate period immediately before the forecasted 12-month period for which new PRP rates will be in effect. For example, on July 30, 2021, Atmos filed for updated PRP rates for October 2021 through September 2022.<sup>2</sup> In accordance with the Commission's previous orders on PRP rate methodology, Atmos filed for rates based on a 13-month average rate base.<sup>3</sup> The first data point Atmos used was plant in service as of September 2021: \$52,460,999.<sup>4</sup> That amount was the sum of (i) plant Atmos had placed in service in prior years and (ii) a *forecast* of plant Atmos planned to place in service through the end of September 2021. In other words, the first data point in Atmos's 13-month average for October 2021 through September 2022 *is a true-up to terminal values* for all prior periods up to and including September 2021. Again, that value was mostly historical when Atmos filed it on July 30, 2021, but it was also a partial projection.

---

<sup>2</sup> See *Electronic Application of Atmos Energy Corporation to Establish PRP Rider Rates for the Twelve Month Period Beginning October 1, 2021*, Case No. 2021-00304, Application (July 30, 2021).

<sup>3</sup> See *id.*

<sup>4</sup> See *id.* at Application PRP Model Exh. B-1, Line No. 1.

Notably, this is exactly the approach the Commission instructed Atmos to use.<sup>5</sup> It is also the approach the Commission instructed Columbia Gas to use for its PRP.<sup>6</sup> It is also substantively the approach Louisville Gas and Electric Company (“LG&E”) uses for its Gas Line Tracker (“GLT”),<sup>7</sup> though due to the timing of LGE’s annual GLT filings, its true-ups to terminal values are always fully actual rather than partially forecasted.<sup>8</sup>

Compared to gas utilities’ PRP mechanisms, all that KAW does differently is to present its QIP rider in annual buckets (i.e., QIP 1, QIP 2, and QIP 3) instead of combining all QIP elements into cumulative values across time:<sup>9</sup>

Line No.		Case No. 2021-00376	Case No. 2021-00090		
		QIP 1 July 2020 - June 2021	QIP 2 July 2021 - June 2022	QIP 3 July 2022 - June 2023	Total QIP
1	QIP Plant Additions	\$9,328,645	\$20,050,000	\$8,737,865	\$38,116,510
2	Retirements	(633,049)	(920,606)	(330,929)	(1,884,585)
3	<b>Net Change to Gross Plant</b>	<b>8,695,596</b>	<b>19,129,394</b>	<b>8,406,936</b>	<b>36,231,925</b>
4					
5	Cost of Removal	549,261	2,005,000	873,787	3,428,048
6	Retirements	633,049	920,606	330,929	1,884,585
7	Depreciation Accrual - QIP 1	(137,516)			(137,516)
8	Depreciation Accrual - QIP 2		(292,680)		(292,680)
9	Depreciation Accrual - QIP 3			(128,626)	(128,626)
10	<b>Net Change to Accum Depr</b>	<b>1,044,794</b>	<b>2,632,926</b>	<b>1,076,090</b>	<b>4,753,810</b>
11					
12	<b>Net Change to Net Plant</b>	<b>9,740,390</b>	<b>21,762,320</b>	<b>9,483,026</b>	<b>40,985,736</b>
13	Accumulated Deferred Taxes - QIP 1	(1,550,183)			(1,550,183)
14	Accumulated Deferred Taxes - QIP 2		(1,635,882)		(1,635,882)
15	Accumulated Deferred Taxes - QIP 3			(1,345,808)	(1,345,808)
16	<b>Net Change to Rate Base</b>	<b>8,190,207</b>	<b>20,126,438</b>	<b>8,137,218</b>	<b>36,453,863</b>
17	Pre-Tax Rate of Return	9.28%	9.28%	9.28%	9.28%
18	QIP Revenue on Net Change to Rate Base	760,223	1,868,156	755,305	3,383,684
19	QIP Depreciation Expense - QIP 1	137,516			137,516
20	QIP Depreciation Expense - QIP 2		292,680		292,680
21	QIP Depreciation Expense - QIP 3			128,626	128,626
22	QIP Property Taxes - QIP 1	120,869	18,819	(4,348)	135,340
23	QIP Property Taxes - QIP 2		265,899	(9,565)	256,334
24	QIP Property Taxes - QIP 3			230,888	230,888
25					
26	<b>QIP Revenue Requirement Rate Adj</b>	<b>\$1,018,608</b>	<b>\$2,445,553</b>	<b>\$1,100,906</b>	<b>\$4,565,068</b>
27					
28	Authorized Revenues 2018-0358	\$98,880,622	\$98,880,622	\$98,880,622	\$98,880,622
29	QIP Rider Charge	1.03%	2.47%	1.11%	4.61%

Precisely because KAW takes this approach to the QIP—i.e., presenting and calculating each annual bucket individually rather than cumulatively—it is necessary to true-up prior

<sup>5</sup> *Electronic Application of Atmos Energy Corporation to Establish PRP Rider Rates*, Case No. 2020-00229, Order at 1-7 and 9 (Ky. PSC Sept. 30, 2020).

<sup>6</sup> *Electronic 2021 Safety Modification and Replacement Program Filing of Columbia Gas of Kentucky, Inc.*, Case No. 2020-00327, Order at 3 (Ky. PSC Apr. 30, 2021).

<sup>7</sup> *See, e.g., Application of Louisville Gas and Electric Company for Approval of Revised Rates to Be Recovered through Its Gas Line Tracker Beginning with the First Billing Cycle for May 2019*, Case No. 2019-00043, Order (Ky. PSC May 6, 2019); Case No. 2019-00043, Application (Feb. 28, 2019).

<sup>8</sup> Each year, LG&E files at the end of February or the beginning of March for GLT rates to be effective May 1 based on 13-month average rate base for the year in which it is filing. The first data point in the 13-month average is rate base as of December of the previous year, which is an historical value when LG&E files.

<sup>9</sup> Case No. 2022-00032, Direct Testimony of Tricia Sinopole Exh. 1 (Mar. 1, 2022).

QIP period values to terminal values to ensure that the QIP accurately and timely reflects the full investment KAW has made to serve customers.

It is helpful to consider the alternative: If KAW never trued-up past QIP periods to actual values when it established new QIP rates each year, the QIP mechanism would routinely and significantly under-collect relative to what would be necessary to earn a recovery of and reasonable return on the capital deployed to serve customers. This is because the starting point for each QIP bucket's 13-month average is zero, *not the sum total of all previous QIP investment* (the latter being how PRP riders are calculated). A simplified illustration of this follows, which assumes \$100 of rate base investment spread evenly across each year and a 10% pre-tax return:

Year	PRP			QIP (w/o terminal value true-ups)		
	Cumulative Investment	Ratemaking Rate Base	Pre-Tax Return	Cumulative Investment	Ratemaking Rate Base	Pre-Tax Return
1	100	50	5	100	50	5
2	200	150	15	200	100	10
3	300	250	25	300	150	15
Total			45			30

So, for Year 2 under a PRP approach, the utility's ratemaking rate base would be \$150 (the \$100 based on a terminal value from Year 1, plus \$50 based on 13-month average for the forecasted Year 2).<sup>10</sup> Without terminal value true-ups as proposed by KAW, the QIP ratemaking rate base for Year 2 would only be \$100 (\$50 for a 13-month average rate base for Year 1 even though Year 1 would then be historic, plus \$50 based on a 13-month average for the forecasted Year 2).

This simplified example clearly shows why no utility could consistently invest capital without regularly filing base rate cases if its other cost recovery mechanisms effectively ignored roughly half of prudently invested capital. Such an approach undermines the purpose of such cost recovery mechanisms,<sup>11</sup> which is in large part to avoid the cost of more frequent base rate cases.

In short, KAW is not seeking special treatment. Rather, it has proposed a QIP approach that would allow timely recovery of and on prudently invested capital, and it is substantively *identical* to the approach the Commission requires and routinely approves for gas utility PRP riders.

<sup>10</sup> The example assumes that a 13-month average results in 50% of what rate base would be if compared to terminal values.

<sup>11</sup> See KAW's response to Item 2 of this same set of data responses.

**KENTUCKY-AMERICAN WATER COMPANY**  
**CASE NO. 2022-00032**  
**COMMISSION STAFF'S SECOND REQUEST FOR INFORMATION**

---

**Witness: Tricia Sinopole**

2. Provide Kentucky-American's position regarding the following: If Kentucky-American's QIP tariff rider reflects a 13-month average balance the terminal values should only be allowed in a general base rate case where the QIP tariff riders are rolled into base rates.

**Response:**

KAW disagrees because delaying the use of terminal values for historic periods until a base rate case: (1) violates the bedrock ratemaking principle that a utility should be allowed recovery of and return on its investments *when* they become used and useful; (2) would be contrary to the ratemaking methodology used for gas utility pipeline replacement programs under the Commission's jurisdiction;<sup>1</sup> and (3) would be contrary to the fundamental reasons the Commission approved KAW's QIP in KAW's last base rate case,<sup>2</sup> namely: (a) more gradual and smaller rate increases to customers; (b) less frequent base rate cases; and (c) more timely recovery of KAW's prudent infrastructure investments.

As Ms. Sinopole has testified,<sup>3</sup> on June 30, 2022, all of KAW's QIP Year 2 investment will be used and useful. The new QIP charge will become effective on July 1, 2022, the day *after* all QIP Year 2 investment will be used and useful. At that point in time, there is no reason to continue to calculate QIP Year 2 rate base by using a 13-month average methodology that is designed to be used exclusively when forecasting rate base.

KRS 278.192 allows rate cases to be filed using a historical test period or a forward-looking test period. If a utility chooses to use a forward-looking test period, then it must calculate rate base on a 13-month average for that forward-looking test period. That requirement is unique to forward-looking test period rate cases only.<sup>4</sup> It does not exist if a utility chooses to use a historic period for calculating rate base. This is consistent with the Commission's directive to KAW to amend its QIP tariff to require use of a 13-month average "in any **forecasted** period."<sup>5</sup> There is simply no reason to use a forecasting method to calculate rate base which will become historical on June 30, 2022.<sup>6</sup>

The seminal utility "return on equity" case of *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n*, 262 U.S. 679, 690 (1923) states, "there must be a fair return upon

---

<sup>1</sup> See KAW's response to Item 1 of this same set of data responses.

<sup>2</sup> Case No. 2018-00358.

<sup>3</sup> See Ms. Sinopole's March 1, 2022 Direct Testimony, pp. 6-9.

<sup>4</sup> See 807 KAR 5:001, Section 16(6)(c) which is the Commission's regulation pertaining to forward-looking test period base rate cases.

<sup>5</sup> Case No. 2021-00090, Ordering Paragraph 5, Order of June 21, 2021 (emphasis added).

<sup>6</sup> See KAW's April 8, 2022 response to PSC 1-6 for further discussion of this issue.

the reasonable value of the property **at the time** it is being used for the public.”<sup>7</sup> As all of QIP Year 2 rate base will be “used for the public” when the new QIP charge becomes effective on July 1, 2022, it is clear that measurement of the amount of that rate base must be based on the value of that rate base as of June 30, 2022 (the “terminal value”). Anything less than that would deprive KAW of a reasonable recovery of and return on its investment. Ultimately, that would be detrimental to KAW’s customers.

When the Commission approved KAW’s QIP in Case No. 2018-00358,<sup>8</sup> it noted the following evidence and argument KAW offered in the case:

- Under KAW’s pipe replacement rate at the time, it would take 377 years to replace all the main in the system yet the main has a useful life expectancy of 60 to 100 years;<sup>9</sup>
- QIP would have substantial benefits to customers by reducing regulatory costs, increasing rates on a more gradual basis compared to general rate cases, and providing regulatory certainty that attracts debt and capital at reasonable costs, all of which lower the rate impact on customers;<sup>10</sup>
- Other American Water subsidiaries filed less frequent rate cases after the implementation of similar infrastructure replacement mechanisms which results in savings to customers from avoided rate case expense;<sup>11</sup>
- QIP would allow American Water (KAW’s parent company) to better compete with other companies for capital and it would allow KAW to better compete with other American Water subsidiaries for discretionary investment dollars from American Water;<sup>12</sup> and
- QIP would mitigate the adverse revenue impact of regulatory lag because it will allow KAW to recover its investment costs on a more current basis than under traditional base rate case ratemaking which will help KAW compete for investment dollars.<sup>13</sup>

After noting those points and considering intervenor positions, the Commission approved the QIP as proposed and stated the following:

---

<sup>7</sup> *Bluefield*, quoting *Willcox v. Consolidated Gas Co.*, 212 U.S. 19, 41 (1902) (emphasis added).

<sup>8</sup> Case No. 2018-00358, June 21, 2019 Order, pp. 73-84.

<sup>9</sup> *Id.*, p. 74.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*, p. 75

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

- The Commission “is cognizant of the need to prudently and timely replace aging infrastructure in order to provide safe, adequate, and reliable water to customers”<sup>14</sup>;
- The case record “contains substantial evidence regarding the need for QIP”<sup>15</sup>;
- There “will be a significant increase in capital costs to replace aging infrastructure”<sup>16</sup> (thereby recognizing the increased need to compete for capital investment dollars);
- It is “reasonable to approve an alternative cost recovery based on smaller, more gradual rate increases”<sup>17</sup>; and
- Denying QIP would mean waiting until the next general rate case for recovery of infrastructure replacement “with the result that customers experience shock from large increases due to rate recovery for several years of capital investment.”<sup>18</sup>

Based on those Commission findings, it is clear that the more gradual and smaller rate increases QIP affords were critical to the Commission’s approval of QIP. And the Commission got it exactly right. Partly because of QIP, KAW has been able to avoid filing a base rate for nearly 3.5 years (its last rate case was filed in November 2018).

This data request poses the question of whether KAW should have to wait until its next base rate case to recover its prudent investments in aging infrastructure. It should not, as that would ultimately lead to more frequent base rate cases with larger rate increases (all else being equal). The Commission should adhere to the correct reasoning it applied when it approved QIP. It can do so by simply following the fundamental ratemaking tenet that full recovery of rate base should happen for plant that is used and useful. As of June 30, 2022, QIP Year 2 investment will be used and useful.

As explained in the March 1, 2022 Citron/Porter testimony filed in this case,<sup>19</sup> since QIP was approved in June 2019, the Commission has greatly reduced the asset classes eligible for QIP compared to what the Commission approved in the 2018 rate case.<sup>20</sup> Any further diminishment of QIP by disallowing recovery of historical, used, and useful rate base by forcing a misapplication of a forecasting calculation mechanism to historical rate base will harm KAW’s ability to compete for capital and result in more frequent base rate cases. Ultimately, the Commission approved QIP because of its benefits to customers. The

---

<sup>14</sup> Id., p. 80.

<sup>15</sup> Id. p. 81.

<sup>16</sup> Id.

<sup>17</sup> Id.

<sup>18</sup> Id.

<sup>19</sup> Citron/Porter March 1, 2022 Direct Testimony, pp. 2-4.

<sup>20</sup> See Case No. 2020-00027, June 17, 2020 Order, p. 16 and Case No. 2021-00090, June 21, 2021 Order, p. 12.

Commission should decline to jeopardize those benefits by disallowing timely and reasonable rate recovery of prudent QIP investments.