COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF WATER SERVICE CORPORATION OF KENTUCKY FOR A GENERAL ADJUSTMENT IN EXISTING RATES AND A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY TO DEPLOY ADVANCED METERING INFRASTRUCTURE	)))))	CASE NO. 2022-00147

THE ATTORNEY GENERAL AND THE CITY OF CLINTON'S POST-HEARING BRIEF

The Intervenors, the Attorney General of the Commonwealth of Kentucky, through his Office of Rate Intervention ("Attorney General") and the city of Clinton ("Clinton"), by counsel, submit the following Post-Hearing Brief to the Kentucky Public Service Commission ("Commission") in the above-styled matter.

STATEMENT OF THE CASE

Water Service Corporation of Kentucky ("Water Service Kentucky" or the "Company") is a Kentucky corporation, and wholly-owned subsidiary of Corix Regulated Utilities (US), Inc. ("Corix Regulated Utilities"), which is based in Chicago, Illinois.[1] Corix Regulated Utilities was previously known as Utilities, Inc.[2] Water Service Kentucky provides water service to approximately 572 customers in Clinton and 5,526 customers in the city of Middlesboro, in Hickman and Bell counties, respectively.[3] Water Service Kentucky does not have any employees,

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[1] Application at 1; Direct Testimony of Patrick Baryenbruch ("Baryenbruch Testimony"), Exhibit PLB-2 at 3.
[2] Direct Testimony of Shawn Elicegui ("Elicegui Testimony"), at 2.
[3] Water Service Kentucky's response to the Attorney General's Second Request for Information ("Attorney General's Second Request"), Items 9(a) and (b).

and depends on the affiliate company Water Service Corporation to provide the services that the Company needs to serve its customers.[4] The Company asserts that Water Service Corporation provides specific services such as accounting, engineering, finance, legal, billing, etc.[5] The thirteen employees based in Kentucky who exclusively provide services to Water Service Kentucky's customers are employees of Water Service Corporation, as are the six regional employees located outside of Kentucky who provide support services to the Company.[6]

On May 19, 2022, Water Service Kentucky filed its notice of intent to file an application for an adjustment of rates with the Commission. The Company subsequently filed its application on May 31, 2022, utilizing a forward-looking test period ("Forecast Period") beginning on January 1, 2023, and ending December 31, 2022.[7] The Company's base period ("Base Period") began on October 1, 2021, and ended on September 30, 2022.[8] Specifically, the application requests an increase in revenues totaling $1,047,688 per year, or a 32.12% increase.[9] Water Service Kentucky is also requesting to increase the residential monthly customer charge from $13.27 to $17.53,[10] or a 32.10% increase. The Company further requests a Certificate of Public Convenience and Necessity ("CPCN") to deploy Advanced Metering Infrastructure ("AMI") within its system.[11]

The Commission issued a deficiency letter on June 8, 2022, to which the Company filed a response on June 13, 2022. The Commission found that the application met the minimum filing requirements and it was deemed filed on June 13, 2022. The Attorney General was granted

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[4] Elicegui Testimony at 5. The two companies have a 2007 Affiliate Interest Agreement ("AIA") that obligates Water Service Corporation to furnish all the services that Water Service Kentucky needs to provide water service to its customers.[4]
[5] *Id*. at 6.
[6] *Id*. at 5.
[7] Application at 2.
[8] *Id*.
[9] *Id*. at 3.
[10] *Id*., Exhibits 3 and 7.
[11] Application at 14 - 15.

intervention on June 14, 2022, and Clinton was granted intervention on August 5, 2022. Following the Commission's issuance of a procedural schedule, the Commission Staff, Attorney General, and Clinton issued several rounds of discovery requests, to which Water Service Kentucky filed responses into the record. On October 12, 2022, Clinton filed the direct testimony of its witness Ms. Shannon Payne into the record. On October 13, 2022, the Attorney General/Clinton filed direct testimony into the record of their witnesses, Messrs. Randy A. Futral and Richard A. Baudino, and responded to Water Service Kentucky's discovery request on November 9, 2022. The Company filed a Base Period update on October 31, 2022, and filed rebuttal testimony on November 23, 2022. An evidentiary hearing was conducted on November 30, 2022. Water Service Kentucky filed responses to post-hearing discovery requests on December 9, 2022.

ARGUMENT

Pursuant to KRS 278.190(3), Water Service Kentucky bears the burden of proof to demonstrate "that an increase of rate or charge is just and reasonable."[12] Water Service Kentucky has failed to meet its burden of proof to demonstrate that the requested revenue increase will result in fair, just, and reasonable rates.[13] The Attorney General/Clinton recommend a downward adjustment to the requested $1,047,688 revenue increase because if the Company's application were accepted as is, then it would result in unjust, unfair, and unreasonable rates due to the following issues.

I. THE COMPANY'S PROPOSAL TO INCREASE ITS RESIDENTIAL MONTHLY CUSTOMER CHARGE BY 32.10% IS UNREASONABLE.

As previously discussed, with respect to the residential class, Water Service Kentucky

[12] *Kentucky-American Water Company v. Commonwealth ex rel. Cowan*, 847 S.W.2d 737,741 (Ky. 1993).
[13] See KRS 278.190. "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…."

proposes to increase its monthly customer charge from \$13.27 to \$17.53,[14] which equates to a 32.10% increase. Barely two years ago, on December 8, 2020, Water Service Kentucky received a rate increase and an increase of the residential monthly customer charge from \$11.45 to \$13.27.[15] Prior to that increase, the Company also received a rate increase and an increase of the residential monthly customer charge from \$10.00 to \$11.45 on February 11, 2019.[16] If the Commission grants the Company's pending request to increase the residential monthly customer charge to \$17.53, it will equate to a 75.3% total increase of the monthly customer charge for residential customers in *less than four years.*

An increase of this magnitude to the residential monthly customer charge will hinder residential customers' ability to control their monthly bills, will act as a disincentive to the conservation of water, and will pose a financial hardship on those customers who are already struggling to make ends meet. This proposed increase in the residential monthly customer charge will hurt Water Service Kentucky's customers who live in poverty especially. Specifically, 29.8%[17] of the Company's customers who live in Bell County, and 20.9%[18] of the customers in Hickman County live at or below the poverty line.

The Commission has always relied upon the principle of gradualism in ratemaking, which mitigates the financial impact of rate increases on customers.[19] Thus, the Attorney General/Clinton

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[14] Application, Exhibits 3 and 7.

[15] Case No. 2020-00160, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates* (Ky. PSC Dec. 8, 2020), Order at 35.

[16] Case No. 2018-00208, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates* (Ky. PSC Feb. 11, 2019), Order at 23.

[17] https://www.census.gov/quickfacts/fact/table/bellcountykentucky/PST045221.

[18] https://www.census.gov/quickfacts/fact/table/hickmancountykentucky/PST045221.

[19] Case No. 2014-00396, *In the Matter of Application of Kentucky Power Company for: (I) A General Adjustment of its Rates for Electric Service; (2) An Order Approving its 2014 Environmental Compliance Plan; (2) An Order Approving its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief, Order* (Ky. PSC June 22, 2014) ("the Commission has long employed the principle of gradualism"); *See also* Case No. 2000-00080, *In the Matter of: The Application of Louisville Gas & Electric Company to Adjust its Gas Rates and to Increase its Charges for Disconnecting Service, Reconnecting Service and Returned Checks*, (Ky. PSC Sept. 27, 2000) ("the

respectfully request that, to the extent rate increases are required, the Commission allocate the potential rate increase to the volumetric charge as opposed to the residential monthly customer.

In the alternative, if the Commission were to approve Water Service Kentucky's requested increase to the residential monthly customer charge, then the Attorney General/Clinton recommend a two-phased approach for any increase. For example, if the Commission were inclined to raise the residential monthly customer charge from $13.27 to $17.53, then the first phase would allow for the customer service charge to increase to $15.40 in the first year, and then under the second phase the customer charge would increase to $17.53 in the second year. This would at least provide an opportunity for Water Service Kentucky's customers to absorb the higher monthly customer charge over the course of a longer period of time, rather than immediately be forced to pay a 32.10% increase. The Attorney General/Clinton respectfully request any increase in the residential monthly charge to be more gradual than Water Service Kentucky's one-time proposed 32.10% increase.

II. THE COMPANY'S AGREEMENT TO SPECIFIC ADJUSTMENTS PROPOSED BY THE ATTORNEY GENERAL/CLINTON WITH THE CORRESPONDING REVENUE REDUCTION AMOUNTS.

In Water Service Kentucky's rebuttal testimony and at the public hearing, the Company agreed with many of the adjustments proposed by the Attorney General/Clinton, which reduces the Company's requested rate increase and proposed revenue requirement by approximately $163,312. The agreed upon adjustments are as follows:

1. Remove Project Phoenix computer asset costs,[20] which is a downward adjustment of $33,068 to the proposed revenue requirement after the gross-up for the Commission

Commission is adhering to the rate-making concepts of continuity and gradualism in order to lessen the impact of these increases on the customers that incur these charges.")

[20] Rebuttal Testimony of Dante DeStefano ("DeStefano Rebuttal"), at 3.

assessment fees and bad debt expense.[21]

2. Remove the regulatory asset for Oracle Fusion implementation costs,[22] which is a $9,122 downward adjustment to the proposed revenue requirement after the gross-up for Commission assessment fees and bad debt expense.[23]

3. Remove the allocated share of reserve for Chicago office rent,[24] which is a $7,063 downward adjustment to the proposed revenue requirement.[25]

4. Reduce the forecast new vehicle costs based on actual costs, net of accumulated deferred income tax ("ADIT"),[26] which is a $4,794 downward adjustment to the proposed revenue requirement after the gross-up for Commission assessment fees and bad debt expense.[27]

5. Reduce the 401(k) match amounts corresponding to historic employee participation,[28] which is a $16,496 downward adjustment to the proposed revenue requirement after the gross-up for Commission assessment fees and bad debt expense.[29]

6. Remove expenses related to termination of the Clinton wastewater contract,[30] which is a $12,038 downward adjustment to the proposed revenue requirement after the gross-up for Commission assessment fees and bad debt expense.[31]

7. Reduce depreciation expense related to the error in calculation,[32] which is a $53,027

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[21] Direct Testimony of Randy A. Futral ("Futral Testimony"), at 18.
[22] DeStefano Rebuttal at 8.
[23] Futral Testimony at 25.
[24] DeStefano Rebuttal at 8.
[25] Futral Testimony at 26.
[26] DeStefano Rebuttal at 8.
[27] Futral Testimony at 29.
[28] Rebuttal Testimony of James Kilbane ("Kilbane Rebuttal"), at 3.
[29] Futral Testimony at 47.
[30] Kilbane Rebuttal, at 5.
[31] Futral Testimony, at 58.
[32] Kilbane Rebuttal at 6.

downward adjustment to the proposed revenue requirement after the gross-up for Commission assessment fees and bad debt expense.[33]

8. Reduce fuel expense to reflect the most current average price per gallon,[34] which is a $5,239 reduction in expense and a $5,464 reduction in the claimed base revenue requirement and base rate increase, after gross-up for Commission assessment fees and bad debt expense.
9. Removal of the allocated costs associated with the vacant Director of Engineering and Asset Management position,[35] which is a reduction of $18,810 in salary/wage expense, $1,467 in payroll tax expense, and 1,045 health insurance expense. The sum of these amounts grossed up for Commission assessment fees and bad debt expense results in a $22,240 reduction from the proposed revenue requirement.[36]

III. RATE BASE ISSUES

a. The Commission should deny Water Service Kentucky's request for a CPCN to deploy AMI because the Company failed to meet the burden of proof pursuant to KRS 278.020(1).

Water Service Kentucky proposes to deploy AMI to one-third of its water system every two years, and to complete the project over a five-year period.[37] The proposed AMI system would include Neptune AMI meters, Gateway data collectors, an MRX920 mobile data collector, and retrofitting materials.[38] The Company anticipates that the total capital costs of the AMI project

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[33] Futral Testimony at 63.
[34] Video Transcript of Evidence ("VTE") at 2:41:15 – 2:41:30 and 2:45:25 - 2:45:43. Mr. Kilbane stated in response to the Attorney General's cross-examination questions that he agreed with Mr. Futral's testimony in that the most current price of gas at local gas stations utilized by Water Service Kentucky is the most accurate and should be used to determine the Company's forecasted fuel expense; Water Service Kentucky's response to the Attorney General's Post-Hearing Request for Information ("Attorney General's Post-Hearing Request"), at 2, Excel AG_PHDR_1-2_cost (1).
[35] Kilbane Rebuttal at 4 and 10; VTE at 2:59:15 – 3:00:12.
[36] *Id*.
[37] Application at 14 – 15.
[38] Direct Testimony of Colby Wilson ("Wilson Testimony") at 11 – 12.

will be $1,696,462 and that deployment will begin in January 2023.[39] Water Service Kentucky projects that it will invest $504,458 in 2023, $589,504 in 2025, and $602,500 in 2027 to deploy the AMI, and the annualized revenue requirement will be $68,199 in 2023, $66,199 in 2024, $134,159 in 2025, $129,820 in 2026, and $196,985 in 2027.[40] The Company also projects operating costs of $7,975 per year for the AMI infrastructure annual training and subscriptions required to utilize the AMI equipment.[41]

The Commission should deny Water Service Kentucky's request for a CPCN to deploy AMI in its water system because the Company failed to meet the burden of proof as required by KRS 278.020(1). In order to obtain a CPCN a utility must demonstrate a need for such facilities and an absence of wasteful duplication.[42] The "need" requires a showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed or operated.[43] Water Service Kentucky argues that an AMI system is beneficial because it would allow the Company to gather real-time consumption data, provide technological benefits to its customers, and eliminate the need to send field technicians for manual meter reads.[44] However, absolutely none of these alleged benefits demonstrate that there is an inadequacy of existing service, let alone the required substantial inadequacy of existing service. There is also *no* evidence in the record to indicate the current meters are not providing reliable service to the customers.[45] Moreover, as of June 30, 2022, there is still a remaining net book value of $251,420 for the Company's existing

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[39] Application at 14 – 15.
[40] Application, Exhibit 41; Direct Testimony of James Kilbane ("Kilbane Testimony"), at 27.
[41] Water Service Kentucky's response to the Attorney General's First Request for Information ("Attorney General's First Request"), Item 100(a) and (b).
[42] *Kentucky Utilities Co. v. Public Service Com'n*, 252 S.W.2d 885 (Ky. 1952).
[43] *Id*. at 890.
[44] Wilson Testimony at 10 – 11.
[45] Water Service Kentucky's response to the Commission Staff's Post-Hearing Request for Information ("Commission Staff's Post-Hearing Request"), at 16.

meters.[46] If the AMI project is approved then customers will not only be forced to pay for the new AMI meters, but will also still be paying for the existing meters through rates as well.[47] Additionally, there are barely more than 6,000 customers to pay for the approximately $1.7 million dollar AMI project. This should not be considered a consumer market large enough to make the AMI project economically feasible. To add insult to injury, Water Service Kentucky did not include any potential ongoing savings attributable to the proposed AMI project in the proposed revenue requirement in the pending case.[48] In other words, the Company is requesting to foist a multi-million dollar AMI project on 6,098 customers, who reside in poverty stricken areas of Kentucky, and include no ongoing economic savings from the project in the rates. Thus, the Company has failed to satisfy the "need" component of KRS 278.020(1).

"Wasteful duplication" is defined as "an excess of capacity over need" and "an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties."[49] The Commission has also held that in order to demonstrate a proposed facility does not result in wasteful duplication, the utility must demonstrate that a thorough review of all reasonable alternatives has been performed.[50] The Company has not provided any documentary evidence that it reviewed any reasonable alternatives, such as conducting a cost-benefit analysis

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[46] Water Service Kentucky's response to Commission Staff's Second Request ("Commission Staff's Second Request"), Item 19(i); Clinton's witness Ms. Payne states on page 7 of her direct testimony that Clinton paid for the meters currently being utilized by Water Service Kentucky in that service territory, and if the meters are replaced then Clinton should be appropriately compensated.

[47] Water Service Kentucky's response to Commission Staff's Second Request, Item 19(i).

[48] VTE 4:20:30 – 4:22:20; Water Service Kentucky's response to the Commission Staff's Second Request, at 19(b) and (c); DeStefano Rebuttal at 15 – 16; The Company did revise its forecasted test period in response to the Attorney General's Second Request, Item 55, and included an assumption that it would be fully staffed for the first time in several years, which increased salaries and wages expense overall, but due to the capitalization of labor associated with the proposed AMI project it would slightly reduce the salaries and wages expense in the first year of deployment.

[49] *Kentucky Utilities Co. v. Public Service Com'n*, 252 S.W.2d 885, 890 (Ky. 1952).

[50] Case No. 2005-00142, *Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for the Construction of a 138 kV Electric Transmission Line in Rowan County, Kentucky* (Ky. PSC Sept. 8, 2005), Order at 11; Case No. 2018-00005, *Electronic Joint Application of Louisville and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for Full Deployment of Advanced Metering Systems* (Ky. PSC Aug. 30, 2018), Order at 7.

of manual read meters or Automated Meter Reading ("AMR") meters as opposed to the proposed AMI system.[51] Further, in response to a Commission Staff discovery question, Water Service Kentucky performed an after-the-fact and deeply flawed cost-benefit analysis of the proposed AMI system.[52] The report was drafted months after the initial application had been filed. Therefore, it is clear that Water Service Kentucky did not rely on the economic analysis to justify its decision to implement the AMI project;[53] instead, it manufactured that analysis to defend its decision that had already been made. In rebuttal testimony, the Company confirmed that it did not update its proposed revenue requirement based on the alleged revenue increases and cost savings benefits espoused in the after-the-fact study and stated that "…the Company generally agrees with Mr. Futral that the AMI implementation may not generate changes such as increased revenues or decreased meter reading costs…"[54] Thus, the Company also failed to satisfy the "wasteful duplication" component of KRS 278.020(1).

Based upon the foregoing, the Attorney General/Clinton respectfully request that the Commission deny Water Service Kentucky's request for a CPCN to implement AMI in its water system, which would be a reduction of $43,813 in the revenue requirement.[55] In the alternative, if the Commission were to grant the Company's request for a CPCN to implement AMI, the Attorney General/Clinton request any and all potential cost savings and/or revenue increases to be included in the rates.

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[51] VTE at 6:26:00 – 6:31:03.
[52] Water Service Kentucky's response to the Commission Staff's Second Request, at 19(a); Water Service Kentucky's response to the Commission Staff's Third Request for Information ("Commission Staff's Third Request"), at 6; Futral Testimony at 11 – 15.
[53] DeStefano Rebuttal at 15.
[54] *Id*.
[55] Futral Testimony at 17.

b. J.D. Edwards and Oracle customer care and billing system computer asset costs should be removed from the Company's proposed revenue requirement.

Water Service Kentucky requests to include expenses associated with Project Phoenix, which includes JD Edwards financial software system ("JD Edwards") and the Oracle customer care and billing system ("Oracle"), in the pending rate case.[56] The Commission has repeatedly denied recovery of expenses associated with Project Phoenix costs, including JD Edwards and Oracle costs, in prior rate cases due to Water Service Kentucky failing to demonstrate that the costs associated with the software systems were reasonable or benefitted its ratepayers.[57] Yet, in the pending case, Water Service Kentucky argues that the Commission's prior disallowances were only applicable to the implementation costs of JD Edwards and Oracle, and not to the enhancement costs of these programs.[58] Water Service Kentucky further states that enhancement costs associated with JD Edwards and Oracle have been recovered in at least the last three rate cases, and "have not been contested by the OAG, any other intervening party, nor removed from the requested revenue requirement in the PSC's final order on the basis of correlation to Project Phoenix."[59] The Company then appears to insinuate in rebuttal testimony that it "explicitly" requested these enhancement costs in the 2020 rate case because the costs could be found in a discovery response excel spreadsheet, "wherein on tab 'wp-1-computers' the rows can be expanded to see all fixed assets…."[60]

These assertions made by the Company are simply inaccurate. The Attorney General has

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[56] Water Service Kentucky's response to the Attorney General's Second Request, Item 29.
[57] Case No. 2008-00563, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC Nov. 9, 2009), Order at 3 – 6; Case No. 2010-00476, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC Nov. 23, 2011), Order at 12 – 13; Case No. 2013-00237, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC July 24, 2014), Order at 18 – 22; Case No. 2020-00160, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates* (Ky. PSC Dec. 8, 2020), Order at 3 – 4 and 22 – 23.
[58] Water Service Kentucky's response to the Attorney General's Second Request, Item 29.
[59] *Id.*; DeStefano Rebuttal at 3.
[60] DeStefano Rebuttal at 4.

consistently objected to the inclusion of Project Phoenix costs in the rates, which includes the JD Edwards and Oracle costs, since these costs were initially proposed in the 2008 rate case.[61] In regard to the most recent 2020 rate case, the Attorney General specifically requested that *all costs* related to Project Phoenix be removed from Water Service Kentucky's revenue requirement due to the Company's continued inability to demonstrate that the software systems benefitted its ratepayers.[62]

Therefore, the Attorney General/Clinton request the Commission to continue to deny all Project Phoenix costs, which includes JD Edwards and Oracle costs, whether the costs are considered implementation costs, enhancement costs, or otherwise. The effect of this recommendation would be a reduction of $4,543 in the requested rate increase.[63]

c. The Company's regulatory asset for deferred rate case expenses should be removed from the Company's proposed revenue requirement.

Water Service Kentucky included $404,475 in deferred rate case expense in rate base in the pending case, with $382,764 relating to the instant case, and $21,711 relating to the remaining unamortized deferred balance associated with Case No. 2020-00160.[64] The Company also included an ADIT offset of $29,093 as a subtraction to rate base related to the unamortized rate case costs from Case No. 2020-00160, but failed to reflect an ADIT offset for the deferred rate case costs included for the pending case.[65]

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[61] Case No. 2008-00563, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC Nov. 9, 2009), Order at 3 – 6; Case No. 2010-00476, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC Nov. 23, 2011), Order at 12 – 13; Case No. 2013-00237, *Application of Water Service Corporation of Kentucky for an Adjustment of Rates* (Ky. PSC July 24, 2014), Order at 18 – 22; Case No. 2020-00160, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates* (Ky. PSC Dec. 8, 2020), Order at 3 – 4 and 22 – 23.
[62] Case No. 2020-00160, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates* (Ky. PSC Dec. 8, 2020), Order at 3 – 4 and 22 – 23.
[63] Futral Testimony at 18.
[64] *Id*. at 21.
[65] *Id*.

The Commission should not allow the regulatory asset for deferred rate case expense in rate base because these expenses were and will be incurred to benefit Water Service Kentucky's ultimate parent company and its shareholders, and not to benefit the customers.[66] Moreover, the revenue requirement cost of the regulatory asset declines each year as it is amortized and as the net rate base amount declines, but customers never benefit from this annual cost reduction until base rates are reset in the future.[67] Water Service Kentucky retains the savings from the declining costs and the Company's customers do not benefit from these reductions because the base revenue recovery is never trued-up.[68]

In prior cases, the Commission has rejected utilities' requests to include a regulatory asset for deferred rate case expenses in rate base.[69] In the most recent final Order addressing this issue the Commission stated, "[t]he Commission agrees that rate case expense regulatory assets should not be included in rate base, as that would allow a return on the unamortized balance of the expense. The Commission has historically excluded this item from rate base to share the cost of rate proceedings between the stockholders and ratepayers…."[70] In its rebuttal testimony, the Company could not provide any specific Commission precedent that supports its position to include rate case expense regulatory assets in rate base.[71] Instead, Water Service Kentucky cited two inapplicable Kentucky cases concerning rate base treatment for materials, supplies and

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[66] *Id*.
[67] *Id*. at 22.
[68] *Id*.
[69] Case No. 2019-00271, *Electronic Application of Duke Energy Kentucky, Inc. for 1) An Adjustment of the Electric Rates; 2) Approval of New Tariffs; 3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and 4) All Other Required Approvals and Relief* (Ky. PSC Apr. 27, 2020), Order at 7 – 8; Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates*, (Ky. PSC May 19, 2022), Order at 17 – 18.
[70] Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates*, (Ky. PSC May 19, 2022), Order at 17 – 18.
[71] VTE at 4:25:00 – 4:26:00.

deferred maintenance, and prepayments.[72]

The Attorney General/Clinton respectfully request the Commission to follow precedent, and deny the Company's request to include the regulatory asset for deferred rate case expenses in rate base. The Attorney General/Clinton recommends the Commission allocate the return on the regulatory asset for the deferred rate case expenses to Water Service Kentucky's parent company and its shareholders, but allocate the amortization expense to the Company's customers.[73] This recommendation is necessary to ensure the costs are equitably shared between the Company's shareholders and customers, and to ensure that the Company does not obtain excessive recovery of these costs as the regulatory asset is amortized and the underlying cost curve declines ultimately to $0, without adjustment to the base revenues to reflect the declines in cost.[74] Over a three-year amortization period, this will result in approximately 13% of the total revenue requirement related to rate case expenses in the pending case to be allocated to the Company's parent company and 87% to be allocated to the customers.[75]

d. The Company's asset ADIT associated with bad debt reserve should be removed from the proposed revenue requirement.

Water Service Kentucky includes two asset ADIT balances related to its bad debt reserve in the forecasted test year rate base.[76] Even though the Company adds the bad debt reserve asset ADIT to rate base, it does not subtract the related temporary difference (the liability bad debt reserve balance) from rate base.[77] The bad debt reserve liability is the same as the temporary difference between book and tax deduction timing that results in the ADIT, with the balance

[72] DeStefano Rebuttal at 7.
[73] Futral Testimony at 22 – 23.
[74] *Id*. at 23.
[75] *Id*.
[76] Water Service Kentucky's response to the Attorney General's First Request, Item 70; Water Service Kentucky's response to the Attorney General's Second Request, Item 44. The Deferred Federal Tax-Bad Debt is $66,133, Deferred State Tax-Bad Debt is $18,084, for a Total Bad Debt Reserve Asset ADIT of $84,217.
[77] Futral Testimony at 29.

representing the difference between the cumulative amounts of bad debt expense recorded each month and the actual accounts receivable balances written off.[78] The tax deduction for bad debt expense is only allowed when the actual accounts receivable is written off.[79]

Moreover, the Company's addition of these asset ADIT amounts to rate base create a mismatch between the temporary difference and the related ADIT, which is extremely problematic because it fails to reflect the economic substance of the bad debt reserve liability.[80] This approach assumes that Water Service Kentucky has prepaid income taxes on the bad debt reserve liability, or temporary difference, and incurs financing costs on the ADIT amounts, but incorrectly assumes that the bad debt reserve liability does not result in savings in financing costs.[81]

In rebuttal testimony, Water Service Kentucky agrees that the Company has prepaid income taxes associated with the bad debt reserve liability, but disagrees that the build-up of the bad debt reserve liability itself represents a savings in financing costs.[82] The Company states that there is no source of funds related to the journal entry that records bad debt expense and at the same time adjusts the level of the bad debt reserve liability on the balance sheet.[83] The recording of the journal entry itself does not represent a source of funds tied to the level of the bad debt reserve liability, but it is important to note that the revenue requirement is not based on the level of accounts receivable amounts that are actually written off. Instead, it is based on the level of bad debt expense that is recorded each month to adjust the bad debt reserve liability to a level that approximates the Company's potential write-offs in future month. The ratepayers are

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[78] *Id*.
[79] *Id*.
[80] *Id*. at 30.
[81] *Id*.
[82] DeStefano Rebuttal at 8 – 9.
[83] *Id*.

therefore currently paying in rates for the expected write-offs in the future. This surplus in ratepayer-provided funds represents an additional capital source of funds and is available to at least pay for the prepayment in income taxes. In rebuttal testimony, the Company cites to a 2015 Commonwealth Edison of Illinois ("ComEd") case, which allegedly supports its position.[84] However, based upon the below excerpt there is one major difference in that case that does more to refute the Company's argument than to support it.

> The Commission rejects the C/I argument that ComEd will recover the cost of its tax prepayment through its uncollectibles recovery rider. ComEd's uncollectibles expense rider only recovers the cost of ComEd's uncollectibles that are actually written off. The additional cost the Company incurs in connection with the prepaid tax, which is measured by the ADIT on bad debt – is not recovered through that rider. The fact that this additional and real cost is not recovered through the uncollectibles rider confirms the need, and the justness, of including that ADIT balance in rate base.[85]

This above excerpt explains that ComEd recovers the cost of its bad debt expense through a separate uncollectibles recovery rider, and it only recovers costs based on the level of uncollectibles that are actually written off. Thus, recovery from ratepayers in that case does not provide a source of funds to at least pay the prepaid income taxes. That is not the situation in the pending case because ratepayers are essentially prefunding the payment of any prepaid income taxes.

Thus, the Attorney General/Clinton recommend the Commission reject the asset ADIT addition to rate base unless it properly reflects the related temporary difference as a subtraction from rate base.[86] These items are interrelated and inseparable and must be matched to properly

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[84]*Id*. at 9, citing to Case No. 15-0287, Commonwealth Edison Company, Annual formula rate update and revenue requirement reconciliation under Section 16-108.5 of the Public Utilities Act. (Ill. Commerce Comm'n Dec. 9, 2015), Order at 23 – 25.
[85]Case No. 15-0287, *Commonwealth Edison Company, Annual formula rate update and revenue requirement reconciliation under Section 16-108.5 of the Public Utilities Act.* (Ill. Commerce Comm'n Dec. 9, 2015), Order at 24.
[86] Futral Testimony at 30.

reflect the Company's costs.[87] The effect of this recommendation is a reduction to rate base of $84,217, and a reduction in the base revenue requirement of $8,249.[88] In the alternative, the Commission could allow the asset ADIT additions to rate base and subtract the related temporary difference from rate base. This would reflect more accurately the avoided financing costs for this liability.[89]

e. Cash working capital is overstated and should be reduced to $0 in the absence of a properly performed lead/lag study.

Water Service Kentucky includes a cash working capital ("CWC") allowance of $344,701 based on the one-eighth operations and maintenance ("O&M") expense methodology.[90] Although the one-eighth O&M expense methodology is simple, it is also outdated and inaccurate.[91] This methodology does not measure the timing of cash receipts or disbursements for revenues and expenses, nor does it reflect the leads and lags in the Company's operating cash flows.[92] However, the lead-lag study approach does measure these leads and lags and accurately determines the average investment by either the Company's customers or its investors.[93] The Company did not file a lead-lag study with its application in the pending case, and refused to provide the same when asked to do so in discovery.[94]

The Commission has consistently found that a lead-lag study is the most accurate way to determine the amount of CWC in rate base.[95] In fact, in the final Order in Case No. 2021-00183,

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[87] *Id*.
[88] *Id*.
[89] *Id*.
[90] *Id*. at 31.
[91] *Id*.
[92] *Id*.
[93] *Id*.
[94] Water Service Kentucky's response to the Attorney General's First Request, Item 63.
[95] Case No. 2021-00190, *Electronic Application of Duke Energy Kentucky Inc. for 1) An Adjustment of the Natural Gas Rates; 2) Approval of New Tariffs, and 3) All Other Required Approvals, Waivers, and Relief* (Ky. PSC Dec. 28, 2021), Order at 15; Case No. 2021-00183, *Electronic Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates; Approval of Depreciation Study; approval of Tariff Revisions; Issuance of a Certificate of Public*

the Commission stated that "[t]he Commission places Columbia Kentucky *and all other utilities on notice* that in any future rate cases, a lead/lag study is to be performed and shall exclude noncash items and balance sheet adjustments."[96] In rebuttal testimony, Water Service Kentucky asserts that it "believes it is an exception to the broad statement the Commission issued" due to its size and sophistication.[97] The Commission's directive to utilities to perform a lead-lag study appears to be both broad and all-encompassing. The Commission specifically stated that all utilities were on notice to utilize a lead-lag study in future rate cases - not just large, sophisticated utilities. Also, even though Water Service Kentucky is a small company, as previously mentioned, it is wholly-owned by a much larger and sophisticated corporation,[98] so the Company's argument that it should be an exception to the rule falls flat.

Due to Water Service Kentucky's failure to comply with the Commission's explicit instructions to perform a lead-lag study, the Attorney General/Clinton recommend that the Commission set the Company's CWC to $0.[99] The Attorney General/Clinton further request that the Commission direct Water Service Kentucky to perform a lead-lag study, excluding noncash items and balance sheet adjustments, in all future rate cases.[100]

Convenience and Necessity; and Other Relief (Ky. PSC Dec. 28, 2021), Order at 14; Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for An Adjustment of Rates*, (Ky. PSC May 19, 2022), Order at 20.

[96] Case No. 2021-00183, *Electronic Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates; Approval of Depreciation Study; approval of Tariff Revisions; Issuance of a Certificate of Public Convenience and Necessity; and Other Relief* (Ky. PSC Dec. 28, 2021), Order at 14. (emphasis added).

[97] DeStefano Rebuttal at 11.

[98] Application at 1; Baryenbruch Testimony, Exhibit PLB-2 at 3.

[99] Futral Testimony at 34.

[100] *Id*.

IV. OPERATING INCOME ISSUES

a. The Company's projected increase in payroll expense and related payroll taxes should be reduced.

Water Service Kentucky includes $936,694 in annualized forecasted test year expense for salaries and wages, which represents an 8.8% increase over the annualized base year amount.[101] The Company states that much of this increase relates to market pay adjustments it plans to implement in 2023, with the average wage increase for non-salaried employees to be 11.2%.[102] Water Service Kentucky hired ScottMadden, Inc. to conduct a wage and benefit study, which concluded that the Company's wages and benefits are competitive and comparable to local, state, and regional averages.[103] But, ScottMadden, Inc. filed a revised wage and benefit study in supplemental testimony, which found that even though Water Service Kentucky's 2022 base pay was 8% below market midpoint, the Company's 2022 total compensation package, including salary as well as health and retirement benefits costs, was actually 8% above the market midpoint.[104]

The Attorney General/Clinton requested for the Company's 2023 total compensation package to be compared to the market midpoint, but the Company advised that "there is not a reliable or informative method of aging the health and retirement benefits data analogous with the method used for the Company's base compensation for 2023."[105] However, it is quite apparent even without the requested comparison, that if the Company's 2022 total compensation was 8% above market midpoint, and the Company provides the large, planned wage increase in 2023, then the Company's 2023 total compensation package will most likely be more than 8% above the

[101] Application, Exhibit 32, line 6.
[102] Water Service Kentucky's response to the Attorney General's First Request, Item 3(n).
[103] Direct Testimony of Quentin Watkins ("Watkins Testimony") at 5.
[104] Supplemental Direct Testimony of Quentin M. Watkins ("Watkins Supplemental Testimony"), at 3 – 4.
[105] Water Service Kentucky's response to the Attorney General's Post-Hearing Request at 1.

market midpoint. This would result in an unreasonably high overall total compensation for the Company's employees.

Therefore, the Attorney General/Clinton recommend that the Commission review Water Service Kentucky's compensation and benefit plan and only allow what is reasonable. If the Commission accepts Mr. Futral's recommendation to limit the projected test year wage increases to an average of only 3% to be consistent with the Company's normal merit raise percentage increases, this would amount to a reduction in payroll expense of $49,716, and a reduction of payroll tax expense in the amount of $3,803.[106] The effect of this recommendation amounts to a reduction of $55,823 in the base revenue requirement, after gross-up for Commission assessment fees and bad debt expense.[107]

b. The Company's incentive compensation tied to financial performance should be removed from the proposed revenue requirement.

Even though Water Service Kentucky removed the vast majority of costs associated with the Company's incentive compensation plans from the proposed revenue requirement, the Company includes incentive compensation costs for the Senior Vice President.[108] The Commission has long-standing precedent, including in Water Service Kentucky's 2020 rate case, of disallowing recovery of the cost of employee incentive compensation plans that are tied to financial performance measures because such plans benefit shareholders while ratepayers receive little to no benefit.[109]

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[106] Futral Testimony at 44 – 43.
[107] *Id*. at 43.
[108] *Id*. at 43.
[109] Case No. 2020-00160, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates* (Ky. PSC Dec. 8, 2020), Order at 19 – 20; Case No. 2014-00396, *Application of Kentucky Power Company for: (1) A General Adjustment of its Rates for Electric Service; (2) An Order Approving its 2014 Environmental Compliance Plan; (3) An Order Approving its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief* (Ky. PSC June 22, 2015), Order at 25; Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 43.

The Company's rebuttal testimony argues that incentive compensation is part of its total compensation package to attract and retain quality employees, which is beneficial for customers.[110] However, Water Service Kentucky failed to provide any Commission precedent that supports their request to require customers to pay for incentive compensation tied to financial metrics in rates. Customers should not be forced to pay for incentive compensation that is directly tied to financial metrics. Instead, these costs should be borne by shareholders.

Hence, the Attorney General/Clinton respectfully request that the Commission follow its long-standing precedent to exclude the Company's incentive compensation tied to financial metrics. This would result in a reduction in the revenue requirement of $6,986, after gross-up for Commission assessment fees and bad debt expense.[111]

c. The Company-paid portion of health insurance expense should be reduced based on Bureau of Labor Statistics ("BLS") averages.

Water Service Kentucky pays 80% of the health insurance premiums for single-only coverage and 79% of the health insurance premiums for all other coverage options, including family coverage.[112] In prior cases, the Commission has limited the recoverable portion of the company-paid health insurance premiums to the most current BLS averages for single and family coverage in order to rein in benefit expenses.[113] The BLS 2021 averages for single and family coverages are 78% and 66%, respectively.[114] When compared to the BLS 2021 averages, Water Service Kentucky is contributing only 1% more in health insurance premiums for single-only

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[110] DeStefano at 13.
[111] Futral Testimony at 44 – 45.
[112] Water Service Kentucky's response to the Attorney General's Second Request, Item 65.
[113] Bureau of Labor Statistics, Healthcare Benefits, March 2021, Table 11, private industry workers, https://www.bls.gov/ncs/ebs/benefits/2021/employee-benefits-in-the-united-states-march-2021.pdf; *See* Case No. 2021-00407, *Electronic Application of South Kentucky Rural Electric Cooperative Corporation for a General Adjustment of Rates, Approval of Depreciation Study, and Other General Relief* (Ky. PSC June 30, 2022), Order at 9.
[114] Case No. 2021-00407, *Electronic Application of South Kentucky Rural Electric Cooperative Corporation for a General Adjustment of Rates, Approval of Depreciation Study, and Other General Relief* (Ky. PSC June 30, 2022), Order at 9.

coverage, but 13% more in family health insurance premiums. Further evidence that Water Service Kentucky is providing excessive benefits can be found in the Company's own wage and benefit study, which as previously discussed, demonstrates that Water Service Kentucky's total compensation in 2022, including health insurance benefits, was 8% above the market midpoint.[115]

The Attorney General/Clinton respectfully request that the Commission reduce the recoverable health insurance expense to a more reasonable level based on the BLS data. The effect of this recommendation would be a reduction of health insurance expense in the amount of $12,343, and a reduction of the revenue requirement of $12,874, after gross-up for Commission assessment fees and bad debt expense.

d. The Company's legal fee expenses should be reduced by removing non-recurring expense.

Water Service Kentucky includes $18,071 in the forecast test year for legal fee expenses.[116] The Company computed this amount by averaging the legal expenses for 2020 and 2021, which were $9,642 and $27,461, respectively.[117] The legal expenses in 2020 and 2021 were exceedingly higher than in prior years due to a personal injury case and the termination of the Clinton wastewater contract case.[118] For example, the legal expense was only $3,453 in 2017, $251 in 2018, and $2,615 in 2019.[119]

The Company asserts in its rebuttal testimony that it made an effort to use an average of the 2020 and 2021 legal expenses to not unreasonably skew the legal cost higher.[120] However, the more reasonable approach would be to remove the expenses associated with the two non-recurring

[115] Watkins Supplemental Testimony at 3.
[116] Application, Exhibit 29.11, line 4.
[117] Water Service Kentucky's response to the Attorney General's First Request, Item 84.
[118] Water Service Kentucky's response to the Attorney General's Second Request, Item 54.
[119] Water Service Kentucky's response to the Attorney General's First Request, Item 84.
[120] Kilbane Rebuttal at 5.

cases, the personal injury lawsuit and Clinton wastewater contract termination case, and then to average the legal expense amounts for the years 2017 – 2021.[121] This approach would more accurately reflect the historic legal expense for the Company. This equates to an expense level of $2,298 in annual legal fee expense instead of the Company's forecasted amount of $18,071.[122]

The Attorney General/Clinton respectfully request the Commission to reduce the legal fee expense to $2,298, which would be a reduction in the revenue requirement of $16,452, after gross-up for Commission assessment fees and bad debt expense.[123] In the alternative, if the Commission deems it appropriate to include all of the legal fee expenses from 2020 and 2021, the Attorney General/Clinton request the Commission to also include the annual legal fee expenses from 2017 – 2019 in the calculated average annual legal fee expense.

e. The Company's amortization expense related to excessive rate case legal costs should be removed from the proposed revenue requirement.

Water Service Kentucky proposed a staggering estimated rate case cost of $459,316 in the pending case, in order to achieve an increase of rates of little more than double the rate case cost.[124] Based upon a three year amortization period, the rate expense included in the test year amounts to $153,105.[125] In the pending case, the Company hired a Kentucky-based law firm that normally handles its rates cases.[126] But, the major cost driver in the proposed rate case cost is Water Service Kentucky's unreasonable decision to hire a second law firm located outside of Kentucky, which has not entered an appearance of record or represented the Company in the pending case.[127] The

[121] Futral Testimony at 55.
[122] *Id.*
[123] *Id.*
[124] Water Service Kentucky's supplemental response to Commission Staff's First Request for Information ("Commission Staff's First Request"), Item 12(c).
[125] Kilbane Testimony at 15.
[126] Water Service Kentucky's supplemental response to Commission Staff's First Request, Item 12(c).
[127] *Id.*

non-Kentucky law firm estimated its costs to be $200,000, while the Kentucky-based law firm estimated its costs at $158,875.[128]

In the Company's rebuttal testimony, it attempts to argue that Water Service Kentucky does not have access to internal legal counsel as larger utilities do, and therefore it was a reasonable decision to hire two separate law firms to assist with the pending case.[129] If this statement is accurate then the Commission should closely scrutinize the allocated costs that Water Service Kentucky's customers are paying since Water Service Corporation is supposed to be providing a complete suite of Corporate Support Services, which allegedly includes legal services.[130] In its rebuttal testimony, the Company also points to the costs from Kentucky-American Water Company's last rate case, and states that those "costs were significantly more than the total estimated legal expense associated with" Water Service Kentucky's pending case.[131] The Company conveniently failed to mention that even though Kentucky-American Water Company's rate case expense was in fact more than double that of Water Service Kentucky's proposed estimated rate case expense, Kentucky-American Water was also requesting a rate increase of almost 20 times that of the Company.[132] Further, Kentucky-American Water has approximately 130,000 water customers[133] to absorb the rate case costs as opposed to Water Service Kentucky's 6,098 customers. The Attorney General/Clinton are not asserting that the rate case expense in Kentucky-American Water Company's last rate case was reasonable, but instead are making the

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[128] *Id*.
[129] Kilbane Rebuttal at 8.
[130] Elicegui Testimony at 6.
[131] Kilbane Rebuttal at 9; Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 47 – 50.
[131] DeStefano Rebuttal at 13.
[132] Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 1.
[133] *Id*.

point that comparing the Company's estimated rate case expense to that of Kentucky-American Water Company's is not a fair or reasonable comparison.

A utility hiring two law firms to handle one rate case is nearly unprecedented.[134] More importantly, it is extremely unreasonable and unjust for a utility requesting a little over $1 million in a rate increase to force its small number of customers to cover the expenses for two separate legal firms. The Company made the unreasonable decision to hire a second law firm to assist with the pending rate case,[135] and should therefore be required to bear the full responsibility for the costs. Thus, the Attorney General/Clinton respectfully request the Commission to remove the full amount of the costs attributable to the hiring of the second law firm that did not represent the Company in the pending case. The Attorney General/Clinton further request the Commission to only allow the Company to include actual rate case costs that are deemed reasonable and necessary, as opposed to estimated rate case costs, in the revenue requirement.

f. The Company's bad debt expense should be reduced in the proposed revenue requirement.

Water Service Kentucky includes $169,278 in bad debt expense associated with uncollectible accounts in the forecasted test year.[136] The Company computed this amount by multiplying its projected service revenues of $4,309,579 by an unrounded factor of approximately 3.93%.[137] This percentage was derived by averaging the ratio of bad debt expense to service revenues for the years 2019, 2020, and 2021.[138] The Company's proposed bad debt expense is not reasonable because two out of the three years that the bad debt percentage is based on were heavily

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[134] VTE at 11:36:30 – 11:37:00.
[135] VTE at 6:34:00 – 6:40:12.
[136] Application, Exhibit 29.2, line 10.
[137] Futral Testimony at 63.
[138] *Id*.

impacted by the Covid-19 pandemic.[139] It would be more reasonable to average the bad debt percentage for years 2017, 2018, 2019, and 2022, since the years 2020 and 2021 were such strong outliers due to the pandemic.[140]

Thus, the Attorney General/Clinton recommend a bad debt factor of 2.12%.[141] The effect of reducing the projected bad debt factor from 3.93% to 2.12% represents a revenue reduction of $79,809 based on the Company's as-filed revenue requirement amount.[142] After synchronizing the projected bad debt expense percentage with the sum of the Attorney General/Clinton's other revenue requirement recommendations, it would result in an increase of $9,056 in the revenue requirement.

In the alternative, it would also be reasonable for the Commission to rely upon the updated bad debt expense percentage information as contained in Water Service Kentucky's Base Period update filing on October 31, 2022. This filing reflects that the Company's actual bad debt percentage for the Base Period of October 1, 2021 – September 30, 2022, was only 2.73%.[143] In rebuttal testimony, the Company states that the bad debt percentage for the first nine months of 2022 was 3.70%,[144] even though it previously stressed the importance of only viewing bad debt expense based on a full twelve-month period, and not just a portion of the year.[145] Hence, if the Commission utilizes the most recent, annual actual bad debt percentage for the Company of 2.73% it will still represent a significant reduction to the revenue requirement when compared to Water Service Kentucky's proposed 3.93% bad debt percentage. The effect of reducing the projected bad debt factor from 3.93% to 2.73% represents a revenue reduction of $53,076 based on the

[139] *Id*. at 66.
[140] *Id*.
[141] *Id*.
[142] *Id*. at 67.
[143] Base Period Update, Exhibit 29.2, Uncollectible Accounts.
[144] Kilbane Rebuttal at 7.
[145] Water Service Kentucky's response to the Attorney General's First Request, Item 88.

Company's as-filed revenue requirement amount. After synchronizing the projected bad debt expense percentage with the sum of the Attorney General/Clinton's other revenue requirement recommendations, it would result in an increase of $5,985 in the revenue requirement.

V. COST OF CAPITAL ISSUES

a. Return on Equity

Based upon the direct testimony of Water Service Kentucky's witness Mr. Dylan D'Ascendis, the Company proposes an inflated and unreasonable 10.60% return on equity ("ROE"),[146] while the Attorney General/Clinton's witness Mr. Baudino recommends a more reasonable 9.25% allowed ROE.[147]

Mr. Baudino's recommended ROE of 9.25% is based on the results of a discounted cash flow ("DCF") analysis as applied to a proxy group of regulated water distribution utilities.[148] The DCF analysis is Mr. Baudino's standard constant growth form of the model that employs growth rate forecasts from the following three sources: dividend and earnings growth from Value Line, and earnings growth from Yahoo! Finance, and Zacks.[149] Mr. Baudino also performed Capital Asset Pricing Model ("CAPM") analyses using both historical and forward-looking data, but did not rely upon these results due to it being a less reliable approach.[150] However, the CAPM results were generally lower than the DCF results in this case, which further confirms the reasonableness of Mr. Baudino's DCF results.[151]

Mr. Baudino relied upon the proxy group of water utilities that Water Service Kentucky's

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[146] Direct Testimony of Dylan D'Ascendis ("D'Ascendis Testimony"), at 3; Direct Testimony of Richard A. Baudino ("Baudino Testimony"), at 3.
[147] Baudino Testimony at 3.
[148] *Id*. at 13.
[149] *Id*.
[150] *Id*.
[151] *Id*.; *See* Baudino Testimony at 29, Table 1 – Summary of ROE Estimates.

witness Mr. D'Ascendis used for his analysis.[152] However, Mr. Baudino excluded The York Water Company from the proxy group because Value Line no longer provided detailed reports on this company.[153] In Mr. D'Ascendis' rebuttal testimony he agreed with Mr. Baudino's removal of The York Water Company from the water utility proxy group.[154] Mr. Baudino used a six-member proxy group for purposes of his ROE analyses including the following: American States Water Co., American Water Works Co., California Water Service Group, Essential Utilities, Middlesex Water Company, and SJW Group.[155]

Mr. Baudino's DCF analysis as applied to the proxy group resulted in the average growth rate range of 9.02% to 9.23%, with an average of 9.14%.[156] The DCF analysis based upon the median growth rates resulted in a range of 7.93% to 9.50%, with the average of 8.92%.[157] Hence, pursuant to the DCF analysis, Mr. Baudino recommends that the Commission adopt an ROE range of 9.00% to 9.50% for the regulated water operations of Water Service Kentucky.[158] Based upon these results, Mr. Baudino more specifically recommends an ROE for Water Service Kentucky of 9.25%, which is the midpoint of the recommended range.[159] The 9.25% recommended ROE is reasonable for a low-risk water utility like Water Service Kentucky,[160] even when considering the increased volatility, higher bond yields, and uncertainty inherent in the market at this time.[161]

As Mr. Baudino's testimony demonstrates, Mr. D'Ascendis' recommended ROE of

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[152] Baudino Testimony at 15.
[153] *Id*. As a result of Value Line no longer providing detailed reports on The York Water Company there were no longer five-year dividend and earnings growth projections, so it was reasonable to exclude it from the water utility proxy group.
[154] Rebuttal Testimony of Dylan D'Ascendis ("D'Ascendis Rebuttal"), at 4.
[155] Baudino Testimony at 15 – 16.
[156] *Id*. at 19.
[157] *Id*.
[158] *Id*. at 29.
[159] *Id*.
[160] *Id*.
[161] *See* Baudino Testimony at 4 – 13, wherein he thoroughly reviews the current economic conditions.

10.60% significantly overstates the investor-required return for lower risk, regulated water utilities,[162] and is inconsistent with current financial market evidence, even when considering the increase in interest rates this year.[163] Mr. D'Ascendis presented his range of ROE results for his proxy group of 9.63% - 11.72%,[164] and then increased this range upward by 1.00% to reflect alleged additional risk for Water Service Kentucky due to its smaller size relative to the water utility proxy group.[165] This resulted in an adjusted ROE range of 10.63% - 12.72%.[166] According to Mr. D'Ascendis' testimony he considered both unadjusted and size adjusted ROE ranges when formulating his 10.60% ROE recommendation, but he did not provide an explanation as to how he actually developed his 10.60% recommendation.[167] Thus, how Mr. D'Ascendis used these ROE ranges to guide his recommendation is unclear and lacks proper guidance.[168]

There are at least four fatal flaws in Mr. D'Ascendis' analysis concerning size adjustment premiums: Commission precedent; the Company being wholly-owned by a much larger company; the inclusion of smaller, riskier unregulated companies in the analysis; and, the arbitrary and substantial reduction of the proposed size adjustment premium.

First, the Commission has continuously rejected the use of size adjustments, flotation cost adjustments, and financial risk adjustments in ROE analyses in prior cases.[169] In two final Orders issued within the past year the Commission stated, "[t]he Commission reiterates that it continues

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[162] *See* Baudino Testimony at 12.
[163] *Id*. at 31.
[164] In Rebuttal Testimony, Mr. D'Ascendis increased his unadjusted ROE range to 9.67% - 12.06%, and his adjusted ROE range to 10.67% - 13.06%; however, he did not increase his recommended 10.60% ROE for Water Service Kentucky.
[165] Baudino Testimony at 31.
[166] *Id*.
[167] *Id*.
[168] *Id*. at 32.
[169] *See* Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates*, (Ky. PSC May 19, 2022), Order at 48; *See* Case No. 2021-00183, *Electronic Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates; Approval of Depreciation Study; Approval of Tariff Revisions; Issuance of a Certificate of Public Convenience and Necessity; and Other Relief*, (Ky. PSC Dec. 28, 2021), Order at 33.

to reject the use of floatation cost adjustments, financial risk adjustments, and size adjustments in the ROE analyses."[170] Similarly, in a final Order issued in August 2021, the Commission stated that, "… a business risk or size adjustment has not been approved in the past and the Commission agrees with the Attorney General and the Joint Intervenors that the explicit inclusion is not reasonable as such an adjustment is arbitrary and inflates the model results."[171] The Commission went on to find that additional risk did exist for that specific utility, not because of its size, but instead because it had acquired small, failing systems that required capital improvements for both regulatory purposes and daily operations.[172]

Second, even though Water Service Kentucky is a small company, it is a wholly-owned subsidiary of Corix Regulated Utilities, which provides the necessary financial support in the form of debt and equity financing, and Water Service Corporation provides various services.[173] Water Service Kentucky's relationship with a much larger corporation such as Corix Regulated Utilities mitigates its risk as compared to being a stand-alone company.[174] In fact, Water Service Kentucky acknowledged the benefits of the Company's affiliation with a larger organization in the following excerpt of direct testimony:

> Specifically, in addition to the centralized expertise that the arrangement provides WSCK, WSCK's customers benefit from economies of scale and scope by WSCK's affiliation with a larger organization. Further, the centralized delivery of common support services – the costs of which are shared among WSCK and the other operating companies within the Corix family that benefit from the services – enables the services to be provided to WSCK and each operating company at a lower cost than if the services were provided to WSCK on a stand-alone basis (assuming replication of the services on such a smaller scale was possible).[175]

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[170] *Id*.
[171] Case No. 2020-00290, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for an Adjustment of Rates and Approval of Construction*, (Ky. PSC Aug. 2, 2021), Order at 109.
[172] *Id*. at 108.
[173] Baudino Testimony at 30.
[174] *Id*.
[175] Direct Testimony of Seth Whitney ("Whitney Testimony"), at 6 – 7. Mr. Whitney abbreviates Water Service Kentucky as WSCK.

Third, Mr. D'Ascendis' small size premium analysis is based on data from Kroll, which includes smaller, riskier unregulated companies.[176] There is no evidence to suggest that the size adjustment premium that Mr. D'Ascendis recommends applies to regulated utility companies such as Water Service Kentucky, because regulated utility companies on average are very different from, and far less risky than, the smaller, unregulated companies that Mr. D'Ascendis relied upon.[177]

Fourth, Mr. D'Ascendis calculated a risk premium of 3.62% associated with Water Service Kentucky's small size, but then in his final recommendation he arbitrarily and substantially reduced the size adjustment premium down to 1%.[178] It is important to note that Mr. D'Ascendis did not provide any basis for his reduction of the size adjustment premium,[179] and the reduction is not based in economic principles. If the actual size adjustment premium of 3.62% that Mr. D'Ascendis calculated were added to his unadjusted ROE range then the resulting adjusted ROE range for Water Service Kentucky would be 13.25% - 15.34%, which is a totally unacceptable and unreasonable ROE range for ratemaking purposes.[180] However, Mr. D'Ascendis substantially reduced the actual size adjustment premium from 3.62% to 1% in order to produce an adjusted ROE range of 10.63% - 12.72%.[181] Mr. D'Ascendis then recommended an ROE of 10.60%, which is below the low end of his adjusted ROE range.[182]

The unreasonable ROE results that Mr. D'Ascendis' actual size adjustment premium of 3.62% produced, coupled with the arbitrariness of Mr. D'Ascendis' substantial reduction of the size adjustment premium to 1%, and the fact that Water Service Kentucky is a wholly-owned

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[176] Baudino Testimony at 33.
[177] *Id*. at 34.
[178] *Id*.
[179] *Id*.
[180] *Id*.
[181] *Id*. at 31.
[182] *Id*. at 32.

subsidiary of a large, sophisticated company provides a sufficient basis for the Commission to apply its past precedent and reject the requested size adjustment premium to the Company's ROE. But, if the Commission were inclined to grant any type of upward adjustment to Water Service Kentucky's ROE due to its size, the Attorney General/Clinton recommends looking at Mr. Baudino's recommended range of reasonable ROE in this case of 9.0% – 9.5%, and potentially going higher than the recommended midpoint of 9.25%.[183] Staying within the calculated range of ROE, but going above the midpoint, is a more reasonable approach to providing any type of increase to the Company's ROE based upon its size, as opposed to Mr. D'Ascendis' arbitrary 1% size adjustment premium or the unadjusted size premium of 3.62%.

Mr. D'Ascendis utilized DCF, risk premium, and CAPM/ECAPM analyses, and reviewed unregulated, non-utility companies to evaluate a rate of return for Water Service Kentucky in the pending case. Mr. D'Ascendis' DCF analyses yielded a mean of 9.44% and median of 9.81% for the proxy group, with an average of a 9.63% ROE.[184] Mr. D'Ascendis updated his DCF results in his rebuttal testimony, with the DCF result increasing slightly to 9.67%.[185] Even though Mr. Baudino did not have any major criticism for Mr. D'Ascendis' DCF analyses, he did note that even though Mr. D'Ascendis correctly utilized earnings growth rates from Value Line, Yahoo! Finance, and Zacks to develop his DCF ROE estimates, he should have considered Value Line's dividend growth forecast due to dividend payments being such a significant portion of the total return to utility shareholders.[186] Value Line's forecast of dividend growth is consistent with Mr. Baudino's earnings growth projections.[187]

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[183] VTE at 7:34:30 – 7:34:18.
[184] Baudino Testimony at 34.
[185] D'Ascendis Rebuttal, at 5.
[186] Baudino Testimony at 35.
[187] *Id.*; *See* Baudino Testimony, Exhibit RAB-3.

In stark contrast to Mr. D'Ascendis' DCF analyses, there are a myriad of flaws in his Risk Premium analyses.[188] As Mr. Baudino notes, in general, the bond yield plus risk premium approach is imprecise and can only provide very general guidance on the current authorized ROE for regulated utilities.[189] Historical risk premiums can change substantially over time based on investor preferences and market conditions.[190] Mr. Baudino calls this approach a "blunt instrument" for estimating the ROE in regulated proceedings.[191] In Mr. Baudino's expert view, a properly formulated DCF model using current stock prices and growth forecasts is far more reliable than the bond yield plus risk premium model that relies on an historical analysis of risk premiums.[192] Using historical risk premiums assumes that the past will look like the future, which is an assumption that may not hold in present day financial markets.[193]

Mr. D'Ascendis relied upon two methods to estimate a Risk Premium ROE – a Predictive Risk Premium Models ("PRPM"), and a total market approach.[194] The PRPM approach yielded an ROE value of 12.39%, and the total market approach yielded an average equity cost rate of 11.05% - 11.10%.[195] In his rebuttal testimony, Mr. D'Ascendis provided updated results with the PRPM result of 12.17% and the total market approach at 11.77%.[196] The average of these two results was 11.97%.[197]

First and foremost, this Commission rejected Mr. D'Ascendis' use of the PRPM approach in a recent case after concluding that it was not a widely accepted approach by regulatory

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188 Baudino Testimony at 36 – 43.
189 *Id*. at 36.
190 *Id*.
191 *Id*.
192 *Id*.
193 *Id*.
194 *Id*.
195 *Id*.
196 D'Ascendis Rebuttal at Exhibit 9.5, Schedule DWD-1R, page 10 of 34.
197 *Id*.

commissions.[198] Mr. D'Ascendis has not provided any new information in the pending case that should sway the Commission to reconsider its prior decision. Second, Mr. D'Ascendis failed to demonstrate that the PRPM model he developed is relied upon by investors to determine their required ROE for regulated utility companies.[199] Third, the ROE estimates produced by the PRPM are excessive and range from 11.02% to 15.89%, even after Mr. D'Ascendis excluded a 20.60% result for American Water Works Company.[200] If this 20.60% result had been included then the average PRPM ROE would have been 13.93%.[201] When considering the full range of PRPM results it shows that this method of estimating the investor required return is deeply flawed, produces highly inflated ROE results, and should continue to be rejected by the Commission.

Mr. D'Ascendis' total market approach to calculating the risk premium similarly projected unreasonable market returns of 11.98% - 15.90%, which are excessive, and should also be rejected by the Commission.[202] Mr. D'Ascendis' 3 – 5 year growth rates, calculated using Value Line and Bloomberg data, of 10.11% - 14.34% are unsustainably high and vastly exceed both the historical capital appreciation for the S&P 500 as well as historical and projected GDP growth rates.[203] The average capital appreciation for the S&P 500 was 8.2% for the historical period 1926 – 2021, and the geometric, or compound growth was 6.40%.[204] This historical experience stands in stark contrast to Mr. D'Ascendis' growth rates of 10.11% - 14.34%.[205] Mr. D'Ascendis' inflated growth

[198] *See* Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates*, (Ky. PSC May 19, 2022), Order at 47 – 48; *See* Case No. 2021-00183, *Electronic Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates; Approval of Depreciation Study; Approval of Tariff Revisions; Issuance of a Certificate of Public Convenience and Necessity; and Other Relief*, (Ky. PSC Dec. 28, 2021), Order at 33; Baudino Testimony at 38.
[199] Baudino Testimony at 38.
[200] *Id*. This information is based upon the Mr. D'Ascendis' analyses as provided in his direct testimony.
[201] Baudino Testimony at 38.
[202] *Id*. at 39.
[203] *Id*.
[204] *Id*. at 40.
[205] *Id*.

rates are also unreasonable when considering both historical and forecasted GDP growth for the United States.[206] Based upon data from the Bureau of Economic Analysis, U.S. Department of Commerce, Mr. Baudino calculated that the compound yearly growth rate for U.S. GDP from 1929-2021 was 6%.[207] This growth nearly matched the historical compound growth rate for capital appreciation for the S&P 500.[208] Further, Mr. Baudino's forecasted GDP growth is much lower than the historical average.[209] For example, the Fed projections called for longer-run real GDP growth of 1.8% and personal consumption expenditures inflation of 2.0%, which translates into forecasted nominal GDP of roughly 3.80%.[210] Even assuming a forecasted long run nominal GDP growth of around 4.0%, the market growth rates of 10.11% to 14.34% used by Mr. D'Ascendis are unreasonable and cannot be sustained over the long run.[211]

Further, the regression analyses Mr. D'Ascendis used to forecast risk premiums are not valid and do not form a sound basis for forecasting the expected risk premium.[212] As Mr. Baudino discusses in his testimony, when applying both the R-squared statistic and the t-statistic tests, Mr. D'Ascendis' regression analyses produce poor results, which means that his models cannot and should not be relied upon to predict market risk premiums based on changes in bond yields.[213] As such, the Commission should reject Mr. D'Ascendis' regression-based analyses to forecast risk premiums.[214]

Moreover, Mr. D'Ascendis' calculated expected total returns based on the S&P Utility Index of 10.66% and from Value Line and Bloomberg of 9.94%, are not reliable because they are

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[206] *Id*.
[207] *Id*.
[208] *Id*.
[209] *Id*. at 4 – 13.
[210] *Id*. at 40.
[211] *Id*.
[212] *Id*. at 41.
[213] *Id*. at 42.
[214] *Id*.

weighted by market capitalization. In other words, utilities with higher capitalization are weighted more heavily than utilities with smaller capitalization.[215] Thus, Mr. Baudino averaged the ROEs calculated by Mr. D'Ascendis without the market cap weighting resulting in an average ROE for the S&P Utilities of 9.36% using Bloomberg and 9.66% using Value Line.[216] This demonstrates that the larger capitalization utilities had calculated ROEs higher than the average and pushed up the market capitalization ROE numbers for both Bloomberg and Value Line in Mr. D'Ascendis' calculations.[217] Having a higher market capitalization is not necessarily predictive of a higher required rate of return ("ROR") from investors, which is why Mr. Baudino recommends that the simple average of the ROEs be used.[218] Based upon the previously discussed issues, the Commission should reject Mr. D'Ascendis' PRPM and total market approach to estimate the risk premium ROE.

Mr. D'Ascendis' CAPM/ECAPM analyses also produced an excessive ROE range of 11.31% - 11.87%, containing fundamental errors and should not be relied upon by the Commission.[219] Mr. D'Ascendis presented six different risk premium analyses that he used to estimate the expected market risk premium ("MRP") for the CAPM/ECAPM.[220] The average of the six MRPs he estimated was 9.80%, with the average MRP using projected data from Value Line and Bloomberg at 10.98%.[221] The main problem with Mr. D'Ascendis' CAPM/ECAPM analyses is that his projected MRPs stems from his same flawed and overstated expected market returns that he used in his RP analyses ranging from 11.98% - 15.90%, with expected long-run

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215 *Id.*
216 *Id.* at 43.
217 *Id.*
218 *Id.*
219 *Id.* The CAPM/ECAPM results are from Mr. D'Ascendis' direct testimony. Mr. D'Ascendis produced an updated average CAPM result of 12.02% in his rebuttal testimony using the same approach that Mr. Baudino addressed in his direct testimony.
220 Baudino Testimony at 43.
221 *Id.* at 44.

growth rates ranging from 10.11% - 14.34%.[222] As Mr. Baudino notes in his testimony, based upon sources such as Kroll the current recommended MRP is 5.5%, the average of the Damodaran MRPs is 5.47%, and the historical supply side MRP is 6.22%.[223] Further, Mr. D'Ascendis' use of the ECAPM, which is designed to account for the possibility that the CAPM understates the ROE for companies with betas less than 1.0, is further evidence of the lack of accuracy inherent in the CAPM itself.[224] The ECAPM adjustment also incorrectly suggests that published betas by such sources as Value Line are incorrect and that investors should not rely on them in formulating their estimates using CAPM.[225] Based upon the foregoing, the Attorney General/Clinton recommends the Commission not rely on Mr. D'Ascendis' CAPM or ECAPM recommendations.

Finally, Mr. D'Ascendis presents a proposal to include unregulated, non-utility companies as an additional method of evaluating the rate of return for Water Service Kentucky, which is inappropriate for estimating the ROE for regulated utility companies.[226] Utilities have protected markets through the designation of service territories, and may increase the prices charged in the face of falling demand or loss of customers.[227] This is completely contrary to competitive, unregulated companies that often lower their prices when demand for their products decline.[228] Non-utility companies face risks that lower risk, regulated water utilities like Water Service Kentucky do not, and will therefore require higher returns from their shareholders.[229] Mr. D'Ascendis' average and median ROE results for the unregulated, non-utility companies group range from 11.31% - 11.62%.[230] These results are far higher than the utility proxy group DCF

[222] *Id*.
[223] *Id*. at 45.
[224] *Id*.
[225] *Id*.
[226] *Id*. at 46.
[227] *Id*.
[228] *Id*.
[229] *Id*. at 46 – 47.
[230] *Id*. at 47. Mr. D'Ascendis' updated result in his rebuttal testimony was 12.06%, and can be found on Table 1.

results from both Mr. D'Ascendis and Mr. Baudino.[231] Mr. D'Ascendis' analysis clearly demonstrates that investors require higher returns from unregulated companies.[232] Thus, these high ROEs for unregulated, non-utility companies should in no way be applied to Water Service Kentucky, or any other regulated water utility company.[233]

Based upon the foregoing, Commission approval of Water Service Kentucky's inflated ROE proposal of 10.60% would cause rates to increase to an unreasonable level and harm ratepayers.[234] Thus, the Attorney General/Clinton respectfully request the Commission to adopt Mr. Baudino's reasonable recommendation of a 9.25% ROE for Water Service Kentucky.

CONCLUSION

WHEREFORE, the Attorney General/Clinton request that the Commission deny Water Service Kentucky's requested rate increase and the CPCN to implement AMI. If the Commission is inclined to grant a rate increase, then it should be limited to what the Company has proven with known and measurable evidence that will result in fair, just, and reasonable rates for the Company's ratepayers.

[231] Baudino Testimony at 47.
[232] *Id*.
[233] *Id*.
[234] *Id*. at 31.

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Certificate of Service and Filing

Pursuant to the Commission's Orders and in accord with all other applicable law, Counsel certifies that the foregoing electronic filing was transmitted to the Commission on December 16, 2022, and there are currently no parties that the Commission has excused from participation by electronic means in this proceeding.

This 16th day of December, 2022.

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