COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

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 and Approval of Certain Regulatory Accounting Treatment	))))))	Case No. 2022-00147

INITIAL BRIEF OF WATER SERVICE CORPORATION OF KENTUCKY

Water Service Corporation of Kentucky ("WSCK" or the "Company") seeks an increase in rates for water service. It also seeks a certificate of public convenience and necessity to deploy advanced metering infrastructure. The following brief provides information in support of WSCK's position in this case related to relevant issues that have been raised in this matter.

I. Background

On May 31, 2022, WSCK filed the application for a general adjustment in rates and a certificate of public convenience and necessity ("CPCN") that is the subject matter of this proceeding. In its application, WSCK sought an overall increase over present annualized levels of $1,047,688 per year for a total revenue requirement request of $4,309,876.[1] WSCK calculated this revenue requirement by using a fully forecasted test year ("Forecast Period") as permitted by 807

[1] Whitney Direct Testimony, Application Exhibit 9.1 ("Whitney Direct") at 3 (filed May 31, 2022).

KAR 5:002 Section 16.[2] In its Application, WSCK used a Base Period reflecting 12 months ending September 30, 2022 with actual results through March 31, 2022 to make this calculation; the Base Period includes six months of actual information and six months of forecasted data. WSCK submitted a Base Period Update on October 31, 2021, with actual results through September 30, 2022. WSCK also utilized a Forecast Period reflecting 12 months ended December 31, 2023, the period extending 12 months past the statutory suspension period.[3]

WSCK also included capital investments in its proposed rate base that are integral to WSCK's continued provision of high-quality and legally compliant water service to its customers. Approval of a CPCN for the development of an Advanced Metering Infrastructure ("AMI") program will enable WSCK to better serve its customers in Clinton and Middlesboro by allowing WSCK to more accurately read meters, promptly identify leaks, eliminate manual meter reading and truck rolls, and redeploy staff in each community to perform other essential functions.[4] This system will also allow customers to have access to accurate information about their water usage.[5] WSCK seeks the rate base treatment for capitalized costs of the AMI program through the Forecast Period.

The Intervenors—the Office of the Attorney General ("OAG") and City of Clinton—filed joint testimonies of Richard Baudino and Randy Futral, and the City of Clinton filed the testimony of Shannon Payne. Baudino testified regarding the investor required return of equity ("ROE") for WSCK's regulated operations. He d asserted that the Kentucky Public Service Commission (the "Commission") should allow an ROE in this matter of 9.25%.[6] Baudino based his

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[2] Kilbane Direct Testimony, Application Exhibit 9.2 ("Kilbane Direct") at 3 (filed May 31, 2022).
[3] *Id.* at 3-4.
[4] Whitney Direct at 10-11.
[5] *Id.* at 11.
[6] Baudino Direct Testimony ("Baudino Direct") at 3 (filed October 13, 2022).

recommendation exclusively on the discounted cash flow ("DCF") without giving any weight to any other analysis, despite performing three Capital Asset Pricing Model tests,[7] and excluding a size adjustment for most accurate results.[8] Futral provided testimony surrounding his recommended adjustments to WSCK's base revenue requirement and his opinions on the Commission's treatment of WSCK's requests surrounding the AMI program and the Fusion costs.[9] Payne's testimony discussed the relationship between the City and WSCK.[10]

At the evidentiary hearing held on November 30, 2022, WSCK presented the following witnesses: Quentin Watkins, Shawn Elicegui, Patrick Baryenbruch, Dylan D'Ascendis, James Kilbane, Dante DeStefano, Corey Napier, Colby Wilson, and Seth Whitney. The Intervenors presented three witnesses at the hearing.

II. Certificate of Public Convenience and Necessity for Advanced Metering Infrastructure

WSCK requests a CPCN to deploy AMI in its Clinton and Middlesboro water systems. Using two-way communications capabilities, AMI meters will transmit relevant data such as water usage to WSCK in real-time. Immediate data collection will allow the Company to analyze community and individual water consumption patterns more efficiently and accurately.[11] Increased efficiency in data collection and evaluation will equip WSCK to identify and isolate potential water leaks.[12] Ultimately, the prevention of and elimination of water loss in the system will enhance the water service WSCK can provide to its customers.

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[7] D'Ascendis Rebuttal Testimony ("D'Asendis Rebuttal) at 13 (filed Nov. 23, 2022).
[8] Baudino Direct at 33.
[9] Futral Direct Testimony at ("Futral Direct") at 5 (filed October 13, 2022).
[10] Payne Direct Testimony at 1 (filed October 12, 2022).
[11] Wilson DirectTestimony, Application Exhibit 9.7 ("Wilson Direct") at 9-10 (filed May 31, 2022).
[12] *Id.* at 10.

AMI will also provide tangible benefits to customers, in addition to enhanced quality of water service. Customers will easily access their water usage information on the MyUtilityConnect application. In real-time, customers will be able to monitor their water consumption and resulting billing, which will afford customers reliable consumption and cost information to better monitor their personal water usage.[13] AMI will increase customer satisfaction through WSCK's increased ability to quickly respond to water leaks or other disruptions to water service.

AMI will deliver more accurate meter readings than WSCK's current manual read meters. Reliable meter reads will result in a significant reduction of meter re-reads from inaccurate initial readings.[14] This will allow WSCK to more efficiently deploy its staff. Field technicians who currently conduct manual meter readings can be redeployed to other activities that are critical to WSCK's operations.[15]

In the course of routine operations, WSCK began installing manual read meters with full retrofit capability in its systems in 2022;[16] and in 2023 with approval of the Commission, WSCK will continue the retrofit and install approximately 2,000 meters across the entire Clinton system and one-third of the Middlesboro system.[17] The existing meters that WSCK has yet to retrofit are scheduled to be tested and replaced as needed beginning in 2023, regardless of the implementation of the AMI system. WSCK will deploy AMI to one-third of its distribution system every two years. After a five-year rollout, AMI will be implemented in the entire service area. The AMI rollout will begin in January 2023.[18] Through the five-year rollout plan, the implementation of AMI will directly correlate with WSCK's current cycle for testing and replacing existing meters. Thus, the

[13] Wilson Direct at 10.
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] *Id.*
[18] Application at 14.

AMI rollout will combine the meter replacement cycle and provide critical modernization of the system while saving duplicative costs of testing existing meters and then subsequently replacing the meters that the Company recently tested.[19] WSCK will also target the start of the meter rollout in 2023 to begin with meters in locations that are less accessible or dangerous for meter readers.[20]

WSCK proposes to install Neptune AMI meters in its system.[21] Following a multi-step review and vendor selection process, issuing a request for information and request for proposals, Corix, WSCK's parent company, selected Neptune AMI because of the vendor's competitive product offerings and pricing.[22] The Company was able to negotiate further discounts to Neptune's pricing on meter interface units and endpoints, reading equipment, and software incorporating Neptune 360 and data plans.[23] Neptune provides its customers with extensive training and maintenance of all products, and it offers a variety of products to implement an AMI system.[24] Neptune has installed AMI across the country, and its experience will serve as a valuable resource to WSCK as it begins this capital project.[25]

To implement AMI, WSCK seeks a CPCN from the Commission pursuant to KRS 278.020(1). WSCK has demonstrated in the course of this proceeding and at the evidentiary hearing on November 30, 2022, that AMI is a needed system upgrade and is not wasteful duplication.[26] AMI will combat the substantial inadequacy of WSCK's current manual meters in Middlesboro and enhance the current AMR metering in Clinton that will soon be obsolete. AMI will provide improvements beyond those that continued operation or maintenance of existing

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[19] Wilson Direct at 10-11.
[20] *Id.* at 11.
[21] *Id.* at 11.
[22] *Id.* at 11.
[23] Response to AG DR 1-13.
[24] *Id.*
[25] *Id.*
[26] *Kentucky Utilities Co. v. Public Service Comm'n*, 252 S.W.2d 885 (Ky. 1952); Northern Kentucky Water Dist., Case No. 2021-00095 (Ky. PSC Sept. 22, 2021).

meters could provide in the ordinary course of business.[27] Further, the AMI program is not wasteful duplication of services or over-investment in capital because of the benefits it will provide WSCK customers, and because WSCK adequately evaluated reasonable alternatives in choosing the Neptune AMI system.[28]

A. WSCK has demonstrated the need for the AMI system.

The deployment of AMI in WSCK's systems will remedy a substantial inadequacy in WSCK's existing water service to its customers through the modernization of WSCK's meter systems that will result in increased efficiency that would not otherwise be possible on WSCK's existing, aging water systems.[29]

Both the Clinton and Middlesboro service areas have seen an upward trend in unaccounted-for-water loss in recent years. In 2016, Clinton experienced unaccounted-for water of 11.2% and Middlesboro of 7.1%.[30] These statistics have considerably increased, and in 2021, WSCK experienced unaccounted-for water levels of 13.23% in Clinton and 15.30% in Middlesboro.[31] As the existing meters age, they are increasingly less capable of detecting and preventing unaccounted-for water. Meters that are already beyond their useful life fail to capture water consumption, which causes both an operational and financial burden on WSCK through unaccounted-for water and the resulting lost revenue that it experiences.[32] WSCK routinely tests and replaces its meters, and it monitors locations where frequent leaks or other issues occur to identify and respond to system failures.[33] This practice is expensive and time consuming to deploy

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[27] *Kentucky Utilities Co. v. Public Service Comm'n,* 252 S.W.2d 890 (Ky. 1952)
[28] *Louisville Gas and Elec*., Case No. 2005-00142 (Ky. PSC Sept. 8, 2005).
[29] *Kentucky Utilities Co. v. Public Service Comm'n,* 252 S.W.2d 890 (Ky. 1952)
[30] Response to PSC DR 2-17.
[31] Wilson Direct at 5.
[32] Vaughn Melton Cost Benefit Assessment at 6, located at Response to PSC DR 2-19.
[33] Wilson Direct at 5.

operations staff to manually read meter in potentially dangerous or inaccessible locations.[34] The enhanced efficiency of the AMI meters will allow WSCK to identify leaks and monitor trouble areas remotely and constantly, which will reduce the unaccounted-for water and impediments to the provision of high-quality water service.[35] Labor and staffing resources will also be preserved as the meter reads will be electronic.

A significant expense WSCK customers experience is the cost of operations staff labor for re-reading meter reads. WSCK has experienced an upward trend of meters requiring re-reads. In 2016, WSCK re-read 563 meters; this number significantly increased in 2021 when WSCK re-read 1,405 meters.[36] This duplicative work generates staffing burdens for WSCK, which ultimately WSCK customers will bear if the current metering system is not upgraded.

Though WSCK has maintained compliance with DOW and has received minimal customer complaints about water quality,[37] the assets in place in each system are aging. In fact, the Clinton metering system is approaching the end of its useful life, and in the next two years will need to be replaced entirely.[38] Without the modernization of the Clinton system, WSCK will continue to test and replace failing meters with manual read meters.[39] Ultimately, this will come at continued expense for the costs of replacing existing meters, testing manual readers, and the inefficient efforts of field technicians continuing to do truck rolls and manual meter reading.[40]

The Neptune AMI system will provide both immediate and long-term benefits by modernizing WSCK's aging water systems in Clinton and Middlesboro. Functioning AMI meters will transmit water usage data in real-time without requiring time consuming and costly manual

[34] *Id.* at 11.
[35] Wilson Direct at 5.
[36] Response to PSC 2-19(d).
[37] Wilson Direct at 6.
[38] Wilson Rebuttal Testimony ("Wilson Rebuttal") at 3 (filed Nov. 23, 2022).
[39] *Id.* at 3.
[40] Wilson Direct at 10-11, Wilson Rebuttal at 3.

meter reads.[41] WSCK will be better able to assess potential unaccounted-for water sources and other problems with the systems' operation and immediately respond to and resolve those issues. Without this technology, WSCK will continue its upward trend of increasing unaccounted-for water rates and will experience greater challenges to providing its customers quality service. This capital investment will benefit customers for twenty years throughout the duration of the Neptune AMI lifespan, an upgrade that will continue to serve the customers of Clinton and Middlesboro far beyond the current useful life of the systems' current or alternative options.[42]

AMI will not only extend the viable life of both water systems, but will also provide direct benefits to the customer that simply cannot occur with the existing metering system. First, customers will be able to access information regarding their water usage and resulting bills from the immediate, accurate water usage data that AMI meters will collect.[43] Not only will this provide transparency to customers, but it will also assist in resolving problems that occur on customers' property quickly with less interruption to the customers' daily activities[44] and continue to provide enhanced service to customers.[45] In sum, these reasons demonstrate WSCK's need for deployment of AMI.

B. WSCK has demonstrated that the AMI system will not result in wasteful duplication.

The implementation of the Neptune AMI system will not result in wasteful duplication of services. AMI will increase the efficacy and efficiency of WSCK's water service to its customers in Clinton and Middlesboro. The balancing of factors analysis the Commission set forth in Case

[41] *Id.* at 11.
[42] Response to PSC DR 2-19.
[43] Wilson Rebuttal at 4.
[44] *Id.* at 4.
[45] *Id.* at 4

No. 2005-00089 reveals that AMI will not result in wasteful duplication of services:[46] WSCK's parent, Corix, evaluated various vendors and programs in selecting the Neptune AMI metering system for the project, the implementation of AMI will not create an "excess of capacity over need,"[47] and the Neptune AMI program will be the least cost option for WSCK customers.[48]

Alternatives to installing AMI meters were evaluated. If the Commission does not approve AMI, WSCK will continue to replace meters with manual read meters.[49] In Clinton, all AMR meters will be replaced with manual read meters.[50] The Clinton metering system, at the end of its useful life, will then be completely replaced within one to two years, which will generate additional costs.[51] As WSCK has noted above, both the Clinton and Middlesboro service areas are experiencing increased water loss as the systems age.[52] As unaccounted-for water rates increase, meter testing and replacement costs increase and labor costs associated with manual readings and re-readings may also increase. WSCK customers will incur these operational costs and lose service quality. While the system may be operational in its existing state, inaction with regard to installing AMI meters will thwart any potential for increased water service quality, which will harm WSCK customers.

A Request for Proposal was issued for vendors of AMI systems when selecting the prospective AMI vendor.[53] Three bids were received from vendors,[54] used various evaluation metrics to generate exhaustive scores for each proposal.[55] Neptune received the highest overall

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[46] *East Kentucky Power Coop., Inc.*, Case No. 2005-00089 at 6 (Ky. PSC Aug. 19, 2005).
[47] *See Kentucky Utilities Co. v. Public Service Comm'n*, 252 S.W.2d 885, 890 (Ky. 1952).
[48] Northern Kentucky Water Dist., Case No. 2021-00095 at 4 (Ky. PSC Sept. 22, 2021);
[49] Wilson Rebuttal at 3.
[50] *Id.* at 3.
[51] *Id.* at 3.
[52] *Id.* at 5.
[53] Response to PSC DR 2-19.
[54] Response to PSC DR 3-08.
[55] *Id.*

internal score of all the submitted proposals.[56] Neptune's package of AMI products presented both product flexibility and competitive pricing to meet the needs of the Clinton and Middlesboro systems.[57] Additionally, additional discounts were negotiated to Neptune's pricing: a reduction of meter interface units and endpoints price by 15% and a reduction of reading equipment and software, including Neptune 360 and data plans, of 10%.[58] Neptune will provide WSCK with training and maintenance of all its products,[59] and will offer vast experience and support in implementing AMI technology.[60] Through a fair and thorough sourcing of competitive offers and evaluation of offers in light of WSCK's needs, multiple alternatives of vendors were fully considered for implementing AMI.

Vaughn & Melton Consulting Engineers, Inc. ("Vaughn & Melton") provided a cost-benefit analysis for the 2022 AMR/AMI systems.[61] In the report, Vaughn & Melton listed the following as advantages to deploying an AMI system:

- Better customer service.
- Daily status information from each meter. No need for manual reads.
- Customers can monitor their water consumption and/or set automatic notifications.
- Instantaneous reading/billing when property is sold or tenant moves out.
- More information available to answer customer/billing questions.
- Reduction in field service calls and avoid adding staff when customer base is increased.
- Saves utility the expense/labor of periodic/multiple trips to each physical location to read the meter.
- Expedited dispute resolution from claims such as leaks, theft, on inaccuracies in reporting.
- Saves vehicles expenses.
- Billing is prepared on real time information instead of estimates or calculated values.

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56 *Id.*
57 Wilson Direct at 11
58 Response to AG DR 1-13.
59 *Id.*
60 *Id.*
61 V&M cost benefit analysis in response to PSC DR 3-06.

- More efficient and accurate collection and transfer of data.
- Improved billing practices.
- Flexible billing and schedule cycles.
- Environmentally sensitive since it reduces water consumption and prevents water abuse/leaks.
- Primary tool in future growth.
- Increased efficiency and potential profit for providers.
- Counteracts the inaccuracies of aging technology.
- Reduced reliance on personnel.
- Always accessible record keeping.
- Accurate/instantaneous data analysis provides informed forecasting and decision making.[62]

The Company also provided a listing of intangible benefits for the AMI project that "provide a positive outcome for which an economic value (in dollars) cannot be easily estimated," including improved customer service, timely leak detection, monthly billing, claims resolutions, personnel safety, and greenhouse gas reduction.[63]

The independent engineering firm concluded that that net present value benefit of the project over the 20-year lifespan of the AMI meters is $1,529,362 to WSCK. AMI meters will accurately measure water consumption and revitalize WSCK's aging water systems. Also, 90% of truck rolls related to meter reads will not be needed in an AMI system, so WSCK can redeploy those individuals to do other operations activities. Ultimately, Vaughn & Melton found that the project would pay for itself in 11 years, nine years prior to the end of the AMI meters' lifecycle.[64] The analysis revealed that during the estimated payback period, WSCK would save: $109,939 from meter turnover, $12,144 from labor savings, $14,520 in carbon footprint, and would gain

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[62] V&M cost-benefit analysis response to PSC DR 3-06 at 2-3.
[63] *Id.* at 6.
[64] *Id.* at 6.

$97,700 from meter accuracy; resulting in a total annual savings or increased revenue of $234,303.[65]

As the Commission has previously noted, the "selection of a proposal that ultimately costs more than an alternative does not necessarily result in wasteful duplication."[66] The analysis of implementing the Neptune system and the overarching benefits it can provide the Company, as considered by both WSCK and Vaughn & Melton, indicate that the deployment of AMI in Clinton and Middlesboro will modernize WSCK's systems and reduce costs through less unaccounted-for water, decrease or avoid labor costs for monitoring meters, and decrease or avoid costs from the replacement of failing meters in an aging system. The AMI program will enhance WSCK's customers' experience and more efficiently and effectively meet the communities' needs for reliable, quality water service. For these reasons, WSCK's proposed AMI deployment will not result in wasteful duplication.

WSCK has demonstrated that there is a need for the AMI system and that it will not result in wasteful duplication. Moreover, this Commission has previously approved CPCNs for advanced-metering projects.[67] Accordingly, WSCK requests similar treatment and approval of a CPCN for deployment of its proposed AMI system.

III. Rate Base Issues

A. Advanced Metering Infrastructure

As discussed above, WSCK requests approval of a CPCN for AMI deployment. Intervenors' witness Futral recommends denial of the CPCN. Based on this recommendation,

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[65] *Id.* at 21, exhibit k.
[66] Northern Kentucky Water Dist., Case No. 2021-00095 at 4 (Ky. PSC Sept. 22, 2021).
[67] *See, e.g.*, Estill County Water Dist. No. 1, Case No. 2021-00207 (Ky. PSC June 25, 2021); Northern Kentucky Water Dist., Case No. 2021-00095 (Ky. PSC Sept. 22, 2021); Elkhorn Water Dist., Case No. 2020-00113 (Ky. PSC Nov. 20, 2020); McCreary County Water Dist.. Case No. 2018-00038 (Ky. PSC June 28, 2018); Beech Grove Water System, Case No. 2016-00255 (Ky. PSC Mar. 9, 2017); Graves County Water Dist., Case No. 2011-00390 (Ky. PSC Nov. 3, 2011).

Futral further recommends that the Commission remove forecasted AMI assets and capitalized costs from rate base.[68] Futral asserts that projected net cost increases included by the Company in the revenue requirement should be removed, in the AMI program is approved.[69]

Because WSCK has adequately supported a CPCN for the AMI project, it requests the Commission reject Futral's position on this issue. Futral's position does not take into account the various qualitative benefits, summarized above, from deploying the AMI program. In addition, to the extent the Commission desires cost savings to exceed costs to implement the metering system, the Company provided support that the Forecast Period revenue requirement reflects a net impact of ($39,103), which would provide customer benefit for as long as the rates in this proceeding are effective.[70] In summary, the Company's request for a CPCN to implement AMI for the Forecast Period should be approved.

B. JDE and Oracle Enhancements

WSCK requests recovery for enhancement costs for J.D. Edwards financial software system and the Oracle Customer Care and Billing system enhancement costs incurred after the implementation of Project Phoenix. Intervenors' witness Futral recommends that the Commission deny recovery of these costs "consistent with the spirit of treatment of all such costs in prior cases."[71] Futral bases his identification of the "spirit" of the Commission's decisions about J.D. Edwards and Oracle software costs on the Commission's denial of implementation costs for each software as part of Project Phoenix.[72]

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68 *See* Futral Direct at 17.
69 *Id.*
70 Response to AG DR 2-55, at tab "AG DR 1-102."
71 Futral Direct at 20.
72 *Id.* at 19.

Contrary to Futral's position, WSCK has sought recovery for enhancement costs to Project Phoenix, including J.D. Edwards and Oracle software enhancement costs, not implementation costs, in its last three rate cases.[73] The OAG nor any other intervenor objected to the inclusion of these enhancements, and the Commission did not remove the requested revenue requirement from the Commission's final order on the basis of linkage to Project Phoenix in any of those rate cases.[74] Additionally, these enhancements have benefited customers through the continuity in use of existing platforms and customer interfaces in addition to the creation of the myUtilityConnect portal that allows customers easy access to their water consumption and billing data.[75] Accordingly, in keeping with the "spirit" of Commission precedent, the Commission should grant continued recovery for the enhancement costs for these software programs.[76]

C. Deferred Rate Case Expense Inclusion in Rate Base

As part of its rate base, WSCK seeks recovery for deferred rate case expense as a regulatory asset. The majority of that request relates to the current rate case, and the remaining $21,711 relates to the remaining unamortized deferred balance from Case No. 2020-00160. Intervenors' witness Futral recommends that the Commission not include the deferred rate case expenses in this proceeding because he believes that only WSCK's parent company will benefit from the inclusion rather than the customers.[77]

Futral's position is unreasonable. A regulator must maintain rates to allow a utility to finance its operations and attract investment, which means that the utility must generate a

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[73] *See Water Service Corp. of Kentucky*, Case No. 2020-00160 (Ky. PSC Dec. 8, 2020); *Water Service Corp. of Kentucky*, Case No. 2018-00208 (Ky. PSC June 18, 2019); *Water Service Corp. of Kentucky*, Case No. 2015-00382 (Ky. PSC May 31, 2016).
[74] DeStefano Rebuttal Testimony ("DeStefano Rebuttal") at 3 (filed Nov. 23, 2022).
[75] *Id.* at 4
[76] *See generally id.* at 3-4.
[77] Futral Direct at 21

reasonable return on investment.[78] Without the present rate case, WSCK is projected to earn a rate of return of -2.12% for the Forecast Period.[79] Ultimately, rate case expenses will benefit the customers by allowing investors to gain a reasonable rate of return, which supports continued capital investment and gives WSCK the ability to provide customers higher quality utility service.

Additionally, the Commission has allowed deferred costs in previously approved rate bases. In Case No. 2018-00358, the Commission allowed Kentucky-American to include deferred maintenance balances and materials and supplies in its rate base.[80] Like the deferred rate case expense, the deferred maintenance cost in the Kentucky-American rate case was incurred upfront by the utility, the upfront cost was expensed (and recovered) over time, and were deemed recoverable based on the reasonableness of their incurrence.[81] Rate case expenses are costs WSCK incurs upfront and are reasonable to ensure the ongoing operation and financial viability of the utility. Therefore, the Commission should allow their inclusion in rate base.

D. ADIT and Bad Debt Expense

WSCK's requested revenue requirement includes the recovery of Accumulated Deferred Income Tax ("ADIT") balances for two assets: Deferred Federal Tax-Bad Debt and Deferred State Tax-Bad Debt. Intervenors' witness Futral contends that these asset ADIT amounts' inclusion in rate base mismatch the treatment of the liability bad debt reserve balance for ratemaking purposes.[82] He recommends that the ADIT assets be removed from rate base unless the related temporary difference between liability bad debt reserve balance is also reflected.[83]

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[78] DeStefano Rebuttal at 6 (citing *Fed. Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 603 (1944); *Bluefield Water Works v. Public Serivce Comm'n*, 262 U.S. 679, 692-93 (1923)).
[79] DeStefano Rebuttal at 6.
[80] *Kentucky-American Water Co*., Case No. 2018-00358 at 19 (Ky. PSC June 27, 2019).
[81] DeStefano Rebuttal at 6.
[82] Futral Direct at 29-30.
[83] *Id.* at 30.

The Commission should allow WSCK to include the bad debt portion of its ADIT balance in rate base. In accounting for bad debt expense, WSCK must denote the incurring of the bad debt expense—a debit—on its books and increase the A/R Reserve to denote a reserve for uncollectible receivables—a credit.[84] The A/R Reserve is not a liability, as there is no party to whom payment is due. Thus, the A/R Reserve does not offset the ADIT that has been funded, but rather it is a denotation in the accounting records to avoid overstating Accounts Receivable. Incurring bad debt expense is tax deductible on a book basis but not a tax basis, causing the temporary difference that requires the Company to incur financing costs, as Futral noted.[85] However, there is no inflow of funds that counteracts the tax payment, and therefore the ADIT asset is maintained until accrued bad debt is written off.[86] The inclusion of bad debt expense in the revenue requirement does not represent an offsetting cash inflow, as the bad debt expense merely allows a gross up to the revenue requirement to account for the portion of revenues that are estimated to be uncollectible – no cash is actually received to "recover" the bad debt expense amount.[87] The Commission should therefore conclude that no offset of cash flows is occurring, and include the bad debt ADIT asset in rate base.

E. Cash Working Capital

WSCK included a cash working capital allowance of $344,701 in its requested recovery in rate base. WSCK based this allowance on its use of the 1/8th operations and maintenance expense methodology. Futral asserts that the Commission should not approve this allowance and set the cash working capital to $0 in the absence of a lead/lag study. Futral contends that the 1/8th expense

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[84] DeStefano Rebuttal at 9.
[85] *Id.* at 8
[86] *See Commonwealth Edison Company*, Case No. 15-0287, at 24 (Ill. Commerce Comm'n Dec. 9, 2015) (articulating Illinois Commerce Commission's treatment of this issue and allowance of ADIT bad debt asset to be included in rate base); DeStefano Rebuttal at 9..
[87] VR: 11/30/22 at 4:37:50-4:38:40.

methodology is inaccurate because it does not quantify the leads and lags in corporate cash flow.[88] He cites multiple cases in which the Commission has deemed that a lead/lag study must be used for the calculation of cash working capital.

Though Futral is correct that a lead/lag study is a superior method of determining cash working capital,[89] his recommendation fails to account for Commission precedent specific to WSCK. In this Commission's 2020 WSCK rate case final order, the Commission said that the 1/8th method is a "reasonable approach for Water Service Kentucky, particularly given its size and relative sophistication, and the Commission will permit its use in this matter given those factors."[90] WSCK's status as one of the smallest investor-owned utilities that the Commission regulates has obviated the need to submit a lead/lag study and allowed it to rely instead on the 1/8th method.[91] Futral admitted that he is not aware of any change to WSCK that would alter the Commission's prior conclusion regarding the "size and relative sophistication" of WSCK.[92] Thus, the Commission should allow WSCK to recover the requested cash allowance in its rate base because it was calculated using an approved methodology for WSCK.

F. Other Recommendations by Futral Related to Rate Base

1. Project Phoenix Computer Assets

Intervenors' witness Futral recommends removal of Project Phoenix costs.[93] WSCK inadvertently included this amount in rate base and is agreeable to its exclusion.[94]

[88] Futral Direct at 31.
[89] DeStefano Rebuttal at 10.
[90] *Water Service Corp. of Kentucky*, *Case No.* 2020-00160 at 4 (Ky. PSC Dec. 8, 2020).
[91] DeStefano Rebuttal at 11.
[92] VR: 11/30/22 at 6:58:30.
[93] *See* Futral Direct at 18.
[94] *See* DeStefano Rebuttal at 3.

2. Oracle Fusion Regulatory Asset

In its Application, WSCK requested establishment of a regulatory asset related to the Fusion implementation.[95] Intervenors' witness Futral recommends that the Commission disallow this request.[96] WSCK agrees to withdraw this request for a regulatory asset and related rate recovery.[97]

3. New Vehicle Costs

WSCK seeks to recover the purchase of two new work trucks as part of the revenue requirement. The company initially estimated the purchase price of each of those vehicles to be $41,600 and $43,264.[98] WSCK has purchased a truck for $29,259 in 2022,[99] and it is hopeful that it can purchase the same model of that truck in 2023 for 4% more than it purchased the other truck, in the amount of $30,429. These prices are respectively $12,341 and $12,835 less than the forecasted new vehicle price. WSCK agrees with Intervenors' witness Futral that the recovered vehicle costs in the rate base should be updated to reflect the actual purchase price and the anticipated reduction of the 2023 purchase price from that which it initially forecasted.[100]

IV. Rate of Return Issues

A. Capital Structure and Cost of Debt

In its Application, WSCK forecasted its capital structure for the 13-month average ended December 31, 2023, to be 50.29% - 49.71% debt-to-equity ratio.[101] It updated its forecasted capital structure in the Base Period Update to be 49.80% - 50.20% debt-to-equity ratio.[102]

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[95] *See* Application at 14, ¶ 19.
[96] *See* Futral Direct at 25.
[97] *See* DeStefano Rebuttal at 3.
[98] Wilson Direct at 8.
[99] Response to AG DR 2-18(b)(2).
[100] DeStefano Rebuttal at 8.
[101] *See* Application, Exhibits 34 and 35.
[102] *See* Base Period Update, Exhibit 35.

Intervenors' witness Futral recommends using "the Company's most current projection of its cost of capital based on the recent actual financing activity."[103] This includes WSCK's updates provided through discovery and the Base Period Update regarding debt and equity ratios and debt issuances with the resulting blended cost of debt rate.[104]

The Forecast Period in this case, as required by 807 KAR 5:001, Section 16(6)(c), utilizes a 13-month average rate base and cost of capital.[105] In contrast, Futral's recommendation uses the cost of capital forecast, as updated in discovery, as of December 31, 2023, which is the end of the Forecast Period. To be consistent with the Commission's regulations, WSCK recommends the Commission utilize the 13-month average Forecast Period capital structure - debt/equity ratios and blended cost of debt - per the Company's Base Period update, filed October 31, 2022. This is consistent with the Commission's rulings on capital structure in past rate cases.[106]

Accordingly, WSCK requests the Commission reject Futral's position on this issue and approve a capital structure of 49.80% – 50.20% debt-to-equity ratio and blended cost of debt rate of 4.75%.

B. Return on Equity

The Commission should allow WSCK a return on equity ("ROE") of 10.6%, which is a conservative measure of ROE based on a 9.6% cost of equity with a 1.00% size adjustment.[107] Relying on four cost of equity valuation models, 9.6% is the lowest plausible cost of equity that WSCK could use in its ROE calculation.[108]

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[103] *See* Futral Direct at 68.
[104] *Id.* at nn.139-141 and accompanying text.
[105] *See generally* DeStefano Rebuttal at 11-12.
[106] *See, e.g.*, *Kentucky-American Water Co.*, Case No. 2018-00358 at 52-55 (Ky. PSC June 27, 2019) (finding that the revised capital structure from the base period update was appropriate with one revision to short-term debt to reflect a revised construction slippage rate).
[107] D'Ascendis Rebuttal at 5
[108] *Id.* at 5.

The cost of equity, premised on opportunity costs, is based on market data and various financial models that compare the utility to comparable or proxy companies.[109] In evaluating WSCK's required ROE, expert Dylan D'Ascendis employed the use of four models to reflect market risk and calculate the cost of equity: the discounted cash flow model, the risk premium model, the predictive risk premium model, and capital asset pricing model.[110] Though all these models present individual benefits of use, no single method of calculating the common equity cost rate is sufficiently precise to negate the benefits of using other models. The use of multiple models bolsters the reliability of the data used to assess the cost of equity and generates a market-reflective required ROE.[111] Similarly, these calculations must account for various market factors such as inflation and rising consumer prices that could cause increased risk and a higher required return for utility investors.[112]

The size of the utility is another critical factor in determining investors' risk tolerance and required ROE. Smaller companies are less able to cope with the volatile market factors such as business cycles and economic conditions.[113] Further, the loss of revenue from a few larger customers would much more significantly impact a smaller company than a bigger company with a larger base of customers.[114] In the present case, WSCK's estimated market capitalization was $14.849 million.[115] This number is incredibly small relative to the median market capitalization rate of $3.1 billion from the Utility Proxy Group, comprised of twenty-four similar businesses.[116] Given the disparity of size between WSCK and its peers, Mr. D'Ascendis appropriately noted that

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[109] D'Ascendis Direct Testimony, Application Exhibit 9.5 ("D'Ascendis Direct") at 8 (filed May 31, 2022).
[110] *Id.* at 15.
[111] *Id.* at 41-42.
[112] D'Ascendis Rebuttal at 13.
[113] D'Ascendis Direct at 42.
[114] *Id.* at 42.
[115] *Id.* at 46.
[116] *Id.*

a size adjustment was necessary to reflect WSCK's increased risk of investment due to being a smaller company.[117] Mr. D'Ascendis conservatively relied on a 9.6% cost of equity after evaluating multiple cost of equity modeling methods. Further, in accounting for market factors and the size of WSCK, he has used a 1.00% size adjustment, modifying WSCK's required ROE to 10.6% to account for a size adjustment that will adequately placate investors' risk tolerance and demand for ROE with realistic market outcomes.

Conversely, the Attorney General's ROE expert, Richard Baudino, asserts that the Commission should allow WSCK an ROE of 9.25% with no size adjustment. Mr. Baudino's recommendation that ROE range from 9.00% to 9.50% is singularly based on his use of the constant growth discounted cash flow ("DCF") cost of equity modeling he applied to a proxy group of six regulated water utilities.[118] WSCK agrees with Mr. Baudino that the DCF method of determining the cost of equity provides significant data to be used in analyzing ROE. The DCF model reveals that an investor purchases stock for an expected rate of return that originates with cash flows from dividends and growth in the market price.[119] Yet, WSCK strongly objects to Mr. Baudino's exclusive reliance on the DCF. Essentially, the use of just one cost of equity model in analysis makes assumptions that simply do not exist. The DCF model requires an assumption that the common equity cost is the same as a booked value of the equity. This simply does not happen in the real world due to a myriad of factors such as investor expectations of earnings per share and dividends per share, interest rates, or investor expectations of mergers or acquisitions.[120] Thus, the DCF model is limited in its ability to accurately reveal a singular, accurate cost of equity. Mr.

[117] *Id.* at 46-47.
[118] Baudino Direct at 3.
[119] D'Ascendis Direct at 15.
[120] D'Ascendis Rebuttal at 16-17.

Baudino's estimate should be discounted as it exclusively relies on the DCF and does not consider other models of cost equity that account for other factors relevant to the ROE analysis.

Mr. Baudino also sets the cost of equity at a market midpoint of 9.25%. He arrives at this number by exclusively relying on the DCF and the book value cost of equity that that singular model generated in his calculations.[121] This midpoint that Mr. Baudino sets understates investors' required ROE. Mr. Baudino's model is based on assumptions that cannot exist in reality, so it logically follows that there is no realistic way for the DCF to accurately reflect investor expectations of ROE. Mr. Baudino's methodology relies on a too simplistic representation of market to book ratios to be reliable.[122]

Additionally, Mr. Baudino's proposed ROE of 9.25% does not contain a size adjustment, which grossly misconstrues investors' risk in a capital investment in WSCK as compared to other similar businesses. The size of WSCK as a stand-alone entity should be considered when determining risk and the ROE investors' expectations as all WSCK capital investments will exclusively be used by WSCK and not any parent or affiliate corporations.[123] As a small company relative to the Utility Proxy Group, WSCK will experience higher levels of risk and greater reverberations of market and revenue changes than the larger companies.[124] Investors are aware of this increased risk associated with a smaller utility, and expect a higher ROE as an exchange for the assumption of risk with their capital investments in WSCK.[125] An upward adjustment to reflect this increased risk for a small company is necessary to predict an accurate required ROE.[126] Thus, the appropriate range of ROE, with the necessary size adjustment, would range from 10.63% to

[121] D'Ascendis Rebuttal at DWD-2R.
[122] D'Ascendis Rebuttal at 18.
[123] *Id.* at 40.
[124] D'Ascendis Direct at 42.
[125] *Id.*
[126] *Id.* at 46.

13.06%.[127] The Commission's adoption of a 10.60% ROE is a conservative benchmark for ROE based on multiple models of risk assessment as it relates to the cost of equity.

C. Rate of Return

Ultimately, WSCK requests approval of the weighted cost of capital calculated in the table below.

Description		Capitalization Ratio		Embedded Cost		Weighted Cost Rate
Debt		49.80%		4.75%		2.36%
Equity		50.20%		10.60%		5.32%
Total		100.00%				7.68%

V. Expense Issues

A. Advanced Metering Infrastructure

As discussed above, WSCK requests approval of a CPCN for AMI deployment. Intervenors' witness Futral recommends denial of the CPCN. Based on this recommendation, Futral further recommends that the Commission remove $19,068 in depreciation and other operating expenses associated with the AMI system.[128] Because WSCK has adequately supported a CPCN for the AMI project, it requests the Commission reject Futral's position on this issue.

If the Commission rejects the CPCN, however, it must increase operating expenses to include $79,676 in salary expense that WSCK accounted for as capitalized labor associated with the AMI project.[129] In his testimony, Futral suggests that the Commission not make this adjustment in order to account for some hypothetical expense associated with vacancies.[130] But

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[127] *Id.*
[128] *See* Futral Direct at 17.
[129] *See* Kilbane Rebuttal at 7-8; Futral Direct at 8.
[130] *See* Futral Direct at 18.

Futral readily admitted that WSCK's $79,676 in capitalized time for the AMI project has no correlation to the $79,676 reduction for which he recommends.[131] Accordingly, the Commission should not give any credence to Futral's position on this issue.

B. Payroll Expenses and Payroll Taxes

Exhibit 32 to WSCK's Application identified annualized Base Period expense to be $861,062, while annualized Forecast Period expense was projected to be $936,694.[132] The reasonableness of WSCK's payroll expense is verified through Quentin Watkin's Wage and Salary Study.[133] Specifically, it found that WSCK's 2022 base pay for 19 direct and allocated employees is 8% below the market midpoint.[134] As a part of increasing salaries to become more competitive in the market, WSCK projects higher than average increases for the 13 Kentucky-based employees during the Forecast Period.[135] Despite these market-related pay adjustments, WSCK's projected base compensation for 2023 will be 2% below the market averages.[136]

Intervenors' witness Futral recommended a reduction of payroll expenses in the amount of $49,716, and a corresponding reduction for payroll taxes in the amount of $3,803. He bases these adjustments on what he says would be reflective of an average increase of "3% to be consistent with normal merit raise percentage increases."[137]

Futral fails to acknowledge, however, that the above-average increases included in the revenue requirement are exclusively for WSCK's Kentucky-based employees.[138] Larger increases

[131] VR: 11/30/22 at 6:55:20.
[132] Application Exhibit 32 at line 6.
[133] *See* Watkins Supplemental Direct Testimony and related exhibits (filed Aug. 16, 2022).
[134] *Id.* at 3.
[135] VR: 11/30/22 at 2:56:10-2:57:02.
[136] *See* Watkins Supplemental Direct Testimony at 3.
[137] *See* Futral Direct at 42.
[138] *See* Response to AG DR_2-15_PSC_DR_1-49_Exhibit_18-32-29_-_Schedule_B_-_SW-PR_Taxes Benefits at tab "2023 Test Year", Column I; *see also* VR: 11/30/22 at 2:56:40.

are necessary for several of the positions, such as Field Tech I and Operator I, to move the positions' base pay closer to market levels.

Futral also erroneously asserts that there were approximately $100,000 of pay increases given in 2021.[139] As stated in discovery,[140] this amount was not completely associated with standard merit increases. The merit increase for the 13 direct personnel and the 6 allocated personnel from 2020 to 2021 was $45,762, which was a 3.1% increase from 2020.[141] The remaining dollars were related to the reorganization changes of allocations and personnel changes. For example, there were three allocated employees in 2021 who are no longer allocated to WSCK, but those three employees continued to be allocated to WSCK in 2021 while an additional employee was added to WSCK's allocation.[142] This overlapping allocation, however, never impacted rates because the 2020 rate case utilized a historical test period and the current case is using a forecasted test year.

For the foregoing reasons, WSCK requests that the Commission reject Futral's position on this issue.

C. Incentive Compensation

Intervenors' witness Futral recommends reduction of $6,698 associated with the financial performance portion of the Company's Employee Incentive Plan ("EIP"). He asserts that this expense should be removed because incentive compensation tied to financial performance benefits shareholders, not customers.[143] Although WSCK acknowledges prior Commission decisions supporting this argument, it respectfully disagrees.[144]

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[139] *See* Futral Direct at 41.
[140] *See* Response to AG DR 1-80.
[141] *See* Response to PSC DR 3-3.
[142] VR: 11/30/22 at 2:54:00-2:54:46.
[143] *See* Futral Direct at 44.
[144] *See* DeStefano Rebuttal at 12-13.

Supreme Court precedent recognizes that utilities must be entitled to maintain rates that allow a reasonable return on investment.[145] A utility's shareholders only arguably "benefit" from financial performance incentives to the extent the incentives are triggered or otherwise compensate for returns above authorized levels. In contrast, performance targets no higher than the authorized return merely meet the lawful requirements of providing a reasonable return to investors, and thus have no negative impact on customers. In addition, the Company includes the EIP for certain employees as part of its total compensation package to attract and retain quality employees in a competitive employment market, which is beneficial for customers.

The combined financial and non-financial metrics of the EIP work together to incentivize achievement of broad operational goals, and provide limitation to the possible prioritization of financial goals over other operating responsibilities, such as compliance, safety, customer service, and continuous improvement initiatives. Financial metrics also incentivize prudent financial management of ongoing operations, which benefits customers. For these reasons, WSCK respectfully requests that the Commission reject Futral's position on this issue.

D. Health Insurance Expense

WSCK included $188,595 in net expense in the Forecast Period applicable to its health insurance costs.[146] Intervenors' witness Futral recommends that health insurance expense be reduced by $28,944 because, he asserts, that the health insurance expense presumes full employment and that the forecasted expense increase of 21% is unreasonable.[147]

[145] *See Fed. Power Comm'n v. Hope Natural Gas*, 320 U.S. 591, 603 (1944); *Bluefield Water Works v. Public Service Comm'n*, 262 U.S. 679, 692-93 (1923).
[146] Application Exhibit 29.14, lines 9-10.
[147] *See* Futral Direct at 49-50.

Currently, however, every employee participates in the health insurance program, and therefore, WSCK incurs applicable costs.[148] WSCK projected the then-vacant positions to have the lowest-cost health insurance to ensure a conservative approach.[149] WSCK acknowledges that one allocated position—Director of Engineering & Asset Management—has not yet been filled. The forecasted health insurance expense for this position is $1,045. WSCK is agreeable to removing this amount for revenue requirement purposes.[150]

Futral's assertion that there was a 21% increase for the forecasted period is flawed.[151] His assertion is based on year-over-year increases from the Base Period trial balance accounts to the Forecast Period of 2023. The Base Period cost for health insurance for the six allocated employees are not reflected in the same accounts as non-allocated employees. The total cost of these allocated dollars would instead have been captured in Salaries and Wages Expense accounts based on how the Company allocates these expenses. The understatement to Base Period health insurance not captured by Futral is $15,991. Accounting for this allocation reduces the 21% to 10% based on the table Mr. Futral references from WSCK's response to AG DR 1-84. The difference between the 10% and the Company's health insurance expense increase of 6% is the reflection of the vacancies incurred during the Base Period.

Accordingly, WSCK requests that the Commission reject Futral's position on this issue. WSCK, however, is willing to concede to the removal of $1,045 from the forecasted health insurance expense, which is associated with the currently vacant allocated position.

[148] *See* Kilbane Rebuttal at 3.
[149] *Id.*
[150] *Id. at 4.*
[151] *See generally id.*

E. <u>Health Insurance Premiums</u>

WSCK covers approximately 80% of the health insurance premiums for single-only coverage, and it pays 79% of the health insurance premiums for all other coverage options.[152] Relying on a recent Commission decision, Futral recommends that the Commission reduce the recoverable amount of health insurance expense to correspond with the Bureau of Labor Statistics ("BLS") averages for single and family coverages of 78% and 66%, respectively.[153]

WSCK is aware of the recent Commission decision that adopts this position. It is worth noting that Futral indicated that his recommendation was simply based on Commission decisions and was not the product of his own opinions.[154] And there are several reasons why the Commission should move away from this position in this case.

First, Futral's proposal would effectively increase the health premium costs to the Company's employees, reducing their take-home pay.[155] He does not make or recommend any related increase in base pay or other total compensation that would offset this increase in cost to employees. This results in a punitive impact to the Company's employees. Moreover, it has a particularly harsh impact to the Kentucky-based direct employees, most of whom have salaries below the market midpoint, as demonstrated by WSCK witness Quentin Watkins.[156]

Second, the 2021 BLS data cited by Futral ultimately derives from the March 2021 Healthcare Benefits Table 11. However, the BLS has a better breakdown of this data that identifies a more relevant dataset for comparison to WSCK.[157] BLS provides a summary of the results cited by Mr. Futral, wherein BLS cites that employers of utility workers – as a subset of the

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[152] *See* Response to AG DR 2-65.
[153] *See* Futral Direct at 50.
[154] VR: 11/30/22 at 6:53:35.
[155] *See generally* DeStefano Rebuttal at 12.
[156] *See* Futral Direct at the table on 42.
[157] *See generally* DeStefano Rebuttal at 13.

broader "employers of private industry workers" data set – paid 84% of single and 79% of family premiums. In addition, more recent surveying of the utility worker data set supports 84% and 81%, respectively, paid by utility employers. These rates are more representative of WSCK's utility industry peers and correlate favorably to the Company's health care premium cost sharing rates.

Futral also acknowledged general concepts that support this position. He agreed that "more granual data is more valuable to" him when considering the reasonableness of a utility's expenses, if data is available for a benchmark.[158] When comparing benchmark data, Futral agreed that it is better to have something more comparable versus less comparable.[159] These general principles support WSCK's position that it would be more appropriate to compare WSCK-provided health care insurance premiums, in contrast to all workers in the private industry sector who may or may not require the same training and certification.

WSCK's total salary and benefit package is within a range of reasonableness, as explained by WSCK witness Quentin Watkins.[160] For the above reasons, WSCK requests that the Commission reject Futral's position on this issue.

F. Legal Expenses

WSCK included $18,071 in expense in the Forecast Period for annual legal fee expenses.[161] In determining this anticipated amount of the expense, WSCK averaged the expense amounts incurred for 2020 and 2021.[162]

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[158] VR: 11/30/22 at 6:52:00.
[159] *Id.* at 6:52:15.
[160] *See* Watkins Supplemental Direct Testimony at 3 (filed Aug. 16, 2022).
[161] Application Exhibit 29.11, line 4.
[162] Kilbane Testimony at 14.

Futral recommends a substantial reduction of this amount based on an average of legal expenses for the years 2017-2021 after removing two matters from that period.[163] This would result in an expense of $2,298, which is a reduction in expense of $15,773.

Futral's recommendation is unsound. Notably, although individualized issues on which legal services may be needed are non-recurring, every utility has legal expense. It is impossible to predict when litigation may arise. Likewise, there are generally recurring issues such as easements, employment, and revisions to Kentucky law and regulations that require legal services.[164] For example, the 2022 General Assembly revised the sales tax exemption for residential utility customers effective January 1, 2023,[165] and there will undoubtedly be legal questions that arise in 2023 related to this issue.

In this case, WSCK attempted to conservatively normalize legal expense by utilizing the average from 2020 and 2021 because the 2022 legal expenses have been unusually high. WSCK submits that this is the most reasonable approach, and it respectfully requests that the Commission reject Futral's position.

G. Fuel Expense

In its application, The Company projected $33,438 in fuel expense in the Forecast Period.[166] This was based on historic usage for the twelve months ended June 30, 2021 of 8,530 gallons multiplied by the gas price of $3.92 per gallon on May 5, 2022 (8,530 x $3.92 = $33,438).[167]

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[163] *See* Futral Direct at 54.
[164] VR: 11/30/22 at 4:07:45-4:08:26.
[165] 2022 Kentucky House Bill 8.
[166] Application Exhibit 29.10, line 2.
[167] Response to PSC DR 1-50.

Futral asserts that the fuel expense projection should be based on the most current average price per gallon. He recommends that the Company reduce fuel expenses based on September 21st gas prices, thus reducing fuel expenses by $5,067.[168]

Futral's position is flawed. He readily admits that the average price of fuel is fluid and volatile.[169] In addition, it is well known that gas prices in America—and Kentucky—are higher in the summer months when refineries transition to a different blend of fuel than what is used in winter. Accordingly, a utility's annual revenue requirement could be overstated if the most current data from a summer month is used, in comparison to a winter month. Similarly, a utility's annual revenue requirement could be understated if the most current data from a winter month is used, in comparison to a summer month. Nevertheless, in this case,[170] WSCK is not contesting the adjustment Futral makes on this issue.

H. Rate Case Expense

The Commission has acknowledged that "[i]t is a well-settled principle of utility law that rate case expenses 'must be included among the costs of operation in the computation of a fair return.'"[171] Likewise, it has stated that a utility is entitled "to recover all prudent and reasonable rate case costs."[172]

The Supreme Court of the United States has also supported recovery of rate case expense. In *Driscoll v. Edison Light & Power Co.*, 307 U.S. 104, 120 (1939), a regulatory agency refused to allow rate case expense to be recovered on the grounds that the utility was defending "obviously excessive" rates. The Court rejected the agency's decision, stating: "Even where the rates in effect

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[168] *See* Futral Direct at 59.
[169] *Id.*
[170] This concession—nor any others—in this case should not be construed in future cases as an admission or precedential.
[171] *Kentucky-American Water Co.*, Case No. 2010-00036 (Ky. PSC. Dec. 14, 2010)(quoting *Ohio Gas Co. v. Pub. Utils. Comm'n of Ohio*, 294 U.S. 63, 73 (1935)).
[172] *Kentucky-American Water Co.*, Case No. 97-034 at 23 (Ky. PSC. Sept. 30, 1997).

are excessive, on a proceeding by a commission to determine reasonableness, we are of the view that the utility should be allowed its fair and proper expenses for presenting its side to the commission."[173]

In its present case, WSCK initially estimated a total of $459,316 of rate case expense, which it proposed to recover through a three-year amortization period for a total of $153,105 to be included in the revenue requirement for rate case expense.[174] Prior to the hearing, WSCK filed the Rebuttal Testimony of James Kilbane, in which it acknowledged that certain estimated legal expenses associated with the rate case would not be incurred. Accordingly, the total estimated rate case expense was decreased by $100,000, which would reduce the amortization expense to an estimated $119,772.[175]

Following the filing of rebuttal testimony, WSCK has further updated its actual and estimated schedules for rate case expenses incurred. The evidence of record demonstrates that WSCK incurred at least $296,992 in rate case expenses through December 8, 2022. In addition, WSCK estimates that it will incur an additional $15,000 in rate case expense for additional work in drafting legal briefs and evaluation of the Commission's final order. Accordingly, WSCK amends its request for recovery of rate case expense to a total of $311,992 (nearly $150,000 below its initial estimate), which applying a three-year amortization period would be $103,997.[176]

Intervenors' witness Futral recommended removing costs associated with expenses incurred for legal services provided by Ice Miller LLP. He maintained that these legal expenses should be removed because (1) this additional expense was unreasonable in comparison to prior

[173] *Driscoll*, 307 U.S. at at 120-121.
[174] *See* Response to PSC DR 1-12 (filed June 28, 2022).
[175] *See* Kilbane Rebuttal at 9 (filed Nov. 23, 2022).
[176] *See* Response to PSC DR 1-12 (filed Dec. 13, 2022).

rate case costs and (2) the work performed by two law firms was duplicative.[177] Futral's rationale is not supported by the evidence in the case.

Futral's consideration of the estimated costs incurred for this case in comparison to the estimated costs incurred from prior WSCK cases has several flaws. First and foremost, the Commission generally considers the actual amount of rate case expense for inclusion in revenue requirement, as opposed to the initial estimate filed with an application.[178] Thus, a more appropriate comparison would be between the rate case expense actually incurred in two comparable rate cases.

Second, the current rate case is significantly more complicated than the past two WSCK rate cases on which Futral attempts to make a comparison.[179] Unlike prior cases, WSCK filed a forecasted test-year case, as authorized by Commission regulations. A forecasted test-year case has additional minimum filing requirements, in comparison to a historical test-year case. In addition, the Commission required WSCK to file (1) a rate base/rate of return case compared to the operating-margin method previously used, which demands the filing of an ROE study, and (2) a wage and salary study.[180] This required additional testimony and information to be filed in the current case compared to prior WSCK cases. The actual rate case expense incurred shows that consulting fees required to comply with the Commission's directives account for much of the increase in rate case expense compared to WSCK's previous rate case.[181]

In contrast to Futral's rationale, a comparison of rate case expense approved in similar cases serves as a better indicator of reasonable expenses. The best comparison to the present case

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[177] *See* Futral Direct at 61.
[178] *See, e.g.*, *Water Serv. Corp. of Kentucky*, Case No. 2020-00160 at 21 (Ky. PSC Dec. 8, 2020) (approving recovery of the rate case expense actually incurred in that case, including a reasonable estimate of additional legal services provided between the filing of the supplemental response and the final order).
[179] *See generally* Kilbane Rebuttal at 8.
[180] *See, e.g.*, *Water Serv. Corp. of Kentucky*, Case No. 2020-00160 at 10, 46.
[181] *See* Response to PSC DR 1-12 (filed Dec. 13, 2022)(showing $137,785 for consultants).

is Kentucky-American Water Company's Case No. 2018-00358, which is the most recent investor-owned water utility to file a forecasted test-year case based on rate base/rate of return. In that case, the utility submitted in its application an estimated rate case expense of $1,230,559.[182] The Commission ultimately determined that a reasonable amount of rate case expense incurred in that case was $1,296,794.[183] The rate case expense WSCK seeks to be determined reasonable in this case is merely $311,992—which is only one-fourth the amount the Commission has previously determined to be reasonable in another case.

WSCK acknowledges that there may be certain issue-related expenses incurred by Kentucky-American's 2018 rate case that WSCK has not included in its case. For example, Kentucky-American's case included a cost-of-service study ($50,000), internal capitalized time for rate case preparation ($312,141), and an unamortized balance of a depreciation study ($15,918).[184] Even if one were to remove those expenses from the Commission-approved rate case expense, the amount would total $918,735. That amount is nearly three times larger than the total rate case expense incurred by WSCK in this matter.

Futral's concern about work by two law firms is also unfounded. As WSCK witness Kilbane explained, the two law firms worked collaboratively to assist WSCK in preparing and presenting this case.[185] The team at Ice Miller is well suited to provide legal advice and information regarding WSCK's and its parent's corporate structure, due to Ice Miller's

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[182] *See* WSCK Hearing Exhibit 1 at page 2 of 63, also available here; *see also* *Kentucky-American Water Co.,* Case No. 2018-00358 at 47 (Ky. PSC June 27, 2019).
[183] *See* *Kentucky-American Water Co.,* Case No. 2018-00358 at 47 (Ky. PSC June 27, 2019).
[184] *See* WSCK Hearing Exhibit 1 at page 2 of 63, also available here; *see also* *Kentucky-American Water Co.,* Case No. 2018-00358 at 47 (Ky. PSC June 27, 2019).
[185] *See generally* Kilbane Rebuttal at 8; VR 11/30/22 at VR: 11/30/22 at 3:55:25-3:56:40.

involvement in other Corix matters.[186] The team at Sturgill Turner is well suited to provide legal advice and information on Kentucky-specific requirements and background.[187]

Questions at the hearing were raised as to the need for several attorneys working on a rate case. The complexity of these types of rate cases demands adequate staffing, and WSCK witnesses testified that the knowledge brought by Ice Miller, which serves as Corix's in-house regulatory counsel, regarding the Corix entity actually increased efficiencies in preparing portions of the rate case.[188] Records from the comparable 2018 Kentucky-American rate case reveal that there were at least six attorneys who billed various amounts of time on that matter, not including in-house regulatory attorneys that WSCK does not have.[189] In comparison, WSCK also had six attorneys, who billed various amounts of time on this matter.[190] But the total hours billed based on the evidence indicates that WSCK attorneys litigated this matter with less than half of the billable hours—1,150 comparted to 475—the 2018 case.[191] Thus, WSCK's utilization of outside counsel is reasonable in comparison to other, similarly situated rate cases.

This is further demonstrated by a comparison of legal expenses incurred in the two rate cases. Kentucky-American estimated legal expenses were $562,500, out of the total revised estimate of $1,337,744.[192] The Commission reduced that amount by $40,950 for work identified in legal invoices that the Commission determined to be unsupported.[193] This results in a total

[186] *Id.*; *see also* VR: 11/30/22 at 3:55:25.
[187] *Id.*
[188] *See* VR: 11/30/22 at 3:56:00-3:56:40.
[189] *See* WSCK Hearing Exhibit 2 at pages 22 and 90 of 90, also available here. At the evidentiary hearing, testimony revealed five outside attorneys who worked on the Kentucky-American 2018 rate case. The entirety of the exhibit revealed a sixth attorney who worked on that case.
[190] *See* Response and Supplemental Responses to PSC DR 1-12 (filed periodically)
[191] Compare WSCK Hearing Exhibit 2, also available here *with* Response to PSC DR 1-12 (filed Dec. 13, 2022). It is also worth noting that there was no objection to the number of hours billed by Kentucky-American's attorneys. *Cf. Kentucky-American Water Co.,* Case No. 2018-00358 at 50 (Ky. PSC June 27, 2019).
[192] *See* WSCK Hearing Exhibit 1 at page 2 of 63, also available here.
[193] *See also* *Kentucky-American Water Co.,* Case No. 2018-00358 at 50 (Ky. PSC June 27, 2019).

amount of legal fees deemed reasonable by the Commission in amount of $521,550. In comparison, WSCK revised actual and estimated legal expense totals only $164,654, which includes $15,000 for estimated expenses following the December update.

For these reasons, WSCK submits that its total rate case expense of $311,992, which applying a three-year amortization period would be $103,997, is reasonable.

I. Bad Debt Expense

WSCK included $169,278 in bad debt expense associated with uncollectible accounts in the Forecast Period.[194] Forecasted bad debt expense was calculated based on the average percentage of uncollectible accounts to revenues for 2019 through 2021, which results in an uncollectible percentage of 3.93 percent.[195]

Intervenors' witness Futral recommends that bad debt expense be calculated by using years 2017, 2018, and 2019 as well as the first 6 months of 2022, resulting in a 2.12% instead of the requested 3.93 percent. He argues that the bad debt expense should not include data from 2020 and 2021 when he believed the uncollectable accounts were heavily impacted by the pandemic.[196]

Futral's opinions, however, are not being realized by WSCK's uncollectible accounts activity. The activity from January to September 2022 reveals a 3.7% factor for bad debt expense.[197] This demonstrates that WSCK is still impacted by fallout from the pandemic. WSCK agrees that the bad debt factor realized in 2021 of 6.21% is abnormally high[198] and should not be used in forecasting WSCK's bad debt expense. But the 2022 factor of 3.7% is far closer to

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194 Application, Exhibit 29.2, line 10.
195 Kilbane Direct at 9.
196 *See* Futral Direct at 66.
197 *See* Kilbane Rebuttal at 7.
198 *See* Response to AG DR 2-45.

WSCK's proposed 3.93%, in contrast to Futral's recommended 2.12% that includes the bulk of its data from 2017 and 2018.

Moreover, data on bad debt expense reveals that it has remained fairly consistent after WSCK resumed collection operations in October 2021.[199] As discussed at the hearing, WSCK accounts for 85% of accounts receivable as uncollectible expense when the account is 180 days past due.[200] In reviewing the WSCK receivables, one can see that they have maintained relatively steady for the months from March to June 2022, which is 180 days after WSCK resumed normal collection operations.[201] WSCK witness Kilbane also explained how revenues have remained similar since rates last increased in January 2021.[202]

Accordingly, WSCK requests the Commission reject Futral's position on this issue.

J. Other Recommendations by Futral on Expenses

1. 401(k) Expenses

Intervenors' witness Futral recommends using historic 401(k) participation rates to calculate the 401k cost in the Forecast Period.[203] He recommends removing $15,815 in expense related to this adjustment. WSCK agrees that Futral's recommendation on this issue is reasonable and agrees with the $15,815 expense to be removed related to 401(k) costs.[204]

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[199] *See* Kilbane Rebuttal at 7.
[200] VR: 11/30/22 at 3:19:10-3:20:50.
[201] *See* Response to AG DR 2-47.
[202] VR: 11/30/22 at 3:53:22-3:55:00.
[203] *See* Futral Direct at 47.
[204] *See* Kilbane Rebuttal at 3.

2. Depreciation Expense

Intervenors' witness Futral recommends removal of $50,838 in expenses due to a depreciation calculation error in the initial filing.[205] WSCK agrees that Futral's recommendation on this issue is reasonable.[206]

3. Clinton Wastewater Expenses

Intervenors' witness Futral recommends removal of $11,541 of expenses related to Clinton's wastewater system.[207] WSCK agrees that Futral's recommendation on this issue is reasonable.[208]

VI. City of Clinton

The City of Clinton filed testimony from City Clerk Shannon Payne. Most of the issues raised in this testimony are not relevant to this rate case. WSCK nevertheless emphasizes that it is committed to maintaining good working relationships with Clinton. Payne confirmed at the hearing that she has not had issues getting in contact with WSCK State Manager Colby Wilson,[209] and that she has an expectation that she will be able to get in contact with him in the future, if necessary.[210]

VII. Pending Motions

WSCK notes that there are five pending motions for confidential treatment. In addition, WSCK filed a Motion for Leave to File Updated Evidence on Rate Case Expense on December 13, 2022.

[205] *See* Futral Direct at 59.
[206] *See* Kilbane Rebuttal at 6.
[207] *See* Futral Direct at 57.
[208] *See* Kilbane Rebuttal at 5.
[209] VR: 11/30/22 at 6:48:28.
[210] *Id.* at 6:48:38.

VIII. Conclusion

WSCK has met its burden of proof in this case with the appropriate modifications noted above. Accordingly, WSCK requests the Commission approve an increase in rates and the CPCN for an AMI program.

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