COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

ELECTRONIC APPLICATION OF BLUEGRASS	)	
WATER UTILITY OPERATING COMPANY	)	
LLC FOR AN ADJUSTMENT OF SEWAGE	)	**CASE NO. 2022-00432**
RATES	)	

TESTIMONY OF

DAVID DITTEMORE

ON BEHALF OF

THE OFFICE OF THE ATTORNEY GENERAL

JUNE 30, 2023

DIRECT TESTIMONY OF DAVID DITTEMORE

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I. Qualifications and purpose of testimony

Q. Please state your name, business address, and occupation for the record.

A. My name is David N. Dittemore. My business address is 609 Regent Park Drive, Mt. Juliet, TN, 37122. I am a self-employed consultant specializing in utility regulatory matters.

Q. Please provide a summary of your background and professional experience.

A. I received a Bachelor of Science Degree in Business Administration from the University of Central Missouri in 1982. I am a Certified Public Accountant licensed in the state of Oklahoma (#7562). I was previously employed by the Kansas Corporation Commission (KCC) in various capacities, including Managing Auditor, Chief Auditor, and Director of the Utilities Division. I subsequently became Manager of Regulatory Affairs for Williams Energy Marketing and Trading. I was self-employed as a Utility Regulatory Consultant for approximately four years representing various clients on regulatory issues. For eleven years, I served as Manager and Director of Regulatory Affairs for KGS, the largest natural gas utility in Kansas, serving approximately 625,000 customers. KGS is a division of ONE Gas, a natural gas utility serving about two million customers in Kansas, Oklahoma, and Texas. I joined the Tennessee Attorney General's Office in September 2017 as a Financial Analyst and served in that role until July 1, 2021, when I initiated my consulting practice. Overall, I have thirty-five years of experience in the field of public utility regulation. I have presented testimony as an expert witness on many occasions. Attached as Exhibit DND-1 is a detailed overview of my background.

Q. Have you previously provided testimony before the Kentucky Public Service Commission?

A. Yes. I provided written testimony in Case No. 2021-00183.

Q. On whose behalf are you testifying?

A. I am providing testimony on behalf of the Office of the Attorney General of the Commonwealth of Kentucky ("AG").

Q. Please summarize the Company's proposal in this proceeding.

A. The Company requests approval of a total Revenue requirement of $3,727,085, representing a rate increase of $1,291,491. This proposal represents an overall increase of 53%.

Q. How is your testimony structured?

A. My testimony is structured as follows:

Scope of Testimony

Revenue Requirement Recommendation

Overview of Company Operations

Sponsored Exhibits

Challenges in Determining an Appropriate Revenue Requirement

Adjustments to Rate Base

Adjustments to Revenue

Adjustments to Operating Expenses

Adjustment to Capital Structure

Comments on Corporate Cost Allocations/Payroll

II. Scope of Testimony

Q. What was the scope of your review in this proceeding?

A. The scope of my review included an analysis of the Revenue requirement proposal of Bluegrass Water Utility Operating Company LLC ("Bluegrass") and a proposed rate design based on the recommended Revenue requirement. My review did not focus on the engineering, infrastructure, and project costs incorporated into the applicant's proposal. Any Revenue requirement issues not addressed in my testimony should not be construed as acceptance or adoption of the Company's methodology unless explicitly stated in my testimony.

III. Revenue Requirement Recommendation

Q. What is the overall Revenue requirement you are supporting in this proceeding?

A. I am recommending the Kentucky Public Service Commission ("Commission") adopt a base rate Revenue requirement of $2,941,223 representing an overall revenue increase of $518,782, comprised of a base rate increase of $454,940, and incremental late fees associated with the rate increase of $63,842. My proposed Revenue requirement is identified as Exhibit DND-4.

Q. What test period is the Company supporting in this proceeding?

A. The Company supports the twelve-month period ended June 30, 2022, as its test period.

IV. Overview of Company Operations

Q. Provide an overview of the nature of the Company's operations.

A. As discussed in the testimony of Mr. Cox, Bluegrass' parent, Central States Water Resources ("CSWR") operates in Missouri, Kentucky, Louisiana, Texas, Arkansas, Tennessee, Mississippi, Arizona, North Carolina, South Carolina, and Florida. In addition, CSWR has pending requests to expand its operations before state regulatory commissions in each state in which it currently operates, plus California. A list of each of these pending acquisitions is listed as Exhibit DND-2. This listing is limited to acquisition dockets and does not include rate increase requests.

Q. What conclusions do you draw from the lengthy list of dockets identified in Exhibit DND-2?

A. CSWR places a significant emphasis on acquisitions, as demonstrated by the number of pending acquisition dockets and the 79% growth in customers over a 16-month period as discussed below.

Q. Please summarize the business model of CSWR

A. CSWR has a unique business model, consisting of acquiring water/wastewater systems, often in great need of repair, and funding the necessary improvements. The Company utilizes third-party contractors to operate and maintain the systems and separate contractors to bill customers. CSWR currently operates approximately 800 water and/or wastewater systems in eleven states. While it has engineers and operations professionals on staff in its headquarters, day-to-day system operations are performed locally by non-CSWR contractors.

V. Sponsored Exhibits

Q. Are you sponsoring exhibits as part of your testimony?

A. Yes. The Exhibits I am sponsoring are identified below:

Exhibit DND-1	Education and Work History
Exhibit DND-2	Listing of current CSWR Acquisition Dockets
Exhibit DND-3	OAG request 2-30, PSC request 3-18
Exhibit DND-4	Summary of OAG Sponsored Rate Increase Recommendation
Exhibit DND-5	Calculation of Rate Base
Exhibit DND-6	Normalize Late Fee Revenue
Exhibit DND-7	Annualize Depreciation/Amortization Expense
Exhibit DND-8	Eliminate Non-Recurring Charges
Exhibit DND-9	Normalize Bad Debt Expense
Exhibit DND-10	Annualize Insurance Expense
Exhibit DND-11	Normalize and Annualize Employee Medical Costs
Exhibit DND-12	Capital Structure Scenarios

VI. Challenges in Determining an Appropriate Revenue Requirement

Q. Are there unique challenges in calculating an appropriate Revenue requirement in this proceeding?

A. Yes. The parent of Bluegrass, CSWR, has expanded greatly since the test period. The system had a customer count of 78,711 as of December 31, 2021, the midpoint of the test period, and had grown to 140,978 customers as of April 2023, an increase of over 79%. This significant growth, coupled with the use of a nearly twelve-month-old test period, poses challenges in establishing an appropriate Revenue requirement. This level of growth, paired with the scope of existing open acquisition dockets, highlights CSWR's focus on growing its water/wastewater systems network. In my opinion, the Company's filed Revenue requirement is not representative of ongoing operations due to the significant level of growth, and therefore the Revenue requirement analysis requires substantial updating.

Q. Did you experience other challenges in reviewing the Company's Revenue requirement proposal?

A. Yes. The information provided by the Company in response to AG discovery requests has proved problematic in updating operating results. One example is the identification of customers in this proceeding. In his testimony, Mr. Cox identifies 2,488 wastewater customers and 348 water customers for a total Bluegrass customer base of 2,836.[1] The response to AG 1-45 identifies 3,471 monthly Bluegrass customers throughout 2021, including water and wastewater customers, a significant deviation from the 2,836 customers identified by Mr. Cox. The level of customer connections owned included in the Company's 2022 second quarter cost allocation calculation is 3,573,[2] which would include both water and wastewater customers. In response to AG 1-124, the Company has indicated that 90.72% of the total customers are wastewater customers.[3] Applying this percentage to the total Bluegrass customer counts identified in responses 1-43, part 6 of 8, effective for the second quarter of 2022, indicates a wastewater customer count of 3,225.[4]

Another example is the evaluation of the Company's proposal to implement a 10% late fee on any past due account.[5] This proposal is supported by its assertion that the Company operates several jurisdictional wastewater systems that are authorized to charge a 10% late payment penalty adopted prior the system acquisition by the Company. The Company has not reflected a test period adjustment to quantify the impact of its proposal within its Revenue requirement.[6] Therefore, the Company is requesting a $1.29 million rate increase, coupled with a request to implement a significant late fee, while failing to

[1] Cox testimony page 4: 19-20. Presumably this customer count would not be calculated on an equivalency basis as is used in Mr. Lyon's rate design calculation.
[2] These customer counts are used in the general allocator calculation used to allocate administrative and general costs among CSWR affiliates. See Response to AG 1-43, part 8 of 8.
[3] The response to AG 2-76 indicates that overhead costs assigned to Bluegrass are split between water and wastewater operations based on customer counts.
[4] Customer counts affect not only proforma Revenue but are also one component of the Company's cost allocation methodology.
[5] Thies testimony page 37:20-22.
[6] See Response to AG 1-66.

recognize additional Revenue from the proposal. Therefore, the Company seeks to increase Revenue in excess of its stated $1.29 million base rate increase. The AG sought to quantify the impact of the Company's proposal on its ongoing Revenue stream, which is necessary to quantify an appropriate Revenue requirement. The Attachment to AG 1-66 indicates that an additional $352,865 of Revenue would be generated if the fee had been implemented in 2022, based on accounts that were **30 days past due**. However, the Company seeks to implement the fee based upon any past due amounts, not simply those 30 days past due. The AG attempted to clarify the Revenue impact of the proposal on all account balances that were past due, consistent with the Company's proposal in request AG 2-7. The information provided in AG 2-7 reflects the Company would have charged late fee Revenue of $356,034 to any past due balance based upon 2022 accounts receivable activity. The claim that the Revenue associated with amounts that are **30 days past due** is nearly identical to the Revenue that would be generated for **all past due** balances is not reasonable.

Q. Do you have an example of an area of discovery where the Company has failed to provide necessary information?

A. Yes. A third example of unresolved issues centers around confirmation of the amount of Business Development related costs the Company has removed from its Revenue requirement proposal. The Company's response to AG 1-124 indicates it has removed $135,709 in CSWR Executive/Business Development costs from total CSWR General Ledger costs in this case. The Business Development costs are subtracted from total

CSWR costs[7] to arrive at net costs subject to applying the Company's general three-part allocation percentage. Based upon the line-item description in this calculation, the reader assumes that the Business Development line item reflects all costs identified and excluded by the Company, however, this is not the case. A close examination of the response to AG 1-124 indicates that these Business Development exclusions are comprised of apparent employee travel expenses and the costs of third-party contractors and do not include any employee compensation.[8] In response to AG 2-26, the Company identifies those employees the Company claims are devoted to Business Development activities and which were purportedly subtracted in arriving at the level of costs assigned or allocated to Bluegrass. The response identifies three full-time employees who are 100% devoted to Business Development activities, one whose time is 95% dedicated to Business Development activities, and five executives who each devote 11% of their time to Business Development activities. However, it is unclear how and where these deductions are reflected in the identical calculations provided in response to AG 1-124 and PSC 2-30.

Q. Do you have specific discovery requests related to the issue of Business Development costs where requested information has not been provided?

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[7] Other items are deducted from total CSWR expenses prior to applying the general allocator. Other subtractions include items identified as Payroll, and other Line-Item Exclusions. The excluded payroll costs reflect those directly charged or indirectly allocated to various CSWR affiliates. The CSWR payroll assigned to Bluegrass operations (water and wastewater) was $333,896 in the test period out of total CSWR payroll/EE costs of $7,224,534. A review of the items identified as payroll indicates such totals also include Property Insurance.

[8] The detailed information publicly provided in AG 1-124 was designated as Confidential in PSC response 3-18. While the cost detail provided was similar, additional cost identifiers were provided in PSC response 3-18 that were not contained in OAG response 1-24.

A. Yes. I have attached Exhibit DND-3, which contains AG Discovery request 2-30 and related questions posed in PSC 3-18. Neither response clearly identifies the amount of Business Development payroll excluded in this case, nor is it traced back to the calculation provided in AG 1-124, demonstrating such costs were eliminated in determining costs allocated to Bluegrass. Other information requested in AG 2-30 concerning the development of costs assigned to Bluegrass remain unanswered.[9]

Q. Do you have any information indicating the amount of expense the Company claims to have designated as Business Development costs that are not subject to allocation to Bluegrass?

A. The Company has provided information in Confidential Response AG 1-53 regarding compensation by employee. I then applied this information to the list of employees engaged either fully or partially in Business Development activities provided in response to AG 2-26. Matching these two pieces of information, I have calculated a total of [redacted] associated with the Business Development function. Again, I wish to emphasize that while the amount has been quantified, it is unclear how it has been eliminated in the Company's cost allocation calculations. The Company should demonstrate that this amount of base compensation has been eliminated from its corporate cost allocations, plus a ratable portion of related employee taxes and benefits.

Q. If the Company can demonstrate that it removed the amount above from costs allocated to Bluegrass, would that satisfy your concerns?

[9] See AG 2-30, parts b – e.

A. The Company's transparency on this issue would confirm that the Company has performed its calculation consistent with its explanation, inclusive of payroll taxes and employee benefits. However, the Commission must also consider whether the claimed costs are a reasonable estimation of Business Development costs given the historic growth of the system coupled with the number of open acquisition dockets throughout the CSWR footprint.

Q. How does your calculation of the Business Development payroll, per the Company's explanation, compare to the total test period payroll?

A. The Business Development payroll of [redacted] represents 11.28% of the total test period payroll.[10] This ratio seems like a relatively small percentage of total payroll costs, given the scope of the Company's acquisition efforts.

Q. Have you discovered other evidence suggesting the costs purportedly subtracted as Business Development costs are understated?

A. Yes. An examination of the detail provided in PSC 3-18 identifies an employee who incurred nearly $5,000 in expenses labeled Business Development related costs. However, this employee is not listed as an employee that incurs any Business Development labor costs identified in response to AG 2-26. Another aspect of the AG 2-26 response that causes me to believe that the Company is understating its Business Development activities is that there are no internal legal resources identified by the Company associated with its Business Development activities. In my opinion, the term Business Development includes the process of acquiring systems. While the Company

[10] The total CSWR payroll is calculated as [redacted] per the Confidential response to AG 1-53.

may rely upon third-party attorneys to a significant extent in the acquisition process, I don't think it's reasonable to assume third-party attorneys act independently without in-house attorneys' review or consultation.

Q. What conclusions can you draw from the various concerns discussed above?

A. The current rates of Bluegrass wastewater customers are quite high. Most customers are paying a flat charge of $85.97/month. All requests to increase monopoly rates deserve a thorough review, especially those of the magnitude proposed in this case. Some customers are facing an increase of nearly $87/month. The Company should address these outstanding issues and any other issues raised by other parties to provide the Commission with sufficient information necessary to determine just and reasonable rates in this proceeding. In this case, the procedural schedule does not allow for further discovery to reconcile some of these issues.

VII. Rate Base Adjustments

Recovery of Acquisition Premium in Rate Base is not appropriate

Q. How have you treated the implications of the Delaplain CPCN, the remote monitoring CPCN, the Site Visit Waiver, and the proposed Randview sale, as discussed in Mr. Thies' testimony on page 26 within the Revenue requirement calculations?

A. I have not incorporated the Revenue requirement implications of these proposals into my Revenue requirement analysis. The Company has not included these implications either, so I have treated them in an identical manner to the Company in this case. The Company identifies the impact of these pending matters on page 26 of Mr. Thies' testimony.

Q. Please now turn to your Rate Base adjustments and identify Rate Base adjustment no. 1.

A. Rate Base adjustment no. 1 reduces land values that were written up within acquisitions pursuant to an independent market value appraisal.

Q. Have you reviewed the appraisal supporting the write-up of the Delaplain land as discussed in Mr. Thies' testimony?

A. Yes, I have.

Q. How does Mr. Thies describe the accounting underlying the Delaplain land value?

A. Mr. Thies indicates that the prior owner failed to account for the land value of the Delaplain and River Bluffs systems. He continues to indicate that an appraisal was undertaken to establish the value of land recorded on the books of Bluegrass.

Q. What is the land value attributed to the Delaplain and River Bluffs system?

A. The Delaplain land value is $607,772. The value attributed to the land of the other system in which an appraisal was used to assign value to land is the River Bluffs development in the amount of $90,684. The total of assets written up associated with land appraisals is $698,456. This adjustment as well as that of Rate Base adjustment nos. 2 and 3, are outlined in Exhibit DND-5.

Q. Do you recommend the Commission accept the write-up of assets within the Bluegrass Rate Base?

A. No. First, as a matter of presentation, these asset write-ups are simply another form of an Acquisition Premium and should be considered for ratemaking recovery in that manner.

Secondly, the appraisal does not consider the unique characteristics of utility property. The concept of valuing utility property is a circular exercise. If the asset is included in Rate Base as authorized by the applicable state utility regulator, it will generate a return and positive cash flow, and the market value is equal to the regulatory authorized Rate Base component. If the asset is not deemed eligible for inclusion in Rate Base, it produces neither a return nor a cash flow. The market value of utility assets is in large part based upon the regulatory treatment authorized by the state utility regulatory authority. If the asset has an alternative use other than in the provision of utility service, it may have a market value greater than the nominal amount included in Rate Base. However, this alternate market value is not the appropriate Rate Base value since the asset is not essential in the provision of utility service. If the asset is required in the provision of utility service, it is not eligible for an alternative use; thus its hypothetical alternative value is irrelevant.

The value of an asset included in Rate Base should be based upon the asset's initial cost when placed in service, less accumulated depreciation. Ratepayers should not be burdened with asset write-ups as a result of acquisitions. For depreciable assets, the Rate Base component is reduced by the accumulated depreciation recorded since the asset was placed in service.

Q. Do you believe the Commission should evaluate the recovery of acquisition premium costs in this proceeding in the context of the rate pressure facing Bluegrass customers?

A. Yes.

Q. Please explain Rate Base adjustment no. 2.

A. Rate Base adjustment no. 2 removes $90,171 of Acquisition Premium costs from Rate Base from ten separate system acquisitions, identified on page 29 of Mr. Thies' testimony. The support for this adjustment is similar to that discussed in Rate Base adjustment no. 1. Customers are facing extreme rate pressure within the Bluegrass system and should not be burdened with incurring the write-up of Rate Base simply due to a change in ownership. This adjustment also impacts Depreciation Expense by $2,350 based upon a company-proposed amortization rate of 2.61%.[11]

Q. Identify Rate Base adjustment no. 3 and provide the rationale for this adjustment.

A. Rate Base adjustment no. 3 removes $39,500 from Rate Base associated with the write-up of asset values on the Springcrest, Woodland Acres, and Herrington Haven systems that the company claims had no historical net book value but for which the reports were not up to date. The support for this adjustment is similar to that for Rate Base adjustment nos. 1 and 2. The Company has recorded this acquisition premium to Account 352.

Q. How do you respond to Mr. Thies' argument that the systems and customers have realized economies of scale in virtually every aspect of operating and managing a small water/wastewater system?

A. The Company is attempting to retain economies of scale in this proceeding through a June 30, 2022 test period, which does not reflect the cost implications associated with the 79% system growth it has experienced since the end of the test period. Secondly,

[11] See AG 1-113, Interest and Depreciation tab.

customers may find it difficult to appreciate any claimed economies of scale given their current monthly bill of $85.97 or the proposed monthly bill of $99.37.

Q. Do you have any other comments concerning the Rate Base components proposed by the Company?

A. Yes. I believe the one-eighth method of determining cash working capital does not typically produce accurate results as it over-simplifies the cash needs of the Company by merely applying an assumed 45-day lag[12] to all operating expenses. In theory, this 45-day period represents the net lag between when Revenue is collected and when operating expenses must be paid. However, in this proceeding, I am not supporting an adjustment to eliminate the results of the 45-day methodology, given the large Accounts Receivable balances reflected in response to AG 2-7. This response indicates that there is indeed a Revenue lag in play associated with the Company's Revenue collection function. For this reason, I have not elected to adjust the Company's cash working capital component of Rate Base.

VIII. Adjustment to Revenue

The Company has not quantified the Revenue impact of its Late Fee proposal

Q. Please identify and discuss the adjustment to Revenue you are supporting.

A. Adjustment no. 4 increases Late Fee Revenue $341,790 to reflect the impact on operating Revenue from the Company's proposal to implement a 10% late fee on any past-due balance. This adjustment is set forth in Exhibit DND-6. The AG is not taking a position on the policy implications of this proposal; however, it understands from Mr. Thies'

[12] Forty-five days equal approximately one-eighth of a year, hence the reference to the one-eighth method.

testimony that this charge has been previously authorized for certain systems it currently operates, and the proposal is to implement the fee across all of its Kentucky systems. The Company's failure to reflect the impact of its proposal on operating Revenue results in a request to increase Revenue by more than the stated $1,291,491. The Company's late fees will also increase as a result of any rate increase granted in this proceeding. Based upon information provided by the Company in AG response 2-7, the appropriate gross-up factor would be 1.1632 applied to any net increase in base rates. In other words, the base rate increase adopted in this proceeding will be approximately 14% less than the Revenue requirement deficiency, with the balance to be collected in estimated late fees based upon test period accounts receivable balances.

Q. Do you have any recommended modifications in the Company's late fee proposal?

A. Yes. If the Commission adopts the requested late fee charge of 10%, I recommend that the Commission clearly state that this fee should be imposed by the Company on those accounts <u>30 days or more past due</u> and should be reflected as such in the Company's tariff. This language differs from the Company's proposal to apply the fee to <u>any</u> past due accounts receivable balance.

IX. Operating Expense Adjustments

Amortization/Depreciation Expense on Acquisition Premium

Q. What is the Amortization and Depreciation Expense level included by the Company associated with its claimed Acquisition Premium?

A. Adjustment no. 5 reduces the Depreciation Expense $3,230 by eliminating the impact on such costs associated with acquisition premiums. This adjustment is calculated in Exhibit

DND-7. I provided the support for this adjustment within the explanation of Rate Base adjustment nos. 2 and 3, discussed above.

Elimination of Non-Recurring Charges

Q. Have you identified non-recurring charges that should be removed from the revenue requirement?

A. Yes. In response to discovery request AG 1-108, the Company indicated certain implementation, training, and data conversion costs associated with its vendor contract Muni-Link, represented one-time costs and were not recurring. Muni-Link is the Company's billing software vendor. The Company identified these non-recurring costs in response to AG Request 1-106. I then applied the appropriate general allocation factors based on the period in which the non-recurring costs were recorded. The resulting adjustment is a reduction in Operating Expenses of $12,035 as contained in Exhibit DND-8.

Elimination of Unsupported Charges

Q. Are you sponsoring an adjustment to bad debt expense?

A. Yes. The Company is proposing an overall request for Bad Debt expense of $46,296. This is the sum of the test period pro-forma balance of $33,382 plus an adder of 1% applied to the Company's rate increase request.

Q. What level of bad debt expense are you sponsoring, and what is the basis for this amount?

A. I am sponsoring a level of Bed Debt Expense of $2,529. This balance represents the amount of written-off accounts during 2022.[13] This amount is admittedly relatively low in relation to the Company's overall Revenues. However, the Company has not supported its level of Bad Debt Expense in this filing.

Q. Briefly describe the accounting theory and process which should be used to record bad debt expense.

A. There are two acceptable methods for accounting for Bad Debt Expense. The method that the Company utilizes, is to record an Allowances for Doubtful Accounts.[14] Under this method, an estimate of Uncollectible Accounts is applied to Revenue, which is designed to estimate the eventual uncollectible Revenue for that period. This allowance is a contra-asset account with a normal credit balance. The offset to the credit entry is to charge (debit) Bad Debt Expense. When an account has been confirmed as uncollectible, the Allowance for Doubtful Accounts is debited, and the Accounts Receivable are written off (credited). The second method is called the Direct Write-off method. When an account is deemed to be uncollectible, it is charged to Bad Debt Expense, while the Accounts Receivable balance is credited.

Q. Earlier, you indicated that the Company has not supported its level of bad debt expense. What is the basis for your conclusion?

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[13] The source of this information is the response to AG 2-14(b). This amount is more significant than the 2021 write-offs ($1,419), or 2020 write-offs ($68).

[14] The Company refers to this as the Accumulated Provision for Uncollectable Accounts in its Trial Balance as reflected in the response to PSC Request 1-3.

A. There are two reasons I came to this conclusion. First, the response to PSC 1-3 includes the Company's Trial Balance during the test period. The Trial Balance reflects that the credits to the Company's Accumulated Provision for Uncollectible Accounts contain credits of approximately $34,000, which is close but not identical to the test period balance of Bad Debt Expense, $32,027. However, there are no debits reflected in the Trial Balance for the Allowance for Doubtful Account. Debits to this account would reflect the actual write-off of an account receivable. Secondly, in response to AG request 2-63 in support for its claimed 1% Bad Debt ratio, the Company indicated that "There is no significant analytical support to provide." This response was a follow-up to the Company's statement in response to AG 1-116, wherein it stated, “The percentage and the methodology have been reviewed by management and deemed sufficient based upon their experience in the industry until such time as the company has more historical, post-Covide-19 data on collections and past due balances.”

For these two reasons, I don't believe the Company has adequately supported its claim for Bad Debt expense in the amount of $44,942, and instead, I recommend Bad Debt expense be set at the amount of account write-offs occurring in the test period, $2,529, resulting in an adjustment of $42,413 as reflected in Exhibit DND-9. This approach reflects the second alternative to determining an acceptable level of Bad Debt expense as described above. The Company has not supported its claimed level of Bad Debt expense in this filing.

Annualize Insurance Expense

Q. Has the Company experienced a material change in Insurance expense since the end of the test period?

A. Yes. Insurance expense has been reduced significantly beginning in January 2023. Exhibit DND-10 quantifies the annualized Insurance expense savings at $89,411, based upon annualizing the expense recordings in the first quarter of 2023, then comparing this result to test period charges. I obtained this information from the response to AG discovery request 1-120.

Employee Benefit Cost Annualization and Normalization

Q. Have you evaluated employee benefits costs for compliance with the regulator treatment authorized by the Commission in Case 2020-00290, the Company's last base rate case?

A. Yes. In Case No. 2020-00290 the Commission found that:

> *It is the Commission practice that, in the absence of any compensation policy or benefits study regarding insurance benefits, an adjustment should be made to both health and dental insurance to bring the employee contributions in line with the Bureau of Labor Statistics average employer contribution percentages of 21 percent for health and the Willis Benefits Benchmarking Survey 60 percent average employer contribution for dental insurance.*[15]

The Company commissioned a report by Madden and Associates, sponsored by Bluegrass witness Quentin Watkins, concluding that the Company's compensation levels, including medical and dental costs, are in line with comparable positions in the St. Louis area.

Q. Do you accept this conclusion reached by Mr. Watkins?

[15] Case No. 2020-00290, pages 85-86, Order of August 2, 2021.

A. No. The study identifies eight positions for the study, including three managers, two specialists, an inspector, and an accountant. None of the surveyed positions included a comparison of a single Bluegrass executive position. Based upon this limited survey, the study then concludes Bluegrass compensation, including benefits, is reasonable for all employees. More importantly, as it relates to considering the reasonableness of benefits, the study identifies Health Benefit costs ranging from $873 - $2,620 per employee.

Q. Have you evaluated this average cost per employee for reasonableness?

A. Yes. Information provided in response to AG 1-47[16] indicates the Company incurred a total of $695,909 in health and dental costs in the test period. I then identified that within the test period, the Company employed 59 people, of which 29 were employed less than the full test period. I then divided the total CSWR test period medical costs by the full 59 employees to arrive at an average cost per employee of $11,795.[17] This cost per employee is significantly greater than the comparable cost used within the Madden study. For this reason, I don't believe the Commission should rely upon the Madden study to justify the inclusion of the total amount of medical costs, nor does the study meet the requirement set out by the Commission in the passage above.

Q. How did you calculate the adjustment to Employee Benefits?

A. I obtained the monthly CSWR medical costs for the test period and months after the test period. The information obtained in this response indicated that Company medical costs had increased significantly after the test period. I obtained the most recent Bureau of

[16] The Company's response to AG 1-47 also includes dental costs, however I deemed them immaterial once such costs would be allocated to Bluegrass.
[17]The true cost per employee would be much greater if the costs were divided by the number of full-time equivalent employees. However, for this purpose, this refinement was not necessary.

Labor Statistics (BLS) data on the average employer contribution for medical costs, identified at a ratio of 78%.

Next, I applied the Company's quarterly test period general allocation ratios, further refined to Bluegrass' wastewater operations to test period costs, and determined that on a weighted average basis, Bluegrass wastewater operations incurred 4.31% of total CSWR medical expenses. I then annualized pro-forma medical expenses using the higher costs incurred in January – March 2023. I then applied the weighted average Bluegrass wastewater allocation percentage to the annualized cost data and further reduced the pro-forma costs to the 78% ratio set out in the BLS data, resulting in an adjustment to increase employee benefit costs $15,375. This adjustment then accomplishes two things. First, it annualized Employee Benefit costs using the most recent quarterly data available. Second, it reflects the Commission's findings in Case No. 2020-00290, that absent supporting evidence to the contrary, employee benefit costs should be limited to the percentage of average employer contributions. These calculations are set out in Exhibit DND-11.

X. Capital Structure

The proposed Capital Structure is not reasonable

Q. Have you reviewed the Capital Structure proposed by Bluegrass?

A. Yes.

Q. Do you believe the capital structure proposed by Bluegrass is reasonable?

A. No, I do not. The Company is proposing a capital structure comprised of 61.16% equity and 38.84% debt, with a requested 11.65% cost of equity producing an overall rate of return of 12.13%. The level of debt is based on the outstanding commercial debt Bluegrass had at the end of its test period. The components of the Company's proposed capital structure have alternatively been referred to as 'actual'[18] and hypothetical.[19] The Company's supported level of debt in the Capital Structure is $2,481,126. This contrasts with the Balance of Notes Payable on the Bluegrass Balance Sheet of $2,900,000[20], further identified as commercial debt. This level of debt is clearly attributed to the capitalization of Bluegrass. For purposes of the Capital Structure I am supporting, I will accept the $2,481,126 supported by the Company. The remainder of the Rate Base is funded by what I will refer to as 'residual' capital; the source is unclear. It is this residual capital that is in dispute.

Q. How has the Company classified this level of residual capital?

A. The Company claims the residual capital as 100% equity, resulting in a capital structure of 61.16% equity, 38.84% debt. This is not reasonable. Funding provided by a parent of Bluegrass is classified as contributed capital (equity) on the books of Bluegrass, but that classification is not necessarily indicative of the true nature of the underlying financing. Just because funds change corporate hands from one entity to another does not require it to be classified as equity in establishing an appropriate rate of return for ratemaking purposes.

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[18] Response to PSC 2-4.
[19] Exhibit PSC 2-19; ROR tab within Excel model, column D.
[20] Response to AG 2-17

Q. Who is providing the residual financing?

A. The Company's response to PSC 3-5 indicates that all equity financing is sourced from CSWR. The audited financial statements of CSWR indicate it has received Capital Contributions of [redacted] and [redacted] in 2021 and 2022, respectively. However, the audited financial statements of CSWR do not disclose who is providing the funding nor who owns CSWR. The ultimate funding source for Bluegrass is private equity capital as alluded to in Mr. Cox's testimony.

"*In 2018, I was able to attract an additional large institutional private equity investor, which allowed me to expand the scope of my business.*"

Q. What practical difference does it make if this residual level of funding is classified as debt or equity?

A. The classification of this residual funding matters a great deal. The proposed equity return sought by Bluegrass, in this case, is 11.65%, resulting in a weighted cost of 7.13%. Equity costs must be 'grossed' up for taxes for the Company to earn an after-tax return, 11.65% in this instance. Debt costs, on the other hand, do not require a tax gross-up as interest expense is tax deductible. Applying the gross-up factor to the 11.65% requested return on equity results in a pre-tax cost of equity of 15.52% (unweighted), contrasted with a comparable cost of debt of 6.8% (unweighted). Thus, the assignment of residual capitalization between debt and equity significantly impacts the resulting overall rate of return and the authorized revenue requirement.

Q. If funding from a parent company is classified as equity on the books of Bluegrass for accounting purposes, why should those proceeds be treated any differently for ratemaking purposes?

A. The Commission should not promote financial engineering to increase the utility's cost of capital beyond what is necessary to compensate utility owners adequately. Utility owners deserve a return on their investment based upon accurately identifying the funding type. Customers should pay rates based upon an accurate determination of capitalization components, nothing more and nothing less. The balance of equity on the books of Bluegrass does not necessarily reflect the true character of the funding provided by its investors. The AG has an outstanding Motion to Compel to obtain the financial statements of the investor of Bluegrass to shed more light on the underlying nature of the residual funding provided to Bluegrass.

Q. In light of the discussion above, what are you recommending regarding the appropriate capital structure of Bluegrass in this proceeding?

A. I am offering three options for the Commission's consideration, all reflected in Exhibit DND-12. In each of these calculations I have used the cost of debt supported by the Company. The capitalization ratios contained in these scenarios is based upon the level of Rate Base I'm supporting, set forth in Exhibit DND-5.

In scenario 1, I have calculated an overall rate of return of 9.23% by incorporating a capitalization ratio of 50% debt and 50% equity. The pre-tax cost of capital under this scenario is 11.16% compared with the Company's supported capital structure of 12.13%.

Scenario 2 directly assigns the $2,481,126 to debt, and the residual capitalization necessary to fund Rate Base is split evenly between debt and equity, resulting in an overall capitalization ratio of 27.69% equity and 72.31% debt. Maintaining the Company's proposed cost of equity produces an overall rate of return of 8.14%, with a pre-tax return of 9.22%.

Finally, Scenario 3 adopts the same capitalization ratios utilized in Scenario 2, but incorporates a return on equity of 9.9%, as authorized by the Commission in Case 2020-00290. This scenario produces an overall rate of return of 7.66%, with a pre-tax return of 8.57%.

The impact of each of these scenarios is quantified incrementally in Exhibit DND-4. In other words, if Scenario 1 were adopted, the impact would be a reduction in the revenue requirement of $54,000. If Scenario 2 were adopted, the revenue requirement impact would be $162,000, representing the sum of Scenarios 1 and 2, and an incremental impact of $108,000 on top of the impact of Scenario 1. Likewise, the impact of adopting Scenario 3 is an incremental $36,000, or $198,000 in total, reflecting the sum of the impacts of Scenarios 1, 2, and 3.

Q. What is your recommended capital structure in this proceeding?

A. I support the capital structure represented in Scenario 3, which incorporates an ROE of 9.9%, the ROE adopted by the Commission in the Company's last rate proceeding. This capital structure recognizes the practical reality that not all funding provided by an investor will be equity and makes the reasonable assumption that such financing is proportional between debt and equity. The Company has the burden of demonstrating the true character of equity funding and has not done so. Absent that demonstration, a reasonable assumption is an equal split between debt and equity.

Q. Are you providing ROE testimony in this proceeding?

A. No. Instead, I simply used the ROE adopted by the Commission in the prior proceeding for illustration purposes.

XI. Corporate Cost Allocations – Payroll Costs

Q. Are you supporting an adjustment to corporate costs allocated to Bluegrass due to the changing nature of CSWR since the end of the test period?

A. No. I do not believe test period operations reflect ongoing operations due to the significant increase in overall operations of CSWR, however, I do not have sufficient information to calculate such an adjustment at this time.

Q. Please discuss how the Company's operations have changed since the end of the test period.

A. The Company's operations have changed in several ways since the test period, including significant increases in its number of CSWR customers, company headcount, and average employee compensation. The increase in customers would significantly reduce the overhead allocations to Bluegrass, while the increases in headcount and compensation would increase costs to Bluegrass.

Q. Discuss the complexities in incorporating the impacts above into an adjustment to payroll and overhead cost allocations.

A. The Company uses two methods to assign payroll costs to its affiliates. Certain employees have their time direct charged to various CSWR affiliates such as Bluegrass. These two payroll cost assignment methods can be seen by a review of the response to the Confidential attachment to OAG 1-53. The portion of payroll costs not directly charged to a particular jurisdiction is then allocated using a three-part general allocation factor composed of ratios of Utility Plant in Service, Direct Labor[21] and Customer Connections. The simple average the four quarters' general allocator applied to Bluegrass is 6.3% for the test period. Then the Bluegrass costs are further allocated between water and wastewater operations, bringing the weighted average allocation applicable to Bluegrass wastewater operations to 5.68%. In addition to impacting the overall general allocator, the growth in the customer base would also impact the direct labor charges assigned to Bluegrass. I cannot reasonably estimate the impact of the growing customer base on the direct payroll charges assigned to Bluegrass operations. Further, I do not have the current Utility Plant in Service or Direct Labor level, necessary to incorporate this information into a revised general allocator.

Q. You mentioned earlier that the Company had experienced an increase in headcount since the end of the test period. Have you annualized payroll costs for the purpose of developing the proposed revenue requirement?

A. No. I don't believe annualizing payroll and applying the general allocators from the test period to such costs will produce a reasonable estimate of Bluegrass allocated costs. As I mentioned earlier, the general allocators properly assigned to Bluegrass will be

[21] In this instance, the Company defines direct labor as O&M costs incurred by third-party contractors.

significantly reduced, with the growth in the overall system occurring from the end of the test period. As of April 2023, the ratio of Bluegrass wastewater customers to total CSWR customers was 1.75%.[22] It is reasonable to conclude that significant economies of scale should accrue to Bluegrass wastewater operations subsequent to the test period. These efficiencies would be offset in some measure by the increase in headcount occurring after the test period.

Q. How did the Company quantify payroll costs for purposes of developing its revenue requirement?

A. The Company identified the payroll costs incurred during the twelve months ending June 30, 2022. The Company did not annualize payroll costs for either new employees starting employment <u>after</u> the test period, employees starting employment <u>during</u> the test period, or for pay increases occurring as of December 31, 2022. Information related to these topics is provided in an attachment to Confidential response to AG 1-53.

Q. Did you consider annualizing payroll as of December 31, 2022, based on the compensation level for those employees the Company included in its revenue requirement?

A. I did consider this but elected not to quantify a payroll adjustment. As of December 31, 2022, the base compensation for those employees who were employed for the full duration of the test period, received an average compensation increase of [redacted] when compared with test period compensation. I rejected annualizing payroll for these

[22] Customer Information from Lyon Exhibit 4, compared with total CSWR customer information supplied in response to AG 1-45.

employees for two reasons. First, the pay increase was significant and not supported by the Company.[23] Secondly, as discussed earlier, the direct and general allocation of such costs should change due to the significant growth in CSWR operations. For all of the above reasons, I believe an adjustment to Overhead and Payroll, costs cannot be reasonably calculated at this time.

XII. Rate Design

Q. Are you supporting a rate design analysis consistent with your proposed revenue requirement?

A. Yes. My rate design proposal is set forth as Exhibit DND-13.

Q. Did the Commission rule on the rate consolidation concept in the last Bluegrass rate case?

A. Yes. The Commission found that a separate rate for each geographically merged system would create unreasonable and undue hardship to individuals within some Bluegrass systems. The Commission adopted a unified rate structure to be in the public interest. Absent rate consolidation, uneven deployment of system capital expenditures would significantly increase rate volatility among individual systems with their own rate structures.

Q. Please explain how you developed your rate design proposal.

A. The first step in this process was determining the rate increase necessary to equalize fixed rates among the customer classes. Applying the highest rates on the Bluegrass system

[23] The Madden study only reviewed eight employee categories, none at the executive level.

results in total base revenue of $2,947,151, or $460,868 greater than current rates. The targeted base rate increase is $454,940, with an additional $63,842 estimated to be generated from Late Fees associated with this rate increase equals the total revenue deficiency I am recommending of $518,782.

Since the rate increase necessary to equalize all customer rates is greater than the targeted revenue increase, this difference must be spread back to customer classes. The result is a monthly charge of $85.80, for fixed-rate customers[24], slightly less than the current monthly rate of $85.97 paid by most Bluegrass customers. The proposed Deleplain variable commercial rate would decline from $8.89 per thousand gallons to $8.87 per thousand gallons.

Q. Does this conclude your testimony?

A. Yes, but I reserve the right to supplement my testimony if new information becomes available.

[24] Multi-family customer would be charged at a 75% level, or $63.36/month.

Exhibit DND-1

David Dittemore

Experience

Blue River Consulting; **Consultant –** Assist clients on regulatory utility matters and natural gas acquisition strategy.

Tennessee Attorney General's Office – **Financial Analyst –** Prepare testimony on behalf of the Tennessee Attorney General's Office, testify as an expert witness, advise legal staff on technical issues, lead settlement discussions.

Kansas Gas Service; **Director Regulatory Affairs; Manager Regulatory Affairs**
Responsible for directing the regulatory activity of Kansas Gas Service (KGS), a division of ONE Gas, serving approximately 625,000 customers throughout central and eastern Kansas.

Strategic Regulatory Solutions; **Consultant;** Serving clients regarding revenue requirement and regulatory policy issues in the natural gas, electric and telecommunication sectors

Williams Energy Marketing and Trading; **Manager Regulatory Affairs;** Monitored and researched a variety of state and federal electric regulatory issues.

MCI WorldCom; **Manager, Wholesale Billing Resolution**; Manage a group of professionals responsible for resolving Wholesale Billing Disputes greater than $50K - $150 million in total.

Kansas Corporation Commission;
Utilities Division Director; Responsible for managing employees with the goal of providing timely, quality recommendations to the Commission covering all aspects of natural gas, telecommunications and electric regulation;
Asst. Division Director; Perform duties as assigned by Division Director.
Chief of Accounting; Responsible for the direct supervision of 9 employees within the accounting section; areas of responsibility included providing expert witness testimony on a variety of revenue requirement topics;
Managing Regulatory Auditor, Senior Auditor, Regulatory Auditor; Performed audits and analysis as directed; provided expert witness testimony on numerous occasions before the KCC; trained and directed less experienced auditors on-site during regulatory reviews.

Education

- B.S.B.A. (Accounting) Central Missouri State University
- Passed CPA exam; (Oklahoma certificate # 7562) – Not a license to practice

Bluegrass Water Utility Operating Company Inc.
List of Outstanding Docket
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022

Exhibit DND-2

Acquisition No	State/Acquired Utility	CSWR Affiliate	Docket No.	W=Water/WW =Wastewater	Customer Count	Date Filed
	Arizona					
1	Winchester Water Company	Cactus State	WS-21155A	W	137	1/6/2023
2	West Village Water Company	Cactus State	WS-21155A-22-0327	W	52	12/31/2022
3	Flagstaff Ranch Water Company	Cactus State	WS-21155A-22-0324	W	360	12/29/2022
4	Green Acres Water Company	Cactus State	WS-2115A-22-0319	W	41	12/23/2022
5	Sunizona Water Company	Cactus State	WS21155A-22-0314	W	34	12/30/2022
6	Santa Cruz Water Company	Cactus State	W-02127A-22-0309	W	18	12/15/2022
	Califormia					
7	Cypress Ridge	CSWR-California	A2301010	W/WW	390	1/23/2023
	Florida					
8	Tymber Creek Utilities Inc.	CSWR-Florida UOC	20220064-WS	W/WW	423	3/15/2022
9	Trade Winds Utilities	CSWR-Florida UOC	2022-0063		521	3/15/2022
10	CFAT H20 Inc.	CSWR-Florida UOC	2022-0062	W/WW	347	3/15/2022
	North Carolina					
11	Crosby Utilities	Red Bird Utility Operating Company LLC	W-992, Sub 8, W-1328, Sub 9	W/WW	488	10/22/2020
12	Baytree Waterfront Properties	Red Bird Utility Operating Company LLC	W-938, Sub 6, W-1328, Sub 8	WW	31	10/9/2020
13	Meadowlands Development LLC	Red Bird Utility Operating Company LLC	W-1328, Sub 6	WW	493	10/9/2020
14	JL Golf Management	Red Bird Utility Operating Company LLC	W-1296, Sub 3, W-1328, Sub 3	W/WW	468	10/8/2020
15	A&D Water Service Inc.	Red Bird Utility Operating Company LLC	W-1328, sub 2	W/WW	934	10/9/2020
16	Etowah Sewer Company	Red Bird Utility Operating Company LLC	W-1328, Sub 0	WW	441	10/8/2020

Bluegrass Water Utility Operating Company Inc.
List of Outstanding Docket
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022

Exhibit DND-2

Acquisition No	State/Acquired Utility	CSWR Affiliate	Docket No.	W=Water/W W =Wastewater	Customer Count	Date Filed
	Lousiana					
17	Joycelyn Sewer Association Inc.	Magnolia Water Utility Operating Company	S-36806	WW	25	5/22/2023
18	Triple Crown Homeowners Association	Magnolia Water Utility Operating Company	S-36683	WW	84	2/16/2023
19	Summerview Development LLC	Magnolia Water Utility Operating Company	S-336657	W/WW	69	1/27/2023
20	Twin Oaks Service Corporation	Magnolia Water Utility Operating Company	S-36584	WW	256	10/31/2022
21	Land Investments LLC	Magnolia Water Utility Operating Company	S-36497	WW	15	7/19/2022
	Mississippi					
22	Robinwood Forest Utility Association	Great River Utility Operating Company	2022-UA-144	W	1120	11/18/2022
23	Superior Utilities	Great River Utility Operating Company	2023-UA-35	W	1480	3/30/2023
24	Deerwood/Plamer Creek/The Woods		2023-UA-77	W/WW	572	5/31/2023
	Missouri					
25	Stone Ridge Meadows	Confluence Rivers	WA-2023-0092	Unknown	18	9/9/2022
26	Four Seasons North MHP, LLC	Confluence Rivers	WA-2023-0284	W/WW	35	3/14/2023
27	LCWS	Confluence Rivers	WA-2023-396 and 398	W/WW	434	5/4/2023
	South Carolina					
28	Hyde Park Water	CSWR-South Carolina Utility	2022-167-W	W	85	5/6/2022
29	AAA Utilities	CSWR-South Carolina Utility	2022-161-W	W	Unknown	4/29/2022
30	Total Environmental Solutions	CSWR-South Carolina Utility	2022-151-W	W	Unknown	4/22/2022

Bluegrass Water Utility Operating Company Inc.
List of Outstanding Docket
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022

Exhibit DND-2

Acquisition No	State/Acquired Utility	CSWR Affiliate	Docket No.	W=Water/WW =Wastewater	Customer Count	Date Filed
	Tennessee					
31	DHS and Associates	Limestone Water	23-00016	W	54	3/1/2023
32	IRM	Limestone Water	23-00037	WW	Unknown	5/24/2023
	Texas					
33	Casey Homes Estates	CSWR-Texas Utility Operating Company	55056	W	118	5/6/2023
34	Circle R Ranchettes Property	CSWR-Texas Utility Operating Company	54899	W	48	4/18/2023
35	Thompson Water and Construction Inc	CSWR-Texas Utility Operating Company	54809	W/WW	544	3/31/2023
36	Southwest Gardens	CSWR-Texas Utility Operating Company	54752	W	130	3/14/2023
37	Valley Vista Water Company	CSWR-Texas Utility Operating Company	54543	W	13	1/4/2023
38	Deer County Water Supply	CSWR-Texas Utility Operating Company	54489	W	24	12/16/2022
39	Intermediary Solutions Holding, Inc.	CSWR-Texas Utility Operating Company	54393	W	194	11/30/2022
40	Hilco H2O	CSWR-Texas Utility Operating Company	54292	W/WW	277	10/31/2022

ELECTRONIC APPLICATION OF BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC FOR ADJUSTMENT OF SEWAGE RATES
CASE NO. 2022-00432

BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC'S RESPONSES TO THE OFFICE OF ATTORNEY GENERAL'S SUPPLEMENTAL REQUEST FOR INFORMATION

REQUEST NO. 2-30: Refer to the attachment to response OAG 1-124 and respond to the following questions:

a. Provide the support for the actual charges of $445,726 as reflected in cell I23 within the OHA Cal tab.

b. Define the term Payroll/EE Removed as reflected in this schedule. Confirm this includes payroll that is direct charged to CSWR affiliates and define the reference to EE. Provide support for these total amounts. If the support can be extracted from the data supplied in the detail tab of Attachment OAG 1-124, please provide instructions on how to access the information.

c. Explain how Executive and Business Development exclusions were developed and provide the support for the totals found in the OHA calc tab. If the support can be extracted from the data supplied in the detail tab of Attachment OAG 1-124, please provide instructions on how to access the information.

d. Provide a supporting schedule for Other Line-Item Exclusions to the extent and independent reviewer could understand the nature of the excluded item. If the support can be extracted from the data supplied in the detail tab of Attachment OAG 1-124, please provide instructions on how to access the information.

e. Provide support for the allocation of overhead costs between water and wastewater services.

RESPONSE: **Please see Exhibit OAG 2-30. For subpart (e), please also see Response to OAG 2-76.**

ELECTRONIC APPLICATION OF BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC FOR ADJUSTMENT OF SEWAGE RATES
CASE NO. 2022-00432

BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC'S RESPONSES TO THE OFFICE OF ATTORNEY GENERAL'S SUPPLEMENTAL REQUEST FOR INFORMATION

Witness: **Brent Thies**

ELECTRONIC APPLICATION OF BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC FOR ADJUSTMENT OF SEWAGE RATES
CASE NO. 2022-00432

BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC'S RESPONSES TO THE COMMISSION STAFF'S THIRD REQUEST FOR INFORMATION

REQUEST NO. 3-18: Refer to the Thies Direct Testimony, page 14, line 15–page 17, line 10, discussing the allocation of "indirect charges" based on a sharing percent. Refer also to the Application, Exhibit 25, Pro Forma Income Statement.

a. Provide the total amount of indirect charges to which the sharing percentage was applied to calculate the "Allocated Overhead" in the amount of $445,726 reflected on line 26 of Exhibit 25.

b. Provide an itemized breakdown of the total amount of indirect charges to which the sharing percentage was applied to calculate the "Allocated Overhead" in the amount of $445,726 reflected on line 26 of Exhibit 25.

c. For each category of expense identified in the itemized breakdown, identify the amount of any business development expense that was removed before the indirect expenses were allocated using Bluegrass Water's proposed methodology, and for any business development expense removed, explain how Bluegrass Water identified the amount to be removed.

RESPONSE: (a) $10,144,799.

(b) Please see CONFIDENTIAL Exhibit PSC 3-18.

(c) Please see CONFIDENTIAL Exhibit PSC 3-18. In addition to removing the cost of salaries associated with business development employees, including the associated executive supervisory expense, the Company removed all expense reports provided by Business Development employees and certain vendors whose primary purpose relates to the acquisition of new systems rather than ongoing business activities.

ELECTRONIC APPLICATION OF BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC FOR ADJUSTMENT OF SEWAGE RATES
CASE NO. 2022-00432

BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC'S RESPONSES TO THE COMMISSION STAFF'S THIRD REQUEST FOR INFORMATION

Witness: **Brent Thies**

Bluegrass Water Utility Operating Company Inc.
Summary of Attorney General Recommendations
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhibit DND-4

Adj No.	Description	Exhibit	Revenue Requirement Impacts: Before Gross-Up Amount (000s)	B/D Gross-Up	Adjustment Amount (000s)
	Bluegrass Request				**$ 1,291**
1	To eliminate write-up of Land Values due to Appraisals	DND-5	(85)	1	(85)
2	To eliminate Acquisition Premium Costs associated with Acquisition of 10 systems	DND-5	(11)	1	(11)
3	To eliminate Acquisition Premium for systems with no book value	DND-5	(5)	1	(5)
4	Reflect Late Payment charges in Other Revenue ORA 1-66 and 2-7)	DND-6	(342)	1	(342)
5	Eliminate Depreciation/Amortization Expense associated with Acquisition Premium	DND-7	(3)	1	(3)
6	Eliminate Non-Recurring Charges - OAG 1-108	DND-8	(12)	1	(12)
7	Reduce Bad Debt Expense	DND-9	(42)	1	(42)
8	Annualize Insurance Savings	DND-10	(89)	1	(89)
9	Normalize and Annualize Employee Medical Benefits	DND-11	15	1	15
10	Scenario 2: Adjust Capital Structure to 50% Debt/50% Equity	DND-12	(54)	1	(54)
11	Scenario 3: Further Adjust Capital Structure to directly assign Debt; residual Capital = 50% Debt, 50% equity	DND-12	(108)	1	(108)
12	Scenario 4: Further Adjust Capital Structure to directly assign Debt; residual Capital = 50% Debt, 50% equity; 9.5% ROE	DND-12	(36)	1	(36)
13	Rate Increase Recommendation supported by OAG				$ 519
14	Total Revenue Requirement Increase recommendation - OAG (000s)				518.782
15	Increase in Base Rates				454.940
16	Increase in Pro-Forma Late Fees				63.842
17	Total Increase in Revenue				518.782

Bluegrass Water Company
Attorney General's Calculation of Rate Base
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhibit DND-5

Line No.	Adj No.	Item	Account	Amount	Rate Base Adjustment ($000's)		Source
1		Rate Base Requested by Bluegrass			$	6,388	
2	1	To Remove Write-Up of Land Values					
3		Delaplain		$ (608)			OAG 1-132
4		River Bluffs		$ (90)			
5		Total			$	(698)	
6	2	To Remove Acquisition Premium	114		$	(90)	Theis Testimony, page 29
7	3	Collection Sewer Asset	352		$	(40)	
8	4	Rate Base Per Supported by OAG			$	5,560	

Bluegrass Water Company
Pro-Forma Adjustment to Other Revenues
Late Fees
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhbit DND-6

Line No.	Item	Amount	Source
1	Test Period Pro-Forma Revenue with application of 10% Late Fee	356,034	Exhibit OAG 2-7; Note this adjustment is calculated the same for the test period as it is for the 12 months ended 6/30/22.
2	Test Period Actual Late Fee Revenue	($14,244)	PSC 2-17, Exhibit 26
3	Net Increase in Pro-Forma Revenues	$ 341,790	
4	Net Increase in Pro-Forma Revenues (000's)	$ 342	

Calculation of Other Revenue Gross-Up Factor

Line No.	Item	Amount	Source
5	Proforma increase in Test Period Other Revenues	$ 341,790	Line 3
6	Test Period Revenue	$2,435,594	Bluegrass Exhibit 26
7	Percentage increase in Revenue associated with Bluegrass Late Fee proposal	12.31%	Line 5/ Line 6
8	Reciprocal Gross Up Factor	0.8769	1/(1-Line 7)

Bluegrass Water Company
Adjustment to Depreciation Expense
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhibit DND-7

I	**Acquisition Premium - Ten Acquired Systems**		**Amount**	**Source**
	Airview		5,588	Theis Testimony page 29
	Brocklyn		13,865	"
	Fox Run		2,689	"
	Golden Acres		850	"
	Great Oaks		850	"
	Kingswood		10,248	"
	Lake Columbia		2,689	"
	LH reatment		36,863	"
	Persimmon Ridge		16,404	"
	Timberland		125	"
	Total		90,171	
	Bluegrass Proposed Amortization Rate		2.61%	Amortization Rate; OAG 1-133
	Adjustment	$	2,353	
	Adjustment (000's)		(2)	
II	**Acquisition Premium - No Book Value**			
	Springcrest		15,000	Thies Testimony, page 30
	Woodland Acres		10,000	"
	Herrington Haven		14,500	"
	Total		39,500	
	Depreciation Rate		2.22%	Spanos Exhibit JJS-1, Section VI-4
	Depreciation Expense - Three Systems	$	877	
	Depreciation Expense Reductio (000s)		(1)	
	Total Depreciation/Amortization Exp Reduction	$	3,230	
	Total Reduction in Depreciation Expense as a result of removal of Acquisition Premium from Rate Base (000s)		(3)	

Note: The acquisition premiums associated with Delaplain and River Bluffs were recorded to Land, resulting in no impact on proforma depreciation expense.

Bluegrass Water Company
Adjustment to Eliminate non-recurring
Software Implementation Costs
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhibit DND-8

Item	Amount	Service Area	Cost Type	Allocation Ratio In Effect (1)	Non-Recurring Charges In Bluegrass Rev. Req.
Link Computer Corporation	$ 83,333.33	CSWR LLC	Implementation	5.07%	$ 4,227.19
Link Computer Corporation	$ 83,333.33	CSWR LLC	Implementation	4.68%	$ 3,903.76
Link Computer Corporation	$ 83,333.33	CSWR LLC	Implementation	4.68%	$ 3,903.76
	Total Adjustment to Eliminate Non-Recurring Charges				$ 12,035
	Adjustment (000's)				$ (12)

Identification of Non-Recurring Implementation Charges in the Test Period
Source: OAG 1-106

(1) General Bluegrass Allocator * 90.26% assignment to wastewater

Bluegrass Water Company
Calculation of Adjustment to Bad Debt Expense
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhibit DND-9

Item	Amount		Source
Less: A/R written Off	$ 2,529		Response to OAG 2-14(b)
Test year End Balance		$ 32,027	Exhibit 26
Pro-Forma Increase		$ 12,915	Exhibit 26
Less: Total Requested Bad Debt Expense	$ 44,942		
Adjustment to Pro-Forma Expenses	$ (42,413)		Adjustment to Bad Debt Expense
Adjustment (000s)	$ (42)		

Bluegrass Water Company
Calculation to Annualize Insurance Expense
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhibit DND-10

Test Period Balances	Year	Amount	Calculations
July	2021	$20,812.59	
August	2021	$20,926.34	
September	2021	$20,926.34	
October	2021	$20,926.34	
November	2021	$19,552.21	
December	2021	$22,910.73	
January	2022	$19,748.00	
February	2022	$19,748.00	
March	2022	$19,748.00	
April	2022	$19,748.00	
May	2022	$19,748.00	
June	2022	$19,800.95	
Total Test Period			$244,596
January	2023	$12,128.00	
February	2023	$12,128.00	
March	2023	$12,128.00	
Total January - March 2023		$36,384.00	
Annualized 2023			$145,536
Reduction in Insurance Expense			($99,060)
Reduction Assigned to Wastewater			90.26%
Adjustment to Reduce Insurance Expense			($89,411)
Adjustments in Thousands			($89)

Source: Discovery Response OAG 1-120

Bluegrass Water Company
Calculation to Annualize and Normalize Employoee Benefit Expense
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhibit DND-11

Analysis of Employee Benefit Costs
Source: OAG 1-47

Month	Expensed Medical Insurance Cost	Employee-Paid Total	Employer-Paid Total	EE Allocation to KY	Bluegrass Requested Employee Medical Costs
July-21	54,659	56	54,603	4.29%	2,344
August-21	56,671	1,113	55,559	4.29%	2,385
September-21	60,167	606	59,560	4.29%	2,557
October-21	65,542	575	64,967	4.77%	3,099
November-21	67,335	598	66,737	4.77%	3,183
December-21	58,764	613	58,151	4.77%	2,774
January-22	-	613	(613)	3.37%	(21)
February-22	60,292	605	59,686	3.37%	2,012
March-22	59,453	636	58,817	3.37%	1,983
April-22	72,950	725	72,225	4.42%	3,191
May-22	72,315	782	71,533	4.42%	3,161
June-22	75,558	874	74,684	4.42%	3,300
	703,705	7,796	695,909		
				Bluegrass Test Period Exp.	29,967
July-22	95,819	915	94,903		
August-22	95,831	931	94,900		
September-22	79,866	956	78,910		
October-22	98,480	1,047	97,433		
November-22	102,170	1,072	101,098		
December-22	107,633	1,089	106,544		
January-23	108,817	1,097	107,720		
February-23	108,817	1,155	107,662		
March-23	119,851	1,179	118,672		

Test Period Totals	695,909
Employees in the test year	59
Medical/Dental cost per Employee to Bluegrass	**11,795**

Calculation of Avg Allocation % in the test period	
Test Period BG Costs	29,967
Divided By Total Test Period Costs	695,909
Overall BG Allocation %	4.31%

Adjustment Calculation			
Total Jan - March 2023	$	337,484	Total Costs before deductions for Employee portion.
Annualize 1Q 2023	$	1,349,937	
BLS Survey %		78%	
Eligible CSWR Costs	$	1,052,951	
Test Period Wtd Allocation		4.31%	
Pro Forma Bluegrass Allocated Exp	$	45,342	
Less: Expense Charged to Bluegrass		(29,967)	
Adjustment to Normalize Employee Benefit Costs	$	15,375	
Adjustment in Thousands	$	15	

Bluegrass Water Utility Operating Company Inc.
Rate of Return Proposals
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhibit DND-12

Bluegrass Capital Structure Proposal

Line No.	Item	Total	Weighted %	Cost	Wtd Cost	Gross-Up Factor
	Long-Term Debt	$ 2,481,126	38.84%	6.80%	2.64%	2.64%
	Common Equity	3,906,942	61.16%	11.65%	7.13%	9.49%
	Total	$ 6,388,068	100%		9.77%	12.13%

Scenario 1
Office of Attorney General
50% Debt/50% Equity Capital Structure

Item	Total	Weighted %	Cost	Wtd Cost	Gross-Up Factor
Long-Term Debt	$ 2,780,000	50.00%	6.80%	3.40%	3.40%
Common Equity	$ 2,780,000	50.00%	11.65%	5.83%	7.76%
Total	$ 5,560,000	100%		9.23%	11.16%

Scenario 2
Office of Attorney General
Debt = Directly Assigned + 50% of Residual Capital
Company Propopsed ROE

Item	Total	Weighted %	Cost	Wtd Cost	Gross-Up Factor
Long-Term Debt	$ 4,020,563	72.31%	6.80%	4.92%	4.92%
Common Equity	1,539,437	27.69%	11.65%	3.23%	4.30%
Total	$ 5,560,000			8.14%	9.22%

Scenario 3
Office of Attorney General
Debt = Directly Assigned + 50% of Residual Capital
9.9% ROE Authorized in Case 2020-00290

Item	Total	Weighted %	Cost	Wtd Cost	Gross-Up Factor
Long-Term Debt	$ 4,020,563	72.31%	6.80%	4.92%	4.92%
Common Equity	1,539,437	27.69%	9.90%	2.74%	3.65%
Total	$ 5,560,000	100%		7.66%	8.57%

Calculation of Tax Gross-Up Factor		
Gross Income	100.00%	
Less: Kentucky State Rate	5.00%	
Net Income After State Taxes		95.00%
Federal Tax Rate	21.00%	
Effective Federal Tax Rate		19.95%
Plus: Kentucky State Rate		5.00%
Effective Overall Tax Rate	24.95%	
Reciprocal Tax Rate	75.05%	
Tax Gross-Up Factor on Equity (1/Reciprocal Rate)	**1.3324**	
Requested Return on Equity	11.65%	
Gross of Tax Cost of Equity - Unweighted	15.52%	

Bluegrass Water Utility Operating Company Inc.
Proposed Rate Design Bluegrass/Attorney General
KY PSC Case No. 2022-00432
Test Year Ended June 30, 2022
$ Thousands

Exhibit DND-13

Development of Rates	Bills	% Bills	Company Proposal: Proposed Fixed Charges	Current Fixed Charges	Proposed Total Charge	Current Total Charge	Difference	Difference (%)	Attorney General Proposal: Revenue At Equal Rates	Rate Reduction	Target Revenue	Proposed Usage Charge
Airview Residential	2,373	8.0%	99.37	85.97	235,825	204,024	31,801	15.6%	204,024	(410)	203,614	85.80
Arcadia Pines	310	1.0%	99.37	85.97	30,804	26,650	4,154	15.6%	26,650	(54)	26,596	85.80
Brocklyn Multifamily (2)	1,119	3.8%	74.53	64.48	83,396	72,153	11,243	15.6%	96,200	(194)	96,007	85.80
Brocklyn Residential	884	3.0%	99.37	85.97	87,841	75,996	11,845	15.6%	75,996	(153)	75,843	85.80
Carriage Park	454	1.5%	99.37	85.97	45,131	39,045	6,086	15.6%	39,045	(79)	38,966	85.80
Darlington Creek	1,400	4.7%	99.37	45.00	139,142	63,011	76,131	120.8%	120,378	(242)	120,136	85.80
Delaplain Commercial (1)	408	1.4%	248.43	-	843,506	442,514	400,992	90.6%	442,514	(890)	441,624	1/
Delaplain	3,654	12.4%	99.37	12.50	363,121	45,678	317,443	695.0%	314,154	(632)	313,522	85.80
Fox Run Residential	420	1.4%	99.37	85.97	41,735	36,107	5,628	15.6%	36,107	(73)	36,035	85.80
Golden Acres Residential	348	1.2%	99.37	85.97	34,581	29,918	4,663	15.6%	29,918	(60)	29,857	85.80
Great Oaks Residential	1,927	6.5%	99.37	85.97	191,517	165,691	25,826	15.6%	165,691	(333)	165,358	85.80
Herrington Haven	288	1.0%	99.37	49.66	28,619	14,302	14,316	100.1%	24,759	(50)	24,710	85.80
Kingswood Residential	1,570	5.3%	99.37	85.97	156,054	135,010	21,044	15.6%	135,010	(272)	134,739	85.80
Lake Columbia Flat	396	1.3%	99.37	85.97	39,351	34,044	5,306	15.6%	34,044	(68)	33,976	85.80
Longview Residential	3,960	13.4%	99.37	85.97	393,522	340,456	53,066	15.6%	340,456	(685)	339,771	85.80
Marshall Ridge	479	1.6%	99.37	85.97	47,551	41,139	6,412	15.6%	41,139	(83)	41,056	85.80
Persimmon Non-Residential (1)	12	0.0%	248.43	214.93	2,981	2,579	402	15.6%	1,032	(2)	1,030	85.80
Persimmon Residential	4,292	14.5%	99.37	85.97	426,501	368,988	57,513	15.6%	368,988	(742)	368,245	85.80
Randview	661	2.2%	99.37	85.97	65,670	56,814	8,856	15.6%	56,814	(114)	56,700	85.80
River Bluffs	2,164	7.3%	99.37	85.97	215,056	186,056	29,000	15.6%	186,056	(374)	185,682	85.80
Springcrest	504	1.7%	99.37	27.43	50,082	13,825	36,258	262.3%	43,329	(87)	43,242	85.80
Timberland	826	2.8%	99.37	85.97	82,112	71,039	11,073	15.6%	71,039	(143)	70,896	85.80
Woodland Acres	1,091	3.7%	99.37	19.47	108,430	21,245	87,185	410.4%	93,808	(189)	93,619	85.80
Total	**29,542**	**100.0%**			**$ 3,712,527**	**$ 2,486,283**	**$ 1,226,244**	**49.3%**	$ 2,947,151	$ (5,929)	$ 2,941,223	
									$ 460,868			

Target Base Rate Increase	454,940
Targeted Revenue	$ 2,941,223
Divided By Rate Equivalent Revenue	$ 2,947,151
Percentage of Target Revenue to Rate Equivalent Reve	99.7988%
Rate Reduction	0.2012%

	(000s)
Increase in Base Rates	454.940
Increase in Pro-Forma Late Fees	63.842
Total Increase in Revenue	518.782

Rate increase at Rate Equalization		
Current Charges	$ 2,486,283	
Rate Equalization Revenue	$ 2,947,151	
Rate Increase to Equalize		$ 460,868
Proposed Base Rate Increase		454,940
Rate Reduction from Rate Equalization	(5,929)	
Target Revenue	$ 2,941,223	

1/

Targeted Revenue -Deleplain Com. Customers	
Usage	49,777
Current Charge	$ **8.89**
Current Revenue	$ 442,514
Target Revenue	$ 441,624
Divided By: Usage	49,777
Proposed Rate	**8.87**

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF BLUEGRASS WATER UTILITY OPERATING COMPANY FOR AN ADJUSTMENT OF SEWAGE RATES;	) CASE NO. 2022-00432

AFFIDAVIT OF DAVID DITTEMORE

State of Tennessee)

David Dittemore, being first duly sworn, states the following:
The prepared Pre-Filed Direct Testimony, Schedules and Exhibits attached thereto constitute the direct testimony of Affiant in the above-styled case. Affiant states that he would give the answers set forth in the Pre-Filed Direct Testimony if asked the questions propounded therein. Affiant further states that, to the best of his knowledge, information and belief his statements made are true and correct. Further affiant saith naught.

David Dittemore
David Dittemore

SUBSCRIBED AND SWORN to before me this 29 day of June, 2023

NOTARY PUBLIC

My Commission Expires: 04/26/2026

TIMOTHY McDONALD
STATE OF TENNESSEE NOTARY PUBLIC
WILSON COUNTY