COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

ELECTRONIC APPLICATION OF KENTUCKY-	**)**	
AMERICAN WATER COMPANY FOR AN	**)**	
ADJUSTMENT OF RATES, A CERTIFICATE	**)**	
OF PUBLIC CONVENIENCE AND NECESSITY	**)**	**CASE NO. 2023-00191**
FOR INSTALLATION OF ADVANCED METERING	**)**	
INFRASTRUCTURE, APPROVAL OF CERTAIN	**)**	
REGULATORY AND ACCOUNTING	**)**	
TREATMENTS, AND TARIFF REVISIONS	**)**	

POST-HEARING BRIEF OF KENTUCKY-AMERICAN WATER COMPANY

Filed: January 5, 2024

Table of Contents

I. STATEMENT OF THE CASE

On May 31, 2023, Kentucky-American Water Company ("KAWC" or "Company") filed a Notice with the Kentucky Public Service Commission ("Public Service Commission" or "Commission") in conformity with 807 KAR 5:001, Section 16(2), expressing its intention to file an application for an increase in rates no earlier than 30 days from the date of Notice. The Notice specifically provided that the application for an increase in rates would be supported by a fully forecasted test period as authorized by Kentucky Revised Statute 278.192.

In keeping with prior practice, simultaneously with the delivery of its Notice to seek an increase in rates, KAWC submitted a Notice of Election of Use of Electronic Filing Procedures. The Commission's May 31, 2023 Acknowledgement Letter assigned a case number to the proceeding. KAWC filed its Application and supporting materials on June 30, 2023.

In its Application filed with the Commission, KAWC sought the Commission's approval of an increase in its annual revenues of $26,051,990 by rates to become effective on or after February 1, 2024 (including a rate suspension period), a Certificate of Public Convenience and Necessity ("CPCN") for the deployment of Advanced Metering Infrastructure ("AMI"), proposed modifications to the Qualified Infrastructure Program ("QIP"), approval of certain regulatory and accounting treatments, and proposed tariff revisions.

On June 30, 2023, Lexington-Fayette Urban County Government ("LFUCG") moved for full intervention and agreed to electronic transmission of all notices and messages in this proceeding. The Commission granted LFUCG's motion to intervene on July 12, 2023, and LFUCG certified on the same day that it has the ability to receive electronic transmissions. On July 3, 2023, the Attorney General ("AG") filed a motion to intervene. The Commission granted the AG's motion on July 5, 2023, and ordered the AG to comply with the service and electronic filing requirements. The adjudication of this matter has proceeded with two intervenors: LFUCG and the AG.

On July 7, 2023, the Commission issued a Deficiency Letter to KAWC, stating that KAWC's initial Application for a CPCN was deficient pursuant to 807 KAR 5:001, Section 15(2)(f), which requires an estimated annual cost of operation after the proposed facilities are placed into service. KAWC responded to the Commission's Deficiency Letter on July 7, 2023 in a filing titled *Annual Cost of Operation for AMI,* stating KAWC's belief that it had complied with the regulation by providing the forecasted annual cost of operation at year ten, which is the first year the infrastructure that is the subject of the CPCN would be fully deployed and placed into service, and the forecasted annual cost of operation at year twenty. KAWC requested that the Commission deem the Application filed as of June 30, 2023. In addition, KAWC provided estimated forecasts of the annual costs of operation and the annual costs of operation net of benefits for each year from 2024 to 2043.

By letter dated July 12, 2023, the Executive Director of the Commission informed all parties of record that the Application met the minimum filing requirements and was thus accepted for filing as of July 7, 2023. On July 14, 2023, KAWC submitted a motion for a ruling from the Commission on the relief requested in KAWC's *Annual Cost of Operation for AMI* filing of July 7, 2023; specifically, KAWC requested a ruling from the Commission on whether the Application was sufficient as of June 30, 2023. The Commission entered a responsive Order on July 25, 2023, holding that KAWC's request that its Application be deemed filed on June 30, 2023 was denied because KAWC "failed to state with clarity in the application that it provided the estimated annual cost of operation after the proposed facilities are placed in service."[1]

[1] Case No. 2023-00191, Order at 6 (Ky. PSC July 25, 2023).

On July 21, 2023, the Commission entered an Order suspending the proposed rates for a period of six months and established a Procedural Schedule providing for two rounds of data requests to KAWC, the filing of intervenors' testimony, one round of data requests to the intervenors, and the filing of rebuttal testimony by the Company's witnesses. In its Order dated September 7, 2023, the Commission scheduled an evidentiary hearing in this matter to begin on December 11, 2023.

Although KAWC's Application requested an annual increase of $26,051,990, on November 8, 2023, KAWC filed its Base Period Update. As a result of the Base Period Update, the requested annual increase was revised to $25,563,294.[2]

With its Application, KAWC presented the testimonies of: Patrick L. Baryenbruch; Ann E. Bulkley; Krista E. Citron; Nicholas Furia; Larry E. Kennedy; William A. Lewis; Robert V. Mustich; Kathryn Nash; Jeffrey Newcomb; Thomas G. O'Drain; Shelley W. Porter; Charles B. Rea; Melissa Schwarzell; Wesley E. Selinger; Harold Walker, III; and John M. Watkins. By notice filed on August 18, 2023, KAWC informed the Commission and all parties that Wesley E. Selinger moved to a new position within American Water and would no longer be a witness in the proceeding. Selinger's direct testimony and data responses were adopted by witnesses Charles B. Rea and John M. Watkins. Subsequent rebuttal testimony was presented from Ann Bulkley; Krista Citron; Nicholas Furia; William Lewis; Robert Mustich; Jeffrey Newcomb; Shelley Porter; Charles Rea; Melissa Schwarzell; Harold Walker; and John Watkins.

The AG and LFUCG co-presented the testimony of Greg R. Meyer, and the AG presented the testimony of Richard A. Baudino.

[2] Base Period Update, Exhibit 37A, Page 2 of 2.

A hearing on the merits of the requests presented in KAWC's Application was held at the Commission on December 11, 2023 and December 13, 2023. The following witnesses for KAWC were presented and subject to cross examination: Kathryn Nash; Melissa Schwarzell; David Hill; Shelley Porter; Krista Citron; William Lewis; Charles Rea; Nicholas Furia; Ann Bulkley; Larry Kennedy; Harold Walker; Patrick Baryenbruch; Robert Mustich; Thomas O'Drain; John Watkins; and Jeffrey Newcomb.

The AG and LFUCG co-presented the testimony of Greg Meyer, and the AG presented the testimony of Richard Baudino. Throughout the course of the hearing, numerous hearing data requests were issued to KAWC. Pursuant to the Commission's Order dated December 14, 2023, the Company filed its responses to these requests on December 22, 2023.

II. REVENUE REQUIREMENT

The Company's revenue requirement is equal to the cost of providing water service to more than 138,000 customers throughout fourteen[3] Kentucky counties.[4] Providing water service is a sprawling endeavor that starts with sourcing more than fifteen billion gallons of surface water from Kentucky lakes and rivers, then treating it to meet or surpass drinking water standards, and finally pumping and distributing it through approximately 2,300 miles of main to reach homes, businesses, schools, and industries throughout KAWC's service territory.[5] Along the way, the Company must work to provide adequate capacity and storage to accommodate peak usage and to help protect communities during fire events. The Company also provides customer service, monthly billing, 24-hour emergency call handling, and a self-service website.[6] The Company

---

[3] Bourbon, Clark, Fayette, Franklin, Gallatin, Grant, Harrison, Jackson, Jassmine, Nicholas, Owen, Rockcastle, Scott, and Woodford Counties.
[4] Direct Testimony of Jeffrey Newcomb at 4.
[5] *Id.*
[6] *Id.*

monitors water quality for a host of contaminants and maintains the distribution system by exercising valves, flushing hydrants, and repairing main breaks at all hours and in all weather conditions. All of these efforts support the Company's provision of safe, clean, reliable water service, sanitation, and fire protection service to customers.[7]

To accomplish all of this, the Company incurs costs for which it seeks recovery through the ratemaking process. The Company's costs include a variety of operating expenses, depreciation and amortization, and various local, state, and federal taxes.[8] The Company must also provide a return—at least equal to the cost of capital—on over $588 million in water infrastructure rate base that supports the Company's provision of service to customers. The Company's forecasted revenue requirement in this proceeding, equal to the cost of providing service, is approximately $141.8 million for the twelve months ending January 31, 2025.[9] This revenue requirement reflects a slight decrease from what the Company initially proposed in its Application, as explained in the Base Period Update filed on November 8, 2023.[10]

The difference between the forecasted revenue requirement and the Company's forecasted revenues at present rates equates to the Company's revenue deficiency.[11] The Company's revenue deficiency in this proceeding, reflective of the Base Period Update, is calculated to be approximately $25.6 million, which is an approximate 22 percent shortfall.[12] The revenue deficiency in this case is fundamentally driven by over $145 million of rate base growth since the Company's last rate case, Case No. 2018-00358, along with increases in certain operations and maintenance ("O&M") expenses, and increases in property taxes charged to the Company by state

[7] *Id.* at 5.
[8] *Id.*
[9] Rebuttal Testimony of Jeffrey Newcomb at 2; Base Period Update Filing Exhibit 37, Schedule A.
[10] *See* Newcomb Direct at 5; Base Period Update Filing Exhibit 37, Schedule A.
[11] Newcomb Direct at 5.
[12] Newcomb Rebuttal at 2.

and local governments.[13] Using Mr. Baudino's recommendations regarding cost of capital and capital structure and his own itemized adjustments, Mr. Meyer first opined that the requested annual increase should be $13,243,000.[14] However, in post-hearing discovery, Mr. Meyer opined that the annual increase should be $15,025,000 and he also provided data that means if Mr. Baudino's capital structure proposal were rejected, the $15,025,000 amount would increase by another $1,124,863 for a total of $16,149,863 using an ROE of just 9.40%.[15]

The Company, through its Application, witness testimony, and responses to data requests, has presented evidence to justify its proposed revenue requirement, which is composed of numerous components. The following revenue requirement components have been directly contested by the AG and LFUCG: employee related expenses, including labor, performance compensation, and non-labor costs; residential revenue forecast; working capital allowance; electronic payment fees; miscellaneous expenses; water losses[16]; and rate of return.[17] A review of the evidentiary record will demonstrate that the Company's proposals related to each of these contested components are more reasonable and should be adopted.

(A) <u>Employee Related Expenses</u>

Employee related expenses include direct labor expenses, such as base salary and wages and performance pay, and non-labor expenses such a payroll tax, employee benefits, and group insurance costs. The AG and LFUCG contest non-labor expenses only as those costs relate to the intervenors' proposed adjustments to labor and performance pay expenses.[18] Because the Company does not agree with any of the proposed adjustments to labor expenses, no adjustments

---

[13] Newcomb Direct at 6.
[14] Direct Testimony of Greg R. Meyer at 5.
[15] See AG/LFUCG responses to KAWC's post-hearing discovery requests, Items 1 and 2.
[16] *See infra* Section III(B).
[17] *See infra* Section V(C).
[18] Meyer Direct at 16.

to non-labor expenses are necessary.[19] The Company explains the reasonableness of expenses tied to direct labor in detail below.

(1) *The Company's Longstanding Position of Including Vacant Positions in its Forecasted Labor Expenses is Reasonable Based Upon Fact and Precedent.*

The forecasted test period labor expense is based on the Company's planned staffing level at hourly rates per contract for union employees and wage rates for non-union employees that reflect forecasted pay increases.[20] Because some labor and labor-related costs are capitalized with capital projects and programs, a capitalization percentage is used to assist in calculating net expense.[21] An adjustment is also made to remove costs appropriately charged to wastewater operations.[22] As a result, O&M labor expenses represent costs related to water operations that are charged to expense on the Company's income statement.[23]

For nearly thirty years, the Company has forecasted its labor expense based on the number of employees that are required to complete the work to continue to provide safe and reliable water service to its many customers throughout the KAWC service territory. The scope of necessary work does not fluctuate based upon how many Company employee roles are filled. While it is difficult to forecast how many vacancies will occur or for what duration they will last in any given year, the work must still get done. As the AG and LFUCG's witness Greg R. Meyer stated during the evidentiary hearing: "I would find it rare that a utility operates with [a] full work force."[24] With a set amount of work to be accomplished each year, when KAWC has vacant employee roles, the work that would be performed by those vacant positions is either (a) delegated to other KAWC

[19] Newcomb Rebuttal at 5.
[20] Direct Testimony of John M. Watkins at 4.
[21] *Id.* at 6-7.
[22] *Id.* at 5.
[23] *Id.*
[24] 12/11/2023 Hearing, VR 15:32:53-15:34:00.

employees, and the Company incurs additional expenses for overtime pay, or (b) contracted to laborers outside of the Company, and the Company incurs additional expenses for contract services.

For ratemaking purposes, the Company has historically forecasted its labor expense based on the salaries and wages owed to the number of employees required to complete the Company's work, instead of forecasting how much potential overtime or contracted labor expenses may result from an unknown number of vacant employee roles. The Commission permitted this approach in Orders issued in 1996,[25] 2005,[26] 2010,[27] and 2019.[28] In each of those four cases, the AG (and LFUCG in Case No. 2018-00358) unpersuasively argued that vacant positions should not be included in the forecasted labor expense, failing to consider "that the decreased direct labor costs from vacant employee positions will be offset by increases in overtime or temporary labor costs."[29]

The Company believes the appropriate level for staffing is presently 156 full time equivalents.[30] Meyer, on behalf of the AG and LFUCG, proposed a $617,983 adjustment to remove forecasted expenses related to seven positions that were vacant as of September 21, 2023.[31] Importantly, Meyer's adjustment did not make any corresponding upwards adjustment to overtime or contract services.[32]

---

[25] *Application of Kentucky-American Water Company to Increase its Rates*, Case No. 95-554, Order at 32 (Ky. PSC Sept. 11, 1996).
[26] *Adjustment of the Rates of Kentucky-American Water Company*, Case No. 2004-00103, Order at 44 (Ky. PSC Feb. 28, 2005).
[27] *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year*, Case No. 2010-00036, Order at 24-25 (Ky. PSC Dec. 14, 2010).
[28] *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates,* Case No. 2018-00358, Order at 37-40 (Ky. PSC June 27, 2019).
[29] *Id.* at 39.
[30] Response to PSC 2-94; Watkins Direct at 4.
[31] Rebuttal Testimony of John M. Watkins at 7; Response to AG 2-10.
[32] Meyer Direct at 7; Watkins Rebuttal at 7.

Because the Company forecasts its labor expense using the necessary number of full-time employees required to complete its work, downward adjustments to its forecasted overtime and contract service expenses are also reflected in the revenue requirement. For example, the Company is projecting 24,677 overtime hours in this case per the Base Period Update Exhibit 37, Schedule G-2, even though there were 33,794 overtime hours during the base period and 26,400 overtime hours in 2022.[33] Similarly, in Case No. 2018-00358, the Company forecasted 16,034 hours of overtime to offset the inclusion of vacancies in labor costs, even though the actual average of overtime hours was 27,500.[34]

The AG and LFUCG have not presented any new arguments to support their position that vacant roles should be excluded from the Company's forecasted labor expense. At the evidentiary hearing in this case, AG and LFUCG witness Meyer stated his belief that the Company has a "tendency" to over-project overtime hours, based solely upon his review of Exhibit 37, Schedule G in the Company's previous 2018 rate case.[35] This mistaken belief creates the foundation for Meyer's recommendation regarding a vacancy adjustment. To clarify, the chart below summarizes the Company's forecasted hours in 2018 compared to the Company's reported hours in the current rate case:

[33] Watkins Rebuttal at 7.
[34] *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates,* Case No. 2018-00358, Order at 39 (Ky. PSC June 27, 2019).
[35] 12/11/2023 Hearing, VR 15:47:34-15:49:00.

Total Company (Water Segment) Employee Hours		
2018 Rate Case Forecasted Period (for the twelve months ended June 30, 2020)	2019 Actual	2020 Actual
Straight-Time = 317,152 Hours Overtime = 16,034 Hours Total = 333,186 Hours	Straight-Time = 288,346 Overtime = 33,034 Total = 321,381	Straight-Time = 310,355 Overtime = 20,841 Total = 331,196
Source: 2018 Rate Case, Updated Exhibit 37, Schedule G-2	**Source: Current Rate Case, Updated Exhibit 37, Schedule G-2**	

As the above chart shows, the Company's last rate case forecasted a labor expense for the twelve months ending June 30, 2020—encapsulating part of the year 2019, and part of the year 2020. The Company's current rate case provided actual employee hours for calendar year 2019 and 2020, but it did not provide a comparison of the actual employee hours worked during the twelve months ending June 30, 2020. As a result, an apples-to-apples comparison of the Company's Exhibit 37, Schedule G-2 from the 2018 rate case and the current rate case is not possible to determine whether the Company over-projected its forecasted employee hours compared to the actual numbers. It also does not account for work that may have been performed by contractors as opposed to employees.

Nonetheless, a comparison of the forecasted hours in the 2018 rate case and the actual hours recorded in 2019 and 2020 is more indicative of the position that the Company does not tend to over-project hours. The Company recorded over twice the amount of actual overtime hours in 2019 as it had projected in the forecasted period for the 2018 rate case. The Company also had a greater actual number of overtime hours in 2020 than it had projected in the forecasted period for the 2018 rate case. The Company has repeatedly demonstrated that it forecasts overtime hours based on the notion that an under-projection of overtime hours will be offset by increases in direct labor costs caused by any vacant roles within KAWC.

The Company's position on including vacant roles in its forecasted labor expense is soundly supported by logic and precedent. The AG and LFUCG's position on excluding vacant roles from the Company's forecasted labor expense is not. It is, further, a position that has been repeatedly argued, and repeatedly denied as unreasonable. Nevertheless, if this Commission decides to adjust the Company's forecasted labor expense as proposed by Meyer, the Company requests that an upward adjustment is made to reflect an increase in overtime of $306,423 and an increase in contract service expenses of $353,020.[36] However, because the AG and LFUCG's proposal fails to consider how a decrease in direct labor costs will be offset by increases in overtime or contract service expenses, the most reasonable outcome follows long-standing Commission precedent and accepts the Company's forecasted labor expenses as proposed.[37]

(2) *The Company's Proposed Labor Capitalization Ratio is Uncontested and Should Be Approved.*

Because some labor and labor-related costs are capitalized through capital projects and programs, the Company uses a capitalization percentage to calculate its net labor expense, as applied based on the position type.[38] To calculate the capitalization rate in this case, the Company pulled the total payroll amount and total capitalized portion of the payroll amount for 2020, 2021, and 2022 on a position-by-position basis.[39] Then, the Company divided the total capitalized payroll amount by the total payroll amount by position to determine the weighted three-year average capitalization percentage on a position by position basis. The Company then applied the

[36] See Response to PSC PHDR-3; Response to PSC PHDR-20; and AG PHDR-4.
[37] For additional support, see Watkins Direct at 3-7; Watkins Rebuttal at 7; Response to AG 1-1; Response to AG 1-10; Original and Supplemental Response to AG 2-10; Response to PSC 2-93; Response to PSC 2-94; Response to PSC PHDR-3; Response to PSC PHDR-20; Base Period Update Exhibit 37, Schedule G.
[38] Watkins Direct at 6.
[39] Watkins Rebuttal at 4.

three-year average capitalization percentage to each position based on that specific position's average capitalization rate.[40] Some of the information used to compute the capitalization rate is located within Filing Exhibit 37, Schedule G, which reflects base pay, overtime pay, and the allocation of management salaries to wastewater.[41] However, Exhibit 37 G does not include compensation related to the Annual Performance Plan, Long-Term Performance Plan, and Shift Premiums, all of which are included in the requested amount of labor expense in the Company's revenue requirement.[42]

Meyer, on behalf of the AG and LFUCG, initially opposed the Company's proposed labor capitalization ratio, relying on the information contained in the Company's Filing Exhibit 37, Schedule G.[43] As the Company was comparing the as-filed labor expenses and the charts Meyer created from the data in Exhibit 37 G, the Company discovered an issue and filed a revised Exhibit 37 G on November 8, 2023.[44] After reviewing the Company's revised Exhibit 37 G, Meyer conceded that the Company's proposed capitalization rate was reasonable,[45] and that the AG and LFUCG would "no longer pursue" the capitalization issue.[46]

Because no party is contesting the Company's proposed labor capitalization percentage of 35.84%,[47] the Company respectfully requests that the Commission decline to make any capitalization adjustment, and instead adopt KAWC's reasonable, unopposed proposal.

---

[40] *Id.*
[41] *Id.* at 5.
[42] *Id.* at 2.
[43] Meyer Direct at 9-12.
[44] Watkins Rebuttal at 2; Base Period Update Exhibit 37, Schedule G.
[45] 12/11/2023 Hearing, VR 15:46:07-15:47:10.
[46] 12/11/2023 Hearing, VR 15:26:50-15:27:11.
[47] Watkins Rebuttal at 6.

(3) *The Company's Total Employee Compensation Should Be Recoverable Because it is Reasonable and Prudently Incurred.*

The Company aims to offer market-level compensation that is on par with other companies that KAWC competes with for talent to ensure that employee compensation is not only competitive, but also reasonable.[48] By using a combination of base and performance compensation, the Company satisfies the dual objective of a competitive market-based total compensation for all employees, while continuing to motivate employees to achieve goals that will improve performance and efficiency for the benefit of the Company's customers.[49]

Employee compensation is a cost of providing utility service, like other prudently incurred costs of service recoverable in rates.[50] Employee compensation must therefore be assessed through the same lens as all other operating costs of the Company: if it is prudently incurred and reasonable in amount, relative to what the industry pays for the same services, it should be recoverable through rates not parsed out based on its individual components. The Company submitted a total renumeration study and an assessment of the Company's performance compensation programs through the direct testimony of Robert V. Mustich, a consultant with Willis Towers Watson with over thirty years of industry and compensation consulting services experience.[51] Because the Company's total compensation is below the market range of plus or minus 10% at 13% below the national market median and 11% below the regional market median, as demonstrated by Mustich's total renumeration study,[52] regardless of the combination of fixed and performance-based

[48] Direct Testimony of William A. Lewis at 45.
[49] *Id.*
[50] *Id.*
[51] Direct Testimony of Robert V. Mustich at 1.
[52] *Id.* at 5-6.

components that the employees earn, the Company's overall compensation expense is inherently reasonable and prudently incurred and should be recoverable like all others costs of service.[53]

The AG and LFUCG, through their witness Meyer, propose to remove the majority of the Company's performance-based compensation expense from the revenue requirement.[54] The Company offers two performance-based compensation plans: the Annual Performance Plan ("APP"), which is available for all full-time employees, and the Long-Term Performance Plan ("LTPP"), which is available for certain exempt employees.[55] Under the LTPP, American Water provides restricted stock units and performance stock units as long-term performance compensation, based on three-year vesting periods.[56] The APP is designed to recognize and reward employee performance against key goals and targets that drive the Company's strategy. For example, the APP goals for 2023 focused on growth, customer satisfaction, safety, environmental leadership, and people.[57]

Meyer proposes to remove an arbitrary 50 percent of the Company's APP and 100 percent of the Company's LTPP from the revenue requirement, contending that the Company's APP and LTPP programs "do not provide measurable benefits to ratepayers."[58] This misconception is clarified by Company witnesses William A. Lewis and Mustich, who explain that the performance-based component of the Company's total market-based compensation plan aligns the interests of KAWC customers, employees, and investors.[59] The market-based compensation philosophy that KAWC has adopted allows it to attract and retain the workforce needed to continue to provide safe and reliable service. At a time the Company and many other employers are finding it increasingly

[53] Lewis Direct at 45.
[54] Meyer Direct at 15.
[55] Lewis Direct at 47.
[56] *Id.* at 48.
[57] *Id.* at 47.
[58] Meyer Direct at 15.
[59] Lewis Direct at 48-50; Mustich Direct at 9-10.

difficult to attract and retain good employees, this point cannot be overstated. Customers receive a benefit when a utility retains a talented workforce, because a stable workforce avoids the costs of hiring and training new employees.[60] The Company's LTPP program is particularly intended to reduce attrition at the higher ranks of the organization.[61] Senior management turnover and the loss of expertise can degrade the continuity of strategy and execution, to the detriment of customers. Importantly, the LTPP achieves its goals of reducing leadership attrition at a lower cost to customers compared to simply increasing leadership's base pay, because performance pay under the LTPP is stock-based.[62] Employees must remain with the organization over a three-year period to realize the full vesting of their awards.

In addition, the plans contain tangible goals that measure and compensate employees for achieving goals directly tied to the delivery of clean, safe, reliable, and affordable water service and the provision of first-in-class customer service.[63] Customers derive a direct benefit from the Company's focus on the strategic goals underlying the plans: customer satisfaction, health and safety, environmental performance, and employ a skilled and diverse workforce. Customers also benefit from the plans' well-grounded financial measures, which keep KAWC and its employees focused on improved performance at all levels, particularly in increasing efficiency, decreasing waste, and boosting overall productivity.[64]

KAWC's total market-based compensation is a reasonable and necessary cost incurred to serve customers. Because the Company's total employee compensation is reasonable and prudently incurred, KAWC requests that this Commission reject the AG and LFUCG's proposal

---

[60] Mustich Direct at 8.
[61] *Id.* at 9.
[62] *Id.*
[63] Lewis Direct at 51.
[64] *Id.* at 51-52.

and instead include the Company's proposed total market-based employee compensation expense in the revenue requirement which includes APP and LTPP compensation. KAWC is aware of the Commission's recent decision involving incentive compensation and a nexus to financial performance,[65] but KAWC asks the Commission to revisit that decision in light of the arguments above and substantial evidence the Company has presented regarding how both the APP and LTPP benefit customers.[66]

(B) <u>Residential Revenue Forecasting</u>

To forecast future KAWC residential and commercial customer usage,[67] and the revenue that will accompany that usage, the Company uses statistical linear regression modeling.[68] These analyses model historical monthly usage per customer from January 2013 through December 2022 to forecast monthly usage per customer for the period January 2023 through December 2027, taking into account trends in declining use, weather normalization, and the impact of the COVID-19 public health emergency on water consumption for KAWC's water service customers.[69] These complex mathematical predictive analyses produce an equation that describes a historical relationship between a set of independent variables, and single dependent variable that can be used to forecast future values of the dependent variable based on the assumed values of the independent variable.[70] The accuracy and reasonableness of a statistical linear regression can be determined

[65] *Application of Kentucky Power Company for a General Adjustment of its Rates*, Case No. 2020-00174, Order at 12-15 (Ky. PSC Jan. 13, 2021)

[66] As Ms. Nash explained at the December 11, 2023 hearing and in response to PSC PHDR-13, the "gating factor" or "circuit breaker" in the 2023 APP Plan has been removed so achieving a certain earnings per share is no longer a requirement for the availability of APP payments going forward. KAWC further notes that only 50 percent of APP payments have a nexus to financial measures under the Growth component of an individual employee's APP payment, and, under the LTPP, the issuance of restricted stock units ("RSUs") happens solely as a result of tenure at the Company without any regard to financial performance.

[67] The Company uses a multi-year average for all other customer classes. Direct Testimony of Charles B. Rea at 44, 52.

[68] Rea Direct at 44.

[69] *Id.* at 34.

[70] *Id.* at 36.

using both quantitative and qualitative metrics, as explained in detail by Company witness Charles B. Rea.[71]

Forecasting customer usage reasonably and accurately is paramount to determining a proper revenue requirement and revenue deficiency in a rate proceeding. While for some customer classes, it may be reasonable to simply take an average of historical data points to project future usage,[72] the Company chose a more advanced analytical approach for forecasting residential and commercial usage due to the number of variables that influence these customer classes, in order to obtain the most accurate results.

The AG and LFUCG, through their witness Meyer, have contested the Company's forecasted revenues as they relate specifically to residential customers,[73] arguing that the Company's residential class revenues are understated, and that test year residential revenues should be increased by $2.2 million.[74] Meyer relied upon historical customer levels in making this determination.[75] First, Meyer calculated the average number of KAWC customers for the years 2018 through 2022.[76] Next, Meyer calculated the average usage per customer for the same time period, based on actual usage data.[77] Finally, Meyer recommended forecasting usage by taking a simple three-year average of usage per customer from 2020, 2021, and 2022, resulting in a recommended forecasted usage of 48.59 MGal per customer.[78]

---

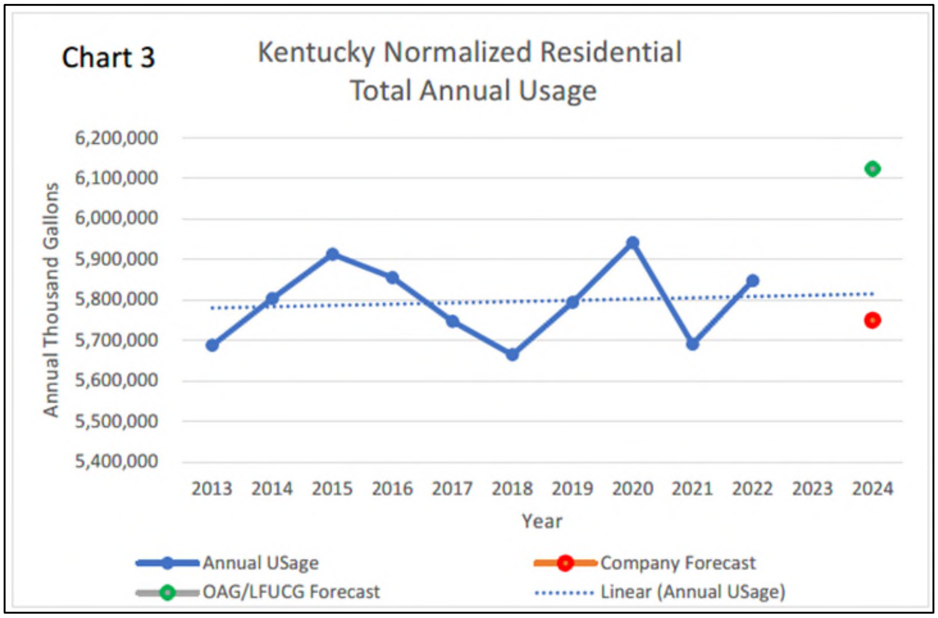
[71] *Id.* at 39-42.
[72] *See id.* at 52.
[73] The AG and LFUCG have not taken issue with the commercial usage forecast, which utilized the same modeling approach. Rebuttal Testimony of Charles B. Rea at 7.
[74] Meyer Direct at 19, 22.
[75] *Id.* at 19-20.
[76] *Id.* at 20.
[77] *Id.* at 21.
[78] *Id.* at 22.

At the evidentiary hearing, Meyer explained that he agreed with KAWC's projected customer count of 126,014 but disagreed with the Company's projected customer usage.[79] Meyer further explained that the methodology underlying his recommended customer usage figure did not account for the possibility that 2020, 2021, or 2022 could have been years where usage was impacted by unusually hot or dry weather,[80] or by the COVID-19 public health emergency.[81] Meyer's analysis is based on actual use per customer, rather than usage data that is normalized for weather or for other external influences such as COVID-19, despite the testimony of Company witness Rea demonstrating that these factors have proven to be significant drivers of residential usage.[82] Any multi-year analysis of customer usage data needs to be done in a way that removes the impacts of different weather conditions on different data points and removes the impacts on usage of one-time events such as COVID-19.[83]

The Company's forecast of residential customers, annualized use per customer, and total usage all follow the historical trends and fall within expected levels given the historical data from 2013 through 2022. Meyer's forecast of annualized use per customer, and particularly his forecast of total residential usage, is well outside of the range suggested by the historical data and is simply unreasonable, as the data in the chart below indicates:[84]

---

[79] 12/11/2023 Hearing, VR 15:37:46-15:38:06.
[80] Although not included as a part of his written testimony, Meyer did state during the evidentiary hearing that the results of his three-year average methodology would be "not that far off" from an alternative analysis which considers this potential, because "the three years of heating degrees days . . . is within 45 heating degree days of your normal." 12/11/2023 Hearing, VR 15:39:07-15:39:28.
[81] 12/11/2023 Hearing, VR 15:38-38-15:39:50.
[82] Rea Direct at 37-38, 45-49; Rea Rebuttal at 4.
[83] Rea Rebuttal at 4.
[84] *Id.* at 10. The Chart shows the combination of the customer count data and the normalized use per customer data and presents that as total normalized annual usage for the 2013 to 2022 time period and the forecast test year. *Id.*



The Company's methodologies for developing customer usage forecasts are sound. The Commission should adopt the Company's methodology for forecasting residential usage, and adopt the forecast as presented by the Company for the purposes of developing billing determinants, revenue requirements, and rates in this proceeding.[85]

(C) <u>Working Capital Allowance</u>

Working capital and other working capital are included in a utility's rate base to recognize the cost of funding the lag between the time utility service is rendered to the customer and the time it takes to collect revenues from the customer to pay for that service.[86] In other words, investors had to provide capital upfront to fund the daily operations of the business before customers pay their bills. The working capital calculations can also properly reflect the impact of any difference in time between when expenses are accrued, and the associated cash is distributed.[87] Working capital is calculated through two separate processes. The first process measures average materials

[85] Rea Rebuttal at 11.
[86] Direct Testimony of Wesley E. Selinger (as adopted by John M. Watkins) at 5.
[87] *Id.*

and supplies balances, the result of which is "Other Working Capital," which is an uncontested component of the Company's working capital allowance in this proceeding.[88] The second process is a lead/lag study, the result of which is "Working Capital."[89]

The Company proposed to include $3,146,000 of working capital in its rate base, which was increased in the Base Period Update to $3,181,000.[90] The Company calculated the appropriate amount of forecasted working capital by utilizing a lead/lag study performed under the direct supervision of Harold Walker, III of Gannett Fleming Valuation and Rate Consultants, LLC.[91] Walker's lead/lag study was based on historical data for the twelve months ending December 31, 2022.[92]

The AG and LFUCG, through their witness Meyer,[93] contend that two adjustments should be made to the Company's working capital recommendation: (1) revising the expense lead days for Service Company charges utilized by the Company from a negative 5.30 day expense lead to a positive 25.60 day expense lead to match the expense lead days for contracted services;[94] and (2) removal of certain cash generating cost of service items from the lead/lag study, including regulatory expense, amortization, uncollectibles, depreciation and amortization, deferred income taxes, and net income.[95]

---

[88] Selinger Direct (as adopted by Watkins) at 5; Base Period Update Exhibit 37, Schedule B-1.
[89] Selinger Direct (as adopted by Watkins) at 5; Base Period Update Exhibit 37, Schedule B-1.
[90] Base Period Update, Exhibit 37, Schedule B-1, Page 2 of 2.
[91] Direct Testimony of Harold Walker, III at 1.
[92] *Id.* at 8.
[93] Meyer Direct at 30-36.
[94] Rebuttal Testimony of Harold Walker, III at 5.
[95] *Id.* at 4.

(1) *KAWC's Service Company Charges Lead Days Should Not Be Adjusted, Because the Company's Recommendation is Based on A Thorough Study Instead of the AG and LFUCG's Hypothetical Analogy.*

Meyer's proposed adjustment to Service Company charges lead days is based on the misrepresentation that "service company operations are no different than any other outside service provider."[96] The services, costs, and billing terms for Service Company charges are not similar to outside services providers.[97] The Service Company exists to provide services to American Water affiliates at cost. The Service Company makes no profit from the provision of these services. The Service Company's billing terms are meant to match expenses with the receipt of payments from affiliates which are the beneficiaries of the services. Prepayment of services does not produce a profit on services. However, prepayment of charges reduces the cost of the services provided.[98]

In addition, the services provided by Service Company charges and contract services expenses are quite different in nature and scope.[99] The cost structure of the services provided by each is also very different. The services provided by Service Company charges are charged at cost, meaning there is no mark-up or financial gain for any services that the Service Company or its employees charge to the affiliates of American Water.[100] In contrast, the services and the related expense of contract services include entrepreneurial profit, meaning they are marked-up for financial gain.[101] There is no reason to expect Service Company charges and contract services expenses to have similar lead days because each provides very different services and have different invoicing practices.[102] The AG and LFUCG unsuccessfully proposed a similar modification to

---

[96] Meyer Direct at 35.
[97] Walker Rebuttal at 6.
[98] *Id.*
[99] *Id.*
[100] *Id.*
[101] *Id.*
[102] *Id.* at 7.

Service Company charges lead days in the Company's last rate case, Case No. 2018-00358.[103] Meyer did not conduct his own lead/lag study to determine his recommended 25.6 day Service Company charges expense lead.[104] Nor did Meyer find any errors in the Service Company charges expense lead day analysis used in Walker's lead/lag study.[105] Instead, Meyer's recommendation assigns a hypothetical number of expense lead days to Service Company charges, based on a fundamental misunderstanding of how these charges differ from other operating expense categories.[106] If hypothetical expense lead days are allowed in lieu of the results of a lead/lag study, it defeats the purpose of conducting a lead/lag study, and results here in nothing more than the arbitrary confiscation of investor-provided capital.

(2) *Eliminating Cost of Service Line Items from KAWC's Determination of Working Capital is Unreasonable.*

Meyer recommends removing six cost of service line items from the determination of the Company's working capital under the pretense that they are "non-cash expenses": regulatory expense, amortization, uncollectibles, depreciation and amortization, deferred income taxes, and net income.[107] The term "non-cash" expense is an accounting term only. It is not a term that has significance from a financial, economic, or regulatory perspective, because something categorized as a "non-cash expense" from an accounting perspective still represents a true expense for a company.[108] Although a company does not write a check to pay "non-cash expenses," the working capital only arises due to customers not paying for previous service provided by the company.[109] When a customer does not pay for the cost of service, it ultimately affects the cash position of the

---

[103] *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates*, Case No. 2018-00358, Order at 4-6, 19 (Ky. PSC June 27, 2019).
[104] Walker Rebuttal at 7.
[105] *Id.*
[106] *Id.*
[107] Meyer Direct at 32.
[108] Walker Rebuttal at 8.
[109] *Id.*

Company; the Company does not recover, and therefore must finance, the cost of providing for uncollected customers' services.

If "non-cash expense" line items are not considered a working capital requirement, then it implies a company would not be impacted if they did not collect that portion of their cost of service comprised of "non-cash expense" line items. Obviously, the collection of the entire cost of service is essential to the operations of a company, otherwise "non-cash expense" items would not be included in the determination of a company's cost of service.[110]

Regulatory expense should be included as an operating expense line item when determining working capital because it relates to the current cash expenditures the Company is making as part of this current rate case. Since the current regulatory expense is only now occurring, only investor provided capital can be the source of cash funding current regulatory expense.[111] Therefore, the inclusion of current regulatory expense as part of the determination of working capital is the only opportunity to recover the cost of raising cash from its investors that is used in day to day operations related to funding regulatory expenses.[112]

Amortization expense should be included as an operating expense line item when determining working capital because it is required to operate a utility, as evidenced by the fact that it is an allowable expense line item in the cost of service. Amortization expense is included in a proper lead/lag study to account for the portion (i.e., 10.3%) of amortization expense that has not been collected or paid for by customers because the Company collects cash associated with amortization expense from customers in the same way it collects all other revenues—with a revenue lag.[113]

---

[110] *Id.* at 9.
[111] *Id.* at 10-11.
[112] *Id.* at 11.
[113] *Id.*

Uncollectibles expense should be included as an operating expense line item when determining working capital because when a customer does not pay for the cost of service, it ultimately affects the cash position of the company. The uncollectibles expense only arises due to customers not paying for previous service provided and funded by the Company, even though the Company does not write a check to pay uncollectible account expenses.[114] The uncollectibles expense is part of the write off process, through amortization, of revenues for services provided to customers for which the Company was never paid. The uncollectibles expense was created the moment the Company determined the customer had defaulted on the promised payment for services.[115]

Depreciation expense is included in a proper lead/lag study to account for the portion (i.e., 10.3%) of depreciation expense that has not been collected or paid for by customers because the Company collects cash associated with depreciation expense from customers in the same way it collects all other revenues—with a revenue lag.[116] Additionally, depreciation expense (accumulated depreciation) is subtracted from gross plant when rate base is determined. Therefore, at any point in time, the amount of depreciation expense (accumulated depreciation) that is subtracted when determining rate base is overstated because it is recorded using accrual accounting while the full cash amount of the expense has yet to be collected because, like all other revenues, it is uncollected from customers for 37.75 days.[117]

Deferred income taxes are included in a proper lead/lag study to account for the portion (i.e., 10.3%) of deferred income tax expense that has not been collected or paid for by customers.[118]

[114] Walker Rebuttal at 11-12.
[115] *Id.* at 12.
[116] *Id.*
[117] *Id.*
[118] *Id.* at 13.

Specifically, deferred income taxes, or ADIT, are subtracted from net plant in the determination of rate base under the premise that they are "cost free capital" provided by customers when customers pay their bills. However, the Company collects cash associated with its deferred tax liability from customers in the same way it collects all other revenues, with a revenue lag of 37.75 days.[119]

Net income, or return on invested capital, should be included in the working capital determination because net income is the property of investors when it is earned but, like all other revenues, it is uncollected from customers for 37.75 days.[120] Mathematically, assigning zero lead days to net income in the working capital determination recognizes the portion of the property, 10.3%, that remains uncollected. Unless investors are allowed a return on the uncollected 10.3% of net income through the working capital requirement, they do not have an opportunity to earn a return on this investment.[121]

Finally, the Company is aware of the Commission's Order in Case No. 2021-00183, involving a rate case of Columbia Gas of Kentucky, which excluded non-cash items from working capital.[122] In that case the Commission reviewed a proposed settlement which included prior settlement agreements to remove non-cash items. However, the Company is also aware of numerous Commission Orders dating back to 1993, expressly declining to eliminate KAWC's non-cash items from the calculation of its working capital:

- In **Case No. 92-452**, the AG recommended exclusion of all non-cash items from working capital.[123] The Commission denied the adjustment and described KAWC's

---

[119] *Id.*
[120] *Id.* at 14.
[121] *Id.*
[122] Meyer Direct at 34.
[123] *Notice of Adjustment of the Rates of Kentucky-American Water Company*, Case No. 92-452, Order (Ky. PSC Nov. 19, 1993).

methodology as "theoretically sound."[124]

- In **Case No. 95-554**, the AG proposed the exclusion of net income from working capital.[125] The Commission denied the adjustment and noted it did not accept the AG's same adjustment in Case No. 92-452.[126]

- In **Case No. 97-034**, the AG proposed the exclusion of depreciation expense and deferred income tax expense from working capital.[127] The Commission denied those adjustments.[128]

- In **Case No. 2004-00103**, the AG proposed the exclusion of depreciation expense from working capital.[129] The Commission denied the adjustment, stating that it "continues to hold its position as stated in previous Orders . . . ."[130]

- In **Case No. 2012-00520**, the AG argued that non-cash expenses and common equity profits should not be included in the calculation working capital.[131] The Commission denied the adjustment, noting that "the AG has consistently presented, and the Commission has consistently refused to adopt, his argument regarding working capital."[132]

- In **Case No. 2018-00358**, the AG and LFUCG argued that non-cash expenses should

---

[124] *Id.* at 20.
[125] *Application of Kentucky-American Water Company to Increase Its Rates*, Case No. 95-554, Order (Ky. PSC Sept. 11, 1996).
[126] *Id.* at 23-24.
[127] *Application of Kentucky-American Water Company to Increase Its Rates*, Case No. 97-034, Order (Ky. PSC Sept. 30, 1997).
[128] *Id.* at 27-28.
[129] *Adjustment of the Rates of Kentucky-American Water Company*, Case No. 2004-00103, Order (Ky. PSC Feb. 28, 2005).
[130] *Id.* at 17.
[131] *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year*, Case No. 2012-00520, Order at 13 (Ky. PSC Oct. 25, 2013).
[132] *Id.* at 14.

> be excluded from the working capital calculation.[133] The Commission denied the adjustment "consistent with precedent and based upon the evidence in the record," stating that that the AG and LFUCG "offered no new evidence or arguments in the current proceeding to disturb our previous findings or to support a change in our position on this matter."[134]

The Company believes that its longstanding approach to calculating working capital is not only logical, but it is necessary to ensure that the opportunity to recover the cost of raising cash from investors used in day-to-day operations exists. The Company respectfully asks the Commission to maintain its position in past Company cases and find that including cost of service line items in a working capital calculation continues to be appropriate. The adjustments to working capital proposed by the AG and LFUCG are unreasonable and should be denied.

(D) <u>Electronic Payment Fees</u>

The Company's goal is to provide customers with the most convenient options to pay their bills.[135] Customers are accustomed to many transactions that are paid electronically, including with a credit or debit card, as most online transactions are today. The Company proposes to waive the electronic payment processing fees assessed by KAWC's vendor for customer payments processed via debit card, credit card, and electronic check, and instead include these fees as a base operating expense within the forecasted test year.[136] The Company included $349,284 in the revenue requirement for electronic payment fees, after annualizing the fees as an operating expense.[137]

---

[133] *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates*, Case No. 2018-00358, Order at 7 (Ky. PSC June 27, 2019).
[134] *Id.* at 9.
[135] Newcomb Direct at 13.
[136] Newcomb Direct at 13; Filing Exhibit 37, Schedules C and D.
[137] Response to AG 1-35(a).

Charging the vendor's processing fee for the use of electronic payment methods, on top of the customer bill, adds friction to the process of paying a bill.[138] Eliminating the direct payment of the fee is expected to help more customers pay their bill on time, avoid late fees and potential disconnections, and improve timely collections. According to a National Association of State Utility Consumer Advocates ("NASUCA") resolution (Resolution 2012-07), "state public utility commissions are urged to survey the utilities within their jurisdictions to determine the options that are available to consumers for paying utility bills without incurring additional charges."[139]

The AG and LFUCG, through their witness Meyer, propose to remove the entire electronic payment fee expense from the revenue requirement because they believe that the Company's proposal would not help with on-time bill payment, and that the Company's proposal will "create a subsidy for higher income individuals as they are most likely to have (and use) a credit card to garner . . . benefits [that] are not generally available to lower income ratepayers who are less likely to have a credit card."[140] Company witness Jeffrey Newcomb responded to these concerns through his rebuttal testimony, explaining first that the availability of a credit card payment option provides customers the benefit of cash flow management.[141] The timing of a customer's cash inflows will not always be perfectly timed with a customer's bill payment due date, and the availability of a fee free credit card payment option provides a means for on-time bill payment to avoid late fees or potential disconnection for non-payment.

In addition, Meyer's contention that eliminating the direct charge of vendor electronic payment fees is likely to create a "subsidy" is misguided for two reasons. First, the vendor

---

[138] Newcomb Direct at 13.
[139] Newcomb Direct at 13-14; NASUCA, *2012-07 Urging Utilities to Eliminate "Convenience" Fees for Paying Utility Bills with Debit and Credit Cards and Urging Appropriate State Regulatory Oversight*, available at https://www.nasuca.org/2012-07-urging-utilities-to-eliminate-convenience-fees-for-payingutility-bills-with-debit-and-credit-cards-and-urging-appropriate-state-regulatory-oversight/.
[140] Meyer Direct at 18.
[141] Newcomb Rebuttal at 6.

electronic payment fees apply to both debit card and credit card transactions.[142] While Meyer has cited to an article from the Federal Reserve concluding that having a credit card was less common at lower income levels, Meyer did not address the prevalence of owning a debit card to make electronic payments. The Company's proposal would benefit customers who pay with debit cards, credit cards, or by electronic check. Second, there are other revenue requirement components that are not directly charged to customers through rate design yet have not been deemed to result in subsidies. For example, customers who choose non-electronic payment options are not directly charged the cost of their chosen payment form, even though the cost of those payment options are reflected in the Company's cost of service and revenue requirement.[143] Customers who choose to receive a paper bill via the United States Postal Service are not directly charged the cost of postage, printing, paper, and an envelope.[144]

The Company's proposal to include electronic payment fees in its revenue requirement will allow customers to conveniently pay their bills via debit card, credit card, or electronic check without incurring the additional processing charge from KAWC's vendor. By including the processing fees as an operating expense, all KAWC customers will benefit from fee-free payment options, regardless of how the customer chooses to pay their bill. The Commission should reject Meyer's proposal and allow the Company to include the requested electronic payment fees in its revenue requirement.[145]

---

[142] *See* Response to AG 2-27; Response to AG 2-28.
[143] Newcomb Rebuttal at 6-7; Response to AG 2-28.
[144] Newcomb Rebuttal at 7.
[145] For additional support, see Newcomb Direct at 13-14; Newcomb Rebuttal at 6-7; Response to AG 1-35; Response to AG 2-27; Response to AG 2-28.

(E) Miscellaneous Expenses

Miscellaneous expenses are a component of operating expenses that include costs related to customer education, community relations, membership dues, directors' fees, hiring costs, office power, heating and oil, and laboratory supplies. The Company has included miscellaneous expense adjustments to account for inflation based on the Consumer Price Index ("CPI") from the U.S. Bureau of Labor Statistics ("BLS"); to remove charitable contributions; and to normalize inventory scrap write-offs.[146]

Through the discovery process, the Company identified $6,799 of Gifts/Promotional items and $2,549 of Membership Dues allocated to Covered Activities,[147] for a combined amount of $9,348 that should have been removed from the forecasted test year.[148] Accordingly, the Company's updated proposed revenue requirement and revenue deficiency reflects a $9,348 reduction to miscellaneous expenses.[149]

Meyer, on behalf of the AG and LFUCG, proposed removal of an additional $111,768 from the Company's revenue requirement related to miscellaneous expenses allocated to food and to Service Company business development, contending that the costs "lacked specificity."[150] Because the Company has specifically explained the composition and value of these costs, Meyer's recommendation should be rejected.

As Company witness Newcomb explained, the $5,699 of expenses allocated to food cost is a de minimis level of normal and ongoing expense that is reasonable.[151] Meyer cited Case Nos.

---

[146] Newcomb Direct at 11-12.
[147] *See* KAWC's Response to AG 1-21. "Covered Activities" include legislative advocacy, regulatory advocacy, and/or public relations; advertising; marketing; legislative policy research; and/or regulatory policy research. *Id.*
[148] Newcomb Rebuttal at 7.
[149] *Id.*
[150] Meyer Direct at 29.
[151] Newcomb Rebuttal at 7.

2003-00433[152] and 2003-00434[153] as precedent related to this expense. These two cases disallowed miscellaneous expenses from inclusion in two electric utilities' revenue requirements related to (a) charitable contributions, (b) employee gifts, award banquets, and other social events, and (c) a portion of membership dues associated with Covered Activities.[154] The cases did not discuss an expense related to food, and therefore the Company is unclear on the precedent to which Meyer refers. The Company has already complied with the Commission precedent presented in Case Nos. 2003-00433 and 2003-00434 by eliminating miscellaneous expenses related to charitable contributions, gifts, and membership dues associated with Cover Activities from its proposed revenue requirement.

Further, the Commission has previously allowed miscellaneous expenses related to food costs to be included in other utilities' rate proceedings.[155] A similar rationale extends to the reasonableness of allowing food expenses for KAWC. Occasionally providing food to employees is a reasonable operating expense tied to encouraging employee attendance and participation in Company meetings. Customers benefit from a workforce that can focus on the key task of providing safe and reliable water service. Sometimes, that workforce needs to be fed. The Company provides food, on occasion, at a reasonable de minimis cost, so that its employees can hone in on what matters: providing top notch water service and customer service to customers.

---

[152] *An Adjustment of the Gas and Electric Rates, Terms, and Conditions of the Louisville Gas and Electric Company*, Case No. 2003-00433, Order at 49-52 (Ky. PSC June 30, 2004).
[153] *An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company*, Case No. 2003-00434, Order at 42-45 (Ky. PSC June 30, 2004).
[154] Case No. 2003-00433, Order at 49-52 (Ky. PSC June 30, 2004); Case No. 2003-00434, Order at 42-45 (Ky. PSC June 30, 2004).
[155] *See Application of Cumberland Valley Electric, Inc. for an Adjustment of Rates*, Case No. 2014-00159, Order at 13 (Ky. PSC Jan. 16, 2015) ("The AG recommended that adjustments be made to Cumberland Valley's annual meeting expense for food and drinks, a singer, entertainment and buckets and bulbs should be removed for ratemaking purposes. . . . The Commission has allowed these types of expenses in previous cooperative rate proceedings as necessary and reasonable to encourage attendance and participation by the cooperative's members.").

Company witness John M. Watkins responded to Meyer's proposal to remove Service Company business development costs allocated to the Company in the amount of $106,069, reiterating the direct and indirect benefits that customers receive as a result of the Service Company's business development activities.[156] In a submitted Company workpaper entitled "KAWC 2023 Rate Case - Support Services Exhibit," the Company breaks down the business development costs into $82,578 attributable to labor and related expenses, and $23,491 to non-labor and other expenses.[157] These Service Company business development costs are both reasonable and necessary.[158]

Service Company business development activities allow for: mitigation of the costs to be recovered per customer, enhanced purchasing power, and the spurring of activities that contribute to customers' local economies.[159] Cost mitigation occurs when business development activities allow KAWC to grow its customer base, which enables the Company to spread system investment costs and operating expenses across a larger customer group, thereby mitigating the costs to be recovered per customer.[160] Enhanced purchasing power results from a growing customer base, which allows KAWC's parent company, American Water, to have greater negotiating leverage to purchase goods and services in bulk quantities at competitive prices, for the benefit of all customers, including KAWC customers.[161] Service Company business development activities also allow American Water and KAWC to acquire new wastewater and water utilities, and to leverage economies of scale to make operational improvements, which in turn improves the quality of water

[156] Watkins Rebuttal at 7-9.
[157] *See* KAWC Response to PSC 1-1 and KAWC Response to AG 2-15(a).
[158] *See* Direct Testimony of Patrick L. Baryenbruch at 4-8.
[159] Watkins Rebuttal at 8.
[160] *Id.*
[161] *Id.* at 9.

consumed by customers and the quality of the public bodies of water into which wastewater effluent is discharged.[162]

The Commission should approve the Company's proposed level of miscellaneous expenses in its revenue requirement because the costs are reasonable, prudently incurred, and provide express benefits to customers.

(F) Rate Case Expenses

As a regulated utility, KAWC has a legal obligation to provide safe and adequate service to its customers at just and reasonable rates. Periodic rate changes are necessary to support the Company's continued provision of safe and adequate service to its customers. The way that KAWC changes its base rates is through the rate case process. The cost of litigating a rate case is a normal and essential cost of service for any regulated public utility and should be treated as such.[163]

The Company is proposing to recover forecasted rate case expenses related to this case over a two-year amortization period, starting at the beginning of the future test year, February 1, 2024.[164] There will be approximately nine months between the date that the first rate case expense was incurred for this rate case, and the proposed amortization start date.[165] A two-year amortization period strikes a balance between customer impact and intergenerational equity, meaning the customers who will be paying the base rates established in this case are the customers from whom the rate case expense incurred to establish those rates are recovered.[166]

---

[162] Watkins Rebuttal at 9. For additional support, see Newcomb Direct at 11-12; Newcomb Rebuttal at 7; Watkins Rebuttal at 7-9; Response to PSC 1-6; Response to PSC 2-25; Response to AG 1-15; Response to AG 1-17; Response to AG 1-21 Response to AG 1-77; Response to AG 2-13; Response to AG 2-14; Response to AG 2-15; Response to LFUCG 1-61; Response to LFUCG 1-62.
[163] Newcomb Direct at 12.
[164] Response to PSC 2-28.
[165] Response to LFUCG 1-90.
[166] *Id.*

Forecasting rate case expenses is difficult due to the timing of the regulatory process. For example, in its 2018 rate case, the Company estimated that rate case expenses would total $1,230,559.[167] However, the Company actually paid $1,326,729 in rate case expenses.[168] The Company can reasonably calculate the amount of invoiced expenses almost up to the date on which the case record closes, which in this proceeding is on January 13, 2024. However, there is some level of rate case expense that must be estimated because the costs are incurred as the record closes, and *after* the record closes. The Company must therefore predict the level of rate case expense that may be incurred after January 13, 2024. Rate case expenses, particularly legal expenses, may be incurred after the record closes for a number of reasons.

After the case is submitted for a decision and the Commission issues its decision, rate case expenses could accrue for: review of the Commission's order in this case; responding to the Commission's orders related to petitions for confidential protection of sensitive information; preparing a motion for reconsideration or rehearing; briefing and reviewing intervenors' briefs on rehearing; responding to any data requests related to rehearing; or preparing and litigating an appeal through the Kentucky courts. These tasks could require input from outside legal counsel and expert consultants. The Company is unable to predict which of these expenses may accrue, and so it has made a necessary and reasonable estimate. Any rate case expenses related to this case in excess of the amount approved by the Commission will be expensed immediately.[169]

To the extent that the invoiced amount of rate case expenses fall short of the Company's forecasted level of expense, the remaining amount of estimated expenses remain reasonable because the Company will undoubtedly incur rate case expenses after the record closes. As of the

[167] Base Period Update, Exhibit 37, Schedule F-6.
[168] *Id.*
[169] Response to PSC 2-28(a).

Company's post hearing discovery responses filed on December 22, 2023, invoiced rate case expense was $926,714.34 leaving $394,322.66 as an estimate of additional rate case expense.[170] As also indicated in that response, the Company will supplement that amount on or before the record closes in this case on January 12, 2024. Because rate case expenses are a necessary and prudently incurred cost of providing utility service, the Company requests that the Commission approve of the entire forecasted amount as proposed.[171]

III. NON-REVENUE AND UNACCOUNTED-FOR WATER LOSS

Reducing water loss is a complex issue with a host of contributing factors. Water loss can be classified into two categories: (1) real loss which is water that escapes the distribution system from leaks or storage overflows; and (2) apparent loss due to meter inaccuracies, billing system data errors, and unauthorized consumption.[172] A significant difficulty in resolving or reducing water loss stems from the fact that the vast majority of a water utility's infrastructure is below the surface—much like an iceberg—where it is cannot be easily seen or measured.

Traditional indicators use a single percentage, either non-revenue water ("NRW") or unaccounted-for water ("UFW"), to measure water loss. NRW is the difference between the amount of water that is produced by a water utility for consumption, and the amount of water that is billed to customers. The Commission defines UFW loss as "the difference of the total amount of water produced and purchased and the sum of water sold, water used for fire protection

[170] See Response to PSC PHDR-12.
[171] For additional support, see Newcomb Direct at 12-13; Response to PSC 2-27; Response to PSC 2-28; Response to PSC PHDR-12; Response to LFUCG 1-90; Base Period Update, Exhibit 37, Schedule F-6.
[172] Lewis Direct at 31.

purposes,[173] and water used in treatment and distribution operations (e.g., backwashing filters, line flushing)."[174]

The American Water Works Association ("AWWA")—a leader in industry standards—recognizes that loss reduction targets are best tailored as system specific goals for each water utility rather than a "one size fits all" approach.[175] KAWC agrees. The Company requests an alternative level of reasonable unaccounted-for water loss of twenty percent be established by the Commission for rate-making purposes, pursuant to 807 KAR 5:066, Section 6(3), which states in relevant part:

> For rate making purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total produced and purchased, excluding water used by a utility in its own operations. Upon application by a utility in a rate case filing . . . an alternative level of reasonable unaccounted-for water loss may be established by the commission. A utility proposing an alternative level shall have the burden of demonstrating that the alternative level is more reasonable than the level prescribed in this section.

The policy enacted by this regulation is "intended to serve as an incentive to promote efficient management."[176]

(A) <u>The Company's Proposal</u>

An Alternative Level of Unaccounted-For Water Loss is Appropriate Considering the Scope of Challenges Facing the Company, and the Company's Demonstrated Efforts to Combat Water Loss.

---

[173] A utility may grant free or reduced rate service to fire districts to fight fires or to train firefighters. KRS 278.170 requires fire districts to maintain estimates of the amount of water used for fire protection and training and to report the water usage on a regular basis.

[174] *Application of Cannonsburg Water District for (1) Approval of Emergency Rate Relief and (2) Approval of the Increase in Nonrecurring Charges*, Case No. 2011-00217, Order at 5 n.12 (Ky. PSC June 4, 2012).

[175] *Key Performance Indicators for Non-Revenue Water*, AWWA Water Loss Control Committee Report at 2 (Nov. 2019), https://www.awwa.org/Portals/0/AWWA/ETS/Resources/WLCCKPIReport%202019.pdf?ver=2019-11-20-094638-933.

[176] *The Notice of Lake Village Water Association, Inc., of a Tariff Amendment Adjusting Rates and Imposing Construction Surcharge*, Case No. 89-075, Order at 5 (Ky. PSC Jan. 29, 1990); *Electronic Investigation into the Measuring, Recording, and Reporting of Water Loss by Kentucky's Jurisdictional Water Utilities*, Case No. 2018-00394, Order at 3 (Ky. PSC Dec. 18, 2018).

An unaccounted-for water loss of twenty percent for rate-making purposes is more reasonable than the default level prescribed by regulation for two primary reasons: (1) a reasonable and realistic twenty percent UFW loss level would satisfy the regulatory policy goal of incentivizing the Company to continue promoting efficient management, as demonstrated by KAWC's robust water loss control program; and (2) a twenty percent UFW loss level is more appropriately tailored to the system specific challenges that KAWC faces, and—despite the Company's best efforts—these challenges cannot reasonably be resolved over a condensed period of time.

KAWC is not asking this Commission to permanently adjust its UFW loss percentage for rate-making purposes. An alternative level of twenty percent may not be reasonable in perpetuity, but it is certainly reasonable at this point in time in light of the intensive efforts that the Company is making to identify and reduce water loss. KAWC has taken a number of concrete steps in recent years to mitigate and reduce water loss, including pressure management, accelerated infrastructure replacement, active leak detection, rapid response to breaks, fire service and water loss audits, and large meter testing and profiling.[177] The Company makes considerable efforts to control water loss, including investment of the capital and labor required to adequately address the issue. For instance, the Company recently reached an agreement to outsource its water line location requests. As a result, the Company is able to rededicate four employees to specialize in addressing NRW loss beginning in January 2024.[178] However, the Company's UFW loss percentage in recent years is the culmination of a myriad of factors: from the Company's aging infrastructure, which is more likely to leak year over year as infrastructure continues to age and the structural integrity of the

[177] Lewis Direct at 31.
[178] 12/13/2023 Hearing, VR 13:06-13:07.

pipe material breaks down, to challenges with private mains which are connected to the Company's infrastructure at roughly 270 "Special Connections."[179]

A review of KAWC's historical UFW percentages indicates that the Company's annual average UFW loss percentage has been above twenty percent since 2019.[180] However, this trend is not indicative of inefficient management or a lack of effort by the Company to address UFW loss. The opposite is true. Water utilities across the country, including KAWC, have been faced with the ongoing challenge of addressing aging infrastructure, with the average expected life of pipe material ranging from 55 years to 110 years.[181] The Company has approximately 2,352 miles of pipe across its service territory.[182] Under the currently approved Qualified Infrastructure Program ("QIP"), the Company is currently able to replace a limited quantity and subset of its aging infrastructure each year: ten to thirteen miles of cast iron main.[183] At this rate, it would take nearly 204.5 years to replace the Company's entire distribution system.[184] Even if the Commission approves the Company's request to expand and accelerate the QIP,[185] there is no feasible method by which the Company could replace aged infrastructure as soon as that infrastructure reaches or exceeds its useful life. Due to capital constraints, labor constraints, and regulatory rate recovery constraints, aged infrastructure replacement must be spread over time. This creates an inevitable lag where the Company has aged infrastructure in the ground that is more likely to leak or to break, and thus the Company is inevitably at a greater risk of increased UFW loss attributable to aging infrastructure.

---

[179] The Company uses the term "Special Connections" to describe a point of demarcation between its water mains and a private water main that is not metered and is generally located at the tapping sleeve and valve connection between KAWC's main and the private main, comprising of approximately 90 miles of private mains. *See* Lewis Direct at 34.
[180] Lewis Direct at 36-37.
[181] Direct Testimony of Krista E. Citron, P.E., MBA at 6.
[182] *Id.* at 3.
[183] *Id.* at 5.
[184] *Id.* at 9.
[185] *See infra* Section VIII.

Replacing aging infrastructure as expediently and efficiently as possible is not the only way that the Company is combatting water loss. Although aging infrastructure is likely a large contributor to UFW, the Company must address multiple potential sources to meaningfully identify and reduce UFW loss. For example, KAWC has implemented new auditing processes related to fire services; meter testing and profiling for effluent meters in plants and for large customer meters; and monitoring the billing system for unusual activities (such as inactive accounts with consumption, or active accounts with no consumption).[186]

Lastly, as explained in the written testimony of Company witnesses Lewis and Shelley W. Porter, the Company has identified its Special Connections as a significant contributor to the Company's UFW loss. Many of these Special Connection agreements were formed between the 1950s and 1990s.[187] Over time, it has become clear to the Company that the 270 Special Connections and 90 miles of associated private mains have caused a number of unanticipated challenges. To the extent leaks develop and private owners delay or neglect needed main or service line repairs, fail to remediate unsafe conditions (e.g., meter vaults), or use substandard materials in those repairs or in construction, KAWC is unable to repair or replace mains and other distribution facilities owned by others on property that the Company does not have legal access to, and the Company is unable to shut off the private mains due to the impact on multiple, sometimes independent, end users.[188] Additionally, KAWC is unable to accurately track and prevent unauthorized use of privately owned fire hydrants and unauthorized connections to be metered between the connection to the KAWC water distribution system and the downstream individual unit meters.[189]

---

[186] Lewis Direct at 33-34.
[187] 12/13/2023 Hearing, VR 13:18-13:19.
[188] Lewis Direct at 39.
[189] Rebuttal Testimony of Shelley W. Porter, P.E. at 3-4.

The Company is actively working to address these challenges associated with Special Connections, but because each Special Connection is unique, the Company needs to tailor the appropriate solution to each of the 270 Special Connections. This is a process that will take time to identify, plan, and implement across each individual Special Connection. And this must be done with an eye on cost because any solution must be cost-effective. While KAWC might have an idea of what lies at the tip of the metaphorical iceberg, it is nearly impossible for the Company to fully identify the concerns and causes for UFW loss across its Special Connections due to its lack of legal access to much of the infrastructure. After studying three of the largest Special Connection systems (Kentucky Horse Park, Blue Grass Airport, and University of Kentucky), the Company has identified steps needed to isolate and measure the UFW loss, including obtaining easements, drafting engineering and construction plans, acquiring construction materials, and assigning labor to construct certain infrastructure such as District Metering Area ("DMA") vaults.[190] Only after the Company identifies the source of UFW loss can it propose solutions to reduce that water loss. However, the Company cannot tackle all 270 Special Connections at once; identifying and reducing UFW loss associated with Special Connections will take significant effort and time.

(B) <u>The AG and LFUCG's Proposal</u>

The AG and LFUCG's Proposal Should Be Rejected Because it Fails to Adequately Account for the Hurdles Associated with Reducing Water Loss.

The AG and LFUCG argue that the Commission should impose the default UFW loss percentage. According to their witness, Meyer, "the Company does not have a clear picture of the water loss issue."[191] As explained, it would be impossible to clearly identify every issue

[190] *Id.* at 6-9.
[191] Meyer Direct at 26.

contributing to the Company's UFW loss, just as it would be impossible to identify every crack within the underbelly of an iceberg. However, the Company has clearly identified that water loss is a critical issue that needs addressing, and it has taken reasonable steps to create a clearer picture, isolate water loss issues, and reduce its UFW. Water loss is an inevitable component of providing water service, and the Company should not be penalized for its continued efforts to address the issue by being held to a UFW loss percentage standard that does not adequately contextualize the system-specific challenges it faces.

There is no simple solution or "one size fits all" approach to combatting water loss, and utilities should not be held to unrealistic standards for UFW loss for rate-making purposes. Allowing a utility to recover costs related to a reasonable portion of its UFW loss creates an incentive to promote efficiency. Conversely, limiting recovery to a prescribed percentage, in light of the practical and logistical hurdles associated with reducing water loss in today's world, fails to reasonably consider the inevitable challenges associated with providing water service. This Commission has been holding water utilities to a default standard of fifteen percent UFW loss since at least 1980.[192] Over the past four decades, the water utility industry has changed in many ways. Technology has advanced, infrastructure has aged and deteriorated, and the cost of providing safe and reliable service has increased. The UFW loss standard that may have been reasonable twenty or forty years ago is no longer fitting for all water utilities in Kentucky; hence, the regulatory standard set forth in 807 KAR 5:066 Section 6(3) allows for reasonable alternatives. In consideration of the rationale set forth, KAWC has met its burden of demonstrating that an alternative level of a twenty percent UFW loss for rate-making purposes is reasonable.[193]

---

[192] *Notice to Adjust Rates by East Pendleton Water District*, Case No. 7801, Order at 2 (Sept. 26, 1980).
[193] For further support, see Lewis Direct at 31-39; Rebuttal Testimony of William A. Lewis at 1-3; Porter Rebuttal at 2-13; Direct Testimony of Kathryn Nash at 13-16; Response to AG 1-31; Response to AG 1-32; Response to AG 1-90; Response to AG 2-21; Response to PSC 2-78; Response to PSC 3-36.

IV. CAPITAL STRUCTURE

Customers benefit from a utility that is well run, generates predictable financial results, and maintains an appropriate capital structure. KAWC's customers benefit from a reasonable capital structure because it: (1) allows the Company to maintain strong credit ratings and (2) enables the Company to access capital markets on good terms and at a reasonable cost.[194] In light of how the Company is projected to be financed for the forecasted test-year, a capital structure composed of 52.22 percent common equity, 45.87 percent long-term debt, 1.54 percent short-term debt, and 0.38 percent preferred stock will allow KAWC to reasonably maintain its financial strength and access cost-efficient financing so that the Company can continue providing safe and reliable service for customers.

(A) <u>The Company's Proposal</u>

KAWC's Proposed Capital Structure Should Be Approved Because It Is Reasonable and Specific to the Company's Projected Needs.

KAWC initially proposed a rate-making capital structure composed of 52.45 percent common equity, 46.21 percent long-term debt, 0.96 percent short-term debt, and 0.38 percent preferred stock.[195] In the Company's Base Period Update filed with the Commission on November 8, 2023, KAWC updated the composition of its proposed capital structure as follows: 52.22 percent common equity, 45.87 percent long-term debt, 1.54 percent short-term debt, and 0.38 percent preferred stock.[196]

[194] Direct Testimony of Nicholas Furia at 7-8.
[195] Exhibit 37, Schedule J-1; Direct Testimony of Ann E. Bulkley at 58.
[196] Base Period Update, Exhibit 37, Schedule J-1.

The only contested element of the Company's proposed capital structure is the common equity ratio.[197] As a baseline, the actual capital structure for the thirteen-month average ending September 30, 2023 reflects a common equity ratio of 51.70 percent.[198]

The Company's expert witness, Ann E. Bulkley, explained that KAWC's proposed common equity ratio is within the range of equity ratios for the proxy group, and is reasonable in light of the fact that credit rating agencies have identified the outlook for the utility sector as "negative." This negative outlook is influenced by increasing interest rates, inflation and commodity costs, and the pressure that those factors place on customer affordability and utilities' prompt rate recovery.[199] While the three-year average common equity ratio of the utilities in Bulkley's proxy group was 53.69 percent, KAWC is proposing an equity ratio of only 52.22 percent.[200] KAWC's proposed equity ratio is similarly well within the range of Commission-ordered common equity ratios for other Kentucky utilities over the previous four years, as demonstrated in the table below.[201]

Utility	Docket	Filed Equity %	Ordered Equity %	Order Date	Case Resolution
Duke (Electric)	2022-00372	52.51%	52.15%	10/12/2023	Litigated
Water Service (Water)	2022-00147	49.71%	50.09%	4/12/2023	Litigated
Atmos (Gas)	2021-00214	57.05%	54.50%	5/19/2022	Litigated
Delta (Gas)	2021-00185	51.76%	51.72%	1/3/2022	Settlement
Duke (Gas)	2021-00190	50.70%	51.34%	12/28/2021	Settlement
Columbia (Gas)	2021-00183	52.64%	52.64%	12/28/2021	Settlement
LG&E (Gas)	2020-00350	53.13%	53.19%	6/30/2021	Settlement
LG&E (Electric)	2020-00350	53.13%	53.19%	6/30/2021	Settlement
KU (Electric)	2020-00349	53.14%	53.23%	6/30/2021	Settlement
Kentucky Power (Electric)	2020-00174	43.25%	43.25%	1/13/2021	Litigated
Duke (Electric)	2019-00271	48.23%	48.23%	4/27/2020	Litigated

Determining a reasonable common equity ratio requires a consideration of the Company's ongoing investments in capital improvements, which are necessary to meet the new and changing

[197] *See* Direct Testimony of Richard A. Baudino at 33 ("I recommend the Commission adopt the Witnesses proposed costs of short-term and long-term debt and preferred stock.").
[198] Rebuttal Testimony of Nicholas Furia at 8.
[199] Bulkley Direct at 8.
[200] Furia Rebuttal at 10.
[201] *Id.* at 10-11.

regulations in the water industry, replace aged treatment and distribution facilities, and enable KAWC to continue providing safe and reliable water service to its customers through the forecasted test-year ending January 31, 2025.[202]

(B) <u>The AG's Proposal</u>

The AG's Proposal to Adjust the Equity Ratio is Arbitrary and Should Be Rejected.

Richard A. Baudino, on behalf of the AG, has proposed adjusting KAWC's common equity ratio to 50.00 percent, and increasing the Company's long-term debt ratio to rebalance the capital structure.[203] Baudino formed this recommendation based seemingly solely on a historical review of the Company's thirteen-month average capitalization amounts from 2017 through 2022.[204] Baudino characterized KAWC's proposed equity ratio as a "sharp break" and a "significant increase" from the historical capitalization ratio in 2022. What Baudino's analysis lacked is any forward-looking data points. By using only outdated figures to determine the proper common equity ratio for the forecasted test-year ending January 31, 2025, the AG's proposal fails to adequately refute the reasonableness of the common equity ratio proposed by KAWC.

According to Baudino's testimony, using historical capitalization ratios as a baseline, a 0.70 percent increase in common equity ratio (from 2022's equity ratio of 49.30 percent to the AG's proposed equity ratio of 50.00 percent) would be reasonable. Instead of this arbitrary "coin-flip" approach, the Company, in accordance with Commission precedent described below, used up-to-date information informed by an understanding of KAWC's ongoing investments in capital improvements, in requesting a 0.52 percent increase in common equity ratio (from 2023's equity ratio of 51.70 to the Company's proposed equity ratio of 52.22 percent).

[202] *Id.* at 9.
[203] Direct Testimony of Richard A. Baudino at 34.
[204] *Id.* at 34.

Baudino admitted during cross-examination that in prior testimony, he relied on the capital structures in his utility proxy group to determine if a utility's proposed capital structure is reasonable.[205] Baudino further admitted he did not perform that analysis in this case, but when presented with the capital structures of the proxy group, agreed that the 3-year average common equity ratio is 53.69 percent—which is materially greater than KAWC's proposed common equity ratio.[206] Further, Baudino conceded that he recently proposed the same adjustment to rebalance Duke Energy's capital structure by reducing its common equity ratio to 50%.[207] He admitted that the Commission's October 12, 2023 Order denied this adjustment, holding "The Commission finds that the Attorney General did not provide sufficient evidence to adjust the capital structure and that Duke Kentucky's proposed updated capital structure should be approved."[208] The same result is merited here.

The AG's proposal to reduce the common equity ratio to 50.00 percent should be rejected because it is arbitrary, unsupported by the evidence, and would not benefit KAWC customers. Instead, the Commission should adopt the Company's recommendation for the capital structure to comprise of 52.22 percent common equity.[209]

V. COST OF EQUITY AND RATE OF RETURN

The key to determining a reasonable rate of return on equity ("ROE") is to ensure that the analysis reasonably reflects investors' views of the financial markets—both in general and, in the context of a proxy group, of the subject company in particular. The Company's ROE

---

[205] 12/11/2023 Hearing, VR 16:11:44-16:13:57.
[206] 12/11/2023 Hearing, VR 16:14:00-16:15:34.
[207] 12/11/2023 Hearing, VR 16:16:20-16:18:10.
[208] 12/11/2023 Hearing, VR 16:18:26-16:18:51; *Electronic Application of Duke Energy Kentucky, Inc. for (1) An Adjustment of Electric Rates; (2) Approval of New Tariffs; (3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and (4) All Other Required Approvals and Relief*, Case No. 2022-00372, Order at 34 (Ky. PSC Oct. 12, 2023).
[209] For additional support, see Application Filing Exhibit 23; Bulkley Direct at 8, 57-62; Bulkley Exhibit AEB-9; Rebuttal Testimony of Ann E. Bulkley at 4-5, 50-52; Furia Direct at 4-8; Furia Rebuttal at 1-11.

recommendation draws from multiple analytical techniques that rely on market-based data to quantify investor expectations regarding required equity returns, adjusted for certain incremental costs and risks. Quantitative models produce a range of reasonable results from which the market-required ROE is selected. That selection is based on a comprehensive review of relevant data and information, and does not necessarily lend itself to a strict mathematical solution.

KAWC retained an expert, Bulkley, to conduct thorough, market-based cost of equity analyses to recommend a reasonable rate of ROE. The differences in the recommended ROEs sponsored by the parties in this case are significant. The Company recommends an ROE of 10.75 percent. Meanwhile, the AG and LFUCG recommend an ROE of 9.40 percent, which falls well below the 10.00 percent to 11.00 percent range recommended by Bulkley.[210]

(A) <u>Framework for Determining a Fair and Reasonable Cost of Equity</u>

The United States Supreme Court's *Hope*[211] and *Bluefield*[212] decisions established the standards for determining the fairness or reasonableness of a utility's authorized ROE. Among the standards established by the Court in those cases are: (1) consistency with other businesses having similar or comparable risks; (2) adequacy of the return to support credit quality and access to capital; and (3) the principle that the specific means of arriving at a fair return are not important, only that the end result leads to just and reasonable rates.[213] In the oft-cited *Hope* decision, the United States Supreme Court stated:

> From the investor or company point of view, it is important that there be enough revenue not only for operating expenses, but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard, the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return,

[210] Bulkley Direct at 7.
[211] *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591 (1944).
[212] *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n*, 262 U.S. 679 (1923).
[213] Bulkley Direct at 10.

> moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[214]

These decisions set forth three standards,[215] each of which must be met in order for the return to be considered just and reasonable:

1 → Comparable return standard

2 → Financial integrity standard

3 → Capital attraction standard

It is important to recognize that investors make rational decisions regarding investments of comparable risk. If an investment does not receive a comparable return to other investments of similar risk, it will be difficult to attract capital.[216] The market for capital is not regional; publicly traded utility companies across the country compete for capital, and utility commissions nationwide rely on proxy groups of these companies to establish market-based costs of equity. The use of a regional review would ignore the utilities included in the proxy group on which Bulkley and Baudino rely and fail to meet the *Hope* and *Bluefield* standards. Since investors are likely to invest equity in utilities with the highest returns, authorizing a return for KAWC that is below the returns awarded to other water, natural gas, and electric utilities could negatively affect the Company's access to capital over the long-term.[217] An authorized return on equity for KAWC that fails to account for the financial risks on cash flow metrics and is substantially below the returns of other risk-comparable utilities would disadvantage KAWC and its customers.

---

[214] *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944) (internal citations omitted).
[215] Bulkley Direct at 11.
[216] *Id.* at 9-10.
[217] Response to LFUCG 1-54 at 1.

(B) <u>The Company's Proposal</u>

KAWC's Recommended ROE is Reasonable and Supported by Substantial Evidence.

Bulkley's analyses incorporate several equity estimation methods, including the Constant Growth Form of the Discounted Cash Flow ("DCF") model, the Capital Asset Pricing Model ("CAPM"), and the Empirical Capital Asset Pricing Model ("ECAPM") to a proxy group of comparable risk utility companies.[218] She also considered the Company's capital expenditure requirements and adjustment mechanisms as compared with the proxy group. In addition, Bulkley's analyses considered capital market conditions and demonstrated that (1) utility stocks underperformed the broader market in 2023; (2) interest rates are currently significantly higher than in the Company's previous rate case proceeding; and (3) inflation remains elevated.[219] The results of Bulkley's analyses demonstrate that KAWC's cost of equity and ROE should be higher than what was approved in the Company's previous rate case—not lower, as proposed by the AG.

Bulkley established a proxy group of companies that are both publicly-traded and comparable to KAWC in certain fundamental business and financial respects to serve as "proxy" for purposes of the cost of equity estimation process.[220] The proxy companies all possess a set of operating and financial risk characteristics that are substantially comparable to KAWC, and therefore provide a reasonable basis for deriving the appropriate ROE.[221] Bulkley developed the proxy group by first identifying U.S. utilities that Value Line classifies as water utilities and applying certain screening criteria.[222] Because of the trend towards consolidation in the utility industry and the resulting small number of water utility companies available for inclusion in the

[218] Bulkley Direct at 3.
[219] *Id.* at 13-24.
[220] *Id.* at 25.
[221] *Id.*
[222] *Id.* at 26.

proxy group, Bulkley also considered electric and natural gas distribution companies.[223] After applying the screening criteria for these companies, the final proxy group comprised of eleven publicly traded water, electric, and natural gas utilities who operate across the United States.[224] The reasonableness of the proxy group is not contested as the AG's witness relied upon the same proxy group, contending that the group "provides a reasonable basis upon which to estimate the ROE" for KAWC in this proceeding.[225]

Bulkley first applied the DCF valuation model. The DCF method is premised on the assumption that a stock's current price represents the present value of all expected future cash flows.[226] The Constant Growth DCF model requires the following assumptions: (1) a constant growth rate for earnings and dividends; (2) a stable dividend payout ratio; (3) a constant price-to-earnings ("P/E") ratio; and (4) a discount rate greater than the expected growth rate.[227] For the proxy group, the mean and median Constant Growth DCF results using the average growth rates range from 9.28 percent to 9.97 percent and the mean and median results using the maximum growth rates are in the range of 10.51 percent to 10.66 percent.[228]

Bulkley also performed a traditional CAPM method of estimating the cost of equity, which is a risk premium approach that estimates the cost of equity for a given security as a function of a risk-free return plus a risk premium to compensate investors for the non-diversifiable or "systematic" risk of that security.[229] To estimate her risk-free rate, Bulkley used (1) the current 30-day average yield of 30-year U.S. Treasury bonds; (2) the average projected 30-year U.S. Treasury bond yield for the third quarter of 2023 through the third quarter of 2024; and (3) the

[223] *Id.* at 28.
[224] *Id.* at 27.
[225] Baudino Direct at 17.
[226] Bulkley Direct at 34.
[227] *Id.* at 35.
[228] *Id.* at 37.
[229] *Id.* at 39.

average projected 30-year U.S. Treasury bond yield for 2024 through 2028.[230] Bulkley used the average Beta coefficients for the proxy group companies as reported by Value Line and Bloomberg, as well as a long-term average utility beta coefficient calculated as an average of the Value Line beta coefficients for the proxy group companies from 2013 through 2022.[231] She estimated the Market Risk Premium based on the expected total return on the S&P 500 Index less the 30-year Treasury bond yield.[232] Bulkley obtained a range of traditional CAPM results for the proxy group of 9.76 percent to 10.53 percent.[233]

In addition, Bulkley performed an ECAPM—the empirical form of the CAPM—which addresses the tendency of the traditional CAPM to underestimate the cost of equity for companies with low beta coefficients, such as regulated utilities.[234] The ECAPM analysis first calculates the product of the adjusted beta coefficient and the market risk premium and applies a weight of 75.00 percent to that result, then calculates the market risk premium without any effect from the beta coefficient and applies a 25.00 percent weight to that result.[235] The combined results of the two calculations, along with the risk-free rate, produce the ECAPM result.[236] Bulkley obtained a range of ECAPM results for the proxy group of 10.32 percent to 10.90 percent.[237]

The results of Bulkley's detailed analyses present a reasonable recommendation of 10.75 percent. This recommendation considers investor expectations and market conditions, including elevated interest rates and the subsequently elevated cost of equity. In light of how the market has

[230] *Id.* at 40.
[231] *Id.* at 40-41.
[232] *Id.* at 41.
[233] *Id.* at 43.
[234] *Id.*
[235] *Id.* at 42.
[236] *Id.*
[237] *Id.*

changed since the Company's last rate proceeding, where the Commission approved an ROE of 9.70, Bulkley's recommendation should be adopted.

(C) <u>The AG's Proposal</u>

The AG's Estimated Cost of Equity is Unreasonably Low and Does Not Reasonably Reflect Investors' Views of Financial Markets Generally and of KAWC Particularly.

The AG filed direct testimony regarding KAWC's return on equity through its witness, Baudino. Baudino reached his recommendation after performing DCF and CAPM analyses, using the same proxy group Bulkley used, and relying primarily on the DCF model.[238] Baudino, in his analysis, recognized recent market trends such as increasing interest rates and declining utility share prices.[239] These market trends indicate a higher cost of equity for utilities. Nonetheless, Baudino concluded that his DCF model supports a recommended ROE range of 8.70 percent to 10.00 percent and proposed reducing the Company's ROE to 9.40 percent.[240]

As the Company fully addressed through the rebuttal testimony of its witness Bulkley, Baudino's reliance on the DCF model likely understates the forward-looking cost of equity for KAWC.[241] Baudino relied on a six-month average historical average dividend yield in his DCF analysis, which is inconsistent with his use of a current average Treasury bond yield in his CAPM analysis.[242] As a result, Baudino's DCF analysis did not fully capture the underperformance of utility stocks that occurred as a result of the higher interest rate environment.[243]

Current and prospective market conditions also support consideration of other cost of equity estimation models, such as the CAPM and ECAPM, which reflect expected market

[238] Baudino Direct at 3.
[239] *Id.* at 32.
[240] *Id.* at 32.
[241] Bulkley Rebuttal at 25.
[242] *Id.* at 18-20.
[243] *Id.* at 19-20.

conditions for the period which KAWC's rates will be in effect.[244] However, Baudino's CAPM analyses present additional cause for concern due to his reliance on the historical market risk premia and the published estimates of the market risk premium ("MRP") from *Kroll* and Professor Damodaran.[245] Baudino relied on three scenarios in his CAPM analyses: one using a forward-looking market return, resulting in an ROE of 12.77 percent; one using historical MRP, resulting in an ROE of 8.64 percent; and one using estimated MRPs from *Kroll*/Damodaran, resulting in ROEs of 8.20 percent and 8.75 percent.[246] The results of Baudino's CAPM analyses using the historical and *Kroll*/Damodaran MRPs are lower than any authorized ROE for any water utility in the last several years, which is of particular concern given that interest rates were at an all time low prior to 2023. Particularly in today's higher interest rate environment, there is no basis to consider relying upon results in this range.[247]

Although Baudino claims to recognize the comparable return, financial integrity, and capital attraction standards that are established by the United States Supreme Court in the *Hope* and *Bluefield* cases,[248] he abandons these standards when establishing his range and ROE recommendation. These Supreme Court decisions together determined that the authorized ROE must meet all three standards: comparable returns, financial integrity, and capital attraction. Baudino's ROE recommendation of 9.40 percent does not provide a return on equity that is comparable to those available to investors in companies with commensurate risk and is not sufficient to allow KAWC to compete for capital with other similar risk firms.

---

[244] *Id.* at 26.
[245] *Id.* at 28.
[246] Baudino Direct at Exhibit RAB-5.
[247] Bulkley Rebuttal at 28-33.
[248] Baudino Direct at 4.

At the evidentiary hearing, Baudino admitted that if his 9.40 percent is accepted, KAWC will have the lowest ROE of any of American Water's operating subsidiaries.[249] Baudino further agreed that four operating subsidiaries had revised rates set in 2023—Illinois, Missouri, Pennsylvania, and Virginia—with an average ROE of 9.80 percent.[250] Baudino also conceded that the Kentucky Commission has not recently adopted ROEs as low as he recommends in this case.[251]

KAWC's proposed ROE of 10.75 percent creates a reasonable opportunity for capital investors to earn a risk-comparable return, allows the Company to maintain its financial integrity, and enables KAWC to attract necessary capital investment for the benefit of its customers. The Company, through the expert testimony of Bulkley, has shown that the range of reasonable market-required ROEs results is 10.00 percent to 11.00 percent.[252] KAWC has also shown that an ROE in the upper end of the zone of reasonableness is appropriate.[253] The Company's proposed ROE recognizes the increase in interest rates that has occurred since the decision in KAWC's last rate case proceeding,[254] and reflects the changes in modeling results as anticipated by Bulkley's analyses, as the utility sector underperformed the market and the dividend yields increased during the pendency of this proceeding.[255] Because Baudino's recommendation fails to reflect reasonable, forward-looking market conditions, the AG's ROE proposal is unreasonably low and should be rejected. KAWC respectfully requests the Commission instead adopt Bulkley's recommended ROE of 10.75 percent.[256]

[249] 12/11/2023 Hearing, VR 15:54:39-15:54:52.
[250] 12/11/2023 Hearing, VR 15:55:55-15:57:25, 16:05:08-16:05:43.
[251] 12/11/2023 Hearing, VR 16:10:30-16:10:50.
[252] Bulkley Direct at 7.
[253] Bulkley Direct at 7; Bulkley Rebuttal at 14-15.
[254] Bulkley Direct at 19, Figure 4.
[255] *See, e.g.*, Bulkley Direct Exhibit AEB-3 and Bulkley Rebuttal Exhibit AEB-2-R (reflecting an initial dividend yield of 2.66 to 2.82 percent, and an updated dividend yield of 3.60 to 3.73 percent).
[256] For additional support, see Bulkley Direct at 2-62; Bulkley Exhibits AEB-1 to AEB-8; Bulkley Rebuttal at 1-50.

VI. UNCONTESTED RATE BASE ISSUES

Rate base measures the Company's net investment in the provision of water service.[257] This investment includes the facilities and property for sourcing, treating, pumping, and distributing potable water for consumption, sanitation, and fire protection, as well as assets to support customer account, customer service, and basic business operations.[258] Of the rate base components included in the Base Period Update Exhibit 37 Schedule B-1, the only contested component of the Company's proposed rate base, as previously discussed, is the working capital allowance.[259] All other rate base components are reasonable as proposed by the Company, and should be approved.

The Company's methodology for calculating rate base utilizes a thirteen-month average rate base calculation for the forecasted test year.[260] Most of the rate base elements were forecasted from actual per books data as of March 31, 2023, adjusted for changes expected through January 31, 2025.[261]

(A) Construction Work in Progress and Allowance for Funds Used During Construction

The National Association of Regulatory Utility Commissioners ("NARUC") allows for the capitalization of allowance for funds used during construction ("AFUDC") during the construction of utility plant in-service ("UPIS"), and the Company has reflected it properly as a component of construction work in progress ("CWIP").[262] The Company is including $1,672,091 of AFUDC in its calculation of present rate revenues. AFUDC is appropriate to include in both rate base and revenues.[263] By including this amount in present rate revenues, the Company is offsetting the

---

[257] Selinger Direct (as adopted by Watkins) at 2.
[258] *Id.*
[259] *See supra* Section II(C).
[260] Selinger Direct (as adopted by Watkins) at 3.
[261] *Id.*
[262] Response to PSC 2-23.
[263] Response to PSC 3-3.

inclusion of CWIP in rate base for projects that are accruing AFUDC until the project is placed into service.[264] Once a project is placed in-service, the project no longer incurs AFUDC and the CWIP balance for that project, including capitalized financing costs for funds used during construction, is reclassed from CWIP to UPIS.[265] CWIP in rate base ensures that the financing included in the Company's capital structure aligns directly with the rate base to be financed.[266] Customers have not and will not pay for the financing costs capitalized as AFUDC as part of UPIS at original cost twice through rates. Those financing costs are only collected once from customers through depreciation expense, the *return of* the Company's UPIS investment, which is different than the ongoing authorized *return on* the thirteen-month average gross UPIS at original cost, net of the thirteen-month average accumulated depreciation.[267]

During the discovery process, Commission Staff inquired into why AFUDC is included in the CWIP balance,[268] and the AG inquired into why including CWIP in rate base is appropriate when using a future test year.[269] These are long-standing, Commission-approved practices.[270] In a 2005 Order, the Commission stated the following:

> Generally, regulated utilities recognize the carrying costs of construction in rates through one of two methods: inclusion of CWIP in rate base or accrual of Allowance for Funds Used During Construction ("AFUDC"). This Commission has, in previous Kentucky-American rate proceedings, applied a hybrid approach that combines these two methods. This approach allows Kentucky-American to include all CWIP in rate base while accruing AFUDC on projects taking longer than 30 days to complete. Under this

[264] *See* Response to PSC 2-23; Filing Exhibit 37, Schedule C-1.
[265] Response to PSC PHDR-6.
[266] Response to AG 1-85.
[267] Response to PSC PHDR-6.
[268] Response to PSC 2-23; Response to PSC 3-2; Response to PSC 3-3; Response to PSC PHDR-6.
[269] Response to AG 1-85.
[270] *See, e.g., Application of Kentucky-American Water Company to Increase its Rates*, Case No. 95-554, Order at 8-11, 30-31 (Ky. PSC Sept. 11, 1996); *Notice of Adjustment of the Rates of Kentucky-American Water Company*, Case No. 10069, Order at 3-5 (Ky. PSC July 31, 1996) (note that a final order in Case No. 10069 was initially issued on June 3, 1988, and then appealed up through the Kentucky Supreme Court, who remanded the rate case to the Commission for further proceedings; the Commission's position on CWIP did not change).

> approach, AFUDC revenue is reported "above the line." This approach eliminates the effects of including AFUDC bearing CWIP in rate base. It further allows Kentucky-American to accrue AFUDC as part of an asset's cost where appropriate and to earn a return on CWIP where AFUDC is not accrued.[271]

In the same case, the Commission found "no merit" to an argument from an intervenor that CWIP should be eliminated because of the Company's use of a forecasted test year.[272] Finally, the Commission stated that "for rate-making purposes the Commission allows Kentucky-American to earn a return on forecasted CWIP in rate base while offsetting the return by moving AFUDC to 'above the line' operating revenues."[273] This approach "eliminates the effects of including the AFUDC bearing CWIP in rate base while allowing Kentucky-American to earn a return on CWIP where AFUDC is not accrued."[274] This Commission expressly approved KAWC's "hybrid approach" again, over the objection of an intervenor, in 2010.[275]

Neither the AG nor LFUCG have contested the Company's approach or proposed an alternative methodology. The Company's long-standing hybrid approach, combining inclusion of CWIP in rate base and accrual of AFUDC, should be approved.[276]

(B) <u>Additional Uncontested Rate Base Components</u>

Several additional components of the Company's proposed rate base[277] have been uncontested in this proceeding, namely: Utility Plant in Service ("UPIS"),[278] Utility Plant

[271] *Adjustment of the Rates of Kentucky-American Water Company*, Case No. 2004-00103, Order at 11 (Ky. PSC Feb. 28, 2005).
[272] *Adjustment of the Rates of Kentucky-American Water Company*, Case No. 2004-00103, Order at 12 (Ky. PSC Feb. 28, 2005).
[273] *Id.* at 42.
[274] *Id.*
[275] *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year*, Case No. 2010-00036, Order at 10-12, 23-24 (Ky. PSC Dec. 14, 2010).
[276] For additional support, see Selinger Direct (as adopted by Watkins) at 4; Response to PSC 1-20; Response to PSC 2-23; Response to PSC 3-2; Response to PSC 3-3; Response to AG 1-85; Response to PSC PHDR-6.
[277] *See* Base Period Update, Exhibit 37, Schedule B-1, Page 2 of 2.
[278] Selinger Direct (as adopted by Watkins) at 4.

Acquisition Adjustments ("UPAA"),[279] Accumulated Depreciation,[280] Contributions in Aid of Construction ("CIAC"),[281] Customer Advances,[282] Deferred Income Taxes,[283] Deferred Income Tax Credits,[284] Deferred Maintenance,[285] Deferred Debits,[286] and Other Rate Base Elements.[287] Company witness Watkins, through the adopted testimony of former Company witness Wesley E. Selinger, describes each of these components.[288] The Company did not make any adjustments or revisions to the proposed amounts of these uncontested components throughout the pendency of this proceeding.[289]

VII. PROPOSED TARIFF REVISIONS

The Company is proposing several revisions to its tariff, as fully described in Filing Exhibits 2, 3, and 37L to the Company's Application, including minor text revisions and the addition of three new provisions to include customer responsibility for backflow assembly certification fees; a Universal Affordability Tariff; and an AMI Opt-Out Fee. Neither the AG nor LFUCG submitted testimony contesting the Company's proposed tariff changes.

(A) Backflow Assembly Certification Fees

KAWC oversees approximately 11,000 backflow assemblies ("BFAs"), which are required to be tested annually by a certified inspector pursuant to 815 KAR 20:120, Section 1(7)(h), to prevent backflow events from occurring at cross-connections. A record of each inspection must be maintained to comply with the regulatory requirements; the Company uses SAP to maintain

---

279 *Id.* at 7.
280 *Id.* at 7-8.
281 *Id.* at 8.
282 *Id.* at 8-9.
283 *Id.* at 9.
284 *Id.* at 9-10.
285 *Id.* at 6.
286 *Id.* at 6.
287 *Id.* at 10.
288 *Id.* at 4-10.
289 *Compare* Filing Exhibit 37, Schedule B-1 *with* Base Period Update, Exhibit 37, Schedule B-1.

this system of record.[290] Together, this testing and record-keeping make up the Company's cross-connection backflow prevention certification program.

Currently, the Company is responsible for: tracking testing due dates; mailing up to three reminder letters to customers with BFAs prior to the testing due date; maintaining a list of certified testers and test kit calibration dates within SAP; ensuring that certified testers are up to date on their certifications; receiving physical copies of test reports by mail; and manually entering test report results into SAP.[291] These tasks are primarily handled by the Company's cross-connection team, who are also responsible for other activities that focus on improving public health protection and providing customer service.[292]

More recently, the Company has contemplated working with a third-party contractor, Backflow Solutions, Inc. ("BSI") to facilitate the administration of the cross-connection backflow prevention certification program. The shift to using BSI's services would promote efficiencies and decrease the amount of manual labor required by the Company's cross-connection team to remain compliant with BFA testing requirements.[293] BSI would manage tester certification and test kit calibration. BSI would ensure that its testers are up to date on their certifications.[294] BSI would require its testers to enter test results directly into an online portal, rather than mailing in physical copies. This would allow records to become available in near real-time, as opposed to a several week average delay under current practices. BSI would also allow customers with multiple BFAs[295] to opt-in to a consolidated mailing letter, so that these customers would receive a single

---

[290] Newcomb Direct at 8.
[291] *Id.* at 8-10.
[292] *Id.* at 10.
[293] *Id.* at 8.
[294] *Id.* at 10-11.
[295] The Company has 74 customers with more than ten BFAs, with one customer having as many as 268 BFAs. Newcomb Direct at 10.

piece of mail summarizing all BFAs that require testing, unlike current practices which require sending a letter for each individual BFA.[296]

The benefits of utilizing BSI for administration of the cross-connection backflow prevention certification program extend to both the Company and its customers.[297] The Company could reallocate the time that is currently spent on administering the certification program, such as receiving and manually entering testing data related to its 11,000 BFAs, and have its employees instead focus on other high value tasks. Customers would benefit from efficiencies because they would receive fewer and more accurate reminder letters in the mail regarding testing due to BSI's ability to report test results in real time. In contrast, under current practices, the physical mailing of test results often causes a delay in entering test results into SAP, and the Company may unnecessarily send a second or third reminder letter to a customer who already completed testing due to the lag in the Company receiving and recording the results.[298]

Customers with cross-connections, under the tariff language currently in effect, are already responsible for all expenses associated with providing, installing, and maintaining BFAs.[299] At its essence, KAWC's request is made only to further clarify that those customers would continue to be responsible for those expenses in the event there is a third-party expense included.[300] For these reasons, and because no party to this proceeding has filed any evidence contesting this change to the Company's tariff, KAWC requests that the Commission approve of the new language to clarify that customers with cross-connections will remain responsible for all of the expenses associated with maintaining their BFAs.

---

[296] Newcomb Direct at 10-11.
[297] While BSI is the proposed contractor for administration of BFA testing and recording, customers will still be free to hire any qualified contractor that they wish to perform the testing. *See* Response to AG 2-26.
[298] Newcomb Direct at 9.
[299] Tariff Section 7.4(a), P.S.C. KY No. 10, Original Sheet Nos. 14-15.
[300] For additional support, see Filing Exhibits 2, 3, and 37L to the Company's Application; Newcomb Direct at 8-11; Response to AG 1-34; and Response to AG 2-26.

(B) Universal Affordability Tariff

The concept of affordability for water service is based on the idea that everyone should have access to drinking water that is: (1) safe, meaning it complies with EPA regulations and Safe Drinking Water Act standards; (2) reliable, so that it is resilient in the face of floods, droughts, and other climate risks; and (3) affordable.[301] The Company, through the testimony of its witness Rea, has demonstrated its detailed approach for assessing the affordability of its water service.[302]

After conducting affordability studies at the statewide enterprise-level and at the community-level to better understand the affordability of water service under the Company's proposed rate structure, the Company concluded that while its water service is affordable for the vast majority of customers, there are some groups of customers for whom affordability of water service may be challenging.[303] As a result, the Company is proposing a data-driven Universal Affordability Tariff specifically designed so that all participating customers have an opportunity to receive Basic Water Service[304] at a level of approximately 2% of annual household income or less.[305]

The Company's proposed Universal Affordability Tariff for water service includes multiple tiers of discounts based on different levels of household income stated as multiples of the Federal Poverty Level ("FPL"). The tariff offers discounts on both the basic 5/8-inch meter charge and the volumetric charges for water service. For customers with incomes that fall between 0 percent to 50 percent of the FPL, a 60 percent discount would be available. For customers with

---

[301] Rea Direct at 4.
[302] *Id.* at 4-15.
[303] *Id.* at 14.
[304] Basic Water Service is a phrase used to describe a water usage level, in terms of gallons per resident per day, that reflects water consumption provided for basic human services—cooking, cleaning, sanitation, and general health requirements—which is then assumed to be constant from month-to-month and not subject to significant seasonality or weather conditions. For the purpose of the Company's affordability analyses, Basic Water Service is defined to be forty gallons of water per household member per day. Rea Direct at 9.
[305] Rea Direct at 15.

incomes that fall between 50 percent and 100 percent of the FPL, a 20 percent discount would be available. For 2024, the household incomes levels that would qualify customers for this program[306] are as follows:

	Household Income	
Household Size	**At 50% FPL**	**At 100% FPL**
1	$7,290	$14,580
2	$9,860	$19,720
3	$12,430	$24,860
4	$15,000	$30,000
5	$17,570	$35,140
6	$20,140	$40,280
7	$22,710	$45,420

The total amount of discounts the Company is proposing to roll directly back into base rates is approximately $116,000. These discounts are rolled directly into the residential volumetric rate, meaning that other residential customers will pay for the cost of the expected discounts assuming a 10 percent participation level. This amount is approximately $0.02 per thousand gallons.[307]

KRS 278.170 specifically addresses issues related to discrimination for free or reduced rate services. Specifically, KRS 278.170(1) states the following:

> No utility shall, as to rate or service, give any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage, or establish or maintain any unreasonable difference between localities or between classes of service for doing a like and contemporaneous service under the same or substantially the same conditions.

[306] Eligibility for 2024 is based on the 2023 federal poverty guidelines.
[307] Response to AG 2-31.

Within the bounds of KRS 278.170(1), "the Commission is authorized to permit reasonable preferences and advantages as to rates and services."[308] Further, under KRS 278.030(3), utilities "may employ in the conduct of its business suitable and reasonable classifications of its service, patrons and rates" which "may, in any proper case, take into account the nature of the use, the quality used, the quantity used, the time when used, the purpose for which used, and any other reasonable consideration."

The proposed Universal Affordability Tariff considers the nature, quantity, timing, and purpose of water use for KAWC customers to reasonably classify eligibility for the program, informed by residential seasonal usage patterns and customer income levels. Across the American Water footprint and specifically in the KAWC service territory, usage data and customer demographic data shows that there is a positive correlation between household income and the seasonal use of water.[309] This means that communities with higher household incomes, and by extension the customers in those communities, generally have more discretionary seasonal use of water than communities with lower household incomes. Lower income customers generally only use Basic Water Service, and do not use water for discretionary purposes in the summertime to the extent that higher income customers do.[310]

Because higher income customers are more likely to have higher levels of seasonal service, the cost of providing service to these customers is greater.[311] The biggest driver of cost of service allocations to customer class for the purposes of setting rates is consumption patterns.[312] Under

---

[308] *Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a New Tariff - Brownfield Development Rider*, Case No. 2007-00192, Order at 11 (Ky. PSC Mar. 7, 2008); *PSC of Ky. v. Commonwealth*, 320 S.W.3d 660, 667 (Ky. 2010) ("The qualifier 'unreasonable' clearly points to the conclusion that reasonable distinctions between recipients of utility services, 'classes of service' or utility rates are legally appropriate.").
[309] Rea Direct at 24, 28.
[310] *Id.* at 24-25.
[311] See Rea Direct at 27-34 for a detailed analysis of the relative cost of providing service to seasonal use customers and basic service customers.
[312] Rea Direct at 26.

the Base/Extra allocation methodology for cost of service, steadier and flatter consumption patterns are allocated less cost per gallon of water served compared to consumption patterns that are peakier or more seasonal.[313] This makes logical sense, in that the cost of investments used to serve higher amounts of water can be spread over a larger usage base with a resulting lower volumetric rate than the same cost of the same size investment that serves smaller amounts of water because the investment is not utilized as efficiently.[314]

Following the same logic, it is entirely appropriate from a cost-of-service perspective that Basic Water Service should be priced at a lower rate than seasonal service, because it is cheaper on a per unit basis to provide Basic Water Service than it is to provide peakier seasonal service.[315] In developing the Universal Affordability Tariff, the Company's analysis concluded that under its current rate design, lower income customers are actually subsidizing higher customers if: (1) seasonal service is more expensive on a per unit basis than Basic Water Service from a cost-of-service and cost causation perspective; (2) higher income customers are more likely to have significantly higher seasonal water use than lower income customers; and (3) a single volumetric rate applies to all service for all customers.[316]

The Company's affordability assessment, rate design analysis, and cost-of-service analysis provides the Commission with all of the factual support necessary to target bills for all residential customers at 2% of household income or less, without unduly discriminating against any customer group. All stakeholders benefit from a financially stable utility providing safe, reliable, and affordable service to its customers and it is in the public interest to implement a rate design package

[313] *Id.* at 26-27.
[314] *Id.* at 27.
[315] *Id.*
[316] *Id.* at 33.

that makes water service affordable for as many customers as possible.[317] The Company's proposed rate design in this case, along with the Company's proposed Universal Affordability Tariff, do just that.[318]

(C) <u>AMI Opt-Out Fee</u>

The Company is proposing to include an AMI opt-out fee for any KAWC customers who opt out of having an AMI meter.[319] For those customers, a $28 charge will be added to each monthly bill.[320] The AMI opt-out fee is intended to cover the cost of an exception-based meter reading.[321] The Company's current New Account Set Up Activation Fee is $28, which is intended to cover the cost of meter reading when customers request a new account or a change in ownership of an existing account. So, because New Account Set Up Activation requires substantially similar work to be performed, the Company is proposing a cost-based $28 opt-out fee for any customers who do not wish to utilize an AMI meter.[322]

This is a cost-based, reasonable charge for the work that will need to be performed by the Company to read non-AMI meters when the customer had an opportunity to upgrade to an AMI meter but chose to opt out of the upgrade.

Because the Company's proposed tariff revisions—including the addition of language addressing backflow assembly certification fees, the Universal Affordability Tariff, and the AMI

---

[317] In addition to the proposed Universal Affordability Tariff, Company shareholders further demonstrate their commitment to water service affordability by donating annually a minimum of $74,264 to KAWC's H2O - Help to Others (H2O) Program, which provides monetary grants to qualifying customers. *See* Response to AG 1-19 and Response to PSC 3-20.
[318] For additional support, see Rea Direct at 4-34; Nash Direct at 11-12; Response to PSC 2-69; Response to PSC 3-20; Response to PSC 3-21; Response to AG 1-37; Response to AG 1-38; Response to AG 2-31; Response to LFUCG 1-89.
[319] See *infra* Section IX for a discussion of the Company's request for a certificate of public convenience and necessity for deployment of AMI.
[320] Application Exhibit 2 at 53.
[321] Response to PSC 2-18.
[322] *Id.*

opt-out fee—are all reasonable and based on sound factual and empirical support, the Company respectfully requests that the Commission approve all of the tariff changes as proposed.

VIII. QUALIFIED INFRASTRUCTURE PROGRAM EXPANSION

In the Company's last rate case, Case No. 2018-00358, the Commission approved a tariff rate adjustment mechanism known as the Qualified Infrastructure Program ("QIP") Rider to allow for capital improvements to replace the Company's aging water system infrastructure, because its infrastructure is deteriorating at a faster rate than the current replacement.[323] The current QIP Rider allows the Company to recover the costs of capital, depreciation, and taxes associated with qualified infrastructure investment between base rate case filings.[324]

As originally proposed, the Company's QIP included replacement of certain water distribution system assets, which currently includes approximately 2,352 miles of pipe of various materials, ranging in sizes from 1.5 to 42 inches, and 17,815 main line valves.[325] The Company's QIP proposal also included replacement of distribution system structures and improvements, supply mains, power generation equipment, pumping equipment, transmission and distribution mains, services, meter and meter installations, and hydrants. Finally, the Company's proposed QIP included replacement of aging treatment plant items or facilities, such as pumping equipment, generators, water quality sampling equipment, Supervisory Control and Data Acquisition ("SCADA") equipment, and treatment equipment.[326] Inclusion of these items would allow for the installation of newer, more efficient infrastructure to continue providing high-quality water service, and ultimately lead to a more efficient operation of the system that benefits customers.[327]

---

[323] *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates*, Case No. 2018-00358, Order at 74, 83 (Ky. PSC June 27, 2019).
[324] Newcomb Direct at 15.
[325] Citron Direct at 3.
[326] *Id.* at 4.
[327] *Id.*

The Commission, after approving the Company's QIP in KAWC's 2018 rate case as proposed, later limited the scope of the program to projects that are "reasonably related or incidental to replacing aging mains" and the replacement of hydrants, valves, and service lines that are incidental to the main replacements.[328] The Company has been authorized to schedule 10 to 13 miles of primarily cast iron and galvanized steel main replacement under the QIP.[329] The QIP commenced in 2020, and the Company most recently began QIP Year 4 on July 1, 2023.[330] The Company, through the testimony of several witnesses and its responses to numerous related data requests, has presented a thorough and compelling case in support of the continuation and expansion of the QIP. [331]

(A) <u>The Company's Proposal</u>

The QIP Should Be Expanded to Allow the Company to Tackle a Broader Scope of Vital Infrastructure Replacements to Best Serve Long-Term Customer Needs.

While the existing scope of the QIP has allowed the Company to accelerate some replacement of its aging infrastructure, it is not sufficient to address the pace at which the Company's aging infrastructure should be replaced to best serve the long-term interest of KAWC customers.[332] As the Company continues to face challenges associated with its aging infrastructure well beyond what can be addressed by the annual replacement of 10 to 13 miles of cast iron main,

[328] *Electronic Application of Kentucky-American Water Company to Amend Tariff for the Establishment of Qualified Infrastructure Program Charge*, Case No. 2020-00027, Order at 16-17 (Ky. PSC June 17, 2020).
[329] Citron Direct at 5.
[330] Citron Direct at 9; Newcomb Direct at 16-17.
[331] For additional support, see Bulkley Direct at 49-50; Bulkley Rebuttal at 48-49; Citron Direct at 2-24; Rebuttal Testimony of Krista E. Citron, P.E., MBA at 1-4; Lewis Direct at 30, 32; Nash Direct at 12-13; Newcomb Direct at 6, 15-24; Newcomb Rebuttal at 19-20; Direct Testimony of Shelley W. Porter, P.E. at 12-14; Response to PSC 2-3; Response to PSC 2-4; Response to PSC 2-5; Response to PSC 2-6; Response to PSC 2-49; Response to PSC 2-52; Response to PSC 3-1; Response to PSC 3-27; Response to PSC 3-46; Response to AG 1-26; Response to AG 1-28; Response to AG 1-68; Response to AG 1-96; Response to AG 1-97; Response to AG 2-16; Response to AG 2-17; Response to AG 2-18; Response to AG 2-20; Response to LFUCG 1-4; Response to LFUCG 1-14; Response to LFUCG 1-22; Response to LFUCG 1-23; Response to LFUCG 1-51; Response to LFUCG 1-52; Response to LFUCG 1-83; Response to LFUCG 1-91; Response to LFUCG 1-92.
[332] Citron Direct at 5.

the Company is seeking to expand the current scope of the infrastructure deemed eligible for QIP cost recovery to 27 to 34 miles of main of any material type, as prioritized through the Company's comprehensive pipeline prioritization model.[333]

The Company's pipeline prioritization model, explained in depth by Company witness Citron,[334] helps KAWC to determine which mains should be replaced each year.[335] The model identifies eight criteria that are crucial in prioritizing main replacement projects by considering the reliability and condition of the main. These criteria are: low pressure; number of breaks/leaks; fire flow; age; material type; size of main; water quality; and customer impact.[336] Due to the interrelationships of the eight criteria, the Company established relative weights for each criterion to ensure that the targeted drivers for the main are given greater consideration. Age, material type, low pressure, number of breaks, and water quality are the primary criteria used to determine main replacement.[337] There are also external drivers that influence the main replacement program, such as roadway paving schedules, coordination with other utilities, and construction fatigue.[338] Combining the prioritization model results with external drivers allows KAWC to maintain an adaptable replacement program which allows for the efficient use of available resources.[339]

In 2023, the Company contracted Stantec Consulting Services Inc. to review the current state of KAWC's distribution system, analyze the replacement needs over 30-, 50-, and 80-year time periods, and recommend an annual replacement program that encompasses the entire KAWC distribution system.[340] Nearly 250 miles of pipe of various materials in KAWC's system will have

---

[333] *Id.*
[334] *Id.* at 10-17.
[335] *Id.* at 10.
[336] *Id.*
[337] *Id.*
[338] *Id.* at 10-11.
[339] *Id.* at 11.
[340] *Id.* at 6.

already reached or exceeded their useful life in or before the year 2025, leading to a large volume of replacements due at once.[341] These replacements will need to be distributed over several years in addition to the replacements of other pipes that reach the end of *their* useful lives during that same time.[342] Based on the current mix of pipe age and material within KAWC's system, the anticipated rate of replacement needs are over twice the current QIP program rate.[343]

Since the QIP began, the Company has replaced approximately 34.5 miles of the system's aging water mains.[344] The current rate of 10 to 13 miles replaced per year represents an average replacement rate of 0.5 percent of the total system per year. Even at this accelerated replacement rate, it still would take nearly 204.5 years to replace the entire distribution system. This is not the optimal level of infrastructure investment because the Company's pipes may only last 60 to 100 years depending on the type of pipe material, soil conditions, and other factors.[345] To close this gap, the Company would need to further accelerate the rate of investment to replace its water infrastructure.

To the extent that pipe replacement is deferred into the future, service quality will suffer from an increasing number of pipe breaks and the resulting service disruptions, health risks from potential drinking water contamination, property damage, and opportunity costs related to community health and economic development.[346] Deferral of pipe replacements year by year has a cumulative effect on the future cost to customers for replacing these pipes, leaving future customers with much larger bills. The AWWA has used the phrase "tidal wave" in studies on this subject to describe the significant and dramatic increase in replacement costs that will result

---

[341] Citron Direct at 6; Citron Rebuttal at 2.
[342] Citron Direct at 6; Citron Rebuttal at 2.
[343] Citron Rebuttal at 2.
[344] Citron Direct at 9.
[345] *Id.*
[346] *Id.* at 10.

tomorrow from deferring pipeline replacements today.[347]

Infrastructure replacement is an intensive and costly undertaking, and recent economic trends such as rising inflation, global supply chain shortages, and shipping delays have presented additional challenges to the Company.[348] As a result, the Company has taken steps to mitigate the cost increase associated with QIP projects, as described by Company witness Citron.[349] These steps include bundling projects for design and construction efficiency, leveraging KAWC's position as an American Water subsidiary to increase purchasing power and decrease delivery lead times, proactively securing QIP project materials on the most economical terms available, expanding the amount of contractors on the Company's pre-qualified list, coordinating with external entities such as LFUCG and other utilities to seek out opportunities for construction coordination, and collaborating with LFUCG to control pavement restoration costs associated with QIP projects.[350]

The costs associated with the QIP are gradually billed to customers through a QIP Rider charge, expressed as a percentage of water and fire service charges for each customer class included in the QIP tariff.[351] The Company is not proposing any changes to how the QIP will be billed to customers.[352] The Company is, however, proposing the following changes and clarifications to the QIP Rider:

- Updating what should be considered qualified investments, to include a broader scope of asset classes;[353]

[347] *Id.*
[348] *Id.* at 19-20.
[349] *Id.* at 18-24.
[350] *Id.*
[351] Newcomb Direct at 23-24.
[352] *Id.* at 23.
[353] Newcomb Direct at 20; Citron Direct at 5; Filing Exhibit 2.

- Imposing an eleven-month QIP test period from February 2025 to December 2025, followed by subsequent twelve-month QIP periods beginning in January 2026;[354]
- Grossing-up of the return on net-QIP eligible plant-in-service, at the overall rate of return on capital authorized in the Company's latest base water rate case, by applying the gross revenue conversion factor authorized in the Company's latest base water rate case;[355]
- Calculating the QIP percentage by dividing the QIP revenue requirement by the total authorized water revenues as approved in the most recent rate case for the classes listed on the QIP tariff sheet, then multiplying the resulting QIP percentage by the number of days the QIP percentage will be in effect, divided by 365 days (or 366 days in a leap year);[356] and
- Establishing contemporaneous filing requirements for the Balancing Adjustment Filings and Annual Filings associated with each QIP period, and calculating the Balancing Adjustment percentage by dividing the Balancing Adjustment credit or surcharge by the authorized water revenues from the most recent rate case for the classes listed on the QIP tariff sheet, then multiplying the resulting percentage by the number of days the Balancing Adjustment percentage will be in effect, divided by 365 days (or 366 days in a leap year).[357]

The proposed expansion of QIP will smooth out rate impacts for customers and avoid rate shock, while allowing for a faster but more gradual cost recovery.[358] The expansion will enable

[354] Newcomb Direct at 20-21.
[355] Newcomb Direct at 21.
[356] *Id.* at 21-22.
[357] *Id.* at 22-23.
[358] Citron Rebuttal at 2.

the Company to avoid filing rate cases as frequently as it did prior to the approval of the QIP, which benefits the Company, its customers, regulators, and intervenors.[359] Finally, expansion will allow the Commission a greater opportunity to examine KAWC's pipeline replacement projects with more detail than would typically occur in a general rate case.[360]

(B) <u>The AG and LFUCG's Proposal</u>

The AG and LFUCG's Proposal Ignores the Benefits of Smoothed Rate Impacts for Customers and Ignores the Necessary Reality that Aged Infrastructure Needs Replacing.

Meyer, on behalf of the AG and LFUCG, proposes to not only deny expansion of the QIP, but to cease continuation of the QIP in general.[361] This brazen recommendation is based on three things: (1) Meyer believes the QIP Rider engages in single-issue ratemaking, (2) Meyer states the Company has not given adequate thought to rate affordability, and (3) Meyer contends that there is no provision in the proposed QIP for the decline in the previous QIP investments rolled into rate base from what is established as base rates in the previous rate case.[362] If the Commission approves continuation of the QIP, Meyer proposes including a depreciation offset to capture the decline in value associated with QIP rolled into rate base.[363] Meyer's testimony does not address the underlying need for the QIP or for replacing aging infrastructure generally.

The assertion that the QIP should be discontinued because it engages in single-issue ratemaking ignores both the Commission's authority to consider and decide ratemaking issues, and the Commission's precedent of establishing and approving riders like the QIP Rider.[364]

---

[359] *Id.* at 2-3.
[360] *Id.* at 3.
[361] Meyer Direct at 41.
[362] *Id.* at 43.
[363] *Id.* at 44.
[364] Newcomb Rebuttal at 19-20.

Meyer's claim that the Company has not given adequate thought to rate affordability is simply false. Rate affordability is and has been a driving factor in proposing the QIP. Alternative cost recovery through the QIP Rider balances the Company's demonstrated need to make prudent infrastructure replacement investments to help ensure safe, adequate, and reliable water service, with the need of customer rates that are fair, just, and reasonable by allowing for smaller, more gradual rate increases between rate cases instead of the rate shock that customers would experience from a large increase due to the rate recovery of several years of infrastructure replacement capital investments all at once in a general rate case.[365] Further, from the perspective of long-term sustainable customer service and maintaining affordable water rates, replacing pipes that are near the end of their useful life in a proactive, systematic, responsible manner will result in lower costs to customers over time as compared with deferring such replacements and addressing problems, such as leaks and main breaks, as they arise.[366] This is evidenced by the fact that planned pipe replacement costs $331 per foot whereas reactive pipe replacements cost over $1,000 per foot on average. That is more than three times the cost to replace a broken pipe than to replace it as part of proactive replacement program, such as QIP.[367] Even beyond the QIP, the Company has demonstrated the deliberate efforts it undertakes to understand and prioritize rate affordability.[368] The Company's proposal to expand QIP demonstrates its commitment to affordability and to avoiding rate shock for customers.

In response to Meyer's third concern, the QIP already has a depreciation offset where the amount of depreciation expense collected through the QIP Rider is reduced by removing

---

[365] *Id.* at 20.
[366] Porter Direct at 13.
[367] *Id.*; *see also* Citron Direct at 8.
[368] Rea Direct at 4-34; *see supra* Section VII(B).

depreciation expense associated with the utility plant in base rates that is being retired as a result of the infrastructure replacement.[369]

There is no question that aging infrastructure needs replacement. The reality today is that aged infrastructure needs replacing, the Company has identified a strategic and reasonable plan to accomplish this replacement through an expanded QIP, and customers will benefit in the long-term from more efficient deployment of capital and the gradual rate impacts that the QIP Rider provides. For these reasons, the Company requests that the Commission reject the AG and LFUCG's proposals, and approve of an expansion to the Company's existing QIP.

IX. CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY FOR AMI DEPLOYMENT

Included within the Company's Application was a request for a CPCN pursuant to KRS 278.020 for deployment of AMI. If a certificate is granted, the Company plans to install AMI-enabled equipment as it completes replacement of its current AMR-enabled equipment in the normal course of business over the next decade.[370] Unlike some other proposed AMI deployment requests that have come before this Commission, KAWC is not planning to accelerate the replacement of metering infrastructure; rather, the Company plans to deploy new, AMI-enabled meters and endpoints only when existing meter and endpoint assets would be replaced anyway.[371] Thus, in essence, all KAWC seeks is approval to change the type of technology (from AMR to AMI) used to transmit usage data from a meter to KAWC. For such a request, a CPCN and a full CPCN analysis may not be necessary, but given the Commission's historical focus on AMI proposals, and out of an abundance of caution, KAWC has requested a CPCN and has satisfied the requirements of a CPCN.

[369] Newcomb Rebuttal at 20.
[370] Rebuttal Testimony of Melissa Schwarzell at 2.
[371] *Id.*

(A) Legal Standard

The statutory requirement for certificates of public convenience and necessity is contained in KRS 278.020(1), which states:

> No person, partnership, public or private corporation, or any combination thereof shall . . . begin the construction of any plant, equipment, property or facility for furnishing to the public any of the services enumerated in KRS 278.010 . . . until that person has obtained from the Public Service Commission a certificate that public convenience and necessity require the service or construction. . . .

Kentucky's highest court has construed "public convenience and necessity" to mean: (1) there is a need for the proposed equipment or service; and (2) the new equipment or service will not create wasteful duplication.[372]

A finding of "need" is supported where there has been a showing of "a substantial inadequacy of existing service" due to a deficiency of service facilities beyond what could be supplied by normal improvements in the ordinary course of business.[373] "Substantial inadequacy of existing service" is not required to be a currently existing deficiency, but rather may be a deficiency expected a number of years into the future "in view of the long range planning necessary in the public utility field."[374]

The prevention of "wasteful duplication" has been interpreted to mean not only a physical multiplicity of facilities, but also an avoidance of "excessive investment in relation to productivity or efficiency."[375] To demonstrate that a proposed project does not result in wasteful duplication, a thorough review of all reasonable alternatives needs to be performed with the fundamental

[372] *Kentucky Utilities Co. v. Public Service Commission*, 252 S.W.2d 885, 890 (Ky. 1952).
[373] *Id.*
[374] *Kentucky Utilities Co. v. Public Service Commission*, 390 S.W.2d 168, 171 (Ky. 1965).
[375] *Kentucky Utilities Co.*, 252 S.W.2d at 890.

principle of a reasonable, least cost alternative embedded in that review.[376] However, "[s]election of a proposal that ultimately costs more than an alternative does not necessarily result in wasteful duplication. All relevant factors must be balanced."[377]

Although cost is a factor, it is not the only factor to be considered. As long as the project is reasonable and feasible, it meets that standard set forth in 278.020(1).[378] The standard has been succinctly described as follows:

> As we view it, if the . . . proposal is feasible (capable of supplying adequate service at reasonable rates) and will not result in wasteful duplication, the Public Service Commission is authorized to grant a certificate . . . .[379]

As a public utility in the Commonwealth of Kentucky and regulated by the Commission, the Company is obligated under KRS 278.030(2) to serve its customers: "Every utility shall furnish adequate, efficient and reasonable service . . . ." The Commission has further explicated this requirement in the following regulation, with which the Company must comply:

> 807 KAR 5:066, Section 1 — "Each utility shall install a suitable measuring device at each source of supply so that a record may be maintained of the quantity of water produced at each source."

(B) <u>The Company's Proposal</u>

The Company's Plan to Upgrade to AMI in the Normal Course of Business Makes Sense for Customers and Meets the Legal Standard for a CPCN.

With those statutory and regulatory requirements in place, the Company has demonstrated that there is a need for AMI deployment in view of the long-range planning necessary in the public utility field, and that no wasteful duplication will result from AMI deployment.

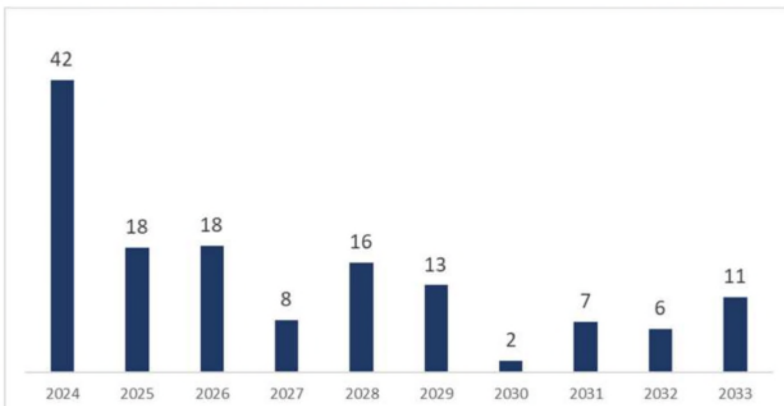
---

[376] *Electronic Application of Big Rivers Electric Corporation for A Certificate of Public Convenience and Necessity to Construct A 161 kV Transmission Line in Henderson County, Kentucky*, Case No. 2022-00012, Order at 8 (Ky. PSC June 6, 2022).
[377] *Id.* at 8-9.
[378] *Kentucky Utilities Co.*, 390 S.W.2d at 172-73.
[379] *Id.* at 175.

(1) *The Company's Long-Term Metering Replacement Needs Demonstrate that the Best Time to Implement AMI Technology is Now.*

With this request for a CPCN, the Company is planning for the long-term, with efficiency and enhanced customer experience at the forefront of its decision-making. KAWC has almost 142,000 meters and endpoints in service as of May 2023.[380] Over the next decade, these meters, endpoints, and other necessary equipment will need replacing as they meet or exceed their useful life:[381]

Figure 4 - Upcoming Forecast for 2" and Smaller Meter Replacements, in 000s



*Meters/endpoints replaced by thousand, per year over the next 10 years.

In 2024, the Company will replace approximately 42,000 5/8-inch meters as a necessary, scheduled maintenance event. Whether the equipment replacement is AMR-enabled or AMI-enabled will not change the fact that replacement is necessary. However, considering the benefits of AMI technology, the Company believes it is in the best interest of its customers to begin deploying an AMI system as the Company completes its necessary and ordinary scheduled replacements. Beginning AMI implementation as soon as possible will allow KAWC to maximize the benefits and cost effectiveness of AMI.

[380] Application Exhibit A at 8.
[381] *Id.* at 11.

System-wide adoption of AMI will take ten years, because the Company does not intend to accelerate the process beyond what is necessary in the ordinary course of business. As displayed in the Figure above, the Company has forecasted the number of meters that will need replacing each year.[382] With 2024 requiring the largest number of replacements, the time to act is now. If a CPCN is not granted and the Company maintains the status quo with its AMR-enabled technology for the meters' useful lives, that means that approximately 30% of its system-wide meters—and the customers associated with those meters—could be prevented from enjoying the technological benefits of AMI until 2034.

The benefits of AMI are widespread, and can be explained as both quantifiable cost savings and as intangible improvements to the system and for KAWC customers. Quantifiably, as explained by Company witness Melissa Schwarzell in the cost-benefit analysis portion of Exhibit A to the Company's Application,[383] a transition to AMI over the next decade will result in savings for meter reading labor, field service representative labor, and associated vehicle costs.

Some key benefits of AMI are more difficult to quantify, but are nonetheless of the utmost importance, such as improved employee safety, enhanced customer service, operational efficiencies, and environmental benefits.[384] Currently, KAWC employees are routinely in the field reading meters. This requires employees to be exposed to some potentially unsafe environments, inclement weather, exposure to vehicular traffic, animals, and the like.[385] AMI meters can be read remotely, reducing the need for readings in the field. With less vehicles on the road and less

---

[382] The forecast is based upon the Company's field experience, which has informed the Company that meters have an approximate useful life of ten years.
[383] Direct Testimony of Melissa Schwarzell at 11; Application Exhibit A at 14-20.
[384] Schwarzell Direct at 11.
[385] Application Exhibit A at 6.

employees devoted to reading meters, KAWC can redeploy resources to refocus efforts on other high value work.

From the Company's perspective, timelier access to information through AMI will allow KAWC to respond more quickly to potential issues, such as communication malfunctions or leaks. Currently, AMR meters transmit vital data to the Company approximately once a month, after a KAWC employee drives by in a company vehicle to perform a reading.[386] This process can result in reactive responses to communication malfunctions or potential leaks. AMI, on the other hand, is capable of transmitting data to the Company on a daily basis. If an AMI-enabled meter is malfunctioning or if there is an anomaly with reported usage indicating a potential leak or issue, then the Company can respond quickly—within hours as opposed to weeks.

AMI will also allow customers to have better access to information related to their water usage. In a world increasingly dominated by speed and access to information, KAWC customers today, and customers over the next decade, expect the Company to utilize the most feasibly advanced technology.[387] AMI deployment will improve how customers understand their water usage, empower customers to make changes in their habits and behaviors to increase water conservation, allow customers to address potential issues or leaks in a timelier manner, and increase billing accuracy.

(2) *Deployment of AMI Over the Next Ten Years Will Not Result in Wasteful Duplication Because Meter Replacements are Necessary in the Ordinary Course of Business.*

The Company considered all reasonable alternatives before concluding that AMI deployment would not result in any wasteful duplication.[388] The alternative technologies included

---

[386] *Id.* at 4.
[387] Application Exhibit A at 7.
[388] *Id.* at 13-15.

continuing with AMR technology, deploying AMI cellular technology, and deploying a blend of AMI cellular and AMI Fixed-Network technology.[389]

Based on both cost and functionality, KAWC selected the Badger AMI cellular system as the replacement for its existing AMR system.[390] This decision was made after a balancing of all the relevant factors.[391] Although Schwarzell's cost-benefit analysis identified one AMR alternative as having a marginally lower cost than Badger AMI,[392] the widespread benefits of AMI make it the clear best long-term option for KAWC and its customers.[393] The vast improvements associated with an AMI system, particularly after the system is fully deployed around 2033, justify the slight difference in cost.

KAWC submitted a deprecation study prepared by Larry E. Kennedy, a depreciation professional with Concentric Energy Advisors, Inc ("Study"). The Study determines the annual depreciation accrual rates and amounts for book purposes applicable to the original cost of investment, as of December 31, 2022, for the water assets of KAWC.[394] The rates and amounts are based on the Straight-Line Method, incorporating the Average Life Group Procedure applied on a Remaining Life Basis.[395] This Study results in a depreciation rate related to Structures and Improvements of 2.31%; Purification, Transmission, and Distribution of 3.07%; and a depreciation rate related to general plant of 9.36%.[396] Neither the AG nor LFUCG objected to the depreciation rates contained in the Study.

[389] *Id.* at 13.
[390] *Id.* at 14.
[391] *See Electronic Application of Big Rivers Electric Corporation for A Certificate of Public Convenience and Necessity to Construct A 161 kV Transmission Line in Henderson County, Kentucky*, Case No. 2022-00012, Order at 9 (Ky. PSC June 6, 2022).
[392] Application Exhibit A at 19.
[393] Schwarzell Direct at 12.
[394] Direct Testimony of Larry E. Kennedy at 3.
[395] *Id.* at 3-4.
[396] *Id.* at 6.

In discovery and at the evidentiary hearing, KAWC witnesses Schwarzell and Kennedy confirmed that the Company has aligned its depreciable life for meters with its cost-benefit analysis supporting its recommended implementation of AMI meters. *Both the Study and the cost-benefit analysis utilize a 10-year life for meters.* Kennedy testified that prior KAWC depreciation studies contained a composite depreciation rate for all meter components (Account 334 assets).[397] The most recently approved depreciation study in 2016 utilized a 40-year composite depreciable life for meter assets. The current Study recommends depreciable lives for each type of meter asset based on KAWC's experience with the operating lives for those assets. The chart below compares the depreciable lives for the meter assets in the Study with the 2016 depreciation rates:

Meter Asset	**2016 Approved Rates**	**Current Study**
Meters	40 years -20% salvage	10 years -15% salvage
Meters – Bronze Case	40 years -20% salvage	10 years -15% salvage
Meters – Plastic Case	40 years -20% salvage	10 years -15% salvage
Meters – Other	40 years -20% salvage	10 years -15% salvage
Meter Reading Units	40 years -20% salvage	10 years -15% salvage
Meter Installations	40 years -20% salvage	60 years -20% salvage
Meter Vaults	40 years -20% salvage	60 years -20% salvage

In response to questions at the evidentiary hearing, Kennedy explained that although the depreciable life for meters is 10 years, the proposed depreciation rate is 24.04% instead of 10%.[398] Kennedy explained there are three components to the depreciation rate for meters. The first component is based on the estimated life, which in this instance is 10 years and 10% in the straight-line depreciation method the Company has utilized. The second component is the accumulated

[397] 12/13/2023 Hearing, VR 9:59:42-10:00:05.
[398] 12/13/2023 Hearing, VR 10:17:00-10:18:20.

depreciation for this asset class. The third component is net salvage, which the Study recommends reducing from the currently approved -20% to -15% in order to moderate the effect of revising the depreciable meter life from 40 to 10 years. Cumulatively, these three components result in the 24.04% depreciation rate.[399]

The Commission should approve a CPCN to allow the Company to improve the technological capabilities of its metering infrastructure in the ordinary course of business, so that both customers and KAWC can benefit from strategic and permanent improvements in safety, customer experience, operational efficiencies, and environmental benefits.[400]

(C) <u>The AG and LFUCG's Response</u>

A Review of the Evidentiary Record Easily Resolves the Concerns of the AG and LFUCG Regarding the Company's Requested CPCN.

Meyer, on behalf of the AG and LFUCG, presented testimony regarding the Company's proposal for AMI deployment.[401] Meyer expressed two main concerns with KAWC's request for a CPCN related to cost savings and stranded investments.

First, Meyer stated that Schwarzell's cost-benefit analysis did not explain how certain cost savings associated with AMI deployment would be reflected in customers' rates.[402] Schwarzell, in her rebuttal testimony, explained that quantifiable financial benefits of AMI deployment demonstrated within the cost-benefit analysis include meter reading labor, field service representative labor, and associated vehicle costs.[403] Because the costs and benefits of AMI will be embedded in the business and operations of the Company as AMI is deployed, the costs and

---

[399] 12/13/2023 Hearing, VR 10:14:25-10:18:20.
[400] For additional support, see Application Exhibit A; Schwarzell Direct at 3-12; Schwarzell Rebuttal at 1-3; Lewis Direct at 39-43; Nash Direct at 15-16; Response to AG 1-38; Response to AG 2-40; Response to LFUCG 1-74; Response to PSC 2-7 to PSC 2-17.
[401] Meyer Direct at 44-46.
[402] *Id.* at 45.
[403] Schwarzell Rebuttal at 1.

benefits will be reflected in the cost of service and customer rates through ongoing rate regulation.[404]

Second, Meyer expressed concern about the potential for stranded investment costs resulting from the retirement of the current AMR-enabled meters.[405] The Company does not anticipate any stranded assets in relation to AMI transition, because the Company is not proposing to retire metering equipment in advance of its normal, scheduled, periodic replacement.[406]

Having displaced the fears of the AG and LFUCG, two things are clear: (1) the Company has demonstrated that it meets the legal standard for a CPCN and (2) allowing the Company to upgrade to AMI in the normal course of business will provide widespread quantifiable and intangible benefits to the Company, its customers, and its employees.

X. ACCOUNTING AND REGULATORY TREATMENT PROPOSALS

The Company is requesting regulatory accounting deferral treatment for production expenses; pension and other post-employment benefit ("OPEB") expenses; taxes other than income (excluding sales tax); and income taxes.[407] The respective annual level of expenses of each account is to be established in this rate case as part of the Company's base rates. As requested, the Company would be permitted to record any amounts above or below the projected level of these expenses into separate regulatory asset or liability accounts through the conclusion of the Company's next rate proceeding.[408] At the time of the next rate proceeding, KAWC will address the recovery of the balances and any request to continue regulatory asset or liability treatment beyond that next base rate proceeding.[409] The Company is not proposing to recover carrying costs

---

[404] *Id.* at 2.
[405] Meyer Direct at 45.
[406] Schwarzell Rebuttal at 2-3; Response to AG 1-89.
[407] Newcomb Direct at 24.
[408] *Id.*
[409] *Id.*

on deferred balances; the Company is only proposing to defer any variance between the base level established in this case and the actual level incurred to an asset or liability account.[410]

(A) Legal Standard

A utility must obtain Commission approval for accounting adjustments before establishing any expense as a new regulatory asset. The Commission has authority—pursuant to its plenary authority to regulate utilities under KRS 278.040 and its authority to establish a system of accounts for utilities under KRS 278.220—to establish regulatory assets. A regulatory asset is created when a utility is authorized to capitalize an expenditure that would be recorded as a current expense under traditional accounting rules. A utility may request recovery of the capitalized amount in future rates, but recovery is subject to Commission review and approval.

The Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation*, which was codified as Accounting Standards Codification (ASC) 980, *Regulated Operations*, provides the criteria for recognition of a regulatory asset.[411] Supplemental to generally accepted accounting principles ("GAAP"), long-standing Commission precedent provides that regulatory assets may be established when a utility incurs:

---

[410] *Id.* at 25.

[411] ASC 980-340-25-1 provides, in full, as follows:

> 25-1 Rate actions of a regulatory can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
>
> a. It is probable (as defined in Topic 450) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
>
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.
>
> A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date.

1) An extraordinary, nonrecurring expense that could not have been reasonably anticipated or included in the utility's planning;
2) An expense resulting from a statutory or administrative directive;
3) An expense in relation to an industry-sponsored initiative; or
4) An extraordinary or nonrecurring expense that, over time, will result in a savings that fully offsets the cost.[412]

(B) <u>Production Expenses</u>

Production costs—including purchased water, fuel and power, chemicals, and waste disposal—are a significant operating expense that the Company must incur to provide safe and reliable service to its customers.[413] As proposed, the production expense accounting deferral would protect both customers and the Company against the volatility in production expense.

As discussed by Company witnesses Newcomb and O'Drain, the Company is seeing volatility in these expenses, particularly chemical pricing.[414] Over the last two years, the chemical market has seen unprecedented price increases, driven by many factors such as inflationary increases in commodity and transportation prices, volatile energy prices, high labor costs, and overall supply pressure within a consolidating chemical market.[415] These factors may continue to impact pricing beyond current contracts, based on ongoing discussions with suppliers, as past price increases factor into the future bid prices.[416] Chemical prices at the end of 2022 were approximately 76% higher than what the Company experienced at the end of 2021, and prices at the end of 2023 have grown 24% from the end of 2022.[417] The fluctuation and volatility associated

[412] *See The Application of East Kentucky Power Cooperative, Inc. for an Order Approving Accounting Practices to Establish a Regulatory Asset Related to Certain Replacement Power Costs Resulting from Generation Forced Outages*, Case No. 2008-00436, Order at 4 (Ky. PSC Dec. 23, 2008).
[413] Newcomb Direct at 27; Watkins Direct at 11-13.
[414] Direct Testimony of Thomas G. O'Drain at 5-12.
[415] *Id.* at 8.
[416] *Id.*
[417] *Id.* at 12.

with production expenses are extraordinary and outside the Company's control, as the Company can no longer reasonably rely upon stability of the chemical market to lock in agreed-upon prices for chemicals for a full calendar year.[418] The current market is simply unpredictable, for the reasons explained by the Company through witnesses Newcomb and O'Drain. Because the Company cannot reasonably or "easily" anticipate pricing[419] and has had to incur extraordinary expenses that it does not expect to incur at the same volatile rates indefinitely, regulatory asset treatment for these expenses is warranted.

(C) <u>Pension and Other Post-Employment Benefit Expenses</u>

Pension and OPEB expenses are calculated using a complex formula based upon actuarial reports that consider a number of variables.[420] The level of fluctuation in these expenses from year to year can change drastically based on market fluctuations, such as changes to interest rates, discount rates and asset returns, and the facts used to calculate the expenses, such as the number of employees or retirees that the Company expects to be eligible for pension or OPEB entitlements. For example, the Company's pension expense increased by 480 percent from the base year expense of $23,580 to the future test year amount of $136,866. The OPEB expense increased by 7.5 percent from ($648,697) in the base year to ($600,322) in the future test year.[421]

When markets change and these expenses reverse, customers will benefit through the recording of deferral accounts. As an illustration, if the requested deferral treatment had been in place beginning in 2020, the Company would have recorded approximate regulatory liabilities of $1,198,000 in 2020; $1,636,000 in 2021; and $1,716,000 in 2022.[422] The net regulatory liabilities

[418] *Id.* at 5.
[419] Meyer Direct at 38.
[420] Newcomb Direct at 30.
[421] *Id.*
[422] *Id.* at 32.

of $4,550,000 would have been presented in this case for amortization and returned to customers in base rates.[423]

Multiple jurisdictions have approved a similar tracking mechanism for OPEB and pension expenses, including Kansas,[424] Missouri,[425] New Jersey,[426] California,[427] and Virginia.[428] A deferral ensures that customers only pay for the pension and OPEB expenses incurred—nothing more and nothing less—while allowing the Company to collect the proper revenues to cover a portion of the Company's labor-related expenses already experiencing volatility.[429]

(D) <u>Taxes Other Than Income Expenses</u>

Taxes other than income (excluding sales tax) include expenses incurred for property tax (county/city and state), payroll taxes, other taxes and licenses, and regulatory assessment fees.[430] Taxes other than income are expenses incurred as a result of statutory or administrative directives.[431] The Company has no control over the tax rates generally, although it regularly appeals its property tax assessments when appropriate, in an attempt to lower its property tax

---

423 *Id.*

424 *In the Matter of the General Investigation into Commission Policy Regarding Pension and Retirement Costs for Investor-Owned Utilities*, Case No. 07-GIMX-1041-GIV, Order at 21 (Kan. Corp. Comm. Aug. 17, 2011) ("The Commission expressly adopts a policy that investor-owned public utilities establish mechanisms for tracking pension, postretirement and post employment costs and expenses.").

425 See *In the Matter of Missouri-American Water Company's Request for Authority to Implement a General Rate Increase for Water Service Provided in Missouri Service Areas*, Case No. WR-2007-0216, Report and Order at 81 (Mo. PSC Oct. 4, 2007) and Appendix E to Nonunanimous Stipulation and Agreement (filed Aug. 9, 2007). *But see* Meyer Direct at 40.

426 *In the Matter of the Petition of New Jersey-American Water Company, Inc. for Approval of Increased Tariff Rates and Charges for Water and Wastewater Service and Other Tariff Modifications*, BPU Case No. WR22010019, Order Adopting Initial Decision/Settlement at 4 (N.J. Bd. Public Utilities Aug. 17, 2022).

427 *Application of California-American Water Company (U210W) for Authorization to Increase its Revenues for Water Service by $25,999,900 or 10.60% in the year 2021, by $9,752,500 or 3.59% in the year 2022, and by $10,754,500 or 3.82% in the year 2023*, Decision 21-11-018, Decision Approving and Adopting Settlement Agreements, Resolving the Remainder of Disputed Issues and Authorizing California-American Water Company's General Rate Increases for 2021, 2022, and 2023 at 121 (Cal. PUC Nov. 23, 2021).

428 *Application of Virginia-American Water Company For a general increase in rates*, Case No. PUR-2021-00255, Final Order at 5 (Va. SCC Apr. 24, 2023).

429 Newcomb Direct at 30-31.

430 *Id.* at 14.

431 *Id.* at 33.

bill.[432] A deferral would allow KAWC customers to benefit from successful appeals, and from actual variations of other tax amounts such as regulatory assessment fees and payroll tax expenses.[433]

(E) <u>Income Tax Expenses</u>

The Company is requesting that if any federal or state income tax rate changes are enacted between the time this proceeding is approved and the Company's next general rate case filing, that the Commission allow the Company to defer the change in income tax expense to a regulatory asset or liability as appropriate.[434] In addition, any effect, excess or deficit, of the federal or state rate change on accumulated deferred income taxes can be included. Like taxes other than income, income taxes are an incurred expense resulting from statutory or administrative directive. Deferring the effects of a federal or state income tax rate change—whether a material change such as what occurred with the Tax Cuts and Jobs Act in 2017, or a minor change such as the Kentucky corporate income tax rate change in 2018—will allow the Company to accrue the effects of the change between rate case filings and recover from customers or refund to customers that effect in base rates in the next general rate case without the Commission having to initiate a filing requirement.[435]

The purpose of the Company's requests for regulatory accounting treatment is to both protect the Company's customers if production, pension, OPEB, or tax expenses were to decrease in the future, as well as to allow the Company the opportunity to include in a future proceeding any increased levels of expenses. When returning in the next case, KAWC will need to show the results of the expense regulatory accounts and ask for recovery. Those balances will be subject to

---

[432] *Id.*
[433] Newcomb Rebuttal at 17.
[434] Newcomb Direct at 35.
[435] Newcomb Rebuttal at 17-18.

Commission scrutiny to determine their reasonableness. In light of the fluctuation and volatility associated with production expenses, the Company believes regulatory asset treatment is appropriate for production, pension, and OPEB expenses because the Company has incurred extraordinary expenses that could not have been reasonably anticipated or included in the utility's planning. Regulatory asset treatment is appropriate for the identified tax expenses because those expenses are incurred as a result of statutory or administrative directives. A decision approving the requested changes to accounting treatment for these expenses will ensure that KAWC customers pay only for actual expenses incurred—nothing more and nothing less.[436]

XI. CONCLUSION

KAWC supported the entirety of its request for rate relief through record evidence in this proceeding. The Company has met its burden of proof with respect to demonstrating the reasonableness of its proposed revenue requirement, including employee related costs, residential revenue forecasting, working capital allowance, electronic payment fees, miscellaneous expenses, rate case expenses, and unaccounted-for water loss. The capital structure and ROE that KAWC has requested are reasonable and premised on the prudent application of a host of cost of equity estimation models. The Company would be placed at a competitive disadvantage if Mr. Baudino's recommended ROE is adopted.

In addition, the QIP expansion that the Company has proposed is critically important to the Company and its customers, as it will allow the Company to address the looming concerns of aging infrastructure more adequately. The Company has also set forth reasonable proposals for tariff

[436] For additional support, see Newcomb Direct at 24-36; Newcomb Rebuttal at 5, 7-19; O'Drain Direct at 3-18; Watkins Direct at 9-13; Response to AG 1-81; Response to AG 1-98; Response to PSC 2-53; Response to PSC 2-54; Response to PSC 2-55; Response to PSC 2-56; Response to PSC 2-58; Response to PSC 2-91; Response to PSC 3-5; Response to PSC 3-26.

revisions, accounting and regulatory treatment of certain expenses, and a CPCN for the deployment of AMI in the ordinary course of business.

KAWC respectfully requests that the Commission approve expansion of QIP, revisions to the Company's tariff, accounting and regulatory treatment changes, the CPCN for AMI deployment, and the requested increase in rates to ensure that the Company is afforded the fair, just, and reasonable rates to which it is entitled.

Respectfully submitted,

Lindsey W. Ingram III
L.Ingram@skofirm.com

Monica H. Braun
Monica.Braun@skofirm.com

Mary Ellen Wimberly
MaryEllen.Wimberly@skofirm.com

STOLL KEENON OGDEN PLLC
300 West Vine Street, Suite 2100
Lexington, Kentucky 40507-1801
Telephone: (859) 231-3000
Fax: (859) 259-3503

BY: Lindsey W. Ingram III

Attorneys for Kentucky-American Water Company

CERTIFICATE

In accordance with the Commission's Order of July 22, 2021 in Case No. 2020-00085 (Electronic Emergency Docket Related to the Novel Coronavirus COVID-19), this is to certify that the electronic filing has been transmitted to the Commission on January 5, 2024; and that there are currently no parties in this proceeding that the Commission has excused from participation by electronic means.

STOLL KEENON OGDEN PLLC

BY: Lindsey W. Ingram III

Attorneys for Kentucky-American Water Company