KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2023-00191
COMMISSION STAFF'S REQUEST FOR INFORMATION ON REHEARING

Witness: Jeffrey Newcomb

1. Refer to Kentucky-American's Petition for Rehearing, pages 3-5 and Kentucky-American's response to Commission Staff's Third Request for Information, Item 1, Attachment. Confirm that Kentucky-American did not include revenues as part of the adjustment to remove the proposed roll-in of the Qualified Infrastructure Program (QIP).

Response:

As set forth in the response to PSC 3-1, the Commission's decision to remove the roll-in of QIP is inconsistent with prior Commission treatment of cost recovery mechanisms. It is also inconsistent with how QIP was proposed in Kentucky-American's 2018 rate case in which QIP was approved. Given that precedent and the fact that the QIP was proposed and approved in the 2018 rate case, Kentucky-American fairly assumed QIP would be rolled into base rates in this case, and, therefore, proposed it that way in its June 30, 2023 Application in this case.

Then, late in the discovery phase in this case, PSC 3-1 was the first time Kentucky-American became aware of the possibility that the Commission might be considering *not* rolling QIP into base rates. Kentucky-American is not challenging that substantive decision on rehearing, but that Commission decision did create complicated revenue requirement and rate design calculations for the Commission to make. As has been stated on rehearing, Kentucky-American believes that the Commission did not accurately reflect the substantive language of its Order when creating Appendix A and B to that Order and that there were errors and omissions by the Commission in making those complicated revenue requirement and rate design calculations. Kentucky-American believes the Commission inadvertently failed to remove QIP revenues from the test year at present rates in determining the required revenue increase in the case.[1] That omission causes the "punitive mismatch" described in Kentucky-American's May 16, 2024, Petition for Rehearing, and if unchanged, will deprive Kentucky-American of the opportunity to earn the return on equity ("ROE") established in the May 3, 2024 Order.

Kentucky-American's proposal for a roll-in of the QIP included three distinct components: (1) that the rate base eligible for recovery in the QIP be included as rate base in the rate case for base rate recovery, (2) that the operating expenses eligible for recovery in the QIP be included as operating expenses in the rate case for base rate recovery, and (3) that the operating revenues associated with the QIP be included as "Test Year at Present Rates"

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[1] Neither the Attorney General nor the Lexington-Fayette Urban County Government, who provided sophisticated revenue requirement testimony in this case (including testimony regarding QIP) through their shared expert witness, Mr. Greg Meyer, have challenged Kentucky-American's rehearing assertion that the Commission improperly failed to remove QIP revenues in determining the revenue requirement.

revenue in the rate case in determining the revenue deficiency/increase as a result of this proceeding. By including all of these items, the net result on Kentucky-American's revenue deficiency/increase was no impact, as all QIP costs (inclusive of a return on the rate base) were matched with revenues; this is appropriate because customers would pay for these QIP costs with or without a rate case. Rate design was the sole point of the shift in Kentucky-American's proposed roll-in of QIP, whereby the QIP would be set to zero, and all recoveries would occur in base rates. The Commission's Order only addressed two of the three components associated with the QIP, which meant that Kentucky-American's revenue deficiency/increase, and the resulting Commission determined rates, were both understated.

Having said all of that, Kentucky-American has provided everything needed within the case record to remove the roll-in of QIP into base rates. Most recently, Kentucky-American has provided Exhibits 1 and 2 to the May 16, 2024, Petition for Rehearing. However, as set forth below, the information required was provided in response to PSC 3-1 and in earlier data Kentucky-American submitted in this case.

PSC 3-1, part a, in reference to Kentucky-American Application, Exhibit 3, page 52,[2] asks Kentucky-American to "Provide the adjustment to remove the roll-in of the Qualified Infrastructure Program (QIP) into base rates. Provide all supporting calculations and documentation in Excel spreadsheet format, with all formulas, columns, and rows unprotected and fully accessible." Kentucky-American provided in its response to PSC 3-1, parts a and b, an Excel file showing the adjustment to the **total revenue requirement** or **revenue at proposed rates** ("the size of the pie") in this case, which is the first step in designing new rates ("determining the size of the pie"). "The size of the pie" was reduced by $8,361,292 (cell H17 on the Excel tab labeled "PSC 3-1, part a") from $142,265,127 (cell E17 on the Excel tab labeled "PSC 3-1, part a") to $133,903,835 (cell K17 on the Excel tab labeled "PSC 3-1, part a"). Knowing these amounts, the Commission had what it needed to design rates given a decision to remove QIP from proposed base rates.

PSC 3-1, part b, in reference to Kentucky-American Application, Exhibit 3, page 52, asks Kentucky-American to "Provide the plant in service, accumulated depreciation, accumulated deferred income taxes, and any expenses related to the QIP in the base and forecasted test periods in Excel spreadsheet format, with all formulas, columns, and rows unprotected and fully accessible." The adjustment provided in that same Excel file in response to PSC 3-1, parts a, includes the plant in service (cell W45 on the Excel tab labeled "PSC 3-1, part b"), accumulated depreciation (cell W56 on the Excel tab labeled "PSC 3-1, part b"), accumulated deferred income taxes (cell R38 on the Excel tab labeled "PSC 3-1, part b ADIT"), and any expenses (cells H10, H11, H14, and H15 on the Excel tab labeled "PSC 3-1, part a") related to the QIP in the forecasted test period as was requested in PSC 3-1, part b.

[2] Exhibit 3 of to Kentucky-American's June 30, 2023 Application is the entire tariff with requested changes shown in a side-by-side format compared to the existing tariff. Page 52 is the page of the tariff addressed QIP program and the amount of the QIP charge.

PSC 3-1 did not ask for, nor indicate in any way, that Commission Staff was requesting the adjustment to remove, or the impact of removing, the proposed roll-in of QIP from the revenue deficiency or increase, nor does the request ask for the amount of QIP revenues in **revenue at present rates** in either part a or b of PSC 3-1. Kentucky-American's responses to PSC 3-1, therefore, do not include the amount of QIP revenues in revenues at present rates, but the amount of QIP revenues in **revenue at present rates** can be found in the case record within Kentucky-American Application, Exhibit 37, Schedule M-3, by summing the QIP Surcharge revenue for each Customer Class for the Test Year at Present Rates.

Customer Class	**Test Year at Present Rates**	**KAW_APP_EX37M_063023 Reference**
Residential	$ 5,448,546	Page 8, Line 26
Commercial	2,628,841	Page 9, Line 21
Industrial	253,230	Page 10, Line 21
Other Public Authority	657,883	Page 11, Line 21
Sales for Resale	112,881	Page 12, Line 23
Miscellaneous	9,322	Page 13, Line 21
Private Fire	310,042	Page 14, Line 21
Public Fire	430,367	Page 14, Line 31
Total	**$ 9,851,113**	

Please refer to KAW_R_PSCRR_NUM001_061424_Attachment ("Attachment") for an Excel file showing how Kentucky-American would have responded had the request asked for the adjustment to remove, or the impact of removing, the proposed roll-in of QIP from the revenue deficiency or increase in PSC 3-1, part a, or had asked for the amount of QIP revenues in revenue at present rates in PSC 3-1, part b. The starting point for the attached Excel file is the information provided in the Excel file that was attached to PSC 3-1. Then, yellow highlights indicate where information has been added, all of which can be found in the existing case record. The increase in the revenue deficiency after removal of QIP is primarily the result of the hypothetical QIP rate calculated for the period July 1, 2024 through January 31, 2025. Kentucky-American's response to PSC 2-52 further explains this hypothetical QIP rate.

PSC 2-52, part a, in reference to Kentucky-American witness Newcomb Direct Testimony, page 6, lines 6-9, asked Kentucky-American to "Explain why Kentucky-American is proposing a theoretical 10.57 percent qualified infrastructure program (QIP) rider charge in this case, as opposed to proposing 8.27 percent in in Case No. 2023-00030." In response to PSC 2-52, part a, Kentucky-American explained: "The forecasted test year is February 1, 2024, to January 31, 2025. The 8.27 percent from Case No. 2023-00030 is for a QIP period that ends June 30, 2024, making it appropriate to forecast what the QIP rate would be for July 1, 2024, to January 31, 2025. The revenue deficiency in this proceeding would be overstated if Kentucky-American were to use the 8.27 percent instead of the theoretical 10.57 percent for July 1, 2024, to January 31, 2025, because the resulting overstatement of the revenue deficiency is revenue that Kentucky-American would forecast to collect from customers with or without a rate case."

PSC 2-52, part b, in reference to Kentucky-American witness Newcomb Direct Testimony, page 6, lines 6-9, asked Kentucky-American to "Provide the base revenue at present water rates for July 1, 2024, to January 31, 2025 with the QIP rider charge at 8.27 percent." In response to PSC 2-52, part b, Kentucky-American explained: "Kentucky-American presumes this request is asking for total operating revenue at present water rates and not just base revenue. Base revenues are not impacted by QIP since QIP is a surcharge applied on top of base revenues. Please see below for total operating revenue at present water rates for July 1, 2024, to January 31, 2025, with the QIP rider charge at 8.27 percent:

	QIP @ 8.27% for July 2024 - January 2025						
	Jul-24	**Aug-24**	**Sep-24**	**Oct-24**	**Nov-24**	**Dec-24**	**Jan-25**
Base Revenue	$9,325,279	$9,333,162	$9,235,469	$8,793,728	$7,992,032	$8,162,693	$8,046,833
QIP Revenue	$771,201	$771,852	$763,773	$727,241	$660,941	$675,055	$665,473
Total Other Operating Revenue	$231,062	$238,203	$219,909	$203,985	$199,012	$197,769	$189,932
TOTAL KYAW Water Operating Revenue	**$10,327,542**	**$10,343,217**	**$10,219,151**	**$9,724,954**	**$8,851,986**	**$9,035,516**	**$8,902,239**

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Thus, the record had the information necessary to make the correct calculations, complicated as they were, to remove QIP from base rates. Here on rehearing, Kentucky-American asks the Commission to do so which is the only way to afford Kentucky-American the opportunity to earn the return the Commission has otherwise allowed.

Witness: Jeffrey Newcomb

2. Refer to Kentucky-American's Petition for Rehearing, pages 3-5 and its Application, Exhibit 37, Schedule M-2 and Schedule M-3. Confirm that Kentucky-American's "Test Year at **Present** Rates" includes QIP revenues that were not included the "Test Year at **Proposed** Rates." (emphasis added). If confirmed, explain why reversing the roll-in of the QIP necessitates removing QIP revenues from "Test Year at Present Rates" as an alternative to including the QIP revenues in "Test Year at Proposed Rates."

Response:

Kentucky-American's Application, Exhibit 37, Schedule M-2 and Schedule M-3, includes QIP revenues in **both** "Test Year at **Present** Rates" **and** "Test Year at **Proposed** Rates" (emphasis added). Line 3 through Line 10 of Schedule M-2 is a summary of each class of customer presented in Schedule M-3. Looking at Schedule M-3, for each class of customer, note that revenue from the QIP Surcharge is listed separately. Under "Test Year at **Present** Rates," note that a dollar amount is listed for revenue from the QIP Surcharge. Under "Test Year at **Proposed** Rates," note that no dollar amount is listed for revenue from the QIP Surcharge because Kentucky-American proposed to roll-in QIP revenues into base rates, and, accordingly, reset the QIP Rider charge to 0 percent. To remove the roll-in of QIP into base rates, both QIP revenue included in Kentucky-American's "Test Year at **Present** Rates" and "Test Year at **Proposed** Rates" needed to be removed when establishing new water base rates in this case. Kentucky-American provided everything needed within the case record to remove the roll-in of QIP into base rates.

To explain the above further, it is important to understand the general theory of both Kentucky-American's proposed treatment of the QIP in the rate case, and the Commission's ultimate decision. In the rate case, Kentucky-American proposed to roll the QIP into base rates and to reset the QIP to zero at the effective date of new base rates. As set forth in the response to Question 1, this was consistent with historical Commission practice and with how Kentucky-American proposed QIP would work in its 2018 rate case in which QIP was approved. However, the Commission's May 3, 2024, Order decided otherwise thereby creating complicated revenue requirement and rate design calculations. Please see the response to Question 1.

Kentucky-American's proposal for a roll-in of the QIP included three distinct components: (1) that the rate base eligible for recovery in the QIP be included as rate base in the rate case for base rate recovery, (2) that the operating expenses eligible for recovery in the QIP be included as operating expenses in the rate case for base rate recovery, and (3) that the operating revenues associated with the QIP be included as "Test Year at **Present** Rates" revenue in the rate case in determining the revenue deficiency/increase as a result of this proceeding. By including all of these items, the net result on Kentucky-American's revenue deficiency/increase was no impact, as all QIP costs (inclusive of a return on the rate base) were matched with revenues; this is appropriate because customers would pay for these QIP costs with or without a rate case. Rate design was the sole point of the shift in Kentucky-American's proposed roll-in of QIP, whereby the QIP would be set to zero, and all recoveries would occur in base rates. The Commission's Order only addressed two of the three components associated with the QIP, which meant that Kentucky-American's revenue deficiency/increase, and the resulting Commission determined rates, were both understated.

Further, Schedule M-2 and Schedule M-3, the subject of this request, serve as a revenue proof. Appendix A, page 2 of 2, of the Order indicates that in the Commission's view, excluding QIP, Kentucky-American's total water revenues in this case should be \$125,455,861, of which \$122,950,468 should come from water base revenues and \$2,505,393 should come from other revenues. Appendix B of the Order provides the Commission-determined water base rates that in theory should recover the \$122,950,468 of water base revenues. A revenue proof, however, where these Commission-determined rates are applied to the Commission ordered billing determinants, shows that these rates only produce water base revenues of \$113,102,665.

Exhibit 1, pages 1 through 8, to Kentucky-American's Petition for Rehearing provides the above referenced revenue proof. Exhibit 1, page 9, also provides a Return on Equity ("ROE") proof that demonstrates that the Commission-determined rates in Appendix B deprive Kentucky-American of an opportunity to earn the 9.70 percent ROE awarded by the Commission. Specifically, Exhibit 1, page 9, Column C, shows that the \$113,102,665 of water base revenues (Line 1) actually result in a ROE of 9.25 percent (Line 48) and not the Commission awarded 9.70 percent ROE. The questions in PSC RR 1-1 and here in PSC RR 1-2 aside, the rates in Appendix B of the Order are deficient and do not align with the language of the Order.

Witness: Jeffrey Newcomb

3. Refer to Kentucky-American's Petition for Rehearing, Exhibit 1 and Exhibit 2. Provide all supporting calculations and documentation in Excel spreadsheet format, with all formulas, columns, and rows unprotected and fully accessible.

Response:

Please refer to KAW_R_PSCRR_NUM003_061424_Attachment 1 for all supporting calculations and documentation in Excel spreadsheet format, with all formulas, columns, and rows unprotected and fully accessible, for Kentucky-American's Petition for Rehearing, Exhibit 1. Appendix A, page 2 of 2, of the Commission's May 3, 2024, Order ("Order") indicates that in the Commission's view, excluding QIP, Kentucky-American's total water revenues in this case should be $125,455,861, of which $122,950,468 should come from water base revenues and $2,505,393 should come from other revenues. Appendix B of the Order provides the Commission determined water base rates that in theory should recover the $122,950,468 of water base revenues. A revenue proof, however, where these Commission-determined rates are applied to the Commission ordered billing determinants, shows that these rates only produce water base revenues of $113,102,665. Exhibit 1, pages 1 through 8, to Kentucky-American's Petition for Rehearing provides this revenue proof. Exhibit 1, page 9, also provides a Return on Equity ("ROE") proof that demonstrates that the Commission-determined rates in Appendix B deprive Kentucky-American of an opportunity to earn the 9.70 percent ROE awarded by the Commission. Specifically, Exhibit 1, page 9, Column C, shows that the $113,102,665 of water base revenues (Line 1) actually result in a ROE of 9.25 percent (Line 48) and not the Commission awarded 9.70 percent ROE.

Please refer to KAW_R_PSCRR_NUM003_061424_Attachment 2 for all supporting calculations and documentation in Excel spreadsheet format, with all formulas, columns, and rows unprotected and fully accessible, for Kentucky-American's Petition for Rehearing, Exhibit 2. Exhibit 2 provides the following:

a. Page 1 is a summary of the revenue requirement and revenue increase Kentucky-American has calculated that reflects the language of the Commission's Order.

b. Page 2 is a summary of the $489,426,491 of rate base that the Commission approved in its Order.

c. Page 3 is a summary of operating income, where moving left to right:

i. The first three (3) columns of numbers reflect the first three (3) columns from page 2 of Appendix A in the Commission's Order.

ii. The fourth column of numbers reflects Kentucky-American's corrections to remove the forecasted QIP revenues at present rates, a related adjustment to uncollectible accounts expense, and the corrections to tax expenses.

Remove forecasted QIP revenues at present rates: The forecasted QIP revenues at present rates can be found in Kentucky-American Application, Exhibit 37, Schedule M-3, by summing the QIP Surcharge revenue for each Customer Class for the Test Year at Present Rates.

Customer Class	Test Year at Present Rates	KAW_APP_EX37M_063023 Reference
Residential	$ 5,448,546	Page 8, Line 26
Commercial	2,628,841	Page 9, Line 21
Industrial	253,230	Page 10, Line 21
Other Public Authority	657,883	Page 11, Line 21
Sales for Resale	112,881	Page 12, Line 23
Miscellaneous	9,322	Page 13, Line 21
Private Fire	310,042	Page 14, Line 21
Public Fire	430,367	Page 14, Line 31
Total	**$ 9,851,113**	

QIP, like Kentucky-American's Kentucky River Authority ("KRA") Withdrawal Fee, is to be a separate tracked cost and revenue requirement outside of base rates, and accordingly, just as one does not see KRA Withdrawal Fees in either the present rate or proposed rate revenues in the rate case, the same should be true for QIP when removing the roll-in from base rates in this case.

Kentucky-American's May 16, 2024, Petition for Rehearing also raises the issue of a mistake the Commission made in determining tax expense. The adjustments reflected in Appendix A, page 2, of the Order result in an increase to taxable income which should result in an increase to overall State and Federal Income Tax Expense. However, the Commission's adjustments to tax expense actually reflect a decrease to tax expense, leaving the Ordered rates insufficient to cover Kentucky-American's income tax obligations. This can be seen in Exhibit 1, page 9, where the effective tax rate is 9.30 percent (line 50). The fourth column of Exhibit 2, page 3, reflects the adjustment necessary to align tax expense to the statutory rates.

Line No.	Description	Reference	Amount
1	Commission Revenue Adjustments	Appendix A, Page 2	$ (1,363,794)
2	Commission O&M Adjustments	Appendix A, Page 2	$ (3,001,638)
3	Commission Depreciation Adjustments	Appendix A, Page 2	$ (1,399,628)
4	Commission General Tax Adjustments	Appendix A, Page 2	$ (1,023,778)
5	Commission Rate Base Adjustment	Page 13 of Order	$ (98,971,075)
6	Weighted Average Cost of Debt	Page 26 of Order (0.04% + 2.16%)	2.20%
7	Commission Interest Expense Adjustment	Line 5 x Line 6	$ (2,177,364)
8	**Commission Adjusted Taxable Income**	**Line 1 less Sum of Lines 2-4 less Line 7**	**$ 6,238,614**
9	State Income Tax Rate		5.00%
10	State Income Tax Expense	Line 8 x Line 9	$ 311,931
11	Commission Pre-Tax Adjusted Income	Line 8	$ 6,238,614
12	Less: State Income Tax Expense	Line 10	$ (311,931)
13	Federal Taxable Income	Line 11 + Line 12	$ 5,926,683
14	Federal Income Tax Rate		21.00%
15	Federal Income Tax Expense	Line 13 x Line 14	$ 1,244,603

iii. The remaining three (3) columns of numbers show the corrected 1) forecast year at present rates, 2) adjustment for proposed ("increased") rates, and 3) forecast year at increased rates.

d. Page 4 provides the computation of the gross revenue conversion factor approved in the Commission's Order.

e. Page 5 provides the Commission's approved capital structure with the 9.70 percent awarded ROE reflected.

The key takeaway from Kentucky-American's Petition for Rehearing, Exhibit 2, is that the resulting base rates from this proceeding should produce $120,635,314 of Water Revenue (Page 3, Line 2), and those revenues, in combination with $2,505,393 of Other Revenues (Page 3, Line 3), will provide Kentucky-American Total Revenues of $123,140,707 (Page 1, Line 38 and Page 3, Line 5), equal to the Kentucky-American's costs as established in this proceeding, and provide Kentucky-American an opportunity to earn an authorized after-tax Rate of Return ("ROR") of 7.26 percent (Page 1, Line 24 and Page 5, Line 10) and awarded ROE of 9.70 percent (Page 5, Line 8) on its $489,426,491 of Net Original Cost Rate Base (Page 1, Line 23 and Page 2, Line 45).

Kentucky-American respectfully requests the Commission order new base rates as a result of this rehearing that can be validated in a revenue proof to produce $120,635,314 of Water Revenues from base rates and to make those new rates effective for service rendered on and after February 6, 2024. Alternatively, the Commission could, if it wishes to do so, order new rates as a result of this rehearing that can be validated in a revenue proof to produce $122,950,468 of Water Revenues from base rates (per Appendix A, page 2 of 2, of the Order) and to make those new rates effective for service rendered on and after February 6, 2024. Kentucky-American's recommendation, however, is to have new base rates designed to produce $120,635,314 of Water Revenues from base rates and to make those new rates effective for service rendered on and after February 6, 2024.

If the Commission finds it helpful, Kentucky-American is providing Exhibit 37, Schedules M-1, M2, M-3 and N, with rates validated in a revenue proof to produce $120,635,314 of Water Revenues in KAW_R_PSCRR_NUM003_061424_Attachment 3. Kentucky-American is also providing Exhibit 37, Schedules M-1, M2, M-3 and N, with rates validated in a revenue proof to produce $122,950,468 of Water Revenues in KAW_R_PSCRR_NUM003_061424_Attachment 4.

Witness: Jeffrey Newcomb

4. Refer to Kentucky-American's Petition for Rehearing, Exhibit 2, page 1. Explain why applying the gross-up factor to only the proposed increase is appropriate.

Response:

Kentucky-American's gross-up of the required after-tax net operating income ("NOI") increase is consistent with the Commission's past practice and its Order in Case No. 2018-00358, Kentucky-American's last general rate case. Kentucky-American's required after-tax NOI in this case is $35,532,363, as shown in Kentucky-American's Petition for Rehearing, Exhibit 2, Page 1, Line 26. One arrives at the required after-tax NOI by multiplying the Commissioned ordered $489,426,491 of Net Original Cost Rate Base (Exhibit 2, Page 1, Line 23 and Exhibit 2, Page 2, Line 45) by the after-tax rate of return of 7.26 percent (Exhibit 2, Page 1, Line 24 and Exhibit 2, Page 5, line 10). Comparing that required after-tax NOI to the after-tax NOI at present rates of $22,016,403 (Exhibit 2, Page 1, Line 28 and Exhibit 2, Page 3, Line 53), one arrives at the required after-tax NOI increase of $13,515,960 (Exhibit 2, Page 1, Line 30 and Exhibit 2, Page 3, Line 53), on which one applies the Gross Revenue Conversion Factor of 134.23 percent (Exhibit 2, Page 1, Line 32 and Exhibit 2, Page 4, Line 15), to calculate a required revenue increase of $18,142,476 (Exhibit 2, Page 1, Line 34 and Exhibit 2, Page 3, Line 1 and Line 5).

After accounting for the incremental uncollectible expense of $109,580 (Exhibit 2, Page 3, Line 29; $109,580 = $18,142,476 x 0.604 percent from Exhibit 2, Page 4, Line 2), PSC fee of $23,622 (Exhibit 2, Page 3, Line 48; $23,622 = $18,142,476 x 0.1302 percent from Exhibit 2, Page 4, Line 3), state income tax expense of $900,464 (Exhibit 2, Page 3, Line 42; $900,464 = ($18,142,476 - $109,580 - $23,622) x 5 percent statutory state income tax rate from Exhibit 2, Page 4, Line 7), and federal income tax expense of $3,592,850 (Exhibit 2, Page 3, Line 45; $3,592,850 = ($18,142,476 - $109,580 - $23,622 - $900,464) x 21 percent statutory federal income tax rate from Exhibit 2, Page 4, Line 11), the required revenue increase of $18,142,476 produces the required after-tax NOI increase of $13,515,960 ($13,515,960 = $18,142,476 - $109,580 - $23,622 - $900,464 - $3,592,850), proving that Kentucky-American's application of the 134.23 percent Gross Revenue Conversion Factor to the required after-tax NOI increase of $13,515,960 is appropriate.