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 FOR INSTALLATION OF ADVANCED METERING INFRASTRUCTURE, APPROVAL OF REGULATORY AND ACCOUNTING TREATMENTS, AND TARIFF REVISIONS	))))))))	**CASE NO. 2023-00191**

THE ATTORNEY GENERAL'S POST-HEARING BRIEF

The Intervenor, the Attorney General of the Commonwealth of Kentucky, through his Office of Rate Intervention ("Attorney General") submits the following Post-Hearing Brief to the Kentucky Public Service Commission ("Commission") in the above-styled matter.

STATEMENT OF THE CASE

Kentucky-American Water Company, Inc. ("Kentucky American" or the "Company") is a Kentucky corporation with its principal office and principal place of business in Lexington, Kentucky.[1] Kentucky American is a wholly-owned subsidiary of American Water Works Company, Inc. ("American Water").[2] Kentucky American is engaged in the distribution and sale of water to over 137,000 customers in its Central Division – Bourbon, Clark, Fayette, Harrison, Jessamine, Nicholas, Scott, and Woodford Counties; Northern Division – Gallatin, Owen, Grant, and Franklin Counties; and Southern Division – Rockcastle and Jackson Counties.[3] The Company

[1] Application at 1.
[2] *Id*. at 2.
[3] *Id*.; Direct Testimony of William A. Lewis ("Lewis Testimony") at 4.

owns, operates, and maintains potable water production, treatment, storage, transmission, and distribution systems to provide water for residential, commercial, industrial, and governmental users in its service territory.[4] In the pending case, Kentucky American forecasts 156 employees comprised of exempt, union hourly, and non-union hourly employees.[5] The Company has certain services such as accounting, customer service, engineering, legal, central lab testing services, human resources, etc. that are provided by American Water Works Service Company, Inc. ("Service Company"), which is an affiliated company.[6]

On May 31, 2023, Kentucky American filed its notice of intent to file an application for an adjustment of water rates with the Commission. The Company subsequently filed its application on June 30, 2023, utilizing a forward-looking test period ("forecast test year") beginning on February 1, 2024, and ending January 31, 2025.[7] The Company's base period is the twelve months beginning on October 1, 2022, and ending on September 30, 2023.[8] Specifically, the application requests an increase in water revenues of approximately \$26.1 million per year, not including the Qualified Infrastructure Program ("QIP") revenues.[9] In rebuttal testimony, and partially in response to the Attorney General's discovery, Kentucky American revised its requested rate increase down to \$25.6 million, which does not include the approximately \$9 million in QIP revenues.[10] According to Kentucky American, the revised requested rate increase equates to an approximately 22% increase in water revenues per year, net of QIP revenues.[11] The revised

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[4] Application at 2.
[5] Direct Testimony of John M. Watkins ("Watkins Testimony") at 3; Kentucky American's response to the Attorney General's First Request for Information ("Attorney General's First Request"), Item 78(a).
[6] Direct Testimony of Patrick L. Baryenbruch ("Baryenbruch Testimony") at 6 and Exhibit 4.
[7] Application at 2 -3.
[8] *Id*. at 3.
[9] *Id*.
[10] Rebuttal Testimony of Jeffrey Newcomb ("Newcomb Rebuttal") at 2; Video Transcript of Evidence ("VTE"), at 9:15:00 – 9:15:25.
[11] Newcomb Rebuttal at 2.

proposed revenue increase, net of QIP revenues, by customer classification are as follows: $13,875,856 or a 22.4% increase for the residential class; $6,825,344 or a 22.8% increase for the commercial class; $665,813 or a 23.1% increase for the industrial class; $1,716,679 or a 23.0% increase for the other public authority class; 259,481 or a 20.2% increase for the sales for resale class; $851,587 or a 24.1% increase for the private fire service and hydrants class; $1,159,966 or a 23.6% increase for the public fire hydrants class; $23,289 or a 21.9% increase for the miscellaneous ("Bulk Sales of Water through Loading Stations") class.[12]

Kentucky American's revised proposed water rate increase will increase the monthly bill for an average residential customer using 3,800 gallons of water to $49.56, which equates to an $8.79 increase, or a 22% increase.[13] Kentucky American is also requesting to increase the monthly customer charge for both the residential and commercial class from $15.00 to $20.00, or a 33% increase.[14] The Company further requests a Certificate of Public Convenience and Necessity ("CPCN") for Advanced Metering Infrastructure ("AMI") deployment; an expansion of the QIP from the current annual replacement of 10 – 13 miles of cast iron and galvanized steel mains to 27 – 34 miles of any type of main; deferral accounting; an alternative level of unaccounted for water loss; a Universal Affordability Tariff; tariff revisions; and, all other required approvals and relief.[15]

The Commission issued a deficiency letter on July 7, 2023, to which the Company filed a response on July 7, 2023. The Commission found that the application met the minimum filing requirements and it was deemed filed on July 7, 2023. The Attorney General was granted intervention on July 5, 2023. The other party who was granted intervention into the pending case

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[12] Kentucky American's response to the Attorney General's Post-Hearing Request for Information ("Attorney General's Post-Hearing Request"), Item 1, Updated Customer Notice.
[13] *Id*.
[14] *Id*.
[15] Application at 10 – 16; Direct Testimony of Krista E. Citron ("Citron Testimony") at 2 and 9.

is Lexington-Fayette Urban County Government ("LFUCG'). Following the Commission's issuance of a procedural schedule, the Commission Staff and the parties issued several rounds of discovery requests, to which Kentucky American filed responses into the record. On September 29, 2023, the Attorney General and LFUCG filed direct testimony into the record of their witness, Mr. Greg R. Meyer. The Attorney General also filed direct testimony into the record of his witness Richard A. Baudino. The Attorney General and LFUCG responded to both Commission Staff's and Kentucky American's discovery requests on November 2, 2023. The Company filed a base period update and rebuttal testimony on November 8, 2023. An evidentiary hearing was conducted during December 11 – 13, 2023. The Attorney General and LFUCG filed responses to post-hearing discovery requests on December 21, 2023, and Kentucky American filed responses to post-hearing discovery requests on December 22, 2023.

ARGUMENT

Pursuant to KRS 278.190(3), Kentucky American bears the burden of proof to demonstrate "that an increase of rate or charge is just and reasonable."[16] Kentucky American has failed to meet its burden.[17] The Attorney General recommends a downward adjustment to the revised requested $25.6 million revenue increase, net of QIP, because if the Company's application were accepted as is, then it would result in unjust, unfair, and unreasonable rates due to the following issues.

I. PROPOSED REVENUE REQUIREMENT ADJUSTMENTS

a. The Commission should exclude all costs associated with vacant employee positions.

Kentucky American is seeking to include costs associated with vacant employee positions

[16] *Kentucky-American Water Company v. Commonwealth ex rel. Cowan*, 847 S.W.2d 737, 741 (Ky. 1993).
[17] *See* KRS 278.190. "At any hearing involving the rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility…."; *See* KRS 278.030(1). "Every utility may demand, collect and receive fair, just and reasonable rates for the services rendered or to be rendered by it to any person."

in the pending rate case.[18] Specifically, the Company includes the costs of seven vacant employee positions, of which two of the positions are under review, and four of the positions were not to be posted until the fourth quarter of 2023.[19] Upon request, Kentucky American provided an update as to vacant employee positions in post-hearing discovery responses, and although a few of the initial vacant employee positions have been filled, it appears the number of overall vacant employee positions have increased to eight due to additional positions becoming vacant.[20] It would be inherently unfair to force Kentucky-American's customers to pay a water rate that includes vacant employee position costs because those costs are not currently being expended, are merely speculative, and there is no guarantee that the positions will be filled. Additionally, the Company admits in response to post-hearing discovery that from 2018 - 2023 it has not operated with zero vacancies for a full calendar year.[21] In other words, the fact that Kentucky American currently has vacant positions is in line with the Company's historical and normal operations. Since Kentucky American admits that it has historically not operated with zero vacancies, one must question the Company's assertion that employee vacancies necessarily lead to increased overtime hours.[22]

The Company contended in rebuttal testimony[23] and at the hearing[24] that the Commission has repeatedly denied the Attorney General's recommendation to exclude costs associated with vacant employee positions. Yet, Kentucky American fails to discuss the Commission's final Order in Case No. 2022-00147, in which the Commission stated that it agreed with the Attorney General's recommendation, and the utility's acceptance of the same, for the expense associated

[18] Kentucky American's response to the Attorney General's Second Request for Information ("Attorney General's Second Request"), Item 10.
[19] *Id*.
[20] Kentucky American's response to the Attorney General's Post-Hearing Request, Item 3.
[21] *Id*. at Item 4.
[22] Kentucky American's response to the Commission Staff's Post-Hearing Request ("Staff's Post-Hearing Request"), Item 3.
[23] Rebuttal Testimony of William A. Lewis ("Lewis Rebuttal") at 11 – 12.
[24] VTE 15:31:30 – 15:35:30.

with a vacant employee position to be eliminated from the revenue requirement.[25]

The Attorney General therefore requests removal of all costs associated with the vacant employee positions, including but not limited to salaries/wages and benefits, from the requested rate increase because if these costs were included it would not lead to fair, just, or reasonable rates for the customers.

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

Kentucky American is requesting full recovery of its incentive compensation costs in the amount of $712,961 in the pending case.[26] Kentucky American's parent company, American Water, offers an annual performance plan ("APP") and a long-term performance plan ("LTPP").[27] Both the non-union and union APPs are determined based on performance in five difference strategic areas: Growth, Customer, Safety, Environmental Leadership, and People. Each strategic area has specified goals required to be met, along with a weighting of each area in the composition of the total payout of incentives.[28] The largest single component for both the non-union and union APPs is in the Growth strategic area, weighted at 50% of the total.[29] The specified goal for the 2023 plan in the Growth area was to achieve an earnings per share target between $4.72 and $4.82.[30] The plan documents also state that, "[u]nder the 2023 APP, no awards will be issued if adjusted Earnings Per Share (EPS) is below 90% of the target." It should be noted that through post-hearing discovery responses Kentucky American asserts that American Water has removed

[25] Case No. 2022-00147, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates and a Certificate of Public Convenience and Necessity to Deploy Advanced Metering Infrastructure* (Ky. PSC Apr. 12, 2023), Order at 27.
[26] Kentucky American's response to the Commission Staff's First Request for Information ("Staff's First Request"), Item 33(a), 2023 Annual Performance Plan Attachment.
[27] *Id*.
[28] *Id*.
[29] *Id*.
[30] *Id*.

the EPS clause for the availability of APP payments to employees, but this relates only to the prohibition of payment under 90% of the EPS target – which remains a goal.[31] Eliminating this prohibition only makes it more likely that incentive awards to employees will be granted.

The LTPP is broken down into three different awards: 1) granting of restricted stock units ("RSUs") accounts for 30% of the award program, 2) granting of performance stock units ("PSUs") accounts for 35% based on total shareholder return ranking among peer companies, and, 3) granting of PSUs based on earnings per share growth accounts for 35% of the program.[32]

The Attorney General recommends removing the 50% of the APP that is driven by earnings per share and to remove the entirety of the LTPP, because these portions are tied to financial metrics that primarily benefit the shareholders and do not provide measurable benefits to the ratepayers. Due to the shareholders being the primary beneficiaries of these programs, it is appropriate to assign the funding of the same to the shareholders.

The Company argues in its rebuttal testimony that the financial measures of the APP and LTPP serve to align the interests of the customers, employees, and investors.[33] This argument falls flat because incentive compensation tied to financial measures that incentivize achievement of shareholder goals for maximizing return on their investments, is in direct contradiction to ratepayer goals of improved service, safety, and reduced rates. Kentucky American also fails to provide any Commission precedent that supports their request to require customers to pay for incentive compensation tied to financial metrics in rates. In fact, the Commission has long-standing precedent of disallowing recovery of these costs.[34] In Kentucky American's last rate case, the

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[31]Kentucky American's response to the Commission Staff's Post-Hearing Request for Information ("Staff's Post-Hearing Request"), Item 13.
[32] Kentucky American's response to the Staff's First Request, Item 33(a), 2023 Annual Performance Plan Attachment.
[33] Lewis Rebuttal at 7.
[34] Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 43; Case No. 2020-00160, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates* (Ky. PSC Dec. 8, 2020), Order at 19 – 20; Case No. 2014-00396,

Commission stated that it has, "consistently disallowed recovery of the cost of employee incentive compensation plans that are tied to financial measures because such plans benefit shareholders while ratepayers receive little benefit."[35] Based upon the foregoing, the customers should not be forced to pay for incentive compensation that is directly tied to financial metrics. Instead, these costs should be borne by shareholders.

The Attorney General therefore requests the Commission follow its long-standing precedent to exclude the Company's incentive compensation that is tied to financial metrics from the revenue requirement.

c. The Commission should deny Kentucky American's request to include credit card processing fees and electronic check fees in the revenue requirement.

Currently, the Company requires customers who pay the water bill with a credit card or an electronic check to pay a $1.95 fee.[36] However, in its application Kentucky American requests to become the first investor-owned utility in Kentucky to waive the payment processing fees assessed to customers who pay their water bills with a credit card,[37] and to instead include these fees in the proposed revenue requirement.[38] In the original application, Kentucky American included $349,284 in credit card processing fees, $5,406 for cash/check via third-party location payments, and $28,374 for Lock Box which includes direct debit payments in the revenue requirement.[39] In the rebuttal testimony, Kentucky American asserts that it updated and added $73,359 in electronic check processing fees because it had come to the Company's attention that these fees had been

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Application of Kentucky Power Company for: (1) A General Adjustment of its Rates for Electric Service; (2) An Order Approving its 2014 Environmental Compliance Plan; (3) An Order Approving its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief (Ky. PSC June 22, 2015), Order at 25.

[35] Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 43.

[36] Kentucky American's response to the Attorney General's First Request, Items 35(b) and (d).

[37] *Id*. at Item 35(a). The Company asserts that, "it is not aware of investor-owned utilities in Kentucky that do not charge a fee to customers who pay their bill using a credit card."

[38] Testimony of Jeffrey Newcomb ("Newcomb Testimony") at 13.

[39] Kentucky American's response to the Attorney General's First Request, Item 35(a).

omitted from the original application.[40] But, in Kentucky American's base period update, the adjustment for electronic check processing fees was listed as $98,470.[41]

Although there is a cost of processing all forms of bill payment, the monetary amount proposed to be included in the revenue requirement to process credit card and electronic check payments is substantially higher than all other payment processing amounts combined. Thus, if Kentucky American's proposal is approved by the Commission, then the customers who pay their water bill with a cash or check, which has limited processing fees, will essentially be subsidizing the customers who utilize a credit card or electronic check to pay their water bill, to which much larger processing fees are applicable. It is possible that if the Company begins to waive the fee to pay a water bill with a credit card then it will entice even more customers to pay with a credit card in order to increase points and rewards associated with various credit card loyalty programs. Consequently, in the pending case the proposed credit card processing fee is $349,284, but in the next rate case that amount could significantly increase.

According to a publication by the Federal Reserve, "[a]lmost all people with income of at least $100,000 had a credit card," and most people with income over $50,000 have a credit card, but at lower income levels having a credit card was less common.[42] Based upon the Federal Reserve publication, 43% of people with family income less than $25,000 do not have a credit card.[43] Due to low-income customers having more difficulty obtaining credit cards,[44] if Kentucky American is allowed to include credit card processing fees in the revenue requirement, then the low-income customers who can least afford it, and in which 43% do not have access to a credit

[40] Newcomb Rebuttal at 4.
[41] Kentucky American Base Period Update, Exhibit 37, Summary of Forecast Year Revisions filed November 2023.
[42] *See* Federal Reserve, Report on Economic Well-Being of U.S. Households in 2022 – May 2023, https://www.federalreserve.gov/publications/2023-economic-well-being-of-us-households-in-2022-banking-credit.htm.
[43] *Id*.
[44] *Id*.

card, will be subsidizing higher income customers' use of credit cards through the water rates.

Moreover, the Commission should disallow the addition of the electronic check processing fees through the base period update as it is in violation of Commission regulation. Pursuant to 807 KAR 5:001, Section 16(6)(d), "[a]fter an application based on a forecasted test period is filed, there shall be no revisions to the forecast, except for the correction of mathematical errors, unless the revisions reflect statutory or regulatory enactments that could not, with reasonable diligence, have been included in the forecast on the date it was filed …"[45] Kentucky American's omission to include the electronic check processing fees in the original application was not a mathematical error, nor was the omission related to statutory or regulatory enactments. The proposed electronic processing fees should be disallowed from the Company's revenue requirement on this basis alone.

The Attorney General recommends that Kentucky American's request to include the credit card and electronic check processing fees in the revenue requirement be denied. The Company can continue to allow customers to pay water bills with credit cards and electronic checks as long as the customer pays 100% of the corresponding fee that is assessed to the Company.[46] If the Commission were to accept this recommended adjustment then it would reduce the Company's revenue requirement by $447,754.

d. The forecasted residential class revenues are understated and should be increased in order to lead to fair, just, and reasonable rates.

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[45] https://apps.legislature.ky.gov/law/kar/titles/807/005/001/.

[46] *See* https://www.duke-energy.com/home/billing/billing-payment-options (Duke Energy Kentucky assesses a "small fee" to a residential customer paying a utility bill with a credit card, debit card, or electronic check.); https://www.kentuckypower.com/account/bills/pay/compare (Kentucky Power Company assesses a $1.85 fee for a residential customer to pay a utility bill with a credit card, debit card, or ATM card.); https://lge-ku.com/residential/payment (Louisville Gas and Electric and Kentucky Utilities charge an additional fee to a residential customer paying a utility bill with a credit card, PayPal, Amazon Pay, Apple Pay, Google Pay, Paypal Credit, or Venmo.); https://www.columbiagasky.com/bills-and-payments/pay-my-bill (Columbia Gas of Kentucky assesses a $2.00 fee to a residential customer paying a utility bill with a credit card, debit card, PayPal, Venmo, or Amazon Pay); https://mountainwaterdistrictky.com/Default.aspx (Mountain Water District assesses a $2.00 fee to a residential customer paying a utility bill with a credit card, and a $1.50 fee to use an e-check.)

In the pending application, Kentucky American forecasted the revenues using statistical modeling of water use per customer as well as assumptions regarding customer growth.[47] Although the Company's proposed average number of residential customers appear reasonable, the proposed average usage of water per residential customer used to annualize the residential revenues is unreasonable.[48] The residential class revenues forecasted by Kentucky American are understated, which in turn unnecessarily inflates the proposed rate increase.[49] Kentucky American's historical residential customer water usage in 2018 was 5.646 billion gallons, 5.932 billion gallons in 2019, 6.073 billion gallons in 2020, 5.875 billion gallons in 2021, and 5.987 billion gallons in 2022.[50] But, for the forecasted test period, the Company only proposes residential water usage of 5.748 billion gallons, which would be the lowest level of water sold to the residential class since 2018.[51] The Company's historical water usage per residential customer is much higher than that proposed for the forecasted test year. The water usage per residential customer in 2018 was 47,300 gallons, 49,140 gallons in 2019, 49,770 gallons in 2020, 47,730 gallons in 2021, and 48,270 gallons in 2022.[52] Yet, Kentucky American proposes an estimated residential customer water usage of 45,620,[53] which is significantly lower than the historical residential average water usage.

In order to reflect normal operations and to arrive at appropriately forecasted residential class revenues, the residential customer water usage should be increased.[54] The level of water usage per residential customer should be based on a three-year average from 2020 – 2022, which would equate to 48,590 gallons per residential customers.[55] The Company argues that its

[47] Rebuttal Testimony of Charles B. Rea ("Rea Rebuttal") at 1 – 2.
[48] *Id*. at 20.
[49] Direct Testimony of Greg R. Meyer ("Meyer Testimony") at 19.
[50] Kentucky American's Application, Exhibit 37, Schedule I-4; Meyer Errata Testimony at 21.
[51] Meyer Testimony at 21.
[52] Meyer Errata Testimony at 21; Kentucky American's Application, Exhibit 37, Schedule I-4.
[53] Meyer Testimony at 21.; Kentucky American's Application, Exhibit 37, Schedule M-3.
[54] Meyer Testimony at 22.
[55] *Id*.

forecasted residential customer water usage was normalized for weather and other external influences such as the Covid-19 pandemic.[56] However, basing the residential customer average water usage on an average of recent past sales is a good representation of the actual customer usage. Additionally, a multi-year average is also a form of weather normalization as the impact of each year's variation is reduced. A residential customer average usage of 48,590 gallons is much more reasonable than the Company's proposed 45,620 gallons when compared to Kentucky American's actual historical residential customer average usage.

If the Commission were to accept this recommendation, then it would increase the test year residential class revenues by approximately $2.2 million.[57] But, based on an offset of $280,143 for additional chemical, fuel, and power expenses related to the proposed increased water sales, the resulting reduction to the Company's revenue requirement would be approximately $1.8 million.[58]

e. The Commission should deny Kentucky American's request for an alternative level of unaccounted-for water loss of 20% to be established because the Company did not meet its burden as required by 807 KAR 5:066, Section 6(3).

Kentucky American requests an alternative level of unaccounted-for water loss of 20% to be established for ratemaking purposes,[59] which based upon the Attorney General's calculations would increase the Company's revenue requirement by approximately $522,333.[60] Unaccounted-for water loss is water that is purchased or produced, but is lost through leaks or unauthorized usage in the distribution system.[61] 807 KAR 5:066, Section 6(3), provides the Commission's standard for unaccounted-for water loss as follows:

[56] Rea Rebuttal at 4.
[57] Meyer Testimony at 22.
[58] *Id*.
[59] Application at 14.
[60] Meyer Testimony at 26.
[61] *Id*. at 23.

> For rate making purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water used by a utility in its own operations. Upon application by a utility in a rate case filing or by separate filing, or upon motion by the commission, 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.[62]

First and foremost, the Attorney General is unaware of any water utility in Kentucky that has been granted an alternative level of unaccounted-for water pursuant to 807 KAR 5:066, Section 6(3). Notably, when asked in discovery whether Kentucky American relied upon any Commission precedent when requesting a deviation from the 15% unaccounted-for water loss, the Company did not provide one single case of a water utility receiving such deviation.[63] It would be unreasonable for a large, sophisticated, investor-owned company such as Kentucky American to be allowed a 20% unaccounted-for water loss while the smaller, less sophisticated water districts and water associations across the state are held to the 15% unaccounted-for water loss standard.

Second, Kentucky American contends that it has approximately 270 special connections with over 90 miles of private mains connected to the Company's distribution system that are a "significant contributor" to the unaccounted-for water loss.[64] The term special connection is used by Kentucky American to describe a point of demarcation between its water mains and a private water main that is not metered.[65] Examples of special connections are private mains owned and maintained by farms, apartment complexes, or commercial properties.[66] According to Kentucky American, initially special connections were thought to be favorable because the Company did not have to make a capital contribution nor maintain the private mains, but over time, leaks developed

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[62] https://apps.legislature.ky.gov/law/kar/titles/807/005/066/.
[63] Kentucky American's response to the Attorney General's Second Request, Item 24.
[64] Rebuttal Testimony of Shelley W. Porter ("Porter Rebuttal") at 2 – 3.
[65] Lewis Testimony at 34.
[66] *Id*.

and the private owners did not make the appropriate repairs.[67] Making matters worse is that a special connection does not have a water meter at the connection to the private main.[68] Consequently, instead of the water loss being the financial responsibility of the special connection customer, any water loss within the private main is reflected as Kentucky American's water loss.[69]

The Company has performed limited surveys on the special connection water loss issue,[70] and in rebuttal testimony discusses potential ways to work with the special connection customers to reduce the unaccounted-for water loss such as through master metering.[71] Yet, even though Kentucky American declares that these special connections are a "significant contributor"[72] to unaccounted-for water loss, the Company also admits that it has not implemented any formal plan to address this major issue.[73] If Kentucky American worked with the special connection customers to resolve these issues, then a "significant contributor" to the unaccounted-for water loss would be resolved. It would be unfair to allow Kentucky American to establish a 20% instead of a 15% unaccounted-for water loss, which will require the Company's customer base to pay increased water rates, when Kentucky American alone has the ability to rectify the significant unaccounted-for water loss associated with the special connection customers.

Thus, the Attorney General recommends the Commission deny Kentucky American's request for an alternative level of unaccounted-for water loss of 20% to be established for ratemaking purposes because pursuant to 807 KAR 5:066, Section 6(3), the Company has not met its burden to demonstrate that the alternative level is more reasonable than the prescribed 15% level. If the Commission were to accept this recommendation based upon the Attorney General's

[67] *Id*. at 35.
[68] *Id*.
[69] *Id*.
[70] Porter Rebuttal at 4 – 9.
[71] *Id*. at 10 – 12.
[72] *Id*. at 2 – 3.
[73] Kentucky American's response to the Attorney General's Second Request, Item 21; VTE at 11:43:00 – 11:43:40.

calculations, this adjustment would decrease the Company's revenue requirement by approximately $522,333.

f. The Commission should exclude food expense and business development costs from Kentucky American's revenue requirement.

Kentucky American includes miscellaneous expenses associated with food, gifts, promotional items, charitable donations, membership dues, and business development costs in its revenue requirement.[74] The Company asserted in response to discovery that it had inadvertently included some expenses related to gifts, promotional items, and specific membership dues and removed those amounts in its base period update.[75] However, Kentucky American asserts that the $5,699 in food expenses were appropriate to keep in the revenue requirement because it is "de minimis,"[76] but did not provide sufficient details to justify why these expenses should be allowed inclusion based upon Commission precedent.[77]

Further, Kentucky American includes $180,082 in direct labor business development costs and $106,069 in service company business development costs in the revenue requirement,[78] even though in its last rate case the Commission disallowed the latter costs. In Case No. 2018-00348, the Commission stated that, "[a]s with the Commission's previous decision concerning business development costs, it is the Commission's belief that external affairs and public policy costs enhance shareholder value but do not benefit ratepayers, and therefore should not be costs borne by ratepayers."[79] Kentucky American attempts to argue that the business development activities,

[74] Meyer Testimony at 27.
[75] *Id.*; Kentucky American's response to the Attorney General's Second Request, Item 13; Newcomb Rebuttal at 7.
[76] Newcomb Rebuttal at 7; Kentucky American's response to the Attorney General's Second Request, Item 13.
[77] *See* Case No. 2003-00433, *An Adjustment of the Gas and Electric Rates, Terms, and Conditions of the Louisville Gas and Electric Company* (Ky. PSC June 30, 2004), Order at 49–52; Case No. 2003-00434, *An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company* (Ky. PSC June 30, 2004), Order at 42–45.
[78] Kentucky American's response to the Attorney General's Second Request, Item 15(a).
[79] Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 40 – 41.

and therefore the associated costs, benefit customers "directly and indirectly" by mitigating the costs to be recovered per customers, enhancing purchasing power, and spurring activities that contribute to the local economies.[80] These general assertions made by the Company do nothing to disprove the Commission's prior finding that Kentucky American's business development costs enhance shareholder value, do not benefit the ratepayers, and therefore the costs should not be borne by the ratepayers. Nor does the Company provide any evidence suggesting that customer growth can be definitively proven to be the result of these business costs or efforts.

Thus, the Attorney General requests the Commission to deny inclusion of all proposed business development costs from the Company's revenue requirement.

g. Kentucky American's cash working capital calculation is excessive and should be reduced in order to achieve fair, just, and reasonable rates.

In the application, Kentucky American includes $3,141,000 in cash working capital based upon a lead/lag study. In rebuttal testimony, Kentucky American increased its cash working capital request to $3,181,000.[81] The Company's lead/lag study includes noncash items such as depreciation, amortization, regulatory expense, uncollectibles, deferred income taxes, and net income.[82]

The most problematic and glaring issue with the Company's lead/lag study is that it does not comply with recent Commission precedent to exclude all noncash items and balance sheet adjustments.[83] In the final Order in Case No. 2021-00183, the Commission stated that it, "places Columbia Kentucky and ***all other utilities*** on notice that in any future rate cases, a lead/lag study

[80] Rebuttal Testimony of John M. Watkins ("Watkins Rebuttal") at 7 – 8.
[81] Rebuttal Testimony of Harold Walker, III ("Walker Rebuttal") at 3 – 4.
[82] Meyer Testimony at 32.
[83] Walker Rebuttal at 8 – 14.

is to be performed and shall exclude noncash items and balance sheet adjustment."[84] Kentucky American's witness acknowledged through rebuttal testimony and at the evidentiary hearing that he had read the final Order in Case No. 2021-00183, but he inexplicably did not believe that the Commission's directive to exclude noncash items from lead/lag studies was applicable to Kentucky American.[85] The Company witness further admitted at the evidentiary hearing that the lead/lag study submitted in the pending case was not in compliance with the Commission's directive from Case No. 2021-00183, and did include noncash items.[86] Interestingly, the Company's witness also confirmed that he has filed lead/lag studies in Missouri on behalf of Missouri-American Water, an affiliate of Kentucky American, which excluded noncash items.[87]

The second issue with the Company's lead/lag study is that it allows for the Kentucky American's affiliated Service Company charges to be treated as a prepayment.[88] In the lead/lag study, the Company lists the expense lead for Service Company charges as a negative 5.3 days.[89] In other words, this lag would assume that Kentucky American must pay its own Service Company 5.3 days before services are rendered.[90] In rebuttal testimony, Kentucky American states that prepayment of Service Company charges does not produce a profit on services, but does reduce the cost of services provided. Yet, Kentucky American does not provide any examples of how prepaying the Service Company charges reduces the cost of services provided. The Service Company charges should be billed to subsidiaries in the same manner as other outside providers –

[84] Case No. 2021-00183, *Electronic Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates; Approval of Depreciation Study; Approval of Tariff Revisions; Issuance of a Certificate of Public Convenience and Necessity; and Other Relief* (Ky. PSC Dec. 28, 2021), Order at 14 (emphasis added).
[85] Walker Rebuttal at 15.
[86] VTE 10:30:20 – 10:30:33.
[87] VTE 10:28:50 – 10:29:15; Meyer Testimony at 33 – 34.
[88] Meyer Testimony at 35.
[89] *Id*.
[90] *Id*.

after the services have been provided.[91] Hence, the Service Company charges should receive the same expense lead as the outside contracted service charges, which is 25.60 days.[92]

For these reasons, the Attorney General recommends that the Commission follow its precedent and remove all noncash items from the lead/lag study, as well as adjust the expense lead days for the Service Company charges to match the contracted service expense lead days. The effect of this recommendation would create a negative $4,961,885 cash working capital, and reduce the Company's proposed revenue requirement by $702,812.[93]

II. COST OF CAPITAL ISSUES

a. Return on Equity

Based upon the direct testimony of Kentucky American's witness Ms. Ann E. Bulkley ("Ms. Bulkley"), the Company proposes an inflated and unreasonable 10.75% return on equity,[94] while the Attorney General's witness Mr. Baudino recommends a reasonable 9.40% allowed return on equity.[95]

Mr. Baudino's recommended return on equity of 9.40% is primarily based on the results of a discounted cash flow ("DCF") analysis as applied to a proxy group of eleven water, gas, and electric companies that was used by Ms. Bulkley.[96] The DCF analysis is Mr. Baudino's standard constant growth form of the model that employs growth rate forecasts from the following sources: Value Line Investment Survey, Yahoo! Finance, and Zacks.[97] Mr. Baudino also performed Capital Asset Pricing Model ("CAPM") analyses using both historical and forward-looking data, and the

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[91] *Id*.
[92] *Id*.; Walker Rebuttal at 5.
[93] Meyer Testimony at 36.
[94] Direct Testimony of Ann E. Bulkley ("Bulkley Testimony") at 7 and 62; Direct Testimony of Richard A. Baudino ("Baudino Testimony") at 4.
[95] Baudino Testimony at 3 and 17.
[96] *Id*. at 3.
[97] *Id*. at 15.

results support the reasonableness of his recommended 9.40% return on equity.[98]

Mr. Baudino utilized the following proxy group for purposes of his return on equity analyses: Atmos Energy Corporation; NiSource, Inc.; Northwest Natural Gas Company; ONE Gas, Inc.; Spire, Inc.; Eversource Energy; American States Water Company; California Water Service Group; Middlesex Water Company; SJW Group; and Essential Utilities, Inc.[99] This is the same proxy group of utilities that Kentucky American's witness Ms. Bulkley used for her analysis.[100]

Mr. Baudino's DCF analysis as applied to the proxy group resulted in the average growth rate range of 8.67% - 9.94%, with an average of 9.07%.[101] The DCF analysis based upon the median growth rates resulted in a range of 8.41% - 9.52%, with the average of 9.04%.[102] Mr. Baudino's CAPM analysis as applied to the proxy group resulted in a historical risk premium range of 8.64% to 10.04%, the range based on the Kroll and Damodaran market risk premiums ("MRPs") were 8.20% - 8.75%, and the forward-looking estimate was 12.77%.[103] However, as Mr. Baudino discusses in his testimony, the forward-looking CAPM return on equity of 12.77% is implausibly high and represents an extreme outlier due to an unsustainably high growth rate for the market of 12.47%.[104] Given recent forecasts of long run Gross Domestic Product ("GDP") growth of 4.0%, a 12.47% constant growth rate simply cannot be sustained indefinitely.[105]

Hence, pursuant to the DCF analysis, and supported by his CAPM analysis, Mr. Baudino recommends that the Commission adopt a return on equity range of 8.70% - 10.00% for the water operations of Kentucky American.[106] Based upon these results, and in consideration of current

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[98] *Id*. at 3.
[99] *Id*. at Exhibit RAB-3 and Exhibit RAB-4.
[100] Bulkley Testimony at 27.
[101] Baudino Testimony at 21.
[102] *Id*.
[103] *Id*. at 31 – 32.
[104] *Id*. at 33.
[105] *Id*.
[106] *Id*. at 3, Table 1 – Summary of Return on Equity Estimates.

financial market conditions, Mr. Baudino more specifically recommends a return on equity for Kentucky American of 9.40%, which is near the midpoint of the recommended range.[107] The 9.40% recommended return on equity is reasonable for a relatively low-risk regulated water utility investment such as Kentucky American,[108] even when considering uncertainty inherent in the market at this time.[109]

As Mr. Baudino's testimony demonstrates, Ms. Bulkley's recommended return on equity of 10.75% significantly overstates the investor-required return for regulated water utilities,[110] and is inconsistent with current financial market evidence, even when considering the increase in interest rates in 2023.[111] Ms. Bulkley concluded that a reasonable return on equity range was 10.00% - 11.00%.[112] Ms. Bulkley stated that after taking into consideration the current conditions in the capital markets, elevated inflationary pressures, the need to recover flotation costs, and Kentucky American's risk profile, she recommends a return on equity of 10.75% from the aforementioned range.[113]

Ms. Bulkley utilized the DCF, CAPM, and Empirical Capital Asset Pricing Model ("ECAPM") to evaluate a rate of return for Kentucky American in the pending case.[114] In the first model, Ms. Bulkley's DCF analyses yielded an average growth rate range of 9.28% to 9.97% for the proxy group.[115] Although Mr. Baudino did not have any major criticism for Ms. Bulkley's

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[107] Baudino Testimony at 32 – 33.
[108] *Id*.
[109] *See* Baudino Testimony at 4 – 15, wherein he thoroughly reviews the current economic conditions.
[110] Baudino Testimony at 37 – 45.
[111] *Id*. at 32.
[112] *Id*. at 31.
[113] Bulkley Testimony at 62; *See* Ann E. Bulkley Rebuttal Testimony ("Bulkley Rebuttal") at 2. In Ms. Bulkley's rebuttal testimony she continues to recommend a 10.75% return on equity for Kentucky American.
[114] Baudino Testimony at 36.
[115] Bulkley Testimony at 38; *See* Bulkley Rebuttal at 14. Ms. Bulkley provided the updated DCF results in her rebuttal testimony, with an average return on equity range of 8.69% to 11.10%, and a median DCF return on equity range of 8.69% to 10.96%.

DCF analyses, he noted that even though Ms. Bulkley used growth rates from Value Line, Yahoo! Finance, and Zacks to develop her DCF return on equity estimates, she should have considered Value Line's dividend growth forecast as well as earnings growth.[116] Mr. Baudino noted that his DCF results were much lower than Ms. Bulkley's results because in Ms. Bulkley's analysis the Yahoo! Finance earnings growth rate was 6.42%, with a median of 6.65%, while in Mr. Baudino's analysis the updated Yahoo! Finance earnings growth rate was 5.66% with a median of 5.40%.[117]

The second model utilizing Ms. Bulkley's CAPM analyses produced an excessive return on equity range of 9.76% - 10.53%.[118] Ms. Bulkley only used one source to estimate her recommended MRP, which was based on a DCF analysis applied to the companies in the S&P 500.[119] The total return on the market of 12.0% was based on a dividend yield of 1.73% and a long-term earnings growth rate of 10.19%.[120] This led to an MRP range of 8.1% to 8.31%, which is overstated and leads to an overestimation of the CAPM return on equity.[121]

The primary problem with Ms. Bulkley's CAPM analysis is her sole reliance on a forward-looking market return for the S&P 500.[122] Ms. Bulkley's projected market return of 12% is overstated due to reliance on an average Value Line long-term projected growth rate of 10.19%, which is unsustainable in the long run.[123] The Value Line 3 – 5 year projected growth rates that are unsustainable in the long run, and vastly exceed both the historical capital appreciation for the S&P 500, as well as historical and projected GDP growth rates.[124] Ms. Bulkley's earnings growth

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[116] Baudino Testimony at 37.
[117] *Id*. at 38.
[118] *Id*. at 34; *See* Bulkley Rebuttal at 14. Ms. Bulkley provided the updated CAPM results in her rebuttal testimony, with the CAPM return on equity range of 9.88% - 10.86%.
[119] Baudino Testimony at 39.
[120] *Id*.
[121] *Id*.
[122] *Id*.
[123] *Id*.
[124] *Id*. at 39 – 40.

forecasts are even more unsustainable when considering both the historical and forecasted GDP growth for the United States, which was 6.1% from 1929 – 2022.[125] Importantly, the 6.1% GDP growth rate matched the historical compound growth rate for capital appreciation for the S&P 500.[126]

The use of an unsustainably high growth rate directly translates to overstated expected MRPs, and the CAPM return on equity result.[127] Ms. Bulkley's overstated MRPs is yet another issue with her CAPM analysis.[128] As Mr. Baudino asserts in his testimony, Kroll recommends an MRP of 5.5%, the average of the Damodaran MRPs is 4.82%, and the historical MRPs range from 5.37% - 7.10%.[129] Ms. Bulkley's lowest MRP of 8.1% significantly exceeds the historical MRP of 7.10%, which is likely overstated itself.[130]

Ms. Bulkley also employed an ECAPM analysis as an alternative to the traditional CAPM, but this is not a reasonable method to use to estimate the investor required return on equity.[131] The ECAPM is designed to account for the possibility that the CAPM understates the return on equity for companies with betas less than 1.0.[132] The argument that an adjustment factor is needed to correct the CAPM results for companies with betas less than 1.0 is further evidence of the lack of accuracy inherent in the CAPM itself and with betas in particular.[133] The ECAPM also suggests that published betas by sources such as Value Line are incorrect and that investors should not rely on them in formulating their estimates using the CAPM. Finally, although Ms. Bulkley cited the source of the ECAPM formula she used, no evidence was provided that investors favor this version

[125] *Id*. at 40.
[126] *Id*.
[127] *Id*. at 41.
[128] *Id*.
[129] *Id*.
[130] *Id*.
[131] *Id*. at 42.
[132] *Id*.
[133] *Id*.

over the standard CAPM. As such, Ms. Bulkley's ECAPM analysis and findings should be rejected.

Ms. Bulkley also presents alleged risks and other considerations that she believes should be considered when setting the allowed cost of equity for Kentucky American, which includes the following: flotation costs, capital expenditure program, environmental and water quality regulation, and the regulatory environment.[134] First, the Commission has consistently disallowed flotation costs to be included in the allowed return on equity for regulated utilities, and Ms. Bulkley provides no new evidence that should cause the Commission to deviate from precedent.[135] Second, the Commission should not increase Kentucky American's return on equity due to its capital expenditure program because only the Company can manage its expenditures and the timing of rate cases to ensure that it collects the cost of providing service to the customers, while maintaining a competitive return on its investments.[136] Additionally the use of a forecasted test year, and its currently approved QIP, both help mitigate the risk of the capital expenditure program.[137] Third, the Commission should not increase Kentucky American's return on equity based on environmental and water quality regulations, because there are no additional risks for Kentucky American when compared to the proxy group.[138] As pointed out in an American Water Investor Presentation,[139] Kentucky American and American Water operate low business risk regulated water operations, and American Water currently maintains strong and stable investment grade credit ratings of A/Baa1.[140] Fourth, the Commission should not increase Kentucky American's

[134] *Id*. at 43.
[135] Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC May 19, 2022), Order at 48.
[136] Baudino Testimony at 44.
[137] *Id*.
[138] *Id*.
[139] *Id*. at Exhibit RAB-2.
[140] Baudino Testimony at 44 – 45.

return on equity because Kentucky's rank by the Regulatory Research Associates ("RRA") was lowered from an Average/1 to an Average/2.[141] Ms. Bulkley provides no basis or analysis as to why Kentucky's RRA ranking being lowered by one notch should have any impact on Kentucky American's return on equity.[142]

Based upon the foregoing, Commission approval of Kentucky American's overly inflated return on equity proposal of 10.75% would cause rates to increase to an unreasonable level and harm ratepayers.[143] Thus, the Attorney General requests the Commission to adopt Mr. Baudino's reasonable recommendation of a 9.40% return on equity for Kentucky American.[144] If the Commission accepts Mr. Baudino's proposed return on equity of 9.40% then it will reduce Kentucky American's requested rate increase by approximately $5,608,705 million.[145]

b. Capital Structure

In the application, Kentucky American's witnesses, Mr. Nicholas Furia ("Mr. Furia") and Ms. Bulkley, recommends a capital structure for the Company consisting of 52.45% common equity, 46.21% long-term debt, 0.96% short-term debt, and 0.38% preferred stock.[146] Kentucky American's proposed cost of long-term debt in the original application is 4.681% short-term debt is 3.818%, and preferred stock is 8.51%.[147] Mr. Baudino accepts the proposed costs of the long-term and short-term debt rates, as well as the preferred stock rate, as filed in the original application, but recommends the Commission deny Kentucky American's proposed capital

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[141] *Id*. at 45.
[142] *Id*.
[143] *Id*. at 4.
[144] *Id*. at 3.
[145] Attorney General and LFUCG's response to Kentucky American's Post-Hearing Request for Information ("Kentucky American's Post-Hearing Request"), Item 2.
[146] Baudino Testimony at 33; Bulkley Testimony at 58; Direct Testimony of Nicholas Furia ("Furia Testimony") at 4; Rebuttal Testimony of Nicholas Furia ("Furia Rebuttal") at 7, Table 4. Mr. Furia updates the recommended capital structure in his rebuttal testimony to 52.219% common equity, 45.868% long-term debt, 1.537% short-term debt, and 0.376% preferred stock.
[147] Baudino Testimony at 33; Application, Schedule J-1.

structure.[148] In Mr. Baudino's expert opinion, the common equity ratio of 52.45% is clearly excessive when compared to Kentucky American's recent historical common equity percentages, which ranged from a low of 46.9% in 2019 to a high of 49.3% in 2022.[149] Thus, Mr. Baudino recommends the Commission adopt a capital structure consisting of 48.66% long-term debt, 50% common equity, 0.96% short-term debt, and 0.38% preferred stock.[150] Mr. Baudino's proposed capital structure is consistent with the Company's 2022 common equity ratio and significantly higher than its common equity ratios over the last five years.[151] Kentucky American's requested common equity ratio of 52.45% would inflate the revenue requirement for Kentucky ratepayers.[152]

The Attorney General requests the Commission to adopt Mr. Baudino's capital structure recommendation of 48.660% long-term debt, 50% common equity, 0.960% short-term debt, and 0.380% preferred stock.[153] If the Commission accepts Mr. Baudino's proposed capital structure then it will reduce the requested rate increase by approximately $1,124,863 million.[154]

III. ADDITIONAL RECOMMENDATIONS OF THE ATTORNEY GENERAL

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

Kentucky American requests a CPCN for cellular AMI deployment throughout its service territory.[155] The Company also proposes a tariff provision to allow customers to opt out of AMI if willing to pay a $28 monthly fee.[156] According to Kentucky American, the cost benefit analysis

[148] Baudino Testimony at 33 – 34.
[149] *Id*. at 34.
[150] *Id*. at 35.
[151] *Id*.
[152] *Id*.
[153] *Id*. at 35.
[154] Attorney General and LFUCG's response to Kentucky American's Post-Hearing Request, Item 2.
[155] Application at 10 – 11.
[156] *Id*.

that the Company conducted supports the requested AMI deployment.[157] Kentucky American also contends that deploying AMI could provide cost savings to customers,[158] although none of those savings are included in the pending revenue requirement.[159]

The Commission should deny Kentucky American's request for a CPCN to deploy AMI in its water system because the Company failed to meet the burden of proof as required by KRS 278.020(1). In order to obtain a CPCN, a utility must demonstrate a need for such facilities and an absence of wasteful duplication.[160] The "need" requires a showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed or operated.[161] Kentucky American argues that an AMI system is beneficial because it would allow the Company to improve safety, customer experience, operational efficiencies, and environmental benefits.[162] However, absolutely none of these alleged benefits demonstrate that there is an inadequacy of existing service, let alone the substantial inadequacy of existing service as required by KRS 278.020(1). There is also no evidence in the record to indicate that the current meters are overall not providing reliable service to the customers.[163]

The Company asserts that it is not requesting an accelerated replacement of meters, but instead plans to replace existing Automated Meter Reading ("AMR") equipment with AMI during the normal, scheduled, periodic replacement over the next decade.[164] Yet, Kentucky American further states that even though the Commission approved a deviation from 807 KAR 5:066, Section

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[157] *Id*.
[158] Application, Exhibit A, Advanced Metering Infrastructure Deployment Plan at 17 – 18. (The most updated version filed into the record on Nov. 9, 2023 by Kentucky American will be referred to throughout the brief.).
[159] Kentucky American's response to the Attorney General's Second Request, Item 34.
[160] *Kentucky Utilities Co. v. Public Service Com'n*, 252 S.W.2d 885 (Ky. 1952), Order at 10.
[161] *Id*. at 890.
[162] Application, Exhibit A, Advanced Metering Infrastructure Deployment Plan at 3.
[163] Kentucky American's response to the Attorney General's Second Request, Item 33; VTE 9:51:15 – 9:51:35.
[164] Application, Exhibit A, Advanced Metering Infrastructure Deployment Plan at 3.

16(1) in Case No. 2009-00253, allowing the Company to keep its 5/8-inch meters in service without testing for accuracy for 15 years instead of the prescribed 10 years, the Company plans to move back to a 10-year replacement cycle for these meters.[165] This decision will result in the Company replacing a total of 78,000 5/8-inch meters over a three-year period – 42,000 in 2024, 18,000 in 2025, and 18,000 in 2026.[166] Kentucky American has approximately 133,218 5/8-inch meters in its system,[167] so the proposed plan will result in the replacement of approximately 58.55% of all of the Company's 5/8 inch meters from 2024 – 2026. Even though the Company claims otherwise, a replacement of almost 60% of the Company's meters over a three-year course constitutes an accelerated pace. As of November 30, 2023, there is still a remaining net book value of $36,827,504 for the Company's existing meters, with a future accrual requirement of $43,039,822.[168] If the Company is allowed to revert back to a 10-year replacement cycle for the 5/8-inch meters instead of the current 15-year replacement cycle, Kentucky American's customers will be required to not only pay for the substantial amounts still owed on the existing meters, but also the accelerated replacement of the new meters as well. Kentucky American claims that there will be no stranded investment associated with the proposed transition to AMI,[169] but that is only accurate if the Commission grants the Company's proposal to drastically increase and accelerate the depreciation rates for the existing meters.[170] If the Commission were to approve of the proposed AMI project, then customers will also be required to pay for the more expensive AMI meters.

[165] *Id*. at 10; *See* Case No. 2009-00253, *Kentucky-American Water Company's Request for Permission to Deviate from 807 KAR 5:066, Section 16(1)* (Ky. PSC Oct. 5, 2011).
[166] Application, Exhibit A, Advanced Metering Infrastructure Deployment Plan at 11.
[167] *Id*. at 8.
[168] Kentucky American's response to the Attorney General's Post-Hearing Request, Item 2.
[169] Kentucky American's response to the Attorney General's First Request, Item 89.
[170] Direct Testimony of Larry Kennedy ("Kennedy Testimony") at 7 – 8; Kennedy Testimony, Exhibit LEK-1, 2022 Depreciation Study, Kentucky-American Water Company Total System, Table 1 Summary of Service Life and Net Salvage Estimates and Calculated Annual and Accrued Depreciation Related to the Recovery of Average Original Cost in Water Plant Based on Original Costs as of December 31, 2022; VTE 9:59:55 – 10:01:40; VTE 10:16:50 – 10:17:45.

Based on this information, the proposed AMI project is not economically feasible for the Company's customers. Kentucky American also admits that the current meter technology is not obsolete, and still readily available.[171] Thus, the Company has failed to satisfy the "need" component of KRS 278.020(1).

"Wasteful duplication" is defined as "an excess of capacity over need" and "an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties."[172] The Commission has also held that in order to demonstrate a proposed facility does not result in wasteful duplication, the utility must demonstrate that a thorough review of all reasonable alternatives has been performed.[173] The Commission has also consistently denied CPCNs for AMI projects that failed to present evidence that the utility's proposed system was the least-cost alternative.[174] Instead of Kentucky American reviewing all reasonable alternatives for metering infrastructure, it limited its review of AMI meters to Badger and Neptune because they were, "selected as strategic partners" of the parent company, American Water in 2016.[175] And, although Kentucky American provided a cost benefit analysis that the Company alleges supports the proposed AMI deployment, the cost benefit analysis actually demonstrates that the existing

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[171] VTE 9:50:10 – 9:50:48.

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

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

[174] Case No. 2022-00147, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates and a Certificate of Public Convenience and Necessity to Deploy Advanced Metering Infrastructure* (Ky. PSC Apr. 12, 2023), Order at 60; Case No. 2018-00005, *Electronic Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for Full Deployment of Advanced Metering Systems* (Ky. PSC Aug. 30, 2018); Case No. 2020-00174, *Electronic Application of Kentucky Power Company for (1) a General Adjustment of its Rates for Electric Service; (2) Approval of Tariffs and Riders; (3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; (4) Approval of a Certificate of Public Convenience and Necessity; and (5) All Other Required Approvals and Relief* (Ky. PSC May 14, 2021).

[175] Kentucky American's response to the Commission Staff's Second Request for Information ("Staff's Second Request"), Item 11(a); VTE 09:54:15 – 9:55:10.

AMR technology already in the Company's system has the least cost net present value, while the proposed AMI technology has the second least cost.[176] Additionally, Kentucky American did not include any potential savings attributable to the proposed AMI project in the proposed revenue requirement in the pending case.[177] Thus, the Company also failed to satisfy the "wasteful duplication" component of KRS 278.020(1).

Even though the Attorney General is aware that the Commission is currently investigating specific metering issues in Case No. 2022-00299,[178] it does not change the fact that Kentucky American simply did not meet its burden of proof as required by KRS 278.020(1). Based upon the foregoing, the Attorney General requests that the Commission deny Kentucky American's request for a CPCN to deploy AMI throughout its service territory. In the alternative, if the Commission were to grant the Company's request for a CPCN to deploy AMI, the Attorney General requests any and all potential cost savings to be included in the revenue requirement.

b. The Commission should deny Kentucky-American's request to expand the QIP.

Kentucky American's QIP was initially approved in Case No. 2018-00358, which allowed the Company to establish a tariff rate adjustment mechanism to make capital improvements to replace its aging water system infrastructure.[179] After the QIP was approved, the Commission limited the projects allowed to flow through the QIP to the replacement of 10 – 13 miles of cast iron and galvanized steel main through the QIP annually.[180] The Company is now requesting in

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[176] Application, Exhibit A, Advanced Metering Infrastructure Deployment Plan at 19; VTE at 9:49:40 – 9:50:10.
[177] Kentucky American's response to the Attorney General's Second Request, Item 34.
[178] Case No. 2022-00299, *Electronic Investigation of Kentucky-American Water Company's Alleged Violation of a Tariff and Commission Regulations Regarding Meters and Monitoring Customer Usage* (Ky. PSC Sep. 27, 2022).
[179] Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 73 – 84.
[180] Citron Testimony at 2 and 9; Case No. 2020-00027, *Electronic Application of Kentucky-American Water Company to Amend Tariff for the Establishment of Qualified Infrastructure Program Charge* (Ky. PSC Jun. 17, 2020); Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC Jun. 21, 2021), Order at 12.

the pending case to expand the QIP to 27 – 34 miles of any type of main annually.[181] As previously discussed, the Company is requesting to roll in QIP costs in base rates and to reset the QIP rider to zero.[182] Kentucky American states that the forecasted annual costs associated with the expansion of the QIP from 2025 – 2028 would be approximately $177 million,[183] and by 2028 the average residential customer's QIP rate would increase to a staggering 14.95%.[184]

The Company's request to expand QIP contradicts the directive in Case No. 2021-00090, in which the Commission stated that, "[a]ny future deviations from the QIP approved by the Commission, such as an accelerated replacement cycle, accelerated spending totals, or including standalone non-main plant replacement projects, will be looked upon with extreme disfavor."[185] Further, when the establishment of the QIP was initially approved, the Commission asserted that it was, "reasonable to approve an alternative cost recovery based on smaller, more gradual rate increases."[186] However, the Company's proposed expansion of the QIP that will cost approximately $177 million from 2025 – 2028 cannot be considered as a small or gradual rate increase. Likewise, the QIP rate for the average residential customer increasing to 14.95% by 2028 is not a small or gradual rate increase either.

It is further problematic that the Company's proposed cost per mile to replace the infrastructure flowing through the QIP has drastically increased. In Case No. 2018-00358, Kentucky American stated that it would cost approximately $153 per linear foot to replace a main

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[181] Citron Testimony at 2.
[182] Newcomb Testimony at 18.
[183] Kentucky American's response to the Attorney General's First Request, Item 26(g) ($42.5 million in 2025, $43.8 million in 2026, $45 million in 2027, and $46 million in 2028 = $177.3 million).
[184] Kentucky American's response to the Attorney General's Second Request, Item 20, Attachment 1.
[185] Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC Jun. 21, 2021), Order at 12.
[186] Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 81.

through the QIP,[187] but in the pending case the replacement cost has more than doubled to $331 per linear foot.[188] In the final Order in Case No. 2018-00358, the Commission stated that the, "same statutory authority that permits the Commission to authorize a QIP also grants us the authority to terminate or limit the QIP."[189] The Commission proceeded to provide an example of the Commission placing limits on a natural gas utility whose forecasted estimates for pipeline replacement were demonstrated to be unreliable.[190]

Just as the Commission placed limits on the natural gas company's pipeline replacement program to protect the customers from unreliable estimates and unreasonable levels of replacement,[191] so should the Commission do the same with Kentucky American's QIP. The Company is requesting to drastically increase QIP costs on its customers due to the estimated replacement costs more than doubling, along with the Company's request to expand the QIP through both miles of replacement and type of mains eligible to be replaced. Thus, in order to protect and safeguard the customers, the Commission should either terminate Kentucky American's QIP or continue to limit the QIP to the replacement of 10 – 13 miles of only cast iron or galvanized steel mains annually. These limitations will ensure that the Company's infrastructure replacement, and the associated cost would be incremental and more affordable for Kentucky American's customers.

Based upon the foregoing, the Attorney General requests the Commission to deny Kentucky American's request in the pending case to expand the QIP to 27 – 34 miles of any type

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[187] Case No. 2018-00348, Direct Testimony of Brent E. O'Neill at 40.
[188] Citron Testimony at 8; VTE 11:41:00 – 11:41:25.
[189] Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 82.
[190] *Id.*; Case No. 2017-00349, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC May 28, 2018).
[191] Case No. 2017-00349, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC May 28, 2018), Order at 37 – 43.

of main annually. If the Commission allows for the continuation of the QIP, the Attorney General recommends implementing a depreciation offset to capture the decline in value of those QIP investments rolled into base rates, rather than only recognizing the effect of the accumulated depreciation for investments currently being recovered through the QIP.[192] This more expansive depreciation offset will protect Kentucky American's ratepayers from providing an excessive return.[193] Essentially, without this consumer protection mechanism the profits of Kentucky American, and thereby its shareholders, will be enhanced.[194]

c. The Commission should deny Kentucky American's proposed Universal Affordability Tariff because it violates KRS 278.170 and KRS 278.030 and would lead to an inequitable result.

Kentucky American proposes a Universal Affordability Tariff, which would allow participating residential customers to receive water service at a discounted rate.[195] According to the proposal, Kentucky American plans to utilize a third-party vendor to conduct income verification and to manage the proposed Universal Affordability Tariff.[196] If the Commission were to approve the proposed Universal Affordability Tariff, then the Company would include the administrative costs of the program in the future revenue requirement to be paid for by the customers.[197] The Company asserts that approximately 11,000 residential water customers have household incomes at or below 100% of the federal poverty level and would qualify for service under the Company's proposed tariff.[198] Kentucky American proposes to allow for a 60% discount for customers with household income that is 0% - 50% of the federal poverty level, and a 20%

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[192] Meyer Testimony at 43.
[193] *Id.*
[194] *Id.*
[195] Direct Testimony of Charles B. Rea ("Rea Testimony") at 14.
[196] Kentucky American's response to the Attorney General's First Request, Item 38(b).
[197] *Id.*
[198] Rea Testimony at 22.

discount for customers with household income that is 50% - 100% of the federal poverty level.[199] It is important to note that Kentucky American's shareholders or parent company will not be subsidizing the proposed Universal Affordability Tariff.[200] Thus, all discounts provided to the approximately 11,000 residential water customers will be exclusively paid for by the rest of the Company's residential customers through higher water rates.[201]

The Attorney General's concerns with Kentucky American's proposed Universal Affordability Tariff are two-fold. First, the Universal Affordability Tariff violates both KRS 278.170 and KRS 278.030, and should therefore be denied as a matter of law. KRS 278.170(1) states that, "no utility shall, as to rates 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."[202] Kentucky American's proposal for certain residential customers to pay a higher water rate in order to provide a discounted water rate to other residential customers constitutes an unreasonable preference or advantage. Further, KRS 278.030(3), states that a utility may employ reasonable classifications of its service, patrons, and rates based upon the nature of the use, the quality used, the quantity used, the time when used, the purpose for which used …"[203] But, KRS 278.030(3) does not state that a utility may create a separate discounted residential rate class based upon income level.

In fact, the Commission previously ruled upon a proposed low-income water rate in Case

[199] *Id*. at 20 – 21.
[200] VTE 11:53:00 – 11:53:25.
[201] *Id*.
[202] https://apps.legislature.ky.gov/law/statutes/statute.aspx?id=14067.
[203] https://apps.legislature.ky.gov/law/statutes/statute.aspx?id=14047.

No. 2020-00160, and found that, "the discounted rate should be denied as a matter of law."[204] The Commission stated that KRS 278.030 does not explicitly permit the establishment of a customer classification based upon income level, and thus, the Commission is not authorized to create a separate rate class for low-income residential customers apart from the general residential customer class. The Commission further cited to KRS 278.170(1), which prohibits the establishment of rates that, "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." Thus, the Commission found that as a creature of statute, it was without the power to approve the proposed reduced water rate.

The second concern the Attorney General has with the proposed Universal Affordability Tariff is for the customers who fall outside of the eligibility for the discounted water rate, but who are nevertheless financially struggling. For example, Kentucky American asserts that a customer in a one person household can qualify for a discounted water rate if they make no more than $14,580 per year.[205] But, a customer in a one person household who makes $14,581 per year will not qualify for a discounted rate. Not only will the customer who is making one dollar over the maximum allowed income not receive the discounted water rate, but that customer will also have to pay a higher water rate to subsidize the discounted rate available to others. Kentucky American attempts to argue that its proposed Universal Affordability Tariff provides a reasonable preference or advantage to the customer who would qualify for the discounted water rate.[206] Yet, it is clear under this scenario that the proposed Universal Affordability Tariff would produce an unreasonable preference or advantage for a customer who is entitled to a discounted water rate

[204] Case No. 2020-00160, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates*, (Ky. PSC Dec. 8, 2020), Order at 38.
[205] Rea Testimony at 21.
[206] Kentucky American's response to the Staff's Second Request, Item 69.

because they make $1 less than another customer who would be forced to pay a higher water rate.

For these reasons, the Attorney General requests that the Commission deny Kentucky American's proposed Universal Affordability Tariff because it is in violation of Kentucky law and leads to inequitable results for residential customers.

d. The Commission should deny Kentucky American's request to grant regulatory accounting deferral treatment to specific expenses.

Kentucky American requests that the Commission grant regulatory accounting deferral treatment for production expenses, pension and other post-employment benefits ("OPEB") expenses, and expenses related to taxes other than income (excluding sales tax) and income taxes.[207] Specifically, Kentucky American requests to set up a regulatory asset for the difference between the authorized level of expense determined by the Commission in this case and the actual expense that the Company incurs when rates are placed into effect.[208] Kentucky American will then ask for amortization of the deferral amounts in the next rate case.[209] In other words, Kentucky American requests to set up three separate tracking mechanisms to ensure exact expense recovery in future rate cases.[210]

The Commission should deny the Company's request to set up these tracking mechanisms for a multitude of reasons. First, the production expense, OPEB expense, and various tax expenses are normal and regular expenses that every large water utility company will incur.[211] The appropriate action for the Company would be to determine a reasonable proposed expense level that it anticipates will cover these expenses and include them in the rates as normal.[212] To the

[207] Newcomb Testimony at 24.
[208] *Id*. at 25.
[209] *Id*.
[210] Meyer Testimony at 37.
[211] *Id*.
[212] *Id*. at 37 – 38.

extent that Kentucky American actually experiences a specific extraordinary level of expense associated with any of these specific expenses then it has the ability to file a general rate case or to file a separate regulatory asset case.[213]

Second, Kentucky American's request to set up these potential regulatory assets are not in compliance with Commission precedent. In order for a utility to allow an expense to be treated as a regulatory asset the Commission requires that the expense be (1) extraordinary/non-recurring, which could not have reasonably been anticipated or included in the utility's planning; (2) resulting from a new statutory or administrative directive; (3) expenses for an industry-sponsored initiative; or (4) an extraordinary/non-recurring expense that will eventually be offset by cost savings.[214] Production expenses, OPEB expenses, and expenses related to taxes other than income (excluding sales tax) and income taxes are recurring, normal expenses, there are no specified new statutory or administrative policies dictating increases to these costs, the request is not the result of industry-sponsored initiatives, and the costs will not eventually be offset by a specific stream of cost savings.[215]

Third, Kentucky American's request for deferral accounting of production expenses, OPEB expense, and expenses related to taxes other than income (excluding sales tax) and income taxes would be reviewing these expense line items in isolation, and fails to consider that there may be cost offsets in other areas that should be applied, or that there may be offsetting revenues resulting from customer growth, improved efficiencies, etc.[216] For example, the request for a deferral accounting related to production expenses ignores that an increase in water usage could

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[213] *Id*. at 38.
[214] Case No. 2008-00436, *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* (Ky. PSC December 23, 2008), Order at 4.
[215] Meyer Testimony at 38.
[216] *Id*. at 39.

be the cause of an increase to production expense.[217] This increased production expense should be offset by additional water revenues.[218] Yet, as proposed, the additional water revenues would not be considered along with the increased production expenses, which would not lead to fair, just, or reasonable rates.[219]

Finally, if regulatory asset deferrals were allowed for these specific expenses then it could disincentivize cost controls.[220] When a company incurs a significant cost increase, there is often pressure to reduce costs in other areas of operations.[221] But, if these expenses are held in isolation, there may be less pressure to find efficiencies, secure offsetting cost reductions, or make changes in the way the company operates to ensure rates are fair, just, and reasonable.[222]

The Attorney General recommends the Commission deny the Company's request for regulatory accounting deferral treatment for production expenses, OPEB expenses, and expenses related to taxes other than income (excluding sales tax) and income taxes, because it would not lead to fair, just, or reasonable rates for the customers.

e. Kentucky American's proposal to increase the residential monthly customer charge by 33% is unreasonable and not supported by the Class Cost of Service Study ("COSS").

As mentioned above, Kentucky American proposes to increase its residential monthly customer charge from $15.00 to $20.00, which equates to a 33% increase.[223] First, an increase of this magnitude to the residential customer charge will hinder residential customers' ability to control their monthly water bills and will pose a financial hardship on those customers already

[217] *Id.*
[218] *Id.*
[219] *Id.*
[220] *Id.*
[221] *Id.*
[222] *Id.*
[223] Rea Testimony at 17; Kentucky American's response to the Attorney General's Post-Hearing Request, Item 1, Updated Customer Notice.

struggling to make ends meet. Second, the increase is unsupported by the Company's own COSS which calculates the residential customer charge at $18.00.[224] The Commission has always relied upon the principle of gradualism in ratemaking, which mitigates the financial impact of rate increases on customers.[225] Kentucky American's proposed 33% increase to the residential monthly customer charge violates this important ratemaking principle.

Moreover, Kentucky American similarly requests to increase the monthly customer charge for the commercial customers from $15.00 to $20.00.[226] If the Commission approves the requested increase to both the residential and commercial monthly customer charge, then the residential customers will pay the same monthly customer charge as the Company's commercial customers.[227] However, under the Company's proposed rates the residential class will be paying a higher volumetric water rate per 1000 gallons than the commercial class - $7.7806 versus $7.0368, respectively.[228] In the final Order of Case No. 2019-00053, the Commission stated that it does not support a rate design in which the small single-phase commercial class pays a monthly customer charge that is lower than that charged to the residential class.[229] The Attorney General is concerned that the Company's proposed monthly customer charge for the residential class being the same as that proposed to be paid by the commercial class, coupled with the higher proposed volumetric

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[224] Kentucky American's response to LFUCG's First Request for Information, Item 56(a); VTE at 11:49:00 – 11:49:59.
[225] *See* Case No. 2014-00396, *In the Matter of Application of Kentucky Power Company for: (I) A General Adjustment of its Rates for Electric Service; (2) An Order Approving its 2014 Environmental Compliance Plan; (2) An Order Approving its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief,* (Ky. PSC June 22, 2014) ("the Commission has long employed the principle of gradualism"); *See also* Case No. 2000-00080, *In the Matter of: The Application of Louisville Gas & Electric Company to Adjust its Gas Rates and to Increase its Charges for Disconnecting Service, Reconnecting Service and Returned Checks* (Ky. PSC Sept. 27, 2000) ("the Commission is adhering to the rate-making concepts of continuity and gradualism in order to lessen the impact of these increases on the customers that incur these charges.")
[226] Kentucky American's response to the Attorney General's Post-Hearing Request, Item 1, Updated Customer Notice.
[227] Application, Exhibit 4.
[228] Kentucky American's response to the Attorney General's Post-Hearing Request, Item 1, Updated Customer Notice.
[229] Case No. 2019-00053, *Electronic Application of Jackson Purchase Energy Corporation for a General Adjustment in Existing Rates* (Ky. PSC June 20, 2019), Order at 16.

water charge for the residential customers than the commercial customers, leads to an inequitable result.

Thus, the Attorney General respectfully requests the Commission to continue to rely upon the principle of gradualism when awarding any increase to the residential monthly customer charge.

CONCLUSION

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

Respectfully submitted,

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Certificate of Service and Filing

Pursuant to the Commission's Orders and in accord with all other applicable law, Counsel certifies that the foregoing electronic filing was transmitted to the Commission on January 5, 2024, and there are currently no parties that the Commission has excused from participation by electronic means in this proceeding.

This 5th day of January, 2024,

Angela M. Awad

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Assistant Attorney General