

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

ELECTRONIC APPLICATION OF	)	
KENTUCKY-AMERICAN WATER	)	CASE NO. 2025-00122
COMPANY FOR AN ADJUSTMENT OF	)	
RATES	)	

POST-HEARING BRIEF OF KENTUCKY-AMERICAN WATER COMPANY

Filed: October 27, 2025

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I. STATEMENT OF THE CASE

On April 16, 2025, Kentucky-American Water Company (“KAWC” or “Company”) filed a Notice with the Kentucky Public Service Commission (“Public Service Commission” or “Commission”) in conformity with 807 KAR 5:001, Section 16(2), expressing its intention to file an application for an increase in rates no earlier than 30 days from the date of Notice. The Notice specifically provided that the Application for an increase in rates would be supported by a fully forecasted test period as authorized by KRS 278.192.

In keeping with prior practice, simultaneously with the delivery of its Notice to seek an increase in rates, KAWC submitted a Notice of Election of Use of Electronic Filing Procedures. By letter dated April 16, 2025, the Commission’s Executive Director assigned a case number to the proceeding. KAWC filed its Application and supporting materials on May 16, 2025.

In its Application filed with the Commission, KAWC sought the Commission’s approval of an increase in its annual revenues of \$26,936,340 by rates to become effective on or after December 16, 2025 (including a rate suspension period) and approval of proposed tariff revisions.

The adjudication of this matter has proceeded with two intervenors: the Attorney General (“AG”) and Lexington-Fayette Urban County Government (“LFUCG”). On May 1, 2025, the AG filed a motion to intervene. The Commission granted his motion on May 6, 2025, and ordered the AG to comply with the service and electronic filing requirements. On May 19, 2025, LFUCG moved for full intervention, agreed to electronic transmission of all notices and messages in this proceeding, and certified its ability to receive electronic transmissions. The Commission granted LFUCG’s motion to intervene on May 27, 2025.

By letter dated May 22, 2025, the Commission’s Executive Director informed all parties of record that the Application met the minimum filing requirements and was accepted for filing as of May 16, 2025.

On May 27, 2025, the Commission entered an Order suspending the proposed rates for a period of six months and established a Procedural Schedule providing for two rounds of data requests to KAWC, the filing of intervenors' testimony, one round of data requests to the intervenors, and the filing of rebuttal testimony by the Company's witnesses. In its Order dated July 1, 2025, the Commission scheduled an evidentiary hearing in this matter to begin on September 23, 2025.

KAWC's Application requested an annual increase of \$26,936,340.¹ On September 15, 2025, KAWC filed its Base Period Update in which it revised its revenue requirement downward from \$163,496,192 to \$163,084,191 but revised its revenue deficiency upward from \$26,936,340 to \$27,211,230 but did not revise its requested annual increase.²

With its Application, KAWC presented the testimonies of: Michael Adams; Deba F. Ather; Ann E. Bulkley; Robert Burton; Michi Chao; Dominic DeGrazia; Jennifer Gonzales; William A. Lewis; John Magner; Max McClellan; Robert V. Mustich; Robert Prendergast; Linda Schlessman; and Harold Walker, III. Subsequent rebuttal testimony was presented from Ann E. Bulkley; Michi Chao; Dominic DeGrazia; William A. Lewis; Robert V. Mustich; Robert Prendergast; and Harold Walker, III.

The AG and LFUCG co-presented the testimonies of Richard A. Baudino and John Defever.

A hearing on the merits of the requests presented in KAWC's Application was held at the Commission on September 23, 2025. The following witnesses for KAWC were presented and subject to cross examination: Michael Adams; Deba F. Ather; Ann E. Bulkley; Robert Burton;

¹ Application, Exhibit 37A, Page 2 of 2.

² Base Period Update, Exhibit 37A, Page 2 of 2. The Base Period Update states a revised Requested Revenue Increase of \$27,111,230 but KAWC Witness DeGrazia testified that "KAWC is not seeking an increase above" the originally proposed increase of \$26.9 million. Rebuttal Testimony of Dominic DeGrazia at 2.

Michi Chao; Dominic DeGrazia; Jennifer Gonzales; William A. Lewis; John Magner; Max McClellan; Robert Prendergast; Linda Schlessman; and Harold Walker, III. The AG and LFUCG co-presented the testimonies of Richard A. Baudino and John Defever.

Pursuant to the Commission's Order dated September 26, 2025, a schedule for post-hearing discovery and submission of briefs was established. Commission Staff and the AG served requests for information in accordance with that schedule and the Company timely filed its responses to these requests.

II. REVENUE REQUIREMENT

The Company's revenue requirement is equal to the cost of providing water service to more than 138,000 customers throughout fourteen³ Kentucky counties.⁴ Providing water service is a sprawling endeavor that starts with sourcing more than fifteen billion gallons of surface water from Kentucky lakes and rivers, then treating it to meet or surpass drinking water standards, and finally pumping and distributing it through approximately 2,400 miles of main to reach homes, businesses, schools, and industries throughout KAWC's service territory.⁵ Along the way, the Company must work to provide adequate capacity and storage to accommodate peak usage and to help protect communities during fire events. The Company also provides customer service, monthly billing, 24-hour emergency call handling, and a self-service website.⁶ The Company monitors water quality for a host of contaminants and maintains the distribution system by exercising valves, flushing hydrants, and repairing main breaks at all hours and in all weather

³ Bourbon, Clark, Fayette, Franklin, Gallatin, Grant, Harrison, Jackson, Jassmine, Nicholas, Owen, Rockcastle, Scott, and Woodford Counties.

⁴ Direct Testimony of Dominic DeGrazia at 6.

⁵ *Id.*

⁶ *Id.*

conditions. All these efforts support the Company's provision of safe, clean, reliable water service, sanitation, and fire protection service to customers.⁷

To accomplish all of this, the Company incurs costs for which it seeks recovery through the ratemaking process. The Company's costs include a variety of operating expenses, depreciation and amortization, and various local, state, and federal taxes.⁸ The Company must also provide a return—at least equal to the cost of capital—on over \$674 million in water infrastructure rate base that supports the Company's provision of service to customers. The Company's forecasted revenue requirement in this proceeding, equal to the cost of providing service, is approximately \$163.1 million for the twelve months ending December 31, 2026.⁹

The difference between the forecasted revenue requirement and the Company's forecasted revenues at present rates equates to the Company's revenue deficiency.¹⁰ The Company's revenue deficiency in this proceeding, reflective of the Base Period Update, is calculated to be approximately \$27.1 million, which is an approximate 20.0 percent shortfall.¹¹ The revenue deficiency in this case is fundamentally driven by over \$181 million of rate base growth since the Company's last rate case, Case No. 2023-00191,¹² along with increases in certain operations and maintenance ("O&M") expenses, and increases in property taxes charged to the Company by state and local governments.¹³ Using Mr. Baudino's recommendations regarding cost of capital and his

⁷ *Id.* at 7.

⁸ *Id.*

⁹ Rebuttal Testimony of Dominic DeGrazia at 2; Base Period Update Filing Exhibit 37, Schedule A.

¹⁰ DeGrazia Direct Testimony at 7.

¹¹ DeGrazia Rebuttal Testimony at 2.

¹² *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 (Ky. PSC May 3, 2024).

¹³ DeGrazia Direct Testimony at 8.

own itemized adjustments, Mr. Defever opined that the requested annual increase should be \$15,094,397.¹⁴

The Company, through its Application, witness testimony, and responses to data requests, has presented evidence to justify its proposed revenue requirement, which is composed of numerous components. The following revenue requirement components have been directly contested by the AG and LFUCG: employee related expenses, including labor, performance compensation, and non-labor costs; working capital allowance; miscellaneous expenses; water losses; growth factor, and rate of return.¹⁵ A review of the evidentiary record will demonstrate that the Company's proposals related to each of these contested components are more reasonable and should be adopted.

(A) Employee Related Expenses

Employee related expenses include direct labor expenses, such as base salary and wages and performance pay, and non-labor expenses such as payroll tax, employee benefits, and group insurance costs. The Company explains the reasonableness of these expenses in detail below.

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

The forecasted test period labor expense is based on the Company's planned staffing level at hourly rates per contract for union employees and wage rates for non-union employees that reflect forecasted pay increases.¹⁶ Because some labor and labor-related costs are capitalized with capital projects and programs, a capitalization percentage is used to assist in calculating net expense.¹⁷ An adjustment is also made to remove costs appropriately charged to wastewater

¹⁴ Direct Testimony of John Defever at 4.

¹⁵ See *infra* Section IV.

¹⁶ Direct Testimony of Robert Prendergast at 4.

¹⁷ *Id.*

operations.¹⁸ As a result, O&M labor expenses represent costs related to water operations that are charged to expense on the Company's income statement.¹⁹

For nearly thirty years, the Company has forecasted its labor expense based on the number of employees that are required to complete the work to continue to provide safe and reliable water service to its many customers throughout the KAWC service territory. The scope of necessary work does not fluctuate based upon how many Company employee roles are filled. While it is difficult to forecast how many vacancies will occur or for what duration they will last in any given year, the work must still get done. AG and LFUCG's witness John Defever acknowledged during the evidentiary hearing that vacancies are typical for water utilities.²⁰ With a set amount of work to be accomplished each year, when KAWC has vacant employee roles, the work that would be performed by those vacant positions is either (a) delegated to other KAWC employees, and the Company incurs additional expenses for overtime pay, or (b) contracted to laborers outside of the Company, and the Company incurs additional expenses for contract services.

For ratemaking purposes, the Company has historically forecasted its labor expense based on the salaries and wages owed to the number of employees required to complete the Company's work, instead of forecasting how much potential overtime or contracted labor expenses may result from an unknown number of vacant employee roles. The Commission permitted this approach in

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ 9/23/2025 Hearing, VR 15:17:56-15:18:05.

Orders issued in 1996,²¹ 2005,²² 2010,²³ 2019,²⁴ and 2024.²⁵ In each of those five cases, the AG (and LFUCG in Cases No. 2018-00358 and 2023-00191) unpersuasively argued that vacant positions should not be included in the forecasted labor expense, failing to consider “that the decreased direct labor costs from vacant employee positions will be offset by increases in overtime or temporary labor costs.”²⁶

The Company believes the appropriate level for staffing is presently 168 full-time equivalents.²⁷ Mr. Defever, on behalf of the AG and LFUCG, proposes a \$610,390²⁸ adjustment to payroll expense to reflect an average 3.6% vacancy rate for the years 2020 through 2024, or in the alternative, a 6.05% reduction “based upon the Company’s historical record of overbudgeting.”²⁹ Importantly, Mr. Defever’s adjustment did not make any corresponding upward adjustment to overtime or contract services.³⁰

The Company’s work must be completed with available resources which consists of full-time employees, overtime, temporary employees, or contract employees. KAWC has two methods by which it can present the cost structure to accomplish its work: (1) assume no vacancies and adjust overtime, temporary employee and contractor expenses accordingly; or (2) assume a

²¹ *Application of Kentucky-American Water Company to Increase its Rates*, Case No. 95-554, Order at 32 (Ky. PSC Sept. 11, 1996).

²² *Adjustment of the Rates of Kentucky-American Water Company*, Case No. 2004-00103, Order at 44 (Ky. PSC Feb. 28, 2005).

²³ *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year*, Case No. 2010-00036, Order at 24-25 (Ky. PSC Dec. 14, 2010).

²⁴ *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates*, Case No. 2018-00358, Order at 37-40 (Ky. PSC June 27, 2019).

²⁵ Case No. 2023-00191 (Ky. PSC May 3, 2024), Order at 15-16.

²⁶ Case No. 2018-00358, Order of June 27, 2019 at 39. *See also* Case No. 2023-00191, Order at 15-16 (“the Attorney General/LFUCG’s adjustment does not account for an increase in overtime or contractor labor to offset unfilled positions”).

²⁷ Direct Testimony of William A. Lewis at 35.

²⁸ Based on his proposal for payroll expense, Mr. Defever also proposes “flow through” reductions for payroll tax (\$180,680) and benefits expense (\$128,619). Defever Direct Testimony at 32-33. Because his payroll expense proposal should be rejected, his “flow through” proposals should likewise be rejected.

²⁹ Defever Direct Testimony at 9.

³⁰ Defever Direct Testimony, Exhibit JD-1, Schedule C-1; Rebuttal Testimony of William A. Lewis at 2.

vacancy rate and include increased expenses for overtime, temporary employee and contractor expenses to complete the work.³¹ The Company has chosen the first method and has presented its cost structure accordingly. It did not include increased expenses for overtime, temporary employees or contractor expenses when calculating its forecasted labor expense. In fact, the Company has consistently forecasted overtime hours based on the notion that an under-projection of overtime hours will be offset by increases in direct labor costs caused by any vacant roles within KAWC.

Mr. Defever chose only a portion of the second methodology, a reduction for employee vacancies. He did not provide for the corresponding increased overtime, temporary or contract labor costs that would be incurred to accomplish the same level of work, as contemplated by the Company's proposed employee level. For example, the Company is projecting 29,637 overtime hours in this case even though there were 34,518 overtime hours during the base period, 29,794 overtime hours in 2024, and 33,172 overtime hours in 2023.³² Therefore, Mr. Defever's proposed reduction is incomplete and insufficient to address the costs required to perform the work.³³

Mr. Defever's proposed adjustment suffers from two additional errors. First, it improperly includes Service Company payroll expense in the vacancy adjustment calculation, which is specific to KAWC's historic to actual employee count.³⁴ No reasoning is provided to justify an adjustment to Support Services payroll expense.³⁵ The inclusion of this expense artificially inflates the proposed adjustment. Second, the proposed adjustment does not take into consideration the effects of Mr. Defever's proposed adjustments to the Company's performance-based

³¹ Lewis Rebuttal Testimony at 2.

³² Base Period Update Exhibit 37, Schedule G-2.

³³ Lewis Rebuttal Testimony at 2.

³⁴ Rebuttal Testimony of Robert Prendergast at 2.

³⁵ *Id.*

compensation expense, which would ultimately reduce the vacancy adjustment.³⁶

Mr. Defever's alternative proposal, which calls for a 6.05% reduction of payroll expense, is also inappropriate. The Company's labor expense was not calculated using budget data but was calculated on a position-by-position basis using the projected 2026 headcount. Because the payroll calculation is based on projected headcount rather than budget assumptions, Mr. Defever's proposed adjustment does not reflect how the Company's labor expense was developed and, therefore, is inappropriate. It reduces payroll expense based on arbitrary data that does not pertain to the calculation of KAWC labor expense.³⁷

In summary, the Company's position on including vacant roles in its forecasted labor expense is soundly supported by logic and precedent. The AG and LFUCG's position on excluding vacant roles from the Company's forecasted labor expense is not. It is, further, a position that has been repeatedly argued, and repeatedly denied as unreasonable. Because the AG and LFUCG's proposal fails to consider how a decrease in direct labor costs will be offset by increases in overtime or contract service expenses, the most reasonable outcome follows long-standing Commission precedent and accepts the Company's forecasted labor expenses as proposed.

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

The Company aims to offer market-level compensation that is on par with other companies that KAWC competes with for talent to ensure that employee compensation is not only competitive, but also reasonable.³⁸ By using a combination of base and performance compensation, the Company satisfies the dual objectives of a competitive market-based total

³⁶ *Id.* at 3.

³⁷ *Id.* at 4.

³⁸ Lewis Direct Testimony at 39.

compensation for all employees, while continuing to motivate employees to achieve goals that will improve performance and efficiency for the benefit of the Company's customers.³⁹

Employee compensation is a cost of providing utility service, like other prudently incurred costs of service recoverable in rates.⁴⁰ Employee compensation must therefore be assessed through the same lens as all other operating costs of the Company: if it is prudently incurred and reasonable in amount, relative to what the industry pays for the same services, it should be recoverable through rates not parsed out based on its individual components.

The Company submitted a total remuneration study and an assessment of the Company's performance compensation programs through the direct testimony of Robert V. Mustich, a consultant with Willis Towers Watson with over thirty years of industry and compensation consulting services experience.⁴¹ This study found that the total direct compensation (which includes base compensation and all performance compensation) that the Company provides its employees was 10 percent **below** the national market median and 8 percent **below** the regional market medium.⁴² It further found that total remuneration (which also includes benefits) provided by the Company was 9 percent **below** the national market median and 7 percent **below** the regional market medium.⁴³

Based upon these findings, none of which were disputed by the AG/LFUCG witness,⁴⁴ Mr. Mustich concluded that while the Company's employees compensation and total remuneration were "market competitive," which is defined as a range extending between 10 percent below to 10 percent above the market medium, they fell at the low end of the competitive range from a national

³⁹ *Id.* at 39-40.

⁴⁰ *Id.* at 40.

⁴¹ Direct Testimony of Robert V. Mustich at 1.

⁴² *Id.* at 7

⁴³ *Id.*

⁴⁴ 9/23/2025 Hearing, VR 15:14:25-15:14:52.

and regional market perspective.⁴⁵ Because the Company's total compensation and remuneration are below the national and regional market median and at the low end of the competitive range of each market, the Company's overall compensation expense is inherently reasonable and prudently incurred and should be recoverable like all others costs of service.⁴⁶

The AG and LFUCG, through Mr. Defever, propose to remove the majority of the Company's performance-based compensation expense from the revenue requirement.⁴⁷ The Company offers two performance-based compensation plans: the Annual Performance Plan ("APP"), which is available for all full-time employees, and the Long-Term Performance Plan ("LTPP"), which is available for certain exempt employees.⁴⁸ Under the LTPP, American Water provides restricted stock units and performance stock units as long-term performance compensation, based on three-year vesting periods.⁴⁹ The APP is designed to recognize and reward employee performance against key goals and targets that drive the Company's strategy. For example, the APP goals for 2025 focus on growth, customer satisfaction, safety, environmental compliance, and people.⁵⁰

Mr. Defever proposes to remove an arbitrary 50 percent of the Company's APP and 70 percent of the Company's LTPP from the revenue requirement, contending that as "incentive compensation based on financial goals benefits primarily the Company's shareholders," they should be responsible for the costs of performance compensation tied to financial goals.⁵¹ This misconception is clarified by Company witnesses William A. Lewis and Mustich, who explain that the performance-based component of the Company's total market-based compensation plan

⁴⁵ *Id.* 8

⁴⁶ Lewis Direct Testimony at 41.

⁴⁷ Defever Direct Testimony at 9-12.

⁴⁸ Lewis Direct Testimony at 42.

⁴⁹ *Id.* at 43.

⁵⁰ *Id.* at 43.

⁵¹ Defever Direct Testimony at 10

aligns the interests of KAWC customers, employees, and investors.⁵² The market-based compensation philosophy that KAWC has adopted allows it to attract and retain the workforce needed to continue to provide safe and reliable service. At a time when the Company and many other employers are finding it increasingly difficult to attract and retain good employees, this point cannot be overstated. Customers benefit when a utility retains talented employees, because a stable workforce avoids the costs of hiring and training new employees.⁵³ The Company's LTPP program is particularly intended to reduce attrition at the higher ranks of the organization.⁵⁴ Senior management turnover and the loss of expertise can degrade the continuity of strategy and execution, to the detriment of customers. Importantly, the LTPP achieves its goals of reducing leadership attrition at a lower cost to customers compared to simply increasing leadership's base pay, because performance pay under the LTPP is stock-based.⁵⁵ Employees must remain with the organization over a three-year period to realize the full vesting of their awards.

In addition, the plans contain tangible goals that measure and compensate employees for achieving goals directly tied to the delivery of clean, safe, reliable, and affordable water service and the provision of first-in-class customer service.⁵⁶ Customers derive a direct benefit from the Company's focus on the strategic goals underlying the plans: customer satisfaction, health and safety, environmental performance, and employ a skilled and diverse workforce. Customers also benefit from the plans' well-grounded financial measures, which keep KAWC and its employees focused on improved performance at all levels, particularly in increasing efficiency, decreasing waste, and boosting overall productivity.⁵⁷

⁵² Lewis Direct Testimony at 45-47; Lewis Rebuttal Testimony at 9-12; Mustich Direct Testimony at 10; Mustich Rebuttal Testimony at 3-4

⁵³ Mustich Direct Testimony at 10.

⁵⁴ Lewis Rebuttal Testimony at 12.

⁵⁵ *Id.*

⁵⁶ Lewis Direct Testimony at 49.

⁵⁷ *Id.*

The AG and LFUCG, through Mr. Defever, also propose to remove \$315,000 of company-paid health insurance premiums that exceeds the most current U.S. Bureau of Labor Statistics (“BLS”) average employer contribution for single and family health insurance coverage.⁵⁸ In its most recent National Compensation Survey, the BLS reported that employers on the average paid 80% of an employee’s single health insurance coverage and 69% of an employee’s family health insurance coverage.⁵⁹ Currently, the Company requires each of its employees to contribute 14% of the cost of his or her health insurance premiums.⁶⁰ Mr. Defever relies solely on misinterpreted Commission precedent to support his proposed adjustment⁶¹ and provides no other supporting evidence or argument.

Mr. Defever’s reliance upon Commission precedent is mistaken for three reasons. First, while the Commission has limited recovery of employer contributions for employee health insurance to BLS national averages, it has established an exception to this rule for utilities that require their employees to pay at least 12% of their health insurance cost.⁶² As the Company requires employees to contribute 14% of the cost of their health insurance, it qualifies for this “safe harbor” and is entitled to recover its full employee health insurance expense.

Secondly, Mr. Defever failed to consider the unionized nature of the Company’s workforce and the binding obligations that follow the collective bargaining process. The Company’s cost

⁵⁸ Defever Direct Testimony at 27-28.

⁵⁹ Bureau of Labor Statistics, News Release 25-1464 (Sep. 25, 2025, Employee Benefits In The United States – March 2025 at 12-13.).

⁶⁰ Lewis Rebuttal Testimony at 19.

⁶¹ Defever Direct Testimony at 27.

⁶² See *Electronic Application of Jackson Purchase Energy Corporation for a General Adjustment in Existing Rates*, Case No. 2019-00053 (Ky. PSC June 20, 2019), Order at 9 (“the Commission finds that as long as the employee contribution rate for health insurance is at least 12 percent, it will not make a further adjustment to the national average”); *Application of Oldham County Water District for an Alternative Rate Adjustment*, Case No. 2023-00252 (Ky. PSC June 18, 2024), Order at 10 (“As a guide for regulated entities, the Commission articulated that as long as the employee contribution rate for health insurance is at least 12 percent, no further adjustment to the national average would be made.”). See also *Electronic Application of Northern Kentucky Water District For An Adjustment of Rates; Issuance of Bonds; Financing; and Tariff Revisions*, Case No. 2022-00161 (Ky. PSC Mar. 16, 2023).

share for health insurance premiums is determined through collective bargaining with its unionized workforce and is set forth in its collective bargaining agreements with its unionized employees. These agreements are legally binding, are negotiated every five years, and cannot be unilaterally changed by KAWC. The Company applies the same cost share levels to its non-union employees. The Commission has generally found that “benefits that are provided under union contracts, given the arms-length negotiating that lead to them, generally indicates that costs agreed to were necessary to attract and retain the employees, and therefore, that the costs are reasonable,”⁶³ It has also found that in the absence of evidence to support a lower employer contribution rate for non-union employees, the same contribution rate should be used for non-union employees.⁶⁴

Thirdly, the Commission’s strict application of the BLS survey results has recently been found to be unlawful and unreasonable. In an Opinion and Order dated September 24, 2025,⁶⁵ the Franklin Circuit Court found the Commission’s use of the BLS survey results as a basis to disallow employer’s health insurance costs was unlawful and unreasonable.⁶⁶ It found that the Commission’s strict application of the BLS survey results to all utilities “without consideration of competing factors” such as the market in which the utility serves and the broader personnel goals promoting longevity and stability in the utility’s workforce constituted an unpromulgated rule that KRS 13A.130 prohibits. Furthermore, it found that the Commission, in determining the reasonableness of a utility’s health insurance costs, should consider the importance of the utility’s benefit package on employee retention, the nature of the labor market in which the utility must

⁶³ *Electronic Application of Jackson Purchase Energy Corporation for a General Adjustment of Rates and Other General Relief*, Case No. 2024-00085 (Ky. PSC Feb. 28, 2025), Order at 28. *See also Electronic Application of Taylor County Rural Electric Cooperative Corporation for a General Adjustment of Rates and Other General Relief*, Case No. 2023-00147 (Ky. PSC Apr. 5, 2024), Order at 5.

⁶⁴ Case No. 2024-00085, Order of Feb. 28, 2025 at 30.

⁶⁵ *Oldham County Water District v. Public Service Commission*, Civil Action No. 24-CI-00725 (Franklin Cir. Ct. Ky. Sep. 24, 2025).

⁶⁶ *Id.* at 7.

compete, and the financial effects on the utility and its ratepayers if the utility is required to replace or change its existing health insurance benefits.⁶⁷ After noting that the BLS survey results are not specific to the area served by the utility challenging the Commission's use "nor to the utility sector in any capacity," the Court observed that "[w]hile it is an essential duty that all utilities operate in a financially sustainable manner, there is no reason for the Commission to require a water utility to operate in the same manner as a restaurant or a bookstore. . . . The standard operating expectations for a utility should be based upon promulgated standards that are specific to the utility sector."⁶⁸ As Mr. Defever's proposal is based solely upon the strict application of the BLS survey results without consideration of other relevant factors, acceptance of that proposal would be neither lawful nor reasonable.

In summary, KAWC's total market-based compensation is reasonable and not excessive. It is a necessary cost incurred to serve customers and benefits customers. Because the Company's total employee compensation is reasonable and prudently incurred, KAWC requests that this Commission reject the AG and LFUCG's proposals and instead include the Company's proposed total market-based employee compensation expense in the revenue requirement, which includes APP and LTPP compensation, employee health insurance, the Employee Stock Purchase Program, and the 401(k) matching contributions KAWC provides to its employees, including those employees who participate in a defined benefit retirement plan.⁶⁹

(B) Working Capital Allowance

⁶⁷ *Id.* at 9.

⁶⁸ *Id.* at 8.

⁶⁹ Because KAWC's total compensation and benefits are reasonable, Mr. Defever's proposed reductions for the Employee Stock Purchase Program (Defever Direct Testimony at 12) and 401(k) matching contributions (Defever Direct Testimony at 22) should be rejected.

Working capital and other working capital are included in a utility's rate base to recognize the cost of funding the lag between the time utility service is rendered to the customer and the time it takes to collect revenues from the customer to pay for that service.⁷⁰ In other words, investors had to provide capital upfront to fund the daily operations of the business before customers pay their bills. The working capital calculations can also properly reflect the impact of any difference in time between when expenses are accrued, and the associated cash is disbursed.⁷¹ Working capital is calculated through two separate processes. The first process measures average materials and supplies balances, the result of which is "Other Working Capital," which is an uncontested component of the Company's working capital allowance in this proceeding.⁷² The second process is a lead/lag study, the result of which is "Working Capital."⁷³

The Company proposed to include \$2,788,000 of working capital in its rate base, which was decreased in the Base Period Update to \$2,772,000.⁷⁴ The Company calculated the appropriate amount of forecasted working capital by utilizing a lead/lag study performed under the direct supervision of Harold Walker, III of Gannett Fleming Valuation and Rate Consultants, LLC.⁷⁵ Walker's lead/lag study was based on historical data for the twelve months ending December 31, 2024.⁷⁶

The AG and LFUCG, through Mr. Defever,⁷⁷ contend that two adjustments should be made to the Company's working capital recommendation: (1) revising the expense lead days for Service Company charges utilized by the Company from a negative 4.20 day expense lead to a positive

⁷⁰ DeGrazia Direct Testimony at 12.

⁷¹ *Id.*

⁷² *Id.* at 12-13; Base Period Update Exhibit 37, Schedule B-1.

⁷³ DeGrazia Direct Testimony at 13; Base Period Update Exhibit 37, Schedule B-1.

⁷⁴ Base Period Update, Exhibit 37, Schedule B-1, Page 2 of 2.

⁷⁵ Direct Testimony of Harold Walker, III at 1.

⁷⁶ *Id.* at 8.

⁷⁷ Defever Direct Testimony at 39-42.

50.7 days expense lead to match the expense lead days for contracted services;⁷⁸ and (2) removal of certain cash generating cost of service items from the lead/lag study, including regulatory expense, amortization, uncollectibles, depreciation and amortization, deferred income taxes, and net income.⁷⁹

(1) KAWC's Service Company Charges Lead Days Should Not be Adjusted, Because the Company's Recommendation is Based on a Thorough Study Instead of Erroneous and Untested Assumptions.

Mr. Defever's proposed adjustment to Service Company charges lead days is based on the erroneous assumption that KAWC treats Service Company charges differently by paying those charges "earlier than necessary."⁸⁰ The Company processes and pays for Service Company expenses in the same manner as it processes and pays for all invoices it receives. Payments of all invoices, including Service Company invoices, are made within a reasonable time after receipt of the invoice.

The Company pays Service Company expense before the midpoint of the service period, not before it receives service.⁸¹ (For example, the services provided in January are paid for in the middle of January.) The Company also pays other vendors' invoices prior to the midpoint of their service periods. According to the lead-lag study, some purchased water invoices are paid before the midpoint of their service periods, as are some contract services invoices, pension invoices, most insurance other than group invoices, most rents invoices, some building maintenance invoices, some telecommunication invoices, some miscellaneous expense invoices, utility tax invoices, some state income taxes (current) invoices, and some federal income taxes (current)

⁷⁸ Rebuttal Testimony of Harold Walker, III at 6; Defever Direct Testimony, Exhibit_JD-1, Schedule CWC.

⁷⁹ *Id.* at 40.

⁸⁰ Defever Direct Testimony at 40.

⁸¹ Walker Rebuttal Testimony at 3.

invoices.⁸²

Mr. Defever also implies that service company operations are no different than any other outside service provider and that its services, costs, and billing terms should be the same as outside providers. The services, costs, and billing terms for Service Company charges, however, are not similar to outside services providers.⁸³ The Service Company exists to provide services to American Water affiliates at cost. The Service Company makes no profit from the provision of these services. The Service Company's billing terms are meant to match expenses with the receipt of payments from affiliates that are the beneficiaries of the services. Prepayment of services does not produce a profit on services. However, prepayment of charges reduces the cost of the services provided.⁸⁴

In addition, the services provided by Service Company charges and contract services expenses are quite different in nature and scope.⁸⁵ The cost structure of the services provided by each is also very different. The services provided by Service Company charges are charged at cost, meaning there is no mark-up or financial gain for any services that the Service Company or its employees charge to the affiliates of American Water.⁸⁶ In contrast, the services and the related expense of contract services include entrepreneurial profit, meaning they are marked-up for financial gain.⁸⁷ There is no reason to expect Service Company charges and contract services expenses to have similar lead days because each provides very different services and have different invoicing practices.⁸⁸

⁸² *Id.*

⁸³ *Id.* at 5.

⁸⁴ *Id.* at 4.

⁸⁵ *Id.* at 5.

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.* at 5. The lead-lag study used to determine the Company's CWC shows a range of expense lead days for the contract services providers of -102.5 (negative) to 279.5, while the Service Company charges lead days only ranged

Mr. Defever has provided no analysis for using contracted service lead days as a substitute for actual lead days of service company charges, and did not conduct his own lead/lag study.⁸⁹ He found no errors in the Service Company charges expense lead day analysis used in Mr. Walker's lead/lag study and adopted the majority of the lead/lag days used in Mr. Walker's direct testimony.⁹⁰

Mr. Defever's only justification for his recommendation was the Commission's rejection of the Company's use of actual data on service company charge in the Company's last rate case.⁹¹ In that case, despite having previously accepted such data and rejected the AG and LFUCG arguments to adjust service company charges lead days,⁹² the Commission found, that the Company had failed to provide "any reasoning for service company expenses to be collected in revenues from customers and paid before service is performed." In the present proceeding, the Company has provided extensive explanation for its use of actual data on service company charges while the AG/LFUCG witness has provided no evidence to demonstrate that such use is unreasonable and his recommendation has failed to consider the differences between services provided by the service company and outside service providers.

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

Mr. Defever recommends removal of all non-cash items from the determination of cash working capital.⁹³ His emphasis on whether an expense involves a cash flow reflects a basic

from -11.0 (negative) to 9.5. Similarly, the length of the service period of the contract services providers ranged from 1.0 day to 214.0 days, while the length of the service period of the Service Company charges only ranged from 29.0 days to 31.0 days.

⁸⁹ Walker Rebuttal Testimony at 4.

⁹⁰ *Id.* at 1.

⁹¹ Defever Direct Testimony at 41.

⁹² See *Electronic Application of Kentucky-American Water Company For An Adjustment of Rates*, Case No. 2018-00358 (Ky. PSC June 27, 2019), Order at 4-9.

⁹³ Defever Direct Testimony at 39-40. These non-cash items are regulatory expense, amortization, uncollectibles, depreciation and amortization, deferred income taxes, and net income. *Id.* at Exhibit_JD-1, Schedule CWC.

misunderstanding of the purpose of cash working capital. Cash working capital is not about whether an expense is cash or non-cash but is about the timing difference between when a utility incurs costs and when it actually collects the revenues necessary to cover those costs.⁹⁴ While non-cash items do not result in a direct cash disbursement - a company does not write a check to pay “non-cash expenses” - a utility still recovers those items through customer bills. Customers pay for these expenses as part of their total bill, and revenues attributable to these expenses are subject to the same service period and collection lag as all other revenues. Excluding the non-cash items does not remove the cost that a utility incurs as a result of the lag.

The removal of non-cash items from the cash working capital calculation will result in an understatement of the amount of capital necessary to bridge the timing gap between when service is and when it is ultimately paid for. Mr. Walker testified that the proposed removal of non-cash items from the cash working capital calculation would result in a \$62,615,481 revenue requirement deficit and would require the Company’s investors to provide \$6,707,576 in working capital to finance that deficit. The ultimate result of this deficit would be to shift the financing burden of the lag from the customers who ultimately are responsible for the lag through their payment behavior and to require the Company and its shareholders to incur an uncompensated financing burden.

Disregarding non-cash items, furthermore, sends the wrong message to the utility and financial communities. It implies that utilities suffer no adverse effects if consumers do not pay the portion of their bills attributable to non-cash items and that the collection of the entire cost of service is **not essential** to a utility’s operations. In the Company’s case, non-cash items represent **52 percent** of its net operating funds. Because net operating funds represent the Company’s cost of service or revenue requirement, the Company’s operations are dependent on the receipt of all

⁹⁴ Walker Rebuttal Testimony at 6.

its net operating funds. Accordingly, the Company is adversely affected when non-cash expenses are not paid by its customers. Excluding non-cash items from cash working capital calculation creates a potential shortfall and understates a utility's need to bridge the timing gap.

Finally, the Company acknowledges that in its last rate case the Commission, citing “recent precedent” held that non-cash items should be excluded from cash working capital determination.⁹⁵ In none of its decisions, however, has the Commission set forth its reasoning for excluding non-cash items or abandoning a considerable precedent that allowed for the inclusion of non-cash items.⁹⁶

In numerous Commission Orders dating back to 1993, the Commission expressly declined to eliminate KAWC's non-cash items from the calculation of its working capital:

- In **Case No. 92-452**, the AG recommended exclusion of all non-cash items from working capital.⁹⁷ The Commission denied the adjustment and described KAWC's methodology as “theoretically sound.”⁹⁸
- In **Case No. 95-554**, the AG proposed the exclusion of net income from working capital.⁹⁹ The Commission denied the adjustment and noted it did not accept the AG's same adjustment in Case No. 92-452.¹⁰⁰
- In **Case No. 97-034**, the AG proposed the exclusion of depreciation expense and

⁹⁵ Case No. 2023-00191, Order of May 3, 2024 at 9.

⁹⁶ *See Hughes v. Coleman*, 60 S.W.3d 540, 543-44 (“[i]t is axiomatic that an administrative agency either must conform with its own precedents or explain its departure from them. An agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored, and if an agency glosses over or swerves from prior precedents without discussion, it may cross the line from the tolerably terse to the intolerably mute. Consequently, while the agency may reexamine its prior decisions and depart from its precedents, it must explicitly and rationally justify such a change of position.”). (citations omitted).

⁹⁷ *Notice of Adjustment of the Rates of Kentucky-American Water Company*, Case No. 92-452, Order (Ky. PSC Nov. 19, 1993).

⁹⁸ *Id.* at 20.

⁹⁹ Case No. 95-554, Order of Sept. 11, 1996.

¹⁰⁰ *Id.* at 23-24.

deferred income tax expense from working capital.¹⁰¹ The Commission denied those adjustments.¹⁰²

- In **Case No. 2004-00103**, the AG proposed the exclusion of depreciation expense from working capital.¹⁰³ The Commission denied the adjustment, stating that it “continues to hold its position as stated in previous Orders”¹⁰⁴
- In **Case No. 2012-00520**, the AG argued that non-cash expenses and common equity profits should not be included in the calculation working capital.¹⁰⁵ The Commission denied the adjustment, noting that “the AG has consistently presented, and the Commission has consistently refused to adopt, his argument regarding working capital.”¹⁰⁶
- In **Case No. 2018-00358**, the AG and LFUCG argued that non-cash expenses should be excluded from the working capital calculation.¹⁰⁷ The Commission denied the adjustment “consistent with precedent and based upon the evidence in the record,” stating that the AG and LFUCG “offered no new evidence or arguments in the current proceeding to disturb our previous findings or to support a change in our position on this matter.”¹⁰⁸

The Company believes that its longstanding approach to calculating working capital is not only logical, but it is necessary to ensure that the opportunity to recover the cost of raising cash

¹⁰¹ *Application of Kentucky-American Water Company to Increase Its Rates*, Case No. 97-034, Order (Ky. PSC Sept. 30, 1997).

¹⁰² *Id.* at 27-28.

¹⁰³ Case No. 2004-00103, Order of Feb. 28, 2005.

¹⁰⁴ *Id.* at 17.

¹⁰⁵ *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year*, Case No. 2012-00520, Order of Oct. 25, 2013 at 13.

¹⁰⁶ *Id.* at 14.

¹⁰⁷ Case No. 2018-00358, Order of June 27, 2019 at 7.

¹⁰⁸ *Id.* at 9.

from investors used in day-to-day operations exists. The Company respectfully asks the Commission to reconsider its recent change of position and find that including cost of service line items in a working capital calculation continues to be appropriate. The adjustments to working capital proposed by the AG and LFUCG are unreasonable and should be denied.

(C) Unaccounted-For Water

In his testimony, Mr. Defever recommends a reduction of \$394,049 to KAWC's production costs: purchased water, fuel and power, chemicals, and waste disposal.¹⁰⁹ He contends that 807 KAR 5:066, Section 6(3) requires this reduction as the Company's forecasted unaccounted-for water loss exceeds 15 percent of forecasted test period's total water produced and purchased. While the Company acknowledges that its forecasted test period unaccounted-for water loss exceeds 15 percent of total water produced and purchased and, therefore, an adjustment is appropriate, Mr. Defever used the Company's non-revenue water percentage for the forecasted test period to calculate his adjustment and thus incorrectly calculated the adjustment.

807 KAR 5:066, Section 6(3) establishes the permissible level of unaccounted-for water for ratemaking purposes. It provides:

Unaccounted-for water loss. Except for purchased water rate adjustments for water districts and water associations, and rate adjustments pursuant to KRS 278.023(4), 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.

Non-revenue water and unaccounted-for water are not the same. Non-revenue water is the difference between all water produced and purchased and all water sold.¹¹⁰ Unaccounted-for water

¹⁰⁹ Defever Direct Testimony at 17.

¹¹⁰ Prendergast Rebuttal Testimony at 9. *See also Electronic Investigation Into the Measuring, Recording, and Reporting of Water Loss By Kentucky's Jurisdictional Water Utilities*, Case No. 2018-00394 (Ky. PSC Dec. 18, 2018), Order at 2, fn. 1 ("Nonrevenue water is defined as 'those components of system input volume that are not billed and produce no revenue; equal to unbilled authorized consumption plus apparent losses plus real losses.'").

is a subset of non-revenue water that refers to the water produced by a utility that does not reach its intended customer less accounted for water such as distribution system flushing, fire department water use, and water used in the water treatment process.¹¹¹ Unaccounted-for water is equal to non-revenue water less accounted for water. Using non-revenue water to calculate an adjustment for unaccounted-for water will, therefore, overstate the amount of the adjustment.

As neither the Company's Application, the direct testimony of Company witnesses nor the Company's responses to requests for information provided a forecasted unaccounted-for water loss percentage, Mr. Defever performed his own calculation. Based upon Exhibit JD-1, Schedule C-4, to his direct testimony, he determined a forecasted unaccounted-for water percentage of 18.4 by dividing forecasted test period total system deliveries into forecasted non-revenue water.¹¹² Using this percentage, he determined that water production costs should be reduced by 3.4 percent.

As Company Witness Lewis testified, Mr. Defever's use of forecasted test period non-revenue water rendered his unaccounted-for water percentage incorrect and resulted in an overstatement of the adjustment to reflect excessive unaccounted-for water.¹¹³ To calculate a more accurate forecasted unaccounted-for water loss percentage, Mr. Lewis used a nine-year average variance between non-revenue water and unaccounted-for water to obtain a forecasted unaccounted-for water loss of 17.24 percent, or 2.24 percent in excess of the permissible limit.¹¹⁴ Applying the 2.24 percent to water production costs, Company Witness Prendergast determined that the appropriate adjustment for excessive unaccounted-for water is \$252,471.¹¹⁵

¹¹¹ Prendergast Rebuttal Testimony at 9. *See also* Case No. 2018-00394, Order of Nov. 22, 2019 at 5 (“[U]naccounted-for water loss is ‘the difference of the total amount of water produced and purchased and the sum of water sold, water used for fire protection purposes, and water used in treatment and distribution operations (e.g., backwashing filters, line flushing).’”).

¹¹² Defever Direct Testimony at 16 and Exhibit JD-1, Schedule C-4.

¹¹³ Lewis Rebuttal Testimony at 16.

¹¹⁴ *Id.* at 16-17.

¹¹⁵ Prendergast Rebuttal Testimony at 10.

(D) Miscellaneous Expenses

Miscellaneous expenses are a component of operating expenses that include costs related to customer education, community relations, membership dues, directors' fees, hiring costs, office power, heating and oil, and laboratory supplies. The Company has included miscellaneous expense adjustments to remove charitable contributions and to apply the O&M Growth Factor.¹¹⁶

Mr. Defever, on behalf of the AG and LFUCG, proposes the removal of \$41,178¹¹⁷ from reported miscellaneous expenses allocated to membership dues of \$55,209, contending that those costs were for memberships in organizations that engaged in lobbying and political activities and that the Company has failed to demonstrate that the membership costs did not include costs for lobbying and political activities.

Following the submission of Mr. Defever's testimony, the Company revisited its membership dues expense to respond to a Commission Staff request for information and to prepare witness rebuttal testimony. It first determined that the "KY Environment Protect" amount of \$13,946 should not be included in Mr. Defever's adjustment to the 2024 Membership Dues expense because these are not costs associated with Memberships and are instead costs associated with individual operator license renewal fees paid to the Kentucky Environmental Protection Agency and are thus necessary to delivering water.¹¹⁸

The Company then re-examined its response to an earlier AG request for information and determined that it could ascertain how the remaining organizations allocate funds to advocacy efforts. Because many of the organizations to which KAWC pays dues are non-profit organizations, they must publicly file IRS Form 990 Return of Organization Exempt From Income

¹¹⁶ Direct Testimony of Michi Chao at 4.

¹¹⁷ Defever Direct Testimony at 32.

¹¹⁸ Response to PSC 4-3.

Tax (“Form 990”), which requires disclosure of certain expenditures, including those tied to lobbying and political activities. Based upon these public disclosures, the Company was able to calculate a percentage of membership dues related to lobbying expenses of 17.3 percent and apply this percentage to its revised total 2024 Membership Dues expense of \$41,263 to determine an estimated total lobbying and political activity cost of \$7,154.¹¹⁹

Ratepayers benefit from the Company’s membership in the organizations that Mr. Defever takes issue. While these organizations engage in lobbying activities, they are not lobbying on the Company’s behalf but on behalf of their regions, their member communities, and the broader interests of Kentuckians. In her rebuttal testimony, Ms. Chao provides examples of these organizations and how they enhance the quality of life in the Commonwealth.¹²⁰ The Company’s participation in these organizations is not for the support of lobbying provided by these organizations but to support the communities that the Company serves and to contribute to regional initiatives that help strengthen local economic activity. Furthermore, it helps ensure that Company remains engaged with its customers and the communities it serves and is at the forefront of local initiatives that may impact the Company’s facilities and operations.

Given the significant benefits that these memberships provide to customers and their communities and the portion of membership dues attributable to lobbying activities represents only a small fraction of total dues expense, the Commission should find Mr. Defever’s proposed adjustment to disallow all membership dues is inappropriate and should instead find the dues in their entirety are reasonable costs for recovery.

Mr. Defever further proposes removal of \$213,516 from Service Company business development expenses, contending KAWC did not provide in detail how the Service Company’s

¹¹⁹ *Id.*; Chao Rebuttal Testimony at 8.

¹²⁰ Chao Rebuttal Testimony at 6-7.

business development costs specifically benefitted Kentucky customers, and that prior Commission cases have disallowed similar costs.¹²¹ Because the Company has specifically explained the composition and value of these costs, Mr. Defever's recommendation should be rejected.

Company witness Robert Prendergast responded to Mr. Defever's proposal to remove Service Company business development costs allocated to the Company, reiterating the direct and indirect benefits that customers receive as a result of the Service Company's business development activities.¹²² In its response to AG Requests 1-56 and 2-49, the Company has provided a breakdown of business development costs as well as a detailed explanation of the benefits from these expenses. These Service Company business development costs provide a demonstrable benefit to the Company's customers and are reasonable and necessary.¹²³

Service Company business development activities allow for: mitigation of the costs to be recovered per customer, enhanced purchasing power, and the spurring of activities that contribute to customers' local economies.¹²⁴ Cost mitigation occurs when business development activities allow KAWC to grow its customer base, which enables the Company to spread system investment costs and operating expenses across a larger customer group, thereby mitigating the costs to be recovered per customer.¹²⁵ Enhanced purchasing power results from a growing customer base, which allows KAWC's parent company, American Water, to have greater negotiating leverage to purchase goods and services in bulk quantities at competitive prices, for the benefit of all customers, including KAWC customers.¹²⁶ Service Company business development activities also

¹²¹ Defever Direct Testimony at 21-22.

¹²² Prendergast Rebuttal Testimony at 10-13.

¹²³ *Id.* at 12.

¹²⁴ *Id.* at 11.

¹²⁵ *Id.* at 12.

¹²⁶ *Id.*

allow American Water and KAWC to acquire new wastewater and water utilities, and to leverage economies of scale to make operational improvements, which in turn improves the quality of water consumed by customers and the quality of the public bodies of water into which wastewater effluent is discharged.¹²⁷ Finally, business development supports activities that help the Company build relationships with local community leaders and businesses that can lead to better communications in emergencies, sharing of best practices, and provide support for local community needs.

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

(E) Growth Factor

In its Final Order in Case No. 2023-00191,¹²⁸ the Commission criticized the Company's use of general Consumer Price Index inflation factors to develop forecasted test year costs and directed the Company to develop and implement forecasting methodologies more reflective of the Company's historical costs. Accordingly, the Company reviewed its historical expense levels for years 2021-2024 for the following categories of expense: Service Company (non-labor costs), Contracted Services, Building Maintenance and Services, Telecommunication, Office Supplies and Services, Employee Related, Miscellaneous, Rents, Customer Accounting, and Maintenance Supplies and Services.¹²⁹ These expenses were then totaled for each year, 2021-2024 to smooth outlier expense increases. The total expense levels for 2021 through 2024 were then used to

¹²⁷ *Id.* at 12.

¹²⁸ Case No. 2023-00191 (Ky. PSC May 3, 2024), Order at 18.

¹²⁹ Prendergast Direct Testimony at 21.

calculate the KAWC O&M Growth Factor of 5.16 percent. This factor was applied to the expense categories listed above.¹³⁰

Arguing that an assumed growth factor is unknown and unwarranted since the costs to which the factor was applied “fluctuate over time and actually decreased from 2020 to 2021, and from 2021 to 2022,” AG Witness Defever recommends the rejection of O&M Gross Factor adjustment and reduction of forecasted test period expense by \$698,109 to reflect the disallowance of this adjustment.¹³¹

Mr. Defever’s adjustment is misplaced for several reasons. First, Mr. Defever selectively relies upon two years when total O&M expense decreased. These two time periods are not representative of longer-term trends in the Company’s O&M expenses. They coincide with the onset of the COVID-19 pandemic and related economic disruptions. The past three years of data reflect a more normal and representative environment of expense growth. Furthermore, the use of a three-year historical period is consistent with the methodology the Company uses to calculate its annual budgets.¹³²

The Company did not avoid the use of a period of decreasing expenses in calculating O&M Growth Factor. It included in its calculation of the O&M Growth Factor the decrease in expense from 2021 to 2022 – one of the time periods to which Mr. Defever refers. A compound growth rate of 5.16 percent still resulted.¹³³ As Mr. Prendergast notes in his rebuttal testimony, if a four-year average were used to calculate the KAWC O&M Growth Factor, which would account for the

¹³⁰ *Id.* at 21-22.

¹³¹ Defever Direct Testimony at 27.

¹³² Response to PSC 2-1.

¹³³ Prendergast Rebuttal Testimony at 14.

additional decrease cited by Mr. Defever (2020 to 2021), the KAWC O&M Growth Factor would still result in an average compound annual growth rate of 2.99 percent.¹³⁴

Mr. Defever's emphasis on fluctuations and occasional declines in expense levels as a reason to reject the Company's O&M Growth Factor is misplaced. It paints an incomplete picture of the current economic environment and its effect on Company expenses. Expense fluctuations are expected as the business continues to grow, improves operational efficiency, adapts to customer demands, meets contractual obligations and regulatory requirements, and addresses aging infrastructure.¹³⁵ Moreover, by using multi-year averages the Company's methodology balances short-term fluctuations and long-term trends by utilizing averages to help ensure that temporary irregularities do not distort the forecast.¹³⁶ This helps provide a stable and representative measure of KAWC's O&M expense needs.¹³⁷

In summary, the O&M Growth Factor is not an arbitrary inflation factor, but instead a company-specific percentage grounded in the Company's actual experience and addresses the Commission's concerns regarding the Company's use of general inflationary percentages in prior rate proceedings. It is a conservative, company-specific metric grounded in the Company's actual data and known costs that smooths irregularities across expenses. Disallowing the growth factor leaves the Company unable to recover its reasonable O&M costs.

(F) Rate Case Expenses

As a regulated utility, KAWC has a legal obligation to provide safe and adequate service to its customers at just and reasonable rates. Periodic rate changes are necessary to support the Company's continued provision of safe and adequate service to its customers. The way that

¹³⁴ *Id.*

¹³⁵ Chao Rebuttal Testimony at 2.

¹³⁶ Response to PSC 5-5.

¹³⁷ Prendergast Rebuttal Testimony at 15.

KAWC changes its base rates is through the rate case process. The cost of litigating a rate case is a normal and essential cost of service for any regulated public utility and should be treated as such.¹³⁸

The Company proposes to recover forecasted rate case expenses related to this case of \$1,218,404 over a two-year amortization period, starting at the beginning of the forecasted test year, January 1, 2026.¹³⁹ A two-year amortization period was proposed to align with the amount of time since the Company's last rate case filing.¹⁴⁰ The Company further proposes to include in the forecasted test period \$332,246 to reflect the amortization of the remaining balance of rate case expenses from the Company's 2023 rate case.¹⁴¹ Total rate case expense included in the forecasted test period is \$941,449.¹⁴²

AG/LFGUG Witness Defever proposes to reduce forecasted case expense by \$425,566 to reflect the use of a three-year amortization period and the amortization of \$332,246 of the remaining balance of the Company's 2023 rate case expense over three years.¹⁴³ This proposed adjustment should be rejected. A three-year amortization period is not consistent with the amount of time that has elapsed since the Company's last rate case filing nor is it consistent with the principle that an appropriate amortization period should reflect a utility's most recent filing history. Furthermore, extending the amortization period for the Company's unamortized 2023 rate case expenses for three additional years conflicts with the Commission's finding in the Company's prior rate case that a three-year amortization period was reasonable and with Mr. Defever's own testimony that a reasonable amortization period for rate case expenses is three years.

¹³⁸ DeGrazia Direct Testimony at 19.

¹³⁹ *Id.* at 18; Response to PSC 1-1, W/P 3-6; Response to AG 1-50.

¹⁴⁰ Response to PSC 2-23.

¹⁴¹ Response to PSC 1-1, W/P 3-6.

¹⁴² *Id.*

¹⁴³ Defever Direct Testimony at 20.

Mr. Defever's recommendation that rate case expense should be limited to those actually incurred at the close of the record in this proceeding should also be rejected. Due to the timing of the regulatory process, limiting rate case expense to the actual expenses as of the closing of the record is problematic. The Company can reasonably calculate the amount of invoiced expenses almost up to the date on which the case record closes, which in this proceeding is on October 28, 2025. However, there is some level of rate case expense that must be estimated because the costs are incurred as the record closes, and *after* the record closes. The Company must therefore predict the level of rate case expense that may be incurred after October 28, 2025.

Rate case expenses, particularly legal expenses, may be incurred after the record closes for a number of reasons. After the case is submitted for a decision and the Commission issues its decision, rate case expenses could accrue for: review of the Commission's order in this case; responding to the Commission's orders related to petitions for confidential protection of sensitive information; preparing a motion for reconsideration or rehearing; briefing and reviewing intervenors' briefs on rehearing; responding to any data requests related to rehearing; or preparing and litigating an appeal through the Kentucky courts. These tasks could require input from outside legal counsel and expert consultants. Although the Company does not intend to recover more or less than the actual rate case in this proceeding,¹⁴⁴ it is unable to predict which of these expenses may accrue, and so it has made a necessary and reasonable estimate.¹⁴⁵

III. CAPITAL STRUCTURE

Customers benefit from a utility that is well run, generates predictable financial results, and maintains an appropriate capital structure. KAWC's customers benefit from a reasonable capital

¹⁴⁴ Contemporaneous with the filing of this brief, KAW has also filed its updated actual rate case expense (via an update to AG 2-16) which totals \$813,240 as of October 27, 2025.

¹⁴⁵ DeGrazia Rebuttal Testimony at 6.

structure because it: (1) allows the Company to maintain strong credit ratings and (2) enables the Company to access capital markets on good terms and at a reasonable cost.¹⁴⁶ The Company proposes a capital structure for the forecasted test period composed of 52.26 percent common equity, 46.1 percent long-term debt, 1.31 percent short-term debt, and 0.33 percent preferred stock.¹⁴⁷ In light of how the Company is projected to be financed for the forecasted test-year, the proposed capital structure will allow KAWC to reasonably maintain its financial strength and access cost-efficient financing so that the Company can continue providing safe and reliable service for customers. It is nearly identical to that approved in the Company's last rate proceeding.¹⁴⁸ The AG and LFUCG do not contest the proposed capital structure.¹⁴⁹

IV. COST OF EQUITY AND RATE OF RETURN

The key to determining a reasonable rate of return on equity ("ROE") is to ensure that the analysis reasonably reflects investors' views of the financial markets—both in general and, in the context of a proxy group, of the subject company. The Company's ROE recommendation draws from multiple analytical techniques that rely on market-based data to quantify investor expectations regarding required equity returns, adjusted for certain incremental costs and risks. Quantitative models produce a range of reasonable results from which the market-required ROE is selected. That selection is based on a comprehensive review of relevant data and information and does not necessarily lend itself to a strict mathematical solution.

KAWC retained an expert, Ann E. Bulkley, to conduct thorough, market-based cost of equity analyses to recommend a reasonable rate of ROE. The differences in the recommended

¹⁴⁶ Direct Testimony of Jennifer Gonzales at 10.

¹⁴⁷ *Id.* at 4; Base Period Update, Exhibit 37, Schedule J-1.

¹⁴⁸ Gonzales Direct Testimony at 4.

¹⁴⁹ Baldino Direct Testimony at 3 ("Regarding KAW's proposed capital structure and cost of debt, I find that they are reasonable as filed and have accepted them for purposes of this case.").

ROEs sponsored by the parties in this case are significant. The Company recommends an ROE of 10.75 percent. Meanwhile, the AG and LFUCG recommend a ROE of 9.50 percent, which falls well below the 10.25 percent to 11.25 percent range recommended by Bulkley.¹⁵⁰

(A) Framework for Determining a Fair and Reasonable Cost of Equity

The United States Supreme Court's *Hope*¹⁵¹ and *Bluefield*¹⁵² decisions established the standards for determining the fairness and reasonableness of a utility's authorized ROE. Among the standards established by the Court in those cases are: (1) consistency with other businesses having similar or comparable risks; (2) adequacy of the return to support credit quality and access to capital; and (3) the principle that the specific means of arriving at a fair return are not important, only that the end result leads to just and reasonable rates.¹⁵³ In the oft-cited *Hope* decision, the United States Supreme Court stated:

From the investor or company point of view, it is important that there be enough revenue not only for operating expenses, but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard, the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.¹⁵⁴

These decisions set forth three standards,¹⁵⁵ each of which must be met for the return to be considered just and reasonable:

1 → Comparable return standard

2 → Financial integrity standard

¹⁵⁰ Direct Testimony of Ann E. Bulkley at 5.

¹⁵¹ *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591 (1944).

¹⁵² *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n*, 262 U.S. 679 (1923).

¹⁵³ Bulkley Direct Testimony at 5.

¹⁵⁴ *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944) (internal citations omitted).

¹⁵⁵ Bulkley Direct Testimony at 9.

3 →Capital attraction standard

It is important to recognize that investors make rational decisions regarding investments of comparable risk. If an investment does not receive a comparable return to other investments of similar risk, it will be difficult to attract capital.¹⁵⁶ Because investors are likely to invest equity in utilities with the highest returns, authorizing a return for KAWC that is below the returns awarded to other water, natural gas, and electric utilities could negatively affect the Company's access to capital over the long-term.¹⁵⁷ An authorized return on equity for KAWC that fails to account for the financial risks on cash flow metrics and is substantially below the returns of other risk-comparable utilities would disadvantage KAWC and its customers.

(B) The Company's Proposal

(1) *KAWC's Recommended ROE is Reasonable and Supported by Substantial Evidence.*

Ms. Bulkley's analyses incorporate several equity estimation methods, including the Constant Growth Form of the Discounted Cash Flow ("DCF") model, the Capital Asset Pricing Model ("CAPM"), and the Empirical Capital Asset Pricing Model ("ECAPM") to a proxy group of comparable risk utility companies.¹⁵⁸ She also considered the Company's capital expenditure requirements and adjustment mechanisms as compared with the proxy group. In addition, Ms. Bulkley's analyses considered capital market conditions and demonstrated that (1) inflation rate remains elevated;¹⁵⁹ (2) despite recent reductions in federal funds rate, significant policy changes (i.e., trade, immigration, fiscal policy and regulation) by the Trump administration have increased uncertainty regarding the path of monetary policy; and (3) long-term interest rates are expected to

¹⁵⁶ *Id.* at 9-10.

¹⁵⁷ Response to LFUCG 1-46 at 1.

¹⁵⁸ Bulkley Direct Testimony at 10.

¹⁵⁹ *Id.*

continue to remain elevated during the period that the Company's adjusted rates will be in effect.¹⁶⁰ The results of Ms. Bulkley's analyses demonstrate that KAWC's cost of equity and ROE should be higher than what was approved in the Company's previous rate case—not lower, as proposed by the AG.

Ms. Bulkley established a proxy group of companies that are both publicly-traded and comparable to KAWC in certain fundamental business and financial respects to serve as “proxy” for purposes of the cost of equity estimation process.¹⁶¹ The proxy companies all possess a set of operating and financial risk characteristics that are substantially comparable to KAWC, and therefore provide a reasonable basis for deriving the appropriate ROE.¹⁶² Ms. Bulkley developed the proxy group by first identifying U.S. utilities that Value Line classifies as water utilities and natural gas distribution companies applying certain screening criteria.¹⁶³ Because of the trend towards consolidation in the utility industry and the resulting small number of water utility companies available for inclusion in the proxy group, Ms. Bulkley considered electric and natural gas distribution companies.¹⁶⁴ After applying the screening criteria for these companies, the final proxy group comprised of eleven publicly traded water and natural gas utilities who operate across the United States.¹⁶⁵ The reasonableness of the proxy group is not contested as the AG's witness relied upon the same proxy group, contending that the group “provides a reasonable basis upon which to estimate the ROE” for KAWC in this proceeding.¹⁶⁶

Ms. Bulkley first applied the DCF valuation model. The DCF method is premised on the assumption that a stock's current price represents the present value of all expected future cash

¹⁶⁰ Rebuttal Testimony of Ann E. Bulkley at 9.

¹⁶¹ *Id.* at 16-17.

¹⁶² *Id.* at 17.

¹⁶³ *Id.*

¹⁶⁴ *Id.* at 19.

¹⁶⁵ *Id.* at 23.

¹⁶⁶ Baudino Direct at 15.

flows.¹⁶⁷ The Constant Growth DCF model requires the following assumptions: (1) a constant growth rate for earnings and dividends; (2) a stable dividend payout ratio; (3) a constant price-to-earnings (“P/E”) ratio; and (4) a discount rate greater than the expected growth rate.¹⁶⁸ For the proxy group, the mean and median Constant Growth DCF results using the average growth rates range from 10.63 percent to 11.17 percent and the mean and median results using the maximum growth rates are in the range of 11.36 percent to 11.59 percent.¹⁶⁹

Ms. Bulkley also performed a traditional CAPM method of estimating the cost of equity, which is a risk premium approach that estimates the cost of equity for a given security as a function of a risk-free return plus a risk premium to compensate investors for the non-diversifiable or “systematic” risk of that security.¹⁷⁰ To estimate her risk-free rate, Ms. Bulkley used (1) the current 30-day average yield of 30-year U.S. Treasury bonds; (2) the average projected 30-year U.S. Treasury bond yield for the third quarter of 2025 through the third quarter of 2026; and (3) the average projected 30-year U.S. Treasury bond yield for 2026 through 2030.¹⁷¹ Bulkley used the average Beta coefficients for the proxy group companies as reported by Value Line and Bloomberg, as well as a long-term average utility beta coefficient calculated as an average of the Value Line beta coefficients for the proxy group companies from 2013 through 2024.¹⁷² She estimated the Market Risk Premium based on the expected total return on the S&P 500 Index less the 30-year Treasury bond yield.¹⁷³ Ms. Bulkley obtained a range of traditional CAPM results for the proxy group of 10.52 percent to 11.57 percent.¹⁷⁴

¹⁶⁷ Bulkley Direct at 26.

¹⁶⁸ *Id.* at 26.

¹⁶⁹ *Id.* at 30.

¹⁷⁰ *Id.* at 30.

¹⁷¹ *Id.* at 32.

¹⁷² *Id.*

¹⁷³ *Id.* at 32.

¹⁷⁴ *Id.* at 35.

In addition, Ms. Bulkley performed an ECAPM—the empirical form of the CAPM—which addresses the tendency of the traditional CAPM to underestimate the cost of equity for companies with low beta coefficients, such as regulated utilities.¹⁷⁵ The ECAPM analysis first calculates the product of the adjusted beta coefficient and the market risk premium and applies a weight of 75.00 percent to that result, then calculates the market risk premium without any effect from the beta coefficient and applies a 25.00 percent weight to that result.¹⁷⁶ The combined results of the two calculations, along with the risk-free rate, produce the ECAPM result.¹⁷⁷ Ms. Bulkley obtained a range of ECAPM results for the proxy group of 11.03 percent to 11.82 percent.¹⁷⁸

After performing these analyses, Ms. Bulkley then considered several factors that would affect the Company’s risk profile relative to the proxy group. These included the Company’s projected capital expenditure requirements, the regulatory environment in which it operated, and flotation costs. While noting that the Company’s current capital expenditures as a percentage of net utility plant are slightly below the median for the proxy group,¹⁷⁹ she found the size of the Company’s proposed capital additions, much of which is not recoverable through the Qualified Infrastructure Program (“QIP”) surcharge, imposes financial strains and risks on the Company.¹⁸⁰ She further found that the Company had a greater than average regulatory risk as compared to the proxy group as the other members of the group have more timely cost recovery between rate proceedings and as the Company had significantly under-earned its authorized ROE in each of the last seven years.¹⁸¹

¹⁷⁵ *Id.* at 34.

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 35.

¹⁷⁹ *Id.* at 36.

¹⁸⁰ *Id.* at 39.

¹⁸¹ *Id.* at 44.

Ms. Bulkley's research and analysis demonstrates that the 10.75 ROE is reasonable for the Company's base rates *and* QIP mechanism. The appropriate comparison for purposes of assessing the business risk and regulatory risk of the Company is relative to the operating utilities of the proxy group – not focusing solely on the Company. As shown on Exhibit AEB-8 in Ms. Bulkley's Direct Testimony, the vast majority of the operating subsidiaries of the proxy group companies have mechanisms to recover the cost of capital expenditures outside of rate proceedings. As such, if the ROE is reduced for the QIP mechanism, the Company is mistakenly being treated as *less* risky than the proxy group, which Ms. Bulkley's detailed analysis clearly refutes.

In summary, Ms. Bulkley found a reasonable range for KAWC's ROE in this proceeding is from 10.25 percent to 11.25 percent, and within that range, an ROE of 10.75 percent reasonably reflects investor required-returned. Her recommendation is based upon detailed cost of equity analyses and consideration of the business and regulatory risks that the Company faces, is supported by significant evidence, reflects current and expected economic conditions, and should be adopted.

(C) The AG's Proposal

(1) *The AG's Estimated Cost of Equity Fails to Reflect That The Cost of Equity Has Increased Since the Company's Last Rate Proceeding.*

The AG filed direct testimony regarding KAWC's return on equity through its witness, Mr. Baudino. Mr. Baudino reached his recommendation after performing DCF and CAPM analyses, using the same proxy group Ms. Bulkley used and a smaller proxy group consisting of water utilities only, and relying primarily on the DCF model.¹⁸² Mr. Baudino, in his analysis, recognized recent market trends such as increasing interest rates.¹⁸³ These market trends indicate a higher

¹⁸² Direct Testimony of Richard A. Baudino at 3; Bulkley Rebuttal Testimony at 10.

¹⁸³ Bulkley Rebuttal Testimony at 10.

cost of equity for utilities. Nonetheless, Mr. Baudino concluded that his DCF analysis of the smaller water proxy group supports a recommended ROE range of 9.25 percent to 9.75 percent and proposed reducing the Company's ROE to 9.50 percent.¹⁸⁴

Mr. Baudino's ROE recommendation should be rejected because it does not appropriately reflect the increase in the cost of equity since the Company's last rate proceeding as indicated by the change in market conditions as well as the change in Mr. Baudino's cost of equity results. In the Company's last rate proceeding, the Commission approved a ROE of 9.70 percent. Mr. Baudino acknowledges that the cost of equity for utilities will increase as interest rates increase.¹⁸⁵ Since he filed his testimony in the Company's last rate proceeding in September 2023, the 30-year Treasury bond yield has increased 60 basis points.¹⁸⁶ Furthermore, long-term interest rates are expected to continue to remain elevated during the period that the Company's rates will be in effect.¹⁸⁷ The results of Mr. Baudino's constant growth DCF analysis using his Combination Proxy Group increased 19 to 66 basis points.¹⁸⁸ While Mr. Baudino recommends an ROE of 9.50 percent for KAWC, which is an increase of 10 basis points from his recommended ROE of 9.40 percent in the Company's last rate proceeding, given the increase in interest rates and the results of his cost of equity analyses since he filed his testimony in the Company's last rate proceeding, his recommended ROE is still 20 basis points below KAWC's current authorized ROE, is obviously inadequate, and cannot be expected to reflect the investor-required return.¹⁸⁹

In this proceeding, Mr. Baudino has made changes to his methodology for recommending a ROE that weaken the credibility and reliability of his results and his recommendation. In

¹⁸⁴ Baudino Direct Testimony at 34.

¹⁸⁵ *Id.* at 5.

¹⁸⁶ Bulkley Rebuttal Testimony at 5.

¹⁸⁷ Bulkley Rebuttal Testimony at 9.

¹⁸⁸ *Id.* at 5.

¹⁸⁹ *Id.* at 7

KAWC’s last rate case in 2023, Mr. Baudino recommended a ROE of 9.40 percent, which was the midpoint of his recommended ROE range of 8.70 percent to 10.00 percent.¹⁹⁰ Similar to the current proceeding, Mr. Baudino relied on DCF and CAPM analyses to develop his recommendation; but only relied on a proxy group containing water and natural gas utilities and did not consider a Water Proxy Group. He set the low-end of his range to 8.70 percent because he concluded that cost of equity estimates below 8.70 percent were “too conservative” given the market conditions at the time his testimony was filed. He excluded his constant growth DCF result of 8.41 percent based on median analyst growth forecasts and projected EPS growth rates from Yahoo! Finance.¹⁹¹ This resulted in a low-end for his constant growth DCF analysis of 8.70 percent which he selected as the low-end of his recommended ROE range. The high-end of his recommended ROE range was set equal to the high-end of his constant growth DCF results and the high-end of his CAPM analyses that rely on historical market risk premia. Had Mr. Baudino applied the same methodology for determining the ROE in the current proceeding as he did in the Company’s last rate proceeding, his recommended ROE range would have been 9.10 percent to 10.50 percent with a midpoint of 9.80.¹⁹² His recommended ROE would have increased from 9.50 percent to 9.80 percent.¹⁹³

In the current proceeding, Mr. Baudino developed a constant growth DCF analysis and a CAPM analysis using a Combination Proxy Group composed of the same water and natural gas utilities that Ms. Bulkley used as well as a proxy group that contains the water utilities included in his Combination Proxy Group and American Water Works Company (“the Water Proxy Group”). He created the Water Proxy Group although he conceded that it is reasonable to rely upon the

¹⁹⁰ *Id.* at 11.

¹⁹¹ *Id.*

¹⁹² *Id.* at 12.

¹⁹³ *Id.* at 13.

Combination Proxy Group to estimate the Company's ROE.¹⁹⁴

Mr. Baudino relies primarily on his DCF results to develop his recommended ROE range of 9.25 percent to 9.75 percent. The low end of his range appears to be based on: (1) the average of his DCF results for the Combination Proxy Group that rely on the median analyst growth forecasts ("Method 2"); and (2) the average of his DCF results for the Water Proxy Group that rely on the average analyst growth forecasts ("Method 1").¹⁹⁵ The high end of his range is based on the average of his DCF results for the Combination Proxy Group using Method 1. The results of Mr. Baudino's constant growth DCF scenarios using projected DPS growth rates range from 7.75 percent to 7.98 percent for the Combination Proxy Group and 8.49 percent to 8.97 percent for the Water Proxy Group.¹⁹⁶ Despite these results being below the 8.70 percent threshold that he found acceptable in the Company's last rate case, Mr. Baudino relied upon them. Mr. Baudino has provided neither support nor an explanation as to why his approach for determining the recommended ROE is not consistent with his approach in the Company's last rate case.

In her rebuttal testimony, Ms. Bulkley pointed to several issues with Mr. Baudino's DCF model and CAPM model which rendered its results unreliable.¹⁹⁷ When these issues were addressed, the average adjusted constant growth DCF result using Method 1 (average) increases from 9.73 percent to 10.31 percent while the average constant growth DCF result using Method 2 (median) increases from 9.23 percent to 9.55 percent. Similarly, the adjusted CAPM analysis results in a range of 9.24 percent to 10.98 percent with an average of 10.13 percent.

Although Mr. Baudino claims to recognize the comparable return, financial integrity, and capital attraction standards that are established by the United States Supreme Court in the *Hope*

¹⁹⁴ Baudino Direct Testimony at 15.

¹⁹⁵ Bulkley Rebuttal Testimony at 10.

¹⁹⁶ Baudino Direct Testimony at 33.

¹⁹⁷ Bulkley Rebuttal Testimony at 13-36.

and *Bluefield* cases,¹⁹⁸ he abandons these standards when establishing his range and ROE recommendation. These Supreme Court decisions together determined that the authorized ROE must meet all three standards: comparable returns, financial integrity, and capital attraction. Baudino's ROE recommendation of 9.50 percent does not provide a return on equity that is comparable to those available to investors in companies with commensurate risk and is not sufficient to allow KAWC to compete for capital with other similar risk firms.

At the evidentiary hearing, Mr. Baudino admitted that if his 9.50 percent is accepted, KAWC will have the lowest ROE of any of American Water's operating subsidiaries that has received a rate adjustment this year.¹⁹⁹ Mr. Baudino further agreed that all four operating subsidiaries that had revised rates set in 2025—Illinois, Missouri, Tennessee, and Virginia—had been awarded an average ROE of 9.75 percent.²⁰⁰ Mr. Baudino also acknowledged that the Kentucky Commission has recently awarded ROEs of 9.75 to three utilities.²⁰¹

KAWC's proposed ROE of 10.75 percent creates a reasonable opportunity for capital investors to earn a risk-comparable return, allows the Company to maintain its financial integrity, and enables KAWC to attract necessary capital investment for the benefit of its customers. The Company, through the expert testimony of Ms. Bulkley, has shown that the range of reasonable market-required ROEs results is 10.25 percent to 11.25 percent.²⁰² The Company's proposed ROE recognizes existing and expected capital market conditions.²⁰³ Because Mr. Baudino's recommendation fails to reflect existing capital market conditions, the AG's ROE proposal is

¹⁹⁸ Baudino Direct Testimony at 4.

¹⁹⁹ 9/23/2025 Hearing, VR 15:47:01-15:47:14.

²⁰⁰ 9/23/2025 Hearing, VR 15:44:04-15:45:13.

²⁰¹ 9/23/2025 Hearing, VR 15:48:11-15:49:32.

²⁰² Bulkley Direct Testimony at 5.

²⁰³ Bulkley Direct Testimony at 19, Figure 4.

unreasonably low and should be rejected. KAWC respectfully requests the Commission instead adopt Bulkley's recommended ROE of 10.75 percent.

V. UNCONTESTED RATE BASE ISSUES

Rate base measures the Company's net investment in the provision of water service.²⁰⁴ This investment includes the facilities and property for sourcing, treating, pumping, and distributing potable water for consumption, sanitation, and fire protection, as well as assets to support customer account, customer service, and basic business operations.²⁰⁵ Of the rate base components included in the Base Period Update Exhibit 37 Schedule B-1, the only contested components of the Company's proposed rate base, as previously discussed, are the working capital allowance and the proposed roll-in of the current QIP into base rates.²⁰⁶ All other rate base components are reasonable as proposed by the Company, and should be approved.

The Company's methodology for calculating rate base utilizes a thirteen-month average rate base calculation for the forecasted test year.²⁰⁷ Most of the rate base elements were forecasted from actual per books data as of February 28, 2025, adjusted for changes expected through December 31, 2026.²⁰⁸

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

In prior rate cases, KAWC has included Construction Work in Progress ("CWIP") in rate base and has calculated the Allowance of Funds used During Construction ("AFUDC") based on the CWIP eligible balances. The present rate and forecasted revenues were then reduced by this AFUDC amount. While it had previously approved this practice,²⁰⁹ the Commission in the

²⁰⁴ DeGrazia Direct Testimony at 11.

²⁰⁵ *Id.*

²⁰⁶ *See supra* Section V.

²⁰⁷ DeGrazia Direct Testimony at 11.

²⁰⁸ *Id.*

²⁰⁹ Case No. 2010-00036, Order of Dec. 14, 2010 at 12.

Company's last rate proceeding ordered that CWIP be removed from KAWC's rate base.²¹⁰ To comply with the Commission's order, the Company has excluded CWIP balance from rate base and removed the AFUDC offset to revenues.²¹¹

(B) Additional Uncontested Rate Base Components

Several additional components of the Company's proposed rate base²¹² have been uncontested in this proceeding, namely: Utility Plant in Service ("UPIS"),²¹³ Utility Plant Acquisition Adjustments ("UPAA"),²¹⁴ Accumulated Depreciation,²¹⁵ Contributions in Aid of Construction ("CIAC"),²¹⁶ Customer Advances,²¹⁷ Deferred Income Taxes,²¹⁸ Deferred Income Tax Credits,²¹⁹ Deferred Maintenance,²²⁰ Deferred Debits,²²¹ and Other Rate Base Elements.²²² Company witness DeGrazia describes each of these components.²²³ With the exception of Deferred Income Taxes, which was adjusted upward \$138,000, the Company made no adjustments or revisions to the proposed amounts of these uncontested components throughout the pendency of this proceeding.²²⁴

²¹⁰ Case No. 2023-00191, Order of May 3, 2024 at 12.

²¹¹ DeGrazia Direct Testimony at 17.

²¹² See Base Period Update, Exhibit 37, Schedule B-1, Page 2 of 2.

²¹³ DeGrazia Direct at 12.

²¹⁴ *Id.* at 14.

²¹⁵ *Id.* at 14-15.

²¹⁶ *Id.* at 15.

²¹⁷ *Id.* at 16.

²¹⁸ *Id.* at 16-17.

²¹⁹ *Id.* at 17.

²²⁰ *Id.* at 13-14.

²²¹ *Id.* at 14.

²²² *Id.* at 10.

²²³ Response to PSC 1-10.

²²⁴ DeGrazia Rebuttal Testimony at 4-5. *Compare* Filing Exhibit 37, Schedule B-1 with Base Period Update, Exhibit 37, Schedule B-1.

VI. QUALIFIED INFRASTRUCTURE PROGRAM SURCHARGE ROLL-IN

Under its present tariff, KAWC is authorized to assess a Qualified Infrastructure Program (“QIP”) Surcharge. Authorized by the Commission in 2019,²²⁵ the QIP surcharge provides the Company an opportunity to recover costs associated with the replacement of aging infrastructure performed under the Company’s QIP.²²⁶ These costs include a return on net QIP plant in service at the overall rate of return on capital authorized in the Company’s latest base water rate case, depreciation expense on QIP plant in-service, and property taxes related to QIP plant.²²⁷ The Company is required to annually submit to the Commission its projected costs for the next QIP period and a balancing adjustment that trues up the projected program costs and revenues with actuals for the proceeding annual QIP period. The Company’s filing becomes effective on January 1 of the following year. The balancing adjustment will be filed no later than March 31 following the end of each 12-month QIP period.²²⁸ While the QIP Surcharge has been in operation for six years and the Company’s tariff suggests that QIP plant can be included in base water rates, no QIP plant has been placed into the Company’s rate base.²²⁹

In its Application, the Company proposes to roll into its net original cost rate base \$82,249,891 of QIP plant in-service,²³⁰ as well as all expenses and revenues associated with the QIP surcharge mechanism.²³¹ This amount represents all constructed QIP plant in-service and all QIP investments authorized in Case No. 2024-00272 for calendar year 2025.²³² If the roll-in is

²²⁵ Case No. 2018-00358, Order of June 27, 2019.

²²⁶ Kentucky-American Water Company Tariff, P.S.C. Ky. No. 10, Sheets 48-49.

²²⁷ *Id.* at Sheet 48.

²²⁸ *Id.* at Sheet 49.

²²⁹ In its last rate proceeding, the Company unsuccessfully sought to roll QIP plant into its base rates. Case No. 2023-00191, Order of May 3, 2024 at 13, 75. That proceeding was the Company’s first application for rate adjustment since the Commission authorized the QIP surcharge.

²³⁰ Response to AG 2-71.

²³¹ DeGrazio Direct Testimony at 9.

²³² Response to AG 2-71.

permitted, all costs recovered through the QIP surcharge for QIP plant constructed or authorized for construction in 2025 would be recovered through base rates and the QIP surcharge would be reduced to zero and remain at zero until January 2027.²³³ The Company's proposal is consistent with Commission practice for other surcharges, such as those to recover the costs of environment compliance²³⁴ and natural gas pipeline replacement.²³⁵

The proposed roll-in of the current QIP plant and costs will lessen the administrative burden of tracking the current level of QIP projects and the separation of costs.²³⁶ There have been six QIP applications along with balancing adjustments since the QIP was approved. This requires a roll forward and the continued tracking of the QIP projects and the costs of capital, depreciation, expenses and taxes associated with qualified infrastructure investment, in each of the filings to account for and be able to calculate the averaging of the rate base, respective to each filing and time period covered. The roll-in of QIP into base rates would, therefore, be a reset of the historical QIP filings and tracking of the filings, which would result in less administrative burden.²³⁷ The roll-in would also allow the Commission to view the revenue requirement holistically and allow QIP costs to be part of standard full cost of service.

While AG/LFUGC witness Defever opposes the proposed roll-in on the grounds that it would reduce transparency,²³⁸ he fails to demonstrate how such a result would occur. All QIP

²³³ The forecasted test period rate base includes all plant additions through December 31, 2026, including those that otherwise would be constructed under the QIP. Therefore, there are no QIP costs to be recovered in calendar year 2026.

²³⁴ See, e.g., *Electronic Examination By The Public Service Commission of The Environmental Surcharge Mechanism of Kentucky Utilities Company For The Two-Year Billing Period Ending April 30, 2019*, Case No. 2019-00205 (Ky. PSC Oct. 22, 2019).

²³⁵ See, e.g., *Electronic Application of Delta Natural Gas Company, Inc. for an Adjustment of Its Rates and a Certificate of Public Convenience and Necessity*, Case No. 2021-00185, (Ky. PSC Jan. 3, 2022); *Electronic Application of Atmos Energy Corporation For An Adjustment of Rates*, Case No. 2021-00214 (Ky. PSC May 19, 2022).

²³⁶ DeGrazio Direct Testimony at 22

²³⁷ Response to AG 2-69.

²³⁸ Defever Direct Testimony at 37.

additions are currently reviewed and authorized by the Commission prior to their construction in a formal proceeding whose documents are readily available through the Commission's website. Commission and intervenor review in each QIP proceeding has been rigorous and thorough. The Company is also required to make annually a public filing showing actual revenues and costs that may be subject to a formal Commission proceeding. As a result, a readily available audit trail exists for any member of the public.

While Mr. Defever is correct that the Company's tariff will still require the Company to maintain a record of QIP plant additions, costs, and revenues between roll-ins,²³⁹ common sense suggests that maintaining this information for a two- or three-year period is much less burdensome than maintaining it for six, ten or fifteen years.²⁴⁰

Should the Commission deny the Company's request to roll QIP plant, revenues, and expenses into base rates, then the Commission must approve a new QIP surcharge rate to ensure that the Company is made whole on its pipeline replacements. The current charge is 11.09 percent, but that charge includes two balancing adjustments that expire at the end of 2025.²⁴¹

VII. CONCLUSION

KAWC supported the entirety of its request for rate relief through record evidence in this proceeding. The Company has met its burden of proof with respect to demonstrating the reasonableness of its proposed revenue requirement, including employee related costs, working capital allowance, miscellaneous expenses, rate case expenses, and unaccounted-for water loss. The capital structure and ROE that KAWC has requested are reasonable and premised on the

²³⁹ *Id.*

²⁴⁰ DeGrazia Rebuttal Testimony at 7.

²⁴¹ *Id.* at 8.

prudent application of a host of cost of equity estimation models. The Company would be placed at a competitive disadvantage if Mr. Baudino's recommended ROE is adopted.

KAWC respectfully requests that the Commission approve revisions to the Company's tariff and the requested increase in rates to ensure that the Company is afforded the fair, just, and reasonable rates to which it is entitled.

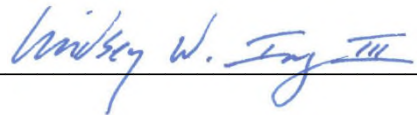
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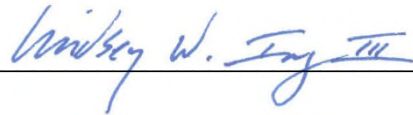
BY:  _____

Attorneys for Kentucky-American Water Company

CERTIFICATE

In accordance with the Commission's Order of July 22, 2021 in Case No. 2020-00085 (Electronic Emergency Docket Related to the Novel Coronavirus COVID-19), this is to certify that the electronic filing has been transmitted to the Commission on October 27, 2025; and that there are currently no parties in this proceeding that the Commission has excused from participation by electronic means.

STOLL KEENON OGDEN PLLC

BY: 

Attorneys for Kentucky-American Water Company