COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY-AMERICAN WATER COMPANY FOR AN ADJUSTMENT OF RATES	)))	CASE NO. 2015-00418

COMMISSION STAFF'S THIRD REQUEST FOR INFORMATION TO KENTUCKY-AMERICAN WATER COMPANY

Kentucky-American Water Company ("KAWC"), pursuant to 807 KAR 5:001, is to file with the Commission the original in paper medium, one paper copy, and an electronic version of the following information. The information requested herein is due on or before April 25, 2016. Responses to requests for information in paper medium shall be appropriately bound, tabbed and indexed. Each response shall include the name of the witness responsible for responding to the questions related to the information provided.

Each response shall be answered under oath or, for representatives of a public or private corporation or a partnership or association or a governmental agency, be accompanied by a signed certification of the preparer or person supervising the preparation of the response on behalf of the entity that the response is true and accurate to the best of that person's knowledge, information, and belief formed after a reasonable inquiry.

KAWC shall make timely amendment to any prior response if it obtains information which indicates that the response was incorrect when made or, though correct when made, is now incorrect in any material respect. For any request to which

KAWC fails or refuses to furnish all or part of the requested information, KAWC shall provide a written explanation of the specific grounds for its failure to completely and precisely respond.

Careful attention should be given to copied material to ensure that it is legible. When the requested information has been previously provided in this proceeding in the requested format, reference may be made to the specific location of that information in responding to this request. When filling a paper containing personal information, KAWC shall, in accordance with 807 KAR 5:001, Section 4(10), encrypt or redact the paper so that personal information cannot be read.

1. Refer to KAWC's Application, Exhibit 37, Schedule B-1, Rate Base Summary as of April 30, 2016, and Application, Exhibit 37, Schedule J-1, Cost of Capital Summary 13-Month Average for Forecast Period Ending August 31, 2017. Verify that KAWC's 13-month average capital structure is for the 13-month period ending April 30, 2016, and not the 13-month period ending August 31, 2017, as stated on the schedule.

2. Refer to KAWC's response to Commission Staff's Second Request for Information ("Staff's Second Request"), Item 1, Application, Exhibit 37, Schedule B-1, Rate Base Summary as of April 30, 2016, and Application, Exhibit 37, Schedule J-1, Cost of Capital Summary 13-Month Average for Forecast Period Ending August 31, 2017.

a. Using KAWC's requested revenue requirement of $33,197,797 and the 13-month average capital structure calculate the following:

(1) The Overall Weighted Cost of Capital.

(2) The Return on Common Equity.

b. Provide all work papers, state all assumptions, and show all calculations used by KAWC to calculate its responses to Items 1.a.(1) and 1.a.(2).

3. Refer to KAWC's response to Staff's Second Request, Item 1. According to KAWC, it "has computed its net operating income using the traditional rate base-times rate-of-return-revenue requirement model." The Commission's historical practice has been to use a utility's capital structure to calculate the allowable revenue requirement in the instances where the capital structure exceeds the net investment rate base ("rate base").[1]

a. Provide a detailed explanation of KAWC's position regarding the Commission's historical practice.

b. Explain in detail why the Commission should not calculate KAWC's revenues requirement by using its 13-month average capital structure in this instant case.

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[1] Case No. 8314, *Notice of Adjustment of Rates of Kentucky-American Water Company* (Ky. PSC Feb. 8, 1982), Final Order at 14; Case No. 8571, *Notice of Adjustment of the Rates of Kentucky-American Water Company on and after September 17, 1982* (Ky. PSC Feb. 17, 1983), Final Order at 26–27; Case No. 9061, *General Adjustment in Electric Rates of Kentucky Power* Company (Ky. PSC Dec. 4, 1984), Final Order at 52–53; Case No. 9283, *Notice of Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Oct. 1, 1985), Final Order at 34–35; Case No. 9482, *Notice of Adjustment of the Rates of Kentucky-American Water Company Effective on and after February 7, 1986* (Ky. PSC July 8, 1986), Final Order at 27; and Case No. 2003-00434, *An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company* (Ky. PSC June 30, 2004), Final Order at 58; Case No. 2014-00396, *Application of Kentucky Power Company for: (1) a General Adjustment of Its Rates for Electric Service; (2) an Order Approving Its 2014 Environmental Compliance Plan; (3) an Order Approving Its Tariffs and Riders; and (4) an Order Granting all Other Required Approvals and Relief (Ky. PSC June 22, 2015), Final Order at 51.*

4. Given that KAWC's rate base exceeds the capital structure by $5,111,115,[2] explain why KAWC's stockholders are entitled to earn a return on its rate base that exceeds their investment.

5. Comment on the prior Commission finding that "capital is preferable to net investment because it represents the investors' actual interest."[3]

6. Refer to KAWC's response to the Staff's Second Request, Item 2. In its reconciliation of rate base to capital, KAWC identified "Other (Net), Miscellaneous and Sundry Items" of $4,071,230. KAWC explained that this difference "is immaterial in nature since it is less than one percent of the Company's rate base and can be attributed to timing differences between plant in service dates and the issuance of permanent financings to fund them."

a. Explain in detail any internal policy at American Water Works Corporation ("American Water") and/or at KAWC that defines materiality.

b. Provide a copy of any internal policy at American Water and/or KAWC that defines materiality.

c. If there is no internal policy, provide the basis for the decision that the difference is immaterial.

d. Explain in detail what KAWC considers to be material for ratemaking purposes and provide the basis for its position.

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[2] $403,866,142 (Application, Exhibit 37, Schedule B-1, Rate Base Summary as of April 30, 2016) - $398,755,027 (Application, Exhibit 37, Schedule J-1, Cost of Capital Summary 13-Month Average for Forecast Period Ending August 31, 2017) = $5,111,115.

[3] Case No. 10117, *Adjustment of Rates of GTE South, Incorporated* (Ky. PSC Sept. 1, 1988), Final Order at 11.

e. Given that KAWC funds its construction projects with short-term debt until permanent financing is issued and that short-term debt is a component of KAWC's capital structure, explain why the difference in KAWC's rate base and capital is the result of timing differences between plant in-service dates and the issuance of permanent financings to fund them.

f. Provide the reconciliation as originally requested by Staff.

7. Refer to KAWC's response to Staff's Second Request, Item 9.

a. Provide the frequency of general rate adjustment proceedings for each American Water subsidiary that currently uses a tariff rider similar to KAWC's proposed QIP, for a period of ten years prior to implementing the tariff rider.

b. Provide the frequency of general rate adjustment proceedings for the same American Water subsidiaries as in 7.a. since adopting the tariff rider.

8. Refer to KAWC's response to Staff's Second Request, Item 13, and to KAWC's response to Commission Staff First Request for Information ("Staff's First Request"), Item 10, Capital Expenditure Plan. KAWC explains that the proposed investment in the projects to be recovered through the Qualified Infrastructure Program ("QIP") are non-revenue producing, and that if investment in the QIP projects is increased it would erode KAWC's ability to achieve the authorized rate of return. Identify each project included in the capital expenditure plan by year that is non-revenue producing, for each year provide the percentage of non-revenue producing investment, and determine the impact of each project on KAWC's ability to achieve the authorized rate of return.

9. Refer to KAWC's response to Staff's Second Request, Item 10.a., the final Order issued by the State of Iowa Department of Commerce Utilities Board ("Iowa Utilities Board") in Docket No. RPU-2013-0002, Dated Feb. 28, 2014.

a. Explain if the QIP tariff rider proposed by KAWC would meet any of the following three primary factors considered by the Iowa Utility Board when it contemplates whether to approve an automatic adjustment mechanism:

(1) The costs being recovered by KAWC through the proposed tariff rider are beyond the direct control of KAWC's management.

(2) The costs being recovered by KAWC through the proposed tariff rider are subject to significant variations.

(3) The proposed costs being recovered through the tariff rider are a significant part of KAWC's costs of providing service.

b. Comment on the finding of the Iowa Utilities Board that "[r]egulatory lag is not sufficient justification for the proposed QIP."

c. The Iowa Utilities Board expressed its concerns of the lack of commitment and plans of the Iowa-American Water Company to increase infrastructure investment. If approved, will KAWC increase its infrastructure investment plans upon approval of the QIP rider, or will there be a delay until a certain level of revenues are generated?

d. How and when will KAWC implement an increase to the current infrastructure replacement plan? Explain.

10. Explain whether any mechanism, such as KAWC's proposed QIP tariff rider, that is designed to reduce regulatory lag should provide some benefit to KAWC's ratepayers.

11. Explain whether KAWC has considered or would consider committing to extending the time between filing rate cases or to reducing the carrying charge for its QIP investment.

12. Refer to KAWC's response to Staff's Second Request, Item 22.a. KAWC states, "[b]y forecasting of the proposed projects in an annual QIP filing, it is incumbent on the Company to ensure that it manages those projects effectively and justify the reason for any changes." Explain if the Commission's review of QIP projects completed in a historical test year would act as an incentive for KAWC to maintain its focus on replacing cast iron mains so that recovery of all its completed projects would be ensured through its QIP rider.

13. Refer to KAWC's response to Staff's Second Request, Item 22.b.

a. KAWC states that it "would expect a more extensive review of the historic filing to ensure that the completed projects qualified and were prudent." Explain why KAWC expects the Commission's review of the completed projects in a historical test year would be more extensive or different than the review the Commission would undertake during the annual forecasted QIP filing.

b. KAWC states that a historical QIP test year "lessens the reduction of regulatory lag, thus reducing the financial benefits to both the customers and the Company." Provide an analysis that quantifies the benefits of reduced regulatory lag that KAWC claims its customers would receive from the use of a forecasted QIP test year.

14. Refer to KAWC's response to Staff's Second Request, Item 23.

a. If KAWC is unable to quantify the costs it would incur in filling its annual QIP applications or its QIP reconciliation applications, explain how KAWC can state that the QIP rider will result in fewer base rate applications, reducing its regulatory cost.

b. Explain if the cost savings of filling base rate cases would be offset by the cost of the required QIP review applications.

15. Refer to KAWC's response to Staff's First Request, Item 18.a., the 2015 Annual Incentive Plan Attachment A, 2015 Financial Payout Curve, and Attachment B, 2015 AIP Non-Financial Performance Measures and to KAWC's response to Staff's Second Request, Item 26.

a. Confirm that under the 2015 Annual Incentive Plan, if American Water's diluted earnings per share reaches $2.44 or below then a funding pool would not be created, which would result in the KAWC and the American Water Works Service Company ("Service Company") employees not being paid an incentive pay award in that year.

b. If the Service Quality Survey was 74 percent or below, but American Water's diluted earnings per share were greater than $2.44, explain if a funding pool would be created, which would allow the KAWC and the Service Company employees to be paid an incentive pay award in that year.

c. State the date KAWC expects the 2016 annual performances plan brochure to be completed and filed in this proceeding.

16. Refer to KAWC's response to Staff's Second Request, Item 27.a., and refer to KAWC's response to Staff's First Request, Item 18.a., the 2015 Annual Incentive Plan Attachment A, 2015 Financial Payout Curve, and Attachment B, 2015 AIP Non-Financial Performance Measures. Either confirm that these are the financial and operational targets that are used for KAWC's Long Term Performance Plan ("LTPP") or provide the financial and operational targets used for KAWC's LTPP.

17. Refer to KAWC's response to Staff's Second Request, Item 27.a.

a. Provide documentation (i.e., reference materials, a study or analysis, etc.) to support the following statement: "[t]hrough phased vesting of stock and options, that benefit can be delivered efficiently and at a lower cost than simply increasing cash compensation."

b. Provide documentation to support the following statement "[T]he benefit to employee retention created by stock and option grants is well-known and well-accepted in both the utility industry and broader industry groups."

18. In responding to Item 30.a. of the Staff's Second Request, KAWC cited its responses to Items 27.a. and 27.b. of that same request. KAWC's reference to those responses is not a direct response to the question that was asked. Confirm that KAWC has not performed or commissioned a study or analysis that quantifies the benefits its ratepayers derive from the Annual Incentive Plan or the LTPP.

19. In responding to Item 30.b. of the Staff's Second Request, KAWC cited its responses to Items 27.a. and 27.b. of that same request. KAWC's reference to those

responses does not sufficiently respond to the question that was asked. Explain in detail how the two Willis Towers Watson's Compensation Program Assessments attached to the Direct Testimony of Robert Mustich explain why KAWC has not performed an analysis or study to quantify the benefits its ratepayers receive from the employee incentive pay plans.

20. In Case No. 2004-00103 the Commission did not allow KAWC to recover the costs of the employee incentive pay plans, finding that KAWC did not address or quantify the benefits its employee incentive plans supposedly provided to the ratepayers and also placed KAWC on notice that "[tlhe mere existence of such [incentive compensation] plans is insufficient to demonstrate that they benefit ratepayers and that their costs should be recovered through rates." [4] Explain in detail how the two Willis Towers Watson's Compensation Program Assessments attached to the Direct Testimony of Robert Mustich address the Commission's prior findings.

21. Refer to KAWC's Application, Exhibit 37, Schedule J-1 and KAWC's response to Staff's Second Request, Item 37. Following the instructions of Staff's Second Request, Item 37, provide a revised Exhibit 37, Schedule J-1 that contains a cost of capital summary based upon the 13-month average for forecast period ending August 31, 2017, which takes into account both changes required by the request.

22. In its response to Item 40 of Staff's Second Request, KAWC identified seven long-term debt instruments that had been issued between 2007 and 2013.

a. Explain why KAWC's projected interest rates exceeded the actual rates for six of seven of the long-term debt issuances listed in the response.

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[4] Case No. 2004-00103, *Adjustment of Rates of Kentucky-American Water Company* (Ky. PSC Feb. 28, 2005), Final Order at 49.

b. Describe the method KAWC used to project the interest rates for each of the seven debt issuances listed in the response. Explain if the methods used in the prior projections differ from the method KAWC has employed in this proceeding.

c. Given that the projected issuance costs for all seven long-term debt issuances exceed the actual costs incurred, explain why KAWC issuance cost projection is reliable.

23. Refer to KAWC's response to Staff's Second Request, Items 42.b. and 42.d. The average spread between the appropriate Treasury Bonds and the American Water Capital Corporation ("American Capital") debt issuance for the six long-term debt issuances on the schedule is 1.19.[5] Explain why it would not be more appropriate to use the average spread to forecast the interest rate for the long-term debt issuance.

24. Refer to KAWC's response to Staff's Second Request, Item 43.a. Provide a detailed description of the impact KAWC's equity ratio of 47.352 percent would have on American Capital's current bond ratings and KAWC's projected long-term debt interest rate.

25. Refer to KAWC's response to Staff's Second Request, Item 43.b.

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Issue Date	Term (Years)	Treasury Bond Rates 10-Year	30-Year	AWCC Issue Rate	Calculated Spreads
12/17/12	30.0		2.94%	4.30%	1.36%
11/01/13	10.5	2.8%		3.85%	1.05%
08/14/14	10.5	2.4%		3.40%	1.00%
08/14/14	28.0		3.20%	4.30%	1.10%
08/13/15	9.5	2.2%		3.40%	1.21%
08/13/15	30.0		2.86%	4.30%	1.44%
Average Spread					1.19%

a. Provide a definition of the term "all-in cost" as used by KAWC in its response.

b. Provide instances where a third-party debt would result in a lower all-in cost to KAWC than it could obtain from American Capital.

c. Provide a comparison of KAWC's projected bond rating with its current debt-to-equity ratio to American Capital's current rating.

26. Refer to KAWC's response to Staff's Second Request, Item 52.d.(2). For each Service Company reorganization that has occurred since calendar year 2000, provide the following:

a. The reason for the Service Company reorganization.

b. A detailed description of the Service Company reorganization.

c. The total cost incurred by American Water for the Service Company reorganization.

d. The cost of the reorganization that was allocated to KAWC.

e. A list of the benefits that KAWC's customers received from the Service Company reorganization. Include a detailed description of each benefit listed.

27. Refer to KAWC's response to Staff's Second Request, Item 52.e. In Case No. 2010-00036, the Commission eliminated the business development costs from forecasted management fees, finding that KAWC failed to identify or describe the business development services that were provided to it by the Service Company.[6] Provide a list of the Business Development services that will be provided to KAWC by the Service Company in the forecasted period. For each item in the list, provide a

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[6] Case No. 2010-00036, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Dec. 14, 2010), Final Order at 41.

detailed description and the cost included in the forecasted Service Company charges for each service.

28. Refer to KAWC's response to Staff's Second Request, Item 52.f.

a. Provide a list of the Government Affairs services that will be provided to KAWC by the Service Company in the forecasted period. For each item in the list provide a detailed description and the cost included in the forecasted Service Company charges for each service.

b. Provide a list of the Regulatory Policy services that will be provided to KAWC by the Service Company in the forecasted period. For each item in the list, provide a detailed description and the cost included in the forecasted Service Company charges for each service.

29. Refer to KAWC's response to Staff's Second Request, Item 75.d.

a. Provide updates to earned returns on equity ("ROE") for the proxy water utilities when they become available from Value Line.

b. Refer to Table 3 for both natural gas utilities and American Water subsidiaries. Provide the dates of the ROE awards shown.

30. Refer to KAWC's response to Staff's Second Request, Item 80.

a. Provide a revised chart showing the comparison of actual average daily consumption to projected average daily consumption in previous cases by Dr. Spitznagel with a column showing the difference between the projected amount and the actual amount, in gallons. In addition, please add the projected average daily consumption for this case, as well.

b. What level of accuracy between the projected average daily consumption in gallons and actual consumption is considered reasonable? Explain in detail and provide all supporting documentation.

c. In Case No. 2000-00120 Dr. Spitznagel included a projection for average daily consumption for other public authority, but this projection is not included by Dr. Spitznagel in subsequent cases. Explain why.

d. Compare the projections for average daily consumption OPA in case No. 2000-00120 and to the actual average daily consumption OPA. Explain why the large variance between the usage projections for those years and the actual usage.

31. Refer to KAWC's response to the Attorney General's Initial Request for Information ("AG's First Request"), Item 38.

a. Confirm that temperature data from the National Oceanic and Atmospheric Administration is used to establish "normal" Cooling Degree Days ("CDD").

b. State whether the temperature data used is exclusively from KAW's service area. If not, state from what area(s) the CDD is collected.

c. Describe any consideration KAWC or Dr. Spitznagel have given to using a period shorter than 30 years to normalize volumes for temperature. The response should include any studies or research performed or consulted regarding the predictive value of using 30 years of CDD data as opposed to some shorter time period.

d. State whether KAWC is aware that in Case No. 2013-00148,[7] the Commission required Atmos Energy Corporation to submit in its next request for an increase in its base rates a comparison of temperature normalization methodologies

[7] Case No. 2013-00148, *Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC Apr. 22, 2014), Final Order.

using time periods including, but not limited to, 20, 25, and 30 years in length, along with support for the time period it proposes to use to normalize revenues and the superiority of the chosen method in terms of its predictive value for future temperatures.

32. Refer to KAWC's response to the AG's First Request, Item 39. State whether a time period shorter than 30 years is used in any other American Water jurisdiction for the purpose of establishing "normal" temperature and CDD. If so, provide the jurisdictions and the time periods used.

33. Refer to KAWC's response to the AG's First Request, Item 40, and to the Direct Testimony of Edward L. Spitznagel ("Spitznagel Testimony"), Appendix D.

a. Provide pages 1 and 2, Projections of Residential and Commercial Water Utilization, using 5-year, 10-year, 15-year, 20-year, and 25-year Average CDD.

b. With regard to the 30-year Avg CDD column shown in Appendix D to the Spitznagel Testimony, state whether the 0.867 average CDD shown for January is correct. If so, explain why January includes CDD.

Aaron D. Greenwell for

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DATED APR 11 2016

cc: Parties of Record

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