

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ORDER

On January 29, 2016, Kentucky-American Water Company (“KAWC”) submitted an application requesting Commission approval of: (1) an increase in its base water rates based upon a forecasted test period; (2) the establishment of a Qualified Infrastructure Program surcharge; and (3) an increase in tap-on fees. On February 22, 2016, the Commission entered an Order that, among other things, established a procedural schedule to ensure the orderly review of KAWC’s application and, in pertinent part, required any objection or motions relating to discovery to be filed upon four business days’ notice.¹

The Attorney General’s Initial Request for Information (“AG’s Initial Request”) to KAWC was filed on March 7, 2016. The AG’s Initial Request, Item 22, states:

Reference the Kentucky American Water application generally. Provide the authorized and earned return on common equity for Kentucky American Water and the other operating utility subsidiaries of American Water over the past five years. Provide copies of all associated work papers and source documents. Provide copies of the source documents, work papers, and data in both hard copy and electronic (Microsoft Excel) formats, with all data and formulas intact.²

¹ Order (Ky. PSC Feb. 22, 2016) at 1 and 3.

² AG’s Initial Request (filed Mar. 7, 2016) at 9.

Pursuant to the Commission's February 22, 2016 Order, KAWC's response to the AG's Initial Request was required to be filed no later than March 24, 2016.³

On March 18, 2016, KAWC filed its Objection to AG Initial Request for Information 22 ("Objection") regarding a portion of the information sought by The AG's Initial Request, Item 22. KAWC states:

While KAWC has no objection to providing its authorized and earned returns over the last five years, as well as the authorized returns for American Water's other operating utility subsidiaries, the **earned** returns of the other operating utility subsidiaries has no relevance as to what **authorized** return should be ordered in this case. [Emphasis in original.]⁴

On March 24, 2016, KAWC filed its responses to the AG's Initial Request, and, for Item 22, KAWC, consistent with its previously filed Objection, provided the authorized return on common equity for American Water Works Company's ("American Water") operating subsidiaries and the earned return on common equity for KAWC, but did not provide the earned return on common equity for American Water's other operating utility subsidiaries.⁵

On March 25, 2016, the Attorney General filed his Response to Kentucky-American Water Company's Objection to Initial Requests for Information ("AG's Response to Objection") and requested the Commission to order KAWC to provide him with the earned return on common equity for American Water's other operating utility subsidiaries. The Attorney General, while noting that "the Commission is not bound by the technical rules of legal evidence," asserted that the Commission should consider the

³ Order (Ky. PSC Feb. 22, 2016), Appendix.

⁴ KAWC Objection (filed Mar. 18, 2016) at 1.

⁵ KAWC Responses to AG's Initial Request (filed Mar. 24, 2016), Item 22 at 1 of 3.

Kentucky Rules of Civil Procedure in adjudicating this discovery dispute.⁶ Per the Attorney General, “CR 26.02(1) grants an expansive scope for the discovery process.”⁷ Further, the Attorney General added that the Commission has observed that, under the Kentucky Civil Rules, “the ‘scope of discovery in Kentucky is quite broad,’ and if a party objects to a discovery request the burden is upon the objecting party to demonstrate that the request is improper.”⁸

In support of his request for the Commission to order KAWC to provide the Attorney General with the earned return on common equity for American Water’s other operating utility subsidiaries, the Attorney General states:

It is imperative for the Attorney General to evaluate the authorized versus earned return on common equity for the other subsidiaries in order to assess whether the operating subsidiaries, as a group or individually, earned returns on common equity above or below the authorized returns. If most of the operating subsidiaries of American Water earn returns on common equity below their authorized returns, it may indicate a management issue with the parent company, or it may be attributable to some other factor, such as excessive allocation of corporate expenses. Moreover, if one of the American Water subsidiaries has a lower return on common equity than Kentucky American Water, yet is not asking for a rate increase from its customers, then this would cast doubt upon the assertion that Kentucky American Water is not earning a just and reasonable rate of return.⁹

The Attorney General added that KAWC’s expert witness on the cost of equity and rate of return, Dr. Vander Weide, included American Water as a member of his

⁶ AG’s Response to Objection (filed Mar. 25, 2016) at 2.

⁷ *Id.*

⁸ *Id.*, quoting Case No. 2007-00134, *The Application of Kentucky-American Water Company for a Certificate of Public Convenience and Necessity Authorizing the Construction of Kentucky River Station II, Associated Facilities and Transmission Main* (Ky. PSC Nov. 15, 2007) at 5.

⁹ *Id.* at 3.

proxy group.¹⁰ The Attorney General argued that, given Dr. Vander Weide's inclusion of American Water in the proxy group, "the earned return on common equity is necessary from all of its subsidiaries in order to assess the relative contributions to the overall return on equity."¹¹ Finally, the Attorney General argued that KAWC had not met its burden of proof to demonstrate that his request was improper by "making a bare bones statement that 'the earned returns of the other operating utility subsidiaries has no relevance as to what authorized return should be ordered in this case.'"¹²

On March 30, 2106, KAWC filed its Reply in Support of Objection ("Reply"). KAWC stated the Attorney General's assertions regarding possible management issues with the parent company or other factors such as excessive allocation of corporate expenses are mistaken.¹³ KAWC stated that it "manages itself through President Nick Rowe and the management team in Lexington, Kentucky."¹⁴ Additionally, KAWC stated that "the earned returns of other operating subsidiaries are irrelevant to whether there is an excessive allocation of corporate expenses."¹⁵ KAWC further noted that it provided numerous responses regarding allocations and expenses.¹⁶

In response to the Attorney General's argument that if other operating utilities had a lower earned return than KAWC but were not requesting a rate increase, it would

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.* at 4.

¹³ KAWC's Reply (filed Mar. 30, 2016) at 1.

¹⁴ *Id.*

¹⁵ *Id.* at 2.

¹⁶ *Id.*

cast doubt upon the assertion that KAWC was not earning a just and reasonable rate of return,¹⁷ KAWC states:

Countless factors go into the decision of when to file a rate case, some of which are: the availability of regulatory mechanisms; controlling law in the governing jurisdiction; planned and/or ongoing capital construction activities; changes in operational expenses; and, the effects of weather. Regardless of when and whether other American Water Operating subsidiaries have filed a rate case, KAWC's return on equity will be based upon its revenues and expenses and not upon the financial results of any other operating utility.¹⁸

With regard to the Attorney General's arguments based upon Dr. Vander Weide's use of American Water in the proxy group, KAWC states:

It is only the return on common equity of American Water Works Company, along with the other companies identified in the proxy group, that are relevant to the assessment of Dr. Vander Weide's recommended return on equity. Otherwise, the corporate structure and financial returns of the other proxy group members' affiliates and subsidiaries would be at issue—even though those companies have no relevance at all to Dr. Vander Weide's recommendations.¹⁹

KAWC, in response to the Attorney General's discussion of CR 26.02(1), states that "the Commission has found that requests that seek irrelevant information regarding affiliate companies are beyond the scope of permitted discovery."²⁰ KAWC argues that the other American Water "operating utilities are not subject to the Commission's jurisdiction and are under no obligation to assist KAW financially in any manner;"

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* at 3.

²⁰ *Id.*, citing Case No. 2011-00161, *Application of Kentucky Utilities Company for Certificates of Public Convenience and Necessity and Approval of Its 2011 Compliance Plan for Recovery by Environmental Surcharge* (Ky. PSC Sept. 1, 2011) at 8.

therefore, the information concerning the other operating utilities is not discoverable because it is not relevant to any issue in the instant case and is not calculated to lead to the discovery of relevant information.²¹

DISCUSSION

The Commission notes that Commission Staff's Second Request for Information to Kentucky-American Water Company ("Staff's Second Request"), Item 75.d., required KAWC to provide "the most current earned and approved returns on equity ("ROEs") for the proxy groups of water and gas utilities or their subsidiaries, including all American Water subsidiaries."²² In response to Staff's Second Request, Item 75.d., KAWC provided the most current earned ROEs for companies in the natural gas utility proxy group, the current approved ROEs for the natural gas utilities, and the current approved ROEs for the American Water subsidiaries.²³ KAWC stated that the current earned ROEs for the proxy water utilities were not yet available and that Dr. Vander Weide did not have information on the current approved ROEs for the water utilities, except for the American Water subsidiaries.²⁴ While KAWC provided the approved ROEs for American Water subsidiaries in response to the Staff's request, KAWC did not file any information concerning the earned ROEs for the American Water subsidiaries and did not explain the absence of the information in its response.

The Commission finds that to the extent that KAWC had an objection relating to Staff's Second Request, Item 75.d., KAWC was required, pursuant to our February 22,

²¹ *Id.*

²² Staff's Second Request (filed Mar. 7, 2016), Item 75 at 30.

²³ KAWC's Response to Staff's Second Request (filed Mar. 24, 2016), Item 75.d. at 2-3.

²⁴ *Id.*

2016 Order, to file the objection upon four business days' notice or explain, in writing, why such notice was not possible.²⁵ We find that KAWC did not file a notice of an objection; further, we find that KAWC did not explain why it had not filed a notice or explain why information regarding the American Water subsidiaries' earned ROEs was not included in its response to Staff's Second Request, Item 75.d.

The Commission finds that KAWC failed to comply with our February 22, 2016 Order and that KAWC failed to properly respond to Staff's Second Request, Item 75.d. The Commission, on its own motion, finds that it should review KAWC's failure to provide the earned ROEs of American Water subsidiaries in response to Staff's Second Request, Item 75.d., in conjunction with determining the Attorney General's request for an Order compelling KAWC to provide him with the earned return on common equity for American Water's other operating utility subsidiaries.

In Case No. 2004-00103, we considered a motion by the Attorney General to compel KAWC to provide, among other things, a list of the companies that had filed a consolidated tax return with KAWC and the taxable income or tax loss of each company and its status as a regulated utility.²⁶ The Attorney General argued that the information sought was relevant to determining whether the filing of consolidated returns had resulted in any savings, financial benefit, or detriment to KAWC.²⁷ As part of its argument against disclosure in Case No. 2004-00103, KAWC stated the financial status of its sister companies with whom it filed a consolidated tax return had no impact on

²⁵ Order (Ky PSC Feb. 22, 2016) at 3.

²⁶ Case No. 2004-00103, *Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Aug. 11, 2004) at 1.

²⁷ *Id.* at 2.

KAWC's rates for water service.²⁸ In overruling KAWC's objection and directing disclosure, we stated that the "filing of a consolidated tax return may potentially affect Kentucky-American's revenue requirement," and therefore, the requested information was relevant and properly discoverable.²⁹

In Case No. 2010-00036, we considered a motion by the Attorney General to compel consolidating accounting information for American Water and the "amounts for subsidiary by account and all eliminations and adjustments to the consolidation."³⁰ Although we rejected two of KAWC's arguments in support of its objection to providing the information, we determined that the Attorney General had failed to demonstrate that the information sought was relevant or would lead to the production of relevant information.³¹

The analyses in the Orders from Case Nos. 2004-00103 and 2010-00036 provide persuasive guidance in resolving the discovery dispute in the instant case. In order for the information to be determined relevant and properly discoverable, the Attorney General is required to demonstrate that the information may potentially affect or lead to information that may potentially affect KAWC's revenue requirement. We find that the Attorney General demonstrates that the information is properly discoverable.

We find that KAWC offered Dr. Vander Weide's testimony in support of its stated revenue requirement contained in its application. Dr. Vander Weide's inclusion of

²⁸ *Id.*

²⁹ *Id.*

³⁰ Case No. 2010-00036, *Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year* (Ky. PSC Aug. 9, 2010) at 1.

³¹ *Id.* at 3.

American Water in the proxy group clearly opened the door for inquiry into the performance of American Water; therefore, the Commission finds that the information may potentially affect or lead to information that may potentially affect KAWC's revenue requirement. Accordingly, we find that the earned returns of American Water's other operating subsidiaries fall within the scope of evidence that is discoverable.

We further find that KAWC filed into the record in the instant case the earned ROEs for American Water subsidiaries for 2014 as part of its response to the AG's Initial Request, Item 16, which sought copies of presentations made to rating agencies and/or investment firms by American Water and/or KAWC.³² With regard to the 2014 earned returns of the American Water subsidiaries, we find that KAWC has waived any objection through placing the information for 2014 into the record. We additionally note that as part of its request for confidential treatment of the presentation containing, among other things, the earned ROEs for the American Water subsidiaries for 2014, KAWC stated that public disclosure of the information in the presentation "could lead to less favorable credit ratings and higher capital costs for KAWC than their competitors."³³

The Commission finds that, based upon KAWC's own assessment, the information provided by American Water to credit rating agencies, including the earned

³² KAWC's Responses to AG's Initial Request (filed Mar. 24, 2016). The AG's Initial Request, Item 16, requested that KAWC "[p]rovide copies of all presentations made to rating agencies and/or investment firms by American Water Works Company, Inc. (American Water) and/or Kentucky American Water between January 1, 2015 and the present." On March 24, 2016, KAWC filed a petition seeking confidential treatment for, among other things, two of the presentations filed in response to the AG's Initial Request, Item 16. The earned ROEs of the American Water Company subsidiaries appear on page 51 of the confidential document titled "American Water Rating Agency Presentation – March 26, 2015." Pursuant to 807 KAR 5:001, Section 13(4), pending action by the Commission on KAWC's motion for confidential treatment, the material is afforded confidential treatment, and the March 26, 2015 presentation is presently in the Commission's non-public file for the instant case.

³³ Petition for Confidential Treatment of Certain Responses to the Commission Staff's Second Request for Information and the Attorney General's and Lexington-Fayette Urban County Government's Initial Request for Information (filed Mar. 24, 2016) at 2.

returns of American Water subsidiaries, may potentially affect or lead to information that may potentially affect KAWC's revenue requirement. Accordingly, we find that KAWC should provide the information concerning earned ROEs of American Water's other subsidiaries for the remaining years sought by the Attorney General and Staff.

In reaching our conclusion that KAWC should provide the earned returns of American Water subsidiaries, we emphasize that our Order pertains only to the discoverability of the information concerning earned ROEs of other American Water subsidiaries. While the Commission expressly declines to make any determination regarding the admissibility of such information through this Order, we do note that Commission's jurisdiction does not extend to other American Water operating subsidiaries. The issue in the instant case is the revenue requirement of KAWC.

We also note that the confidential treatment for the 2014 information on earned returns that has already been filed into the record by KAWC will be determined by a separate Order. If KAWC believes that the remaining information on earned returns to be provided warrants confidential treatment, then KAWC should file a petition for confidential treatment when it files the information.

In summary, the Commission finds that the earned returns of American Water's other operating utility subsidiaries fall within the scope of information that is discoverable because it may affect or lead to information that may affect KAWC's revenue requirement. We find that the Attorney General has established good cause to compel KAWC to provide the production of the earned returns of American Water's other operating subsidiaries and that we should overrule KAWC's objection. We further

find that KAWC failed to comply with our Order of February 22, 2016, with regard to Staff's Second Request, Item 75.d.

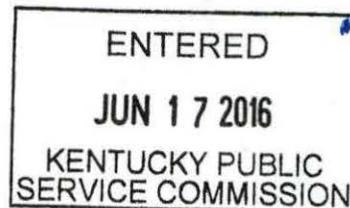
IT IS THEREFORE ORDERED that:

1. KAWC's objection to providing the Attorney General with the earned returns of American Water's other operating utility subsidiaries as sought through the AG's Initial Request, Item 22, is overruled.

2. The Attorney General's request for the Commission to order KAWC to provide the earned returns of American Water's other operating utility subsidiaries in response to the AG's Initial Request, Item 22, is granted, and KAWC shall file within seven days of the date of this Order the information regarding earned ROEs for American Water's other operating subsidiaries.

3. KAWC shall file within seven days of the date of this Order information regarding American Water subsidiaries' earned ROEs as requested by Staff's Second Request, Item 75.d.

By the Commission



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