COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF KENTUCKY-
AMERICAN WATER COMPANY FOR AN
ADJUSTMENT OF RATES

CASE NO. 2018-00358

NOTICE OF FILING

Notice is given to all parties that the following materials have been filed into the record of this proceeding:

- The digital video recording of the evidentiary hearing conducted on May 14, 2019 in this proceeding;

- Certification of the accuracy and correctness of the digital video recording;

- All exhibits introduced at the evidentiary hearing conducted on May 14, 2019 in this proceeding;

- A written log listing, *inter alia*, the date and time of where each witness’ testimony begins and ends on the digital video recording of the evidentiary hearing conducted on May 14, 2019.

A copy of this Notice, the certification of the digital video record, hearing log, and exhibits have been electronically served upon all persons listed at the end of this Notice.

Parties desiring to view the digital video recording of the hearing may do so at:


Parties wishing an annotated digital video recording may submit a written request by electronic mail to pscfilings@ky.gov. A minimal fee will be assessed for a copy of this recording.
Done at Frankfort, Kentucky, this 22nd day of May 2019.

Gwen R. Pinson
Executive Director
Public Service Commission of Kentucky
<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Company/Address</th>
</tr>
</thead>
<tbody>
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<td>200 East Main Street, Lexington, KY 40507</td>
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<tr>
<td>Linda C Bridwell</td>
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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF KENTUCKY- ) CASE NO.
AMERICAN WATER COMPANY FOR AN ) 2018-00358
ADJUSTMENT OF RATES  

CERTIFICATION

I, KaBrenda L. Warfield, hereby certify that:

1. The attached DVD contains a digital recording of the Hearing conducted in
   the above-styled proceeding on May 14, 2019. Hearing Log, Exhibit List, and Witness List
   are included with the recording on May 14, 2019.

2. I am responsible for the preparation of the digital recording;

3. The digital recording accurately and correctly depicts the Hearing of
   May 14, 2019.

4. The Hearing Log attached to this Certificate accurately and correctly states
   the events that occurred at the Hearing of May 14, 2019 and the time at which each
   occurred.

Signed this 20th day of May, 2019.

KaBrenda L. Warfield, CKP
Paralegal Consultant

Kathy Gillum, Notary Public
State at Large
Commission Expires: September 3, 2021
ID#: 584704
Judge: Bob Cicero; Talina Mathews; Michael Schmitt
Witness: Richard A Baudino; Lane Kollen; Melissa L Schwarzell
Clerk: KaBrenda Warfield

Event Time | Log Event
--- | ---
8:24:02 AM | Session Started
8:24:03 AM | Session Paused
8:57:27 AM | Session Resumed
8:57:28 AM | Chairman Schmitt
Note: Fields, Angela
We are now back on the record in the case of 2018-00358 Application Of Kentucky American Water Company For An Adjustment Of Rates this is the begin of the second day of the hearing.

8:57:45 AM | Chairman Schmitt
Note: Fields, Angela
At this time is there any member of the public present who would like to step forward and make a statement to the Public Service Commission either orally or in writing about this case or any of the issues in the case if so please approach the microphone at this time and state your name and residence address?

8:58:05 AM | Chairman Schmitt
Note: Fields, Angela
No one having come forward. We are now ready to take some additional testimony. Mr. Ingram do you have a witness?

8:58:17 AM | Chairman Schmitt - witness Schwarzell
Note: Fields, Angela
Swearing the witness in.

8:58:27 AM | Chairman Schmitt
Note: Fields, Angela
You may be seated. Counsel.

8:58:29 AM | Atty Ingram Kentucky-American - witness Schwarzell
Note: Fields, Angela
Direct Examination.

8:59:26 AM | Atty Ingram Kentucky-American
Note: Fields, Angela
Mrs. Schwarzell is available for Cross your honour.

8:59:29 AM | Chairman Schmitt
Note: Fields, Angela
Mr. McNeil Mr. Chandler questions?

Note: Fields, Angela
Cross Examination.

9:02:19 AM | POST HEARING DATA REQUEST
Note: Fields, Angela
Provide work papers to prove that out.

9:02:25 AM | Asst. Atty Gen. McNeil - witness Schwarzell
Note: Fields, Angela
Cross Continued.

Note: Fields, Angela
Chairman may I approach?

Note: Fields, Angela
I'm passing out a packet that is all in the record, just selections from your rebuttal and certain responses you sponsored.

Note: Fields, Angela
Cross Continued.
9:17:47 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
Your argument tho is the same argument that every utility has [click on the link for Vice Chairman Cicero’s remarks.]

9:18:21 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
I understand the normalization and I also understand the fact that you would have to go out and obtain [click on link for Vice Chairman Cicero's remarks.]

9:19:18 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
That was just an interjection it's Mr. McNeil's time to ask questions. Thank you.

9:19:27 AM  
Asst. Atty Gen. McNeil - witness Schwarzell  
Note: Fields, Angela  
Cross Continued.

9:20:02 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
Do you think that Kentucky American Water would be open to a stay out period if they received a QIP approval?

9:20:27 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
I would take that as a no then.

9:21:05 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
Thank you.

9:21:07 AM  
Asst. Atty Gen. McNeil - witness Schwarzell  
Note: Fields, Angela  
Cross Continued.

9:22:28 AM  
Asst. Atty Gen. McNeil - witness Schwarzell  
Note: Fields, Angela  
No further questions Chairman.

9:28:58 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
I would take that as a no then.

9:29:05 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
Thank you.

9:29:07 AM  
Asst. Atty Gen. McNeil - witness Schwarzell  
Note: Fields, Angela  
Cross Continued.

9:29:32 AM  
Asst. Atty Gen. McNeil - witness Schwarzell  
Note: Fields, Angela  
Cross Continued.

9:30:28 AM  
Asst. Atty Gen. McNeil - witness Schwarzell  
Note: Fields, Angela  
No further questions Chairman.

9:30:30 AM  
Chairman Schmitt  
Note: Fields, Angela  
Mr. Gardner Mr. Osterloh questions?

9:30:47 AM  
Atty Gardner LFUCG - witness Schwarzell  
Note: Fields, Angela  
Cross Examination.

9:30:54 AM  
POST HEARING DATA REQUEST  
Note: Fields, Angela  
Atty Gardner LFUCG - witness Schwarzell  
Note: Fields, Angela  
How many employees American Water has corporate.

9:38:54 AM  
Atty Gardner LFUCG - witness Schwarzell  
Note: Fields, Angela  
I'm going to hand out just for ease of reference the service agreement and then the chart relating to the payments that Kentucky American Water makes to the service company.

9:39:08 AM  
Atty Osterloh LFUCG - witness Schwarzell  
Note: Fields, Angela  
May I approach?

9:39:10 AM  
Atty Gardner LFUCG - witness Schwarzell  
Note: Fields, Angela  
Cross Continued.

9:43:06 AM  
POST HEARING DATA REQUEST  
Note: Fields, Angela  
Atty Gardner LFUCG - witness Schwarzell  
Note: Fields, Angela  
Capital cost.

9:43:48 AM  
Atty Gardner LFUCG - witness Schwarzell  
Note: Fields, Angela  
Cross Continued.

9:49:31 AM  
POST HEARING DATA REQUEST  
Note: Fields, Angela  
Atty Gardner LFUCG - witness Schwarzell  
Note: Fields, Angela  
A manual that determines how those cost are allocated?

9:50:22 AM  
Atty Gardner LFUCG - witness Schwarzell  
Note: Fields, Angela  
Cross Continued.

9:52:46 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
So if somebody pushes back and says that their portion is unreasonable [click on the link for Vice Chairman Cicero's remarks.]

9:53:03 AM  
Vice Chairman Cicero - witness Schwarzell  
Note: Fields, Angela  
Who receives the push back portion should it be decided that it was unfair to the locality that it was being allocated to?
Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela
That amount has to be allocated to someone else then?

Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela
Even on a long term basis cost are accrued cost are allocated there’s no disappears and someone eats it at the corporate level.

Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela
That’s an efficiency improvement that reduced the over all cost [click on the link for Vice Chairman Cicero’s remarks.]

Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela
Short term versus long term short term is a push back to say that [click on the link for Vice Chairman Cicero’s remarks.]

Atty Gardner LFUCG - witness Schwarzell
Note: Fields, Angela
A copy of whatever document allows the service company to question and disagree with a charge.

Atty Gardner LFUCG - witness Schwarzell
Note: Fields, Angela
Atty Gardner LFUCG - witness Schwarzell

Atty Gardner LFUCG - witness Schwarzell
Note: Fields, Angela
The most recent bill that Kentucky American Water received.

Atty Gardner LFUCG - witness Schwarzell
Note: Fields, Angela
To know whether there has to be something affirmative every month that the Kentucky American Water Company does to pay that or after a set period of time does service company draw that?

Atty Gardner LFUCG - witness Schwarzell
Note: Fields, Angela

Atty Gardner LFUCG - witness Schwarzell
Note: Fields, Angela
May I proceed?

Atty Osterloh LFUCG
Note: Fields, Angela
Inaudible

Atty Osterloh LFUCG - witness Schwarzell
Note: Fields, Angela
Inaudible

Atty Osterloh LFUCG - witness Schwarzell
Note: Fields, Angela

Atty Osterloh LFUCG - witness Schwarzell
Note: Fields, Angela

Atty Osterloh LFUCG - witness Schwarzell
Note: Fields, Angela
Show the amounts that have been refunded and any amounts that have not been refunded

Atty Osterloh LFUCG - witness Schwarzell
Note: Fields, Angela

Created by JAVS on 5/20/2019
POST HEARING DATA REQUEST
Note: Fields, Angela
Provide the updated analysis reflecting the Final Order by the Commission in KU's rate case.

Atty Osterloh LFUCG - witness Schwarzell
Note: Fields, Angela
Atty Osterloh LFUCG - witness Schwarzell

May I approach please?

Cross Continued.

No further questions.

This is a good time to take a break. So let's take our morning recess at this time and we'll reconvene at twenty minutes until eleven o'clock.

We are now back on the record. Mr. Pinney cross examination?

Cross Examination.

Well I think that you should pursue that [click on link for Vice Chairman Cicero's remarks.]

Cross Continued.

We provide in Excel Spreadsheet form the cost of each of the projects.

Cross Continued.

A revised schedule in billing analysis based upon the revised revenue requirements that were set forth in the April 15, 2019 filing.

Cross Continued.

Commissioner Cicero questions.

So Kentucky-American Water is requesting a QIP program?

And you are also asking for a deviation from the 15% to 20%?

Typically a QIP type program would be granted in recognition of a cost to replace infrastructure [click on link for Vice Chairman Cicero's remarks.]
That would be the same argument that every utility would make in terms of deviation and at the same time receiving an accelerated pipe line replacement program.

I believe at the end of 2018 the water loss was 20.8%?

So at this point even with the replacement program Kentucky-American Water [click on the link for Vice Chairman Cicero's remarks.]

You seem to diminish the important of the QIP Program [click on the link for Vice Chairman Cicero's remarks.]

Are you saying the QIP Program is a valuable program or its not?

Well you may or may not be aware, I believe you are because Kentucky-American Water recently aquired Rockcastle and they were one of the water utilities that the Commission has recently subjected to an investigation on excessive water loss [click on the link for Vice Chairman Cicero's remarks.]

So I'm still unsure here on this QIP Program and its viability or whether you think there's benefits or not?

Right. Not to interrupt you, I mean I had the discussion with Mr. Rowe so I think my open ended question was with regard to [click on link for Vice Chairman Cicero's remarks.]

Let's go back to the leak detection program.

When I asked the question about whether Kentucky-American Water would be willing to stay out for a certain amount of time in return for a QIP Program you were [click on link for Vice Chairman Cicero's remarks.]

But in terms of a leak detection program [click on link for Vice Chairman Cicero's remarks.]

Has Kentucky-American identified mains as the main source of leakage or is it service lines?

There appears to be three levels here. Did I understand you to say that there are no employees for American Water they're all at the service corp level?

So when we go back to allocated cost you and I both agree that when there is cost incurred they have to be allocated to someone?

Administrative overhead is not a profit center they don't earn any money therfore whatever cost are incurred they have to go somewhere? Do you agree with that?

So we know that service corp is allocated because those are servicing [click on the link for Vice Chairman Schmitt's remarks.]
If there is personnel at American Water Corp I would like to know how those are flowing down through the process?

Because this agreement I believe is just between Service Corp and Kentucky American Water right?

So that means the allocated cost would have to go from American Water into the Service Corp and then down to Kentucky-American water?

I'm interested to finding out how those cost work their way through.

You also made a comment that you believe the prepayment of invoices was okay.

How far in advance is the prepayment paid?

Two weeks ahead of time?

You realize that the contract talks about one of the permissible charges under the allowance for overhead is interest on working capital?

So when you say it's done on a cost basis there and it should be permitted on a prepayment basis?

Do they?

All the items that are in a contract?

Forty thousand dollar credit sits on Service Corps books?

So it's on the Service Corps books that they are reallocating back.

It's the forty thousand? What's the total that they have for interest income on their water service corp?

It's not important. We are only interested in the Kentucky-American portion of the interest income.

? the forty thousand I would have an issue myself for a prepayment.

Well the only reason I took issue with your statement that it is done on a cost basis is because

I don't have anything else Chairman.
11:09:10 AM Chairman Schmitt
Note: Fields, Angela Commissioner Mathews?

11:09:12 AM Chairman Schmitt
Note: Fields, Angela I have no questions.

11:09:13 AM Chairman Schmitt
Note: Fields, Angela Mr. Ingram questions?

11:09:19 AM Atty Ingram Kentucky-American - witness Schwarzell
Note: Fields, Angela Redirect.

11:14:46 AM Atty Ingram Kentucky-American - witness Schwarzell
Note: Fields, Angela No further questions.

11:14:49 AM Chairman Schmitt
Note: Fields, Angela Commissioner Cicero did you have something else?

11:14:52 AM Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela In the Attorney General's first request for information item 4 [click on the link for Vice Chairman Cicero's remarks.]

11:15:24 AM Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela Why does it go like this?

11:15:30 AM Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela So it's a decrease of fifteen and then an increase of twenty five. It's a significant change.

11:16:53 AM Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela Can you provide that answer?

11:16:55 AM Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela Alright Mrs. Vinsel do you have that?

11:16:59 AM Vice Chairman Cicero - witness Schwarzell
Note: Fields, Angela Thank you.

11:17:01 AM Chairman Schmitt - witness Schwarzell
Note: Fields, Angela May this witness be excused?

11:17:03 AM Chairman Schmitt - witness Schwarzell
Note: Fields, Angela You may step down thank you.

11:17:05 AM Chairman Schmitt
Note: Fields, Angela Alright is that the case for Kentucky-American or Mr. Ingram do you have something else?

11:17:14 AM Chairman Schmitt
Note: Fields, Angela Alright who's up next AG?

11:17:17 AM Chairman Schmitt
Note: Fields, Angela You may call a witness.

11:18:26 AM Chairman Schmitt
Note: Fields, Angela Now let me ask Mr. Chandler, I know you are sharing this witness with Lexington you're doing the only direct is that correct?

11:18:36 AM Chairman Schmitt
Note: Fields, Angela Alright thank you.

11:18:37 AM Chairman Schmitt - witness Kollen
Note: Fields, Angela Swearing the witness in.

Note: Fields, Angela Before I introduce Mr. Kollen, can the AG move to introduce AG Exhibit15 that was provided yesterday?

Note: Fields, Angela Direct Examination.

11:18:57 AM Chairman Schmitt
Note: Fields, Angela Is there any objection?

11:18:59 AM Chairman Schmitt
Note: Fields, Angela Then let it be marked and filed as AG Exhibit 15.
Asst. Atty Gen. Chandler - witness Kollen
Note: Fields, Angela
Direct Examination.

11:30:13 AM
Asst. Atty Gen. Chandler - witness Kollen
Note: Fields, Angela
Thank you Mr. Kollen. Mr. Kollen is available for cross examination Chairman.

11:30:19 AM
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
Cross Examination.

11:32:18 AM
Asst. Atty Gen. Chandler - witness Kollen
Note: Fields, Angela
Can you provide him a copy if you are going to site to specific sources and specific amounts?

11:32:28 AM
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
Cross Continued.

11:33:57 AM
Chairman Schmitt
Note: Fields, Angela
Can I ask a question?

11:33:58 AM
Chairman Schmitt - witness Kollen
Note: Fields, Angela
Do you agree with the accuracy of the testimony or are you agreeing that the testimony you were shown made that statement?

11:34:18 AM
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
Cross Continued.

11:36:00 AM
Kentucky-American Reference 01
Note: Fields, Angela
Commissions Decision in Case No. 2014-00396
Note: Fields, Angela
Attorney Ingram Kentucky-American witness Kollen

11:39:30 AM
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
Cross Continued.

11:40:45 AM
Kentucky-American Reference 02, 03, and 04
Note: Fields, Angela
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
Order in Case No. 92-452, Order in 97-034, and Order 2012-00520

11:41:08 AM
Chairman Schmitt
Note: Fields, Angela
You can if you prefer but it doesn't matter because they are going to be cited in briefs so we know what they are and it's not necessary but when Counsel wants to do that for one reason or another inaudible.

11:41:38 AM
Chairman Schmitt
Note: Fields, Angela
Sometimes when I check out the record or something it will all be there rather than find it somewhere else but it really isn't necessary. So whatever you prefer.

11:43:41 AM
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
Cross Continued.

11:49:36 AM
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
May I approach your honour?

11:49:39 AM
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
Cross Continued.

11:59:40 AM
Kentucky-American Reference 05, 06, and 07
Note: Fields, Angela
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
Order in Case No. 2018-0035, Order in 2018-00034, and Order in 2018-00040

12:01:22 PM
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
Cross Continued.

12:10:26 PM
Asst. Atty Gen. Chandler - witness Kollen
Note: Fields, Angela
You honour he already said that he doesn't have a recollection of the Orders it's improper for him to continue to ask.

12:10:32 PM
Chairman Schmitt
Note: Fields, Angela
Sustained.

12:10:35 PM
Attorney Ingram Kentucky-American witness Kollen
Note: Fields, Angela
I have no further questions.
Alright at this time let's take a lunch break until 1:15 and then we'll come back and try to finish up with additional cross of Mr. Kollen's

Okay, we are now back on the record. Mr. Kollen is back on the stand. Staff do you have questions?

So if I said forty years seemed reasonable that would just be an opinion right?

It's very subjective.

Mr. Ingram pointed out several rate cases that the unprotected rate classes were given an amortization period of between [click on the link for Vice Chairman Cicero's remarks.]

Is that your opinion or why are you relying on the fact that they may have been settlements?

I guess the exception I took is that because its a settlement that sets them apart from what the Commission is looking at [click on the link for Vice Chairman Cicero's remarks.]

I think you also asked a question about the [click on the link for Vice Chairman Cicero's remarks.]

Can you refresh us on what that new evidence is?

You may contend that their argument is wrong. I've heard the infinity argument before and I believe that the Commission was unpersuaded by that argument.

No I have not heard that argument before and I don't believe it made a difference.

I appreciate you providing your insight into it.

Thank you. I don't have anything else Chairman.

Commissioner Mathews?

I have no questions.

Mr. Chandler?
          Note: Fields, Angela  Redirect.
1:19:40 PM  AG EXHIBIT 16
          Note: Fields, Angela  Asst. Atty Gen. Chandler - witness Kollen
          Note: Fields, Angela  Testimony Of Matthew A. Horeled On Behalf Of Kentucky Power
Company In Support Of The Settlement Agreement Case No. 2018-00035
1:20:34 PM  Asst. Atty Gen. Chandler - witness Kollen
          Note: Fields, Angela  Redirect Continued.
          Note: Fields, Angela  That's all the questions I have for Mr. Kollen
1:27:19 PM  Chairman Schmitt - witness Kollen
          Note: Fields, Angela  May this witness be excused?
1:27:24 PM  Chairman Schmitt - witness Kollen
          Note: Fields, Angela  You may step down and be excused.
1:27:25 PM  Chairman Schmitt
          Note: Fields, Angela  Another witness?
1:27:35 PM  Chairman Schmitt - witness Baudino
          Note: Fields, Angela  Swearing the witness in.
1:27:56 PM  Chairman Schmitt
          Note: Fields, Angela  Please be seated. Mr. Chandler.
1:28:01 PM  Asst. Atty Gen. Chandler - witness Baudino
          Note: Fields, Angela  Direct Examination.
          Note: Fields, Angela  Chairman Mr. Baudino is available for cross examination.
1:28:49 PM  Chairman Schmitt
          Note: Fields, Angela  Mr. Ingram Mrs. Braun?
1:28:51 PM  Atty Braun Kentucky-American - witness Baudino
          Note: Fields, Angela  Cross Examination.
1:30:47 PM  KENTUCKY-AMERICAN EXHIBIT 01
          Note: Fields, Angela  Atty Braun Kentucky-American - witness Baudino
          Note: Fields, Angela  DIRECT TESTIMONY AND EXHIBITS OF RICHARD A. BAUDINO CASE
NO. 16-0550-W-P
1:31:36 PM  Atty Braun Kentucky-American - witness Baudino
          Note: Fields, Angela  Cross Continued.
1:39:35 PM  KENTUCKY-AMERICAN EXHIBIT 02
          Note: Fields, Angela  Atty Braun Kentucky-American - witness Baudino
          Note: Fields, Angela  Order from West Virginia Case No. 16-0550-W-DSIC
1:40:12 PM  Atty Braun Kentucky-American - witness Baudino
          Note: Fields, Angela  Cross Continued.
1:55:46 PM  KENTUCKY-AMERICAN EXHIBIT 03
          Note: Fields, Angela  Copy of the press release of the downgrades.
          Note: Fields, Angela  Atty Braun Kentucky-American - witness Baudino
1:56:30 PM  Atty Braun Kentucky-American - witness Baudino
          Note: Fields, Angela  Cross Continued.
2:04:20 PM  KENTUCKY-AMERICAN EXHIBIT 04
          Note: Fields, Angela  FEDERAL FUNDS RATE JANUARY 2014 THRU JANUARY 2019
          Note: Fields, Angela  Atty Braun Kentucky-American - witness Baudino
2:05:06 PM  Atty Braun Kentucky-American - witness Baudino
          Note: Fields, Angela  Cross Continued.
2:09:05 PM  Atty Braun Kentucky-American - witness Baudino
          Note: Fields, Angela  Thank you. I have no other questions.
2:09:07 PM  Chairman Schmitt
          Note: Fields, Angela  Any questions?
2:09:11 PM  GC Pinney PSC - witness Baudino
          Note: Fields, Angela  Cross Examination.

2:11:55 PM  Chairman Schmitt - witness Baudino
          Note: Fields, Angela  How do you know the Commission didn't make it's own decision?

2:12:19 PM  Chairman Schmitt - witness Baudino
          Note: Fields, Angela  Go a head. I don't have another question.

2:12:25 PM  GC Pinney PSC - witness Baudino
          Note: Fields, Angela  Cross Continued.

2:16:08 PM  GC Pinney PSC - witness Baudino
          Note: Fields, Angela  No further questions your honour.

2:16:14 PM  Commissioner Mathews - witness Baudino
          Note: Fields, Angela  May I?

2:16:16 PM  Commissioner Mathews - witness Baudino
          Note: Fields, Angela  You said that it's the Attorney General's and your position. Is that also Lexington-Fayette Urban County Government's position?

2:16:40 PM  Chairman Schmitt - witness Baudino
          Note: Fields, Angela  Don't leave out Lexington.

2:16:44 PM  Chairman Schmitt - witness Baudino
          Note: Fields, Angela  They contributed to the fees. Commissioner Cicero questions?

2:16:53 PM  Vice Chairman Cicero - witness Baudino
          Note: Fields, Angela  Are you currently representing any other organizations in front of a state regulatory group?

2:17:02 PM  Vice Chairman Cicero - witness Baudino
          Note: Fields, Angela  Any other organization in front of any other state Public Service Commission?

2:17:12 PM  Vice Chairman Cicero - witness Baudino
          Note: Fields, Angela  And are you recommending in those cases a similar ROE or are you saying that Kentucky-American Water happens to be just similar enough that this 9.1 that you are recommending is just unique to them?

2:18:01 PM  Vice Chairman Cicero - witness Baudino
          Note: Fields, Angela  Over the past year how many times would you say you represented someone before a state Public Service Commission?

2:18:52 PM  Vice Chairman Cicero - witness Baudino
          Note: Fields, Angela  In those eleven cases have they all been settled?

2:19:15 PM  Vice Chairman Cicero - witness Baudino
          Note: Fields, Angela  What would you say the highest ROE was in those eleven cases that you recommended?

2:19:56 PM  Vice Chairman Cicero - witness Baudino
          Note: Fields, Angela  And did you have any Commission agree with your assessment and rule that it should be 9.1 or 9.2 or 9.3 have you had any Commission agree with you on that assessment that that's where the ROE needs to be?

2:21:37 PM  Vice Chairman Cicero - witness Baudino
          Note: Fields, Angela  So with all due respect [click on the link for Vice Chairman Cicero's remarks.]

2:22:40 PM  Vice Chairman Cicero - witness Baudino
          Note: Fields, Angela  So that's just my comment. I don't have anything else.

2:22:45 PM  Chairman Schmitt
          Note: Fields, Angela  Commissioner Mathews?

2:22:48 PM  Chairman Schmitt - witness Baudino
          Note: Fields, Angela  Over the 2015, 2016, to now the dow jones industrial average is up about ten thousand points isn't that correct?

2:23:08 PM  Chairman Schmitt - witness Baudino
          Note: Fields, Angela  Don't they always say a rising tide lifts all the boats?
Chairman Schmitt - witness Baudino
Note: Fields, Angela  
No further questions.

Chairman Schmitt
Note: Fields, Angela  
Anything?

Asst. Atty Gen. Chandler - witness Baudino
Note: Fields, Angela  
Redirect.

Vice Chairman Cicero - witness Baudino
Note: Fields, Angela  
Versus what was recommended?

Asst. Atty Gen. Chandler - witness Baudino
Note: Fields, Angela  
Redirect Continued.

Chairman Schmitt - witness Baudino
Note: Fields, Angela  
Let me ask a question. If short terms rates ten years or whatever is higher than the thirty year is that sometimes considered to be evidence of an upcoming recession?

Asst. Atty Gen. Chandler - witness Baudino
Note: Fields, Angela  
Redirect Continued.

Chairman Schmitt
Note: Fields, Angela  
Why don't we ask him questions rather than lead him and he might understand what he is supposed to say.

Asst. Atty Gen. Chandler - witness Baudino
Note: Fields, Angela  
Redirect Continued.

Asst. Atty Gen. Chandler - witness Baudino
Note: Fields, Angela  
Those are all the questions I have for Mr. Baudino Chairman.

Chairman Schmitt
Note: Fields, Angela  
Commissioner Cicero has a question.

Vice Chairman Cicero - witness Baudino
Note: Fields, Angela  
Mr. Chandler had you go through the ROE's in several cases [click on the link for Vice Chairman Cicero's remarks.]

Vice Chairman Cicero - witness Baudino
Note: Fields, Angela  
And there was several that were in the low nines, those were all from 2018 is that correct?

Vice Chairman Cicero - witness Baudino
Note: Fields, Angela  
Would you say that, that contributed to the downgrading by Moody's?

Vice Chairman Cicero - witness Baudino
Note: Fields, Angela  
And it talked about its declining financial condition. And I wondered if that was a possibility that contributed something to it?

Vice Chairman Cicero - witness Baudino
Note: Fields, Angela  
You would agree that a higher ROE increases cash flow?

Vice Chairman Cicero - witness Baudino
Note: Fields, Angela  
I don't have any other questions.

Chairman Schmitt - witness Baudino
Note: Fields, Angela  
And you would agree probably that a lack of a sufficient incom to support the company's operations would generally require more debt?

Chairman Schmitt - witness Baudino
Note: Fields, Angela  
May this witness be excused?
Your honour I neglected to move for admission of Exhibits one thru four. I would like to do so now.

Sustained. Let Kentucky-American Exhibits one thru four be admitted into evidence.

Anything else?

The Attorney General would like to move for the admission of Attorney General sixteen.

AG sixteen is also admitted.

Okay anything else?

I drafted an Order because we are out of time [click on the link for Chairman Schmitt's remarks.]

So here is how it is going to be and if it becomes some impossible problem call file a motion okay.

POST HEARING DATA REQUEST

SHELLE BE FILED ON OR BEFORE THURSDAY MAY 16, 2019.

RESPONSES TO POST HEARING DATA REQUEST

SHELLE BE FILED ON OR BEFORE FRIDAY MAY 24, 2019.

THE APPLICANT SHALL FILE ITS POST HEARING BRIEF

ON OR BEFORE FRIDAY MAY 31, 2019.

INTERVENORS SHALL FILE POST HEARING BRIEFS

ON OR BEFORE TUESDAY JUNE 11, 2019.

THE APPLICANT'S REPLY BRIEF

SHELLE BE FILED ON OR BEFORE FRIDAY JUNE 14, 2019.

THIS CASE SHALL STAND SUBMITTED FOR DECISION

BY THE COMMISSION EFFECTIVE 12:01 AM EASTERN DAYLIGHT TIME ON JUNE 15, 2019.

Alright if there is nothing else. Anything else? Then this hearing is adjourned. Thank you.

Session Paused
Session Ended
<table>
<thead>
<tr>
<th>Name:</th>
<th>Description:</th>
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<tbody>
<tr>
<td>Kentucky-American Exhibit 02</td>
<td>Order In Case No. 16-0550-W-DSIC.</td>
</tr>
<tr>
<td>Kentucky-American Exhibit 03</td>
<td>Moody's Investors Service Press Release April 1, 2019.</td>
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</tbody>
</table>
PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

CASE NO. 16-0550-W-P

WEST VIRGINIA-AMERICAN WATER COMPANY, a public utility,
Charleston, West Virginia.
Petition for approval of a 2017 Infrastructure Replacement
Program Surcharge Mechanism.

DIRECT TESTIMONY
AND EXHIBITS
OF
RICHARD A. BAUDINO

ON BEHALF OF
THE WEST VIRGINIA ENERGY USERS GROUP
J. KENNEDY AND ASSOCIATES, INC.

SEPTEMBER 22, 2016
DIRECT TESTIMONY OF RICHARD A. BAUDINO

1 Q. Please state your name and business address.
2 A. My name is Richard A. Baudino. My business address is J. Kennedy and Associates, Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

6 Q. What is your occupation and by whom are you employed?
7 A. I am a consultant to J. Kennedy and Associates.

9 Q. Please describe your education and professional experience.
10 A. I received my Master of Arts degree with a major in Economics and a minor in Statistics from New Mexico State University in 1982. I also received my Bachelor of Arts Degree with majors in Economics and English from New Mexico State in 1979. I began my professional career with the New Mexico Public Service Commission Staff in October 1982 and was employed there as a Utility Economist. During my employment with the Staff, my responsibilities included the analysis of a broad range of issues in the ratemaking field. Areas in which I testified included cost of service, rate of return, rate...
design, revenue requirements, analysis of sale/leasebacks of generating plants, utility
finance issues, and generating plant phase-ins.

In October 1989, I joined the utility consulting firm of Kennedy and Associates as a
Senior Consultant where my duties and responsibilities covered substantially the same
areas as those during my tenure with the New Mexico Public Service Commission Staff.
I became Manager in July 1992 and was named Director of Consulting in January 1995.
Currently, I am a consultant with Kennedy and Associates.

Exhibit ____(RAB-1) summarizes my expert testimony experience.

Q. On whose behalf are you testifying?
A. I am testifying on behalf of the West Virginia Energy Users Group ("WVEUG").

Q. What is the purpose of your Direct Testimony?
A. The purpose of my Direct Testimony is to address the Application For Approval of 2017
Infrastructure Replacement Program ("IRP") filed by West Virginia-American Water
Company ("WVAW" or "Company"). In so doing, I will address relevant portions of the
Application filed by the Company as well as the pre-filed Direct Testimony submitted by
Company witnesses Jeffrey L. McIntyre and John S. Tomac.

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For the purpose of this proceeding, WVEUG's membership consists of The Chemours Company and Dow
Chemical Company.

J. Kennedy and Associates, Inc.
Q. What are your conclusions and recommendations to the Public Service Commission of West Virginia ("Commission")?

A. I recommend that the Commission reject the Company's proposed IRP. The Commission adequately addressed the Company's ongoing commitments to infrastructure replacement in its last rate case, Case No. 15-0676-W-42T. In that proceeding, the Commission allowed the Company to include certain system replacement projects expected to be completed after the end of the Company's historical test year and before the rate effective period began ("the Transition Period"). This modification to the Commission's traditional practice of using an historical test year for ratemaking purposes recognized WVAW's unique circumstances and effectively addressed the Company's need for system improvements and replacements. In this proceeding, WVAW failed to demonstrate that its proposed IRP is reasonable and necessary.

The Company's filed IRP represents a radical overreach of the more modest IRP proposed by Staff witness Terry Eads in Case No. 15-06760-W-42T, which WVEUG also opposed in that case. The Company has so broadly defined investments that would qualify for its IRP that it would likely never need to file a rate case before the Commission again. The proposed IRP fails on several important points, which are as follows:

- WVAW failed to show that its proposed IRP is necessary.
- WVAW's proposed categories of IRP-eligible facilities are overly broad and open ended.
- WVAW's proposed IRP fails to include an adequate review process that would ensure reasonableness of costs for eligible facilities.
- WVAW's proposed amendment process for its IRP would turn the surcharge and included costs into moving targets.
- WVAW has unreasonably proposed to collect costs associated with the projected average level of investment in IRP facilities between February 25 and December 31, 2016. Essentially, this proposal allows the Company to collect future test year costs that the Commission rejected in the last rate proceeding.
- WVAW's proposed IRP fails to provide adequate protections to customers from unreasonable costs and rate increases.

The legion of defects associated with WVAW's proposed IRP warrants its outright rejection by the Commission. The Company's proposed IRP would result in a "real time" ratemaking arrangement that will supplant the current regulatory paradigm with a system that irreparably harms West Virginia customers.

If the Commission chooses to accept the implementation of an IRP for WVAW, however, its proposed IRP should undergo a complete revision. Specifically, I recommend that the Commission incorporate the following principles and modifications into any IRP it may approve in this proceeding:

1. The IRP should be limited to a 2-year Pilot Program.
2. IRP eligible facilities should be limited to smaller diameter mains and services consistent with a recommendation made by Staff witness Mr. Fowler in Case No. 15-0676-W-42T.

3. IRP eligible facilities should be limited to non-revenue producing and non-expense reducing plant that serves to replace existing plant.

4. Facilities extended to serve new customers in areas that are underserved or unserved should be excluded from the IRP.

5. The yearly cap on IRP related rate increases from current authorized tariff rates should be limited to 2.5%.

6. The cumulative cap on customer IRP related rate increases over currently authorized tariff rates should be limited to 5%.

7. The yearly increase in WVAW's IRP eligible facilities should be limited to the general rate of inflation as measured by the Consumer Price Index.

8. The return on equity for IRP eligible facilities should be reduced by one percent from the Commission's last authorized return on equity. For the proposed Pilot Program, the allowed return on equity for any IRP eligible facilities should be 8.75%.
9. WVAW should be required to file a base rate proceeding within two years of IRP implementation. At that time, the IRP rate should be reset to zero and all facilities included in the IRP should be included in base rates.

10. The IRP revenue requirement should be collected using a fixed monthly charge.

**WVAW Proposed IRP**

Q. Please summarize WVAW's proposed IRP as contained in its Application and supporting Direct Testimony.

A. The Company's proposed IRP is described beginning on page 4 of its Application. WVAW proposes to include seven categories of what it considers to be non-revenue producing, non-expense reducing utility plant in its IRP. The seven categories of eligible facilities are described on pages 6 and 7 of the Application.

The IRP would be implemented covering IRP plant placed into service from February 25, 2016. WVAW stated it would invest approximately $32.5 million in IRP facilities in 2016 and 2017. Exhibit 2 to the Application contains the projected and budgeted IRP facilities through 2020.

On page 9 of its Application, WVAW states that when IRP projects are completed the Company would submit a work order package for review by Staff and the Consumer Advocate Division ("CAD") for auditing purposes. Also on page 9, the Company
explains its reconciliation process in which the revenue requirement associated with the actual cost of IRP facilities would be compared with the revenue received from the "IRP Rate Component." Paragraph 18 on page 10 provides a description of WVAW's proposed IRP Rate Component. Costs recovered through the IRP Rate Component would include return on rate base, related income taxes, depreciation expense, state property taxes, and the West Virginia Business and Occupation ("B&O") tax.

WVAW also seeks inclusion of a revenue requirement associated with the projected average level of investment in IRP Facilities between February 25 and December 31, 2016. The Company claims that these costs should be included within the IRP scope "to bridge the gap in recovery between the current rate base cut-off period of February 24, 2016 and the beginning of a full-year IRP period beginning January 1, 2017."

The Application (Paragraph 32, page 15) also contains certain conditions on the Commission's approval of the IRP, including the relationship to base rate cases, an annual rate increase cap of 5%, a cumulative rate increase cap of 10%, and an earnings test.

Q. Should the Commission approve WVAW's proposed IRP?

A. No. WVAW's proposed IRP is unreasonable and should be rejected in its entirety.
Q. In general terms, please explain why the Company's proposed IRP should be rejected.

A. As I stated in my Direct Testimony in Case No. 15-0676-W-42T, I am not in favor of automatic adjustment clauses such as the IRP, as a general matter. Automatic adjustment clauses that allow the pass-through of capital costs simply do not allow the requisite amount of regulatory scrutiny that a full rate proceeding does. In a rate case, the Commission, its Staff, and other parties have time to conduct a detailed examination and review all of the elements of a utility's revenue requirement to ensure that the costs ratepayers are required to pay are prudently incurred. WVAW's proposed IRP would enable the Company to pass through significant new costs without this regulatory scrutiny. Although the utility and its shareholders certainly benefit from increased cash flows from such automatic clauses, ratepayers are far less assured that costs subject to this treatment are prudently incurred. As a result, these surcharges effectively shift the risk of investment from the utility and its shareholders to ratepayers. The regulatory paradigm is in turn shifted such that the balance is skewed between providing the utility with a monopoly and protecting captive ratepayers; the upshot is that surcharges like this one favor the utility to the disadvantage of its customers.

Q. Let us now move to your specific conclusions with respect to WVAW's proposed IRP. To begin with, did WVAW make a proper showing that an IRP of the magnitude it is proposing is necessary?

A. No. It is important to keep in mind that the Commission just granted the Company a 15.1% rate increase in its Order dated February 24, 2016, in Case No. 15-0676-W-42T.
In that Order, the Commission went beyond its traditional adherence to using an historical test year based on the facts and circumstances in that proceeding. The Commission approved inclusion of certain non-revenue producing additions in the Transition Period and established the Company's rate base at the beginning of the Rate Year. On page 26 of its Order, the Commission noted the following:

Based on the evidence presented in this case, establishing rate base at the beginning of the Rate Year is reasonable because inclusion of additional investment in rate base elements for the Transition Period (i) will provide a reasonable level of known and measurable rate base that will be used and useful and in service at the time the new rates authorized in this proceeding become effective, (ii) will provide a better matching of revenues, expenses and rate base present in the Rate Year than would adherence to a non-representative HTY approach, and (iii) will better mitigate the impact of regulatory lag than would AFFAC. WVAWC should cease recording AFFAC on the effective date of new rates authorized in this case.²

In its Order, the Commission significantly expanded the manner in which costs and system investments are reflected in WVAW's rate base by including investments through the Transition Period. This Transition Period ran from January 2015 through February 29, 2016, a full 14 months after the end of the Company's 2014 historic test year. This expansion of rate recognition for non-revenue producing net plant essentially made WVAW whole with respect to infrastructure replacement investment through February of this year.

WVAW failed to provide any evidence of financial need for the sort of expansive IRP it is proposing in this proceeding. In my opinion, the Commission's Order in the base rate case more than adequately reflected the Company's infrastructure replacement

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requirements for the rate effective year of 2016.

Q. On pages 6 and 7 of his Direct Testimony, Mr. McIntyre described seven categories of investment that are to be included in the Company's IRP. Should all of these categories of investment be included in an IRP?

A. No. All seven of the proposed investment categories are so broadly defined that they could include any and all future system investments by WVAW. In fact, nowhere in the investment descriptions provided by Mr. McIntyre do the words "infrastructure replacement" occur. An IRP should only include investments that replace existing infrastructure, such as replacement mains and services.

Especially objectionable are the following categories of investment for proposed inclusion:

d. distribution mains and related facilities initially constructed under "shopping center agreements", etc.

e. facilities the acquisition or construction of which are recommended or required by the Commission, the West Virginia Bureau for Public Health, etc.

f. facilities that extend public water service to new customers in areas of the state that are unserved or underserved.

g. other facilities the costs of which the Commission may later include within the definition of IRP facilities.³

Categories d., e., and g. are essentially "catch-all" categories that cover nearly every conceivable investment that WVAW may make in the future. Clearly, these proposed categories of investment have absolutely nothing to do with infrastructure replacement.

³ Application, pp. 6-7.
and should be rejected by the Commission.

Category f. should also be rejected. This definition was drawn from Senate Bill 390, a statute that does not apply to water utilities. I strongly recommend that the Commission reject language that would allow a water company to pass system expansion projects through an IRP.

Q. Does the Company's proposed IRP provide for a reasonable review process to ensure that eligible costs are prudently incurred?

A. No. In fact, WVAW's proposed IRP completely lacks any mechanism for Commission review to determine if costs passed through the IRP have been prudently incurred. WVAW's Application, page 9, paragraph 14, discusses a work order package that the Company will submit when individual main replacement projects are completed. These work order packages would be submitted to Staff and CAD "for auditing purposes." Mr. Tomac describes a mechanism to compare actual costs incurred and revenues received in order to determine any potential over-recovery or under-recovery. Direct Testimony of John S. Tomac, page 3, line 16 through page 4, line 5. The Company's proposed IRP, however, fails to include a prudence review process. Simple auditing and revenue reconciliation cannot assure customers that the costs for which they are being charged through the IRP are reasonable, and such measures provide no vehicle for the input of intervenors beyond Staff and CAD.
Q. On page 8 of his Direct Testimony, Mr. McIntyre describes the Company's proposal to amend its IRP filing in certain circumstances. Should the Company be allowed to amend its filing in the manner described by Mr. McIntyre?

A. No. The type of amendment process described by Mr. McIntyre would turn its IRP filing into a moving target and place the Staff, CAD, and other parties at a disadvantage in terms of evaluating the reasonableness of additions to the Company's IRP filing after it has been filed. If WVAW needs to "replace a major facility that suffers an unexpected failure" or make "substantial investment in a category of IRP facilities that was not included in the earlier filing covering the current IRP calendar year," as described by Mr. McIntyre, then the Company is free to file a base rate case and/or a certificate of convenience and necessity case and include such facilities in that filing. The Commission should not allow the Company to make changes in its IRP filing after it has been filed.

Q. On page 4 of his Direct Testimony, Mr. Tomac testifies that WVAW seeks to include investment in IRP facilities from February 25 through December 31, 2016. Should the Commission allow the Company to include this period in its proposed IRP?

A. Absolutely not. Mr. Tomac's proposal is an attempt to skirt normal regulatory lag between rate cases and to inappropriately fill a gap between the beginning of the Rate Year from the last base rate case and the implementation date of the proposed IRP.
Moreover, Mr. Tomac's proposal represents a back-door means of recovering future test year costs that the Commission Order rejected in the base rate case. The Commission stated in its Base Rate Case Order that allowing the Company to reflect certain costs through the Transition Period was a better match of revenues, expenses, and rate base for the Rate Year than would be achieved using an historical test year.\(^4\) The Commission rejected the Company's fully projected future test year. Now in its IRP filing, the Company seeks to recover projected costs beyond the Transition Period. The Commission should reject the Company's attempt to recover investment from February 25 through December 31, 2016, in this proceeding.

Q. Do the proposed caps on yearly and cumulative rate increases adequately protect customers?

A. No. As I stated previously, the Commission just ordered a 15.1% increase for WVAW customers this year. The Company now wants further increases through an accelerated IRP process that could increase rates by another 5% – 10% over the next few years. Given the impact from the last rate case, if the Commission decides to approve an IRP, then I recommend lower caps on yearly and cumulative rate increases. I will describe my proposal more fully in the next section of my Direct Testimony.

In addition, as the Company acknowledged in response to CAD data request 01-23, attached as Exhibit__ (RAB-2), the 10% cap as proposed would likely never be reached. Thus, this cap does not provide ratepayers with any real protection, unless the Company was to attempt to include capital expenditures "over the average annual $18.5 million

\(^4\) See Base Rate Case Order, p. 26.
amount" currently proposed for inclusion in the surcharge. With a cap set so high, there
would be very little reason for the Company to ever need to seek a base rate case.

**Recommended Revisions to WVAW's Proposed IRP**

Q. If the Commission decides to approve an IRP for WVAW, what are the main
principles and elements that should be included?

A. I recommend that the following principles and elements be part of any IRP that the
Commission approves for WVAW:

1. The IRP should be limited to an initial 2-year Pilot Program.

2. IRP eligible facilities should be limited to mains 3 inches in diameter and smaller
and associated services. This recommendation is based on a recommendation
made by Staff witness Fowler in Case No. 15-0676-W-42T.

3. IRP eligible facilities should be limited to non-revenue producing and non-
expense reducing plant that serves to replace existing plant.

4. Facilities extended to serve new customers in areas that are underserved or
unserved should be excluded from the IRP.

5. The yearly cap on IRP related rate increases from current authorized tariff rates
should be limited to 2.5%.

6. The cumulative cap on customer IRP related rate increases over currently authorized tariff rates should be limited to 5%.

7. The yearly increase in WVAW's IRP eligible facilities should be limited to the general rate of inflation as measured by the Consumer Price Index.

8. The return on equity for IRP eligible facilities should be reduced by 1% from the Commission's last authorized return on equity. For this proposed Pilot Program, the allowed return on equity for any IRP eligible facilities should be 8.75%.

9. WVAW should be required to file a base rate proceeding within two years of IRP implementation. At that time, the IRP rate should be reset to zero and all facilities included in the IRP should be included in base rates.

10. The IRP revenue requirement should be collected using a fixed monthly charge.

Q. Please explain why the IRP should be limited to a 2-year Pilot Program.

A. A 2-year pilot IRP is a reasonable first step for the Commission, its Staff, the CAD, and other parties to gauge the effectiveness and workability of an IRP for WVAW. It is important to bear in mind that an IRP represents a significant change in the way WVAW has been regulated by the Commission. In the Company's last base rate case, the
Commission approved a significant change to its traditional ratemaking approach by including plant in rate base through the Transition Period. This decision significantly expanded WVAW's historical thirteen-month rate base by $33.1 million. In its Base Rate Case Order, the Commission stated:

The Commission is at a crossroads regarding the rate base treatment that will provide WVAWC a reasonable opportunity to meet these challenges and at the same time moderate the impact on customer rates. WVAWC has met its burden of proof regarding the inadequacy of the thirteen-month average HTY rate base approach in this case. The combination of declining per residential customer usage, little if any customer growth, and increased costly system replacements described in WVAWC and Staff testimony are unique to WVAWC and lead to the inescapable conclusion that the HTY approach, under current circumstances and operations for WVAWC, does not properly match revenues, expenses and rate base in the Rate Year. Further, the experimental AFFAC approach has provided minimal relief to WVAWC from regulatory lag and is not working as intended. The Commission believes it is time to cease the AFFAC approach and consider other alternatives.

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Based on the evidence presented in this case, establishing rate base at the beginning of the Rate Year is reasonable because inclusion of additional investment in rate base elements for the Transition Period (i) will provide a reasonable level of known and measurable rate base that will be used and useful in service at the time the new rates authorized in this proceeding become effective, (ii) will provide a better matching of revenues, expenses and rate base present in the Rate Year than would adherence to a non-representative HTY approach, and (iii) will better mitigate the impact of regulatory lag than would AFFAC. WVAWC should cease recording AFFAC on the effective date of new rates authorized in this case.5

Clearly, the Commission considered both the needs of WVAW and its customers in its decision to deviate from the historical test year and expand the Company's rate base in the last rate case. I recommend that the Commission continue a carefully considered

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5 Base Rate Case Order, p. 26 (emphasis added).
approach in implementing an IRP for WVAV in this proceeding as well.

WVAV's open-ended IRP proposal would continue indefinitely and could very well end future base rate cases for the Company. This is an unacceptable approach to ratemaking and one that cannot ensure just and reasonable rates for customers. Approving an IRP as a 2-year pilot program would enable the Company to include a certain level of necessary replacement projects, but with more limited regulatory review than would be afforded by a full rate proceeding. In my opinion, this strikes a reasonable balance between company, shareholder, and ratepayer interests.

Q. Please explain why IRP eligible facilities should be limited to mains 3 inches in diameter or less.

A. Limiting IRP eligible facilities to smaller mains and services continues a careful and moderate approach to IRP implementation for WVAV and its customers. Consistent with my recommendation for a 2-year pilot IRP, limiting eligible facilities to smaller mains and services represents a balancing of company and customer interests.

In Case No. 15-0676-W-42T, Staff witness Mr. Jonathan M. Fowler stated the following in his Direct Testimony:

Q: BASED ON YOUR REVIEW OF THE COMPANY'S INFRASTRUCTURE AS DISCUSSED ABOVE, WHAT ARE THE ENGINEERING DIVISION'S RECOMMENDATIONS AT THIS TIME?
A: The Engineering Division would encourage the Company to begin accelerating the replacement of their system, starting with the smaller diameter mains and services. While other aspects are in similar need of upgrade, this is where customers are most likely to see an immediate benefit in the form of improved service and reduced outages. In addition, this would provide an opportunity to make minor (i.e. low incremental cost) improvements in system hydraulics and performance; for instance upsizing small diameter mains by one nominal size (i.e. 2''-to-3'' or 3''-to-4'', etc.) may generally be accomplished at a very small incremental cost since labor, equipment, fuel and restoration costs are largely constant for smaller-size main construction and will not increase significantly as a result of sensible upsizing. (Such upsizing of smaller mains would improve system capacity, extend component life and enhance reliability at little incremental cost.)

My conclusion based on Mr. Fowler's testimony is that only including smaller sized mains and associated services in the IRP would give ratepayers the most value for their money. This is very important considering the fact that ratepayers have just had a 15.1% rate increase approved by the Commission on February 24, 2016.

Q. Why should IRP facilities be limited to non-revenue producing and non-expense reducing plant?

A. This condition is consistent with the regulatory goal of only including facilities in an IRP that replace existing infrastructure. The IRP should not be used for new facilities that expand the Company's rate base and total revenues. This type of plant should only be included in a base rate proceeding so that the Commission, Staff, CAD, and other parties can evaluate the reasonableness of the cost of such facilities as well as whether such investment is used and useful.

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6 Direct Testimony of Jonathan M. Fowler, Case No. 15-0676-W-42T, pp. 11-12.
Q. Please explain why facilities extended to serve unserved or underserved areas should be excluded from the IRP.

A. The basis for this condition is fundamentally the same as the basis for the prior condition regarding non-revenue producing and non-expense reducing plant. It is inappropriate to include the cost of facilities that expand the utility's system in an IRP. Such facilities should only be included in a base rate proceeding (and/or a certificate of convenience and necessity case), in which the Commission may properly evaluate the usefulness of such facilities as well as whether the costs were prudently incurred.

Q. Please provide the basis for the yearly and cumulative rate caps.

A. West Virginia customers need to be protected from excessive future rate increases that may flow through an IRP. As I mentioned earlier, the Commission just approved a 15.1% increase in the Company's rates on February 24, 2016. Now, WVAW is filing for an IRP that includes even more yearly rate increases for its customers. The Company proposed a yearly cap of 5% and a total cumulative rate increase cap of 10%. These caps do not provide enough rate impact protection for customers considering the recently approved 15.1% increase.

In order to mitigate future rate increases to West Virginia ratepayers, I recommend that the yearly increase to the Company's tariff rates be limited to 2.5% and that the total cumulative increase be limited to 5%. This recommendation is 50% lower than the Company's recommended caps, which fail to provide sufficient rate mitigation for customers.
Q. Why should any yearly increase in IRP eligible plant be limited to the rate of inflation as measured by the Consumer Price Index?

A. This condition places a reasonable upper limit on the amount of IRP eligible plant that the Company can be allowed to place into an IRP. The Company's current proposal provides no such tangible limit on the yearly plant increases that can be included in the IRP. Including an upper limit on the yearly increases in IRP eligible plant serves as another rate mitigation tool for the Commission. It also serves as a limit on the amount of plant that would be subject to a lower level of regulatory scrutiny compared to a base rate proceeding.

Q. Please explain why the return on equity for IRP eligible plant should be reduced by one percent from the current Commission authorized return on equity.

A. A reduction in the return on common equity for IRP eligible plant recognizes an important balancing of interests between shareholders and ratepayers. An IRP represents a shift in the current regulatory paradigm in favor of the utility's shareholders. IRP eligible plant will be receiving a current return as well as depreciation treatment in an expedited manner when compared with a traditional rate case. Such treatment is a clear benefit to shareholders, all other things held equal. Therefore, it is reasonable for the Commission to recognize a reduction in the return on equity for plant included in WVAW's IRP. A reduction of one percent from the Company's current authorized return on equity to 8.75% is a reasonable and conservative adjustment and assists in mitigating the rate impact to customers during the effective period of the IRP. Once WVAW files for a base rate case, plant included in the IRP should be rolled into its rate base and...
receive a full return on equity.

Q. Explain the basis for requiring WVAW to file a base rate case no later than two years after the implementation of the IRP.

A. At some point, the Commission should assess the workability and reasonableness of an IRP within a base rate case proceeding. The Company's proposed IRP has no provision for any such review by the Commission. Conceivably, WVAW could stay out of a base rate case indefinitely, especially considering the expansive categories of plant that it intends to include in its proposed IRP. This may be an advantageous arrangement for WVAW and its shareholders, but it places the Commission and West Virginia ratepayers at an extreme disadvantage with respect to properly reviewing the reasonableness of the costs of IRP eligible plant. A requirement that WVAW file a rate case within two years of the implementation of an IRP ensures that the Commission, Staff, and other parties can review the reasonableness of cost recovery from ratepayers.

Q. How should a review process be structured to ensure that costs passed through an IRP are prudent?

A. In IRP filings submitted by the Company after the initial year of implementation, WVAW should be required to submit detailed actual cost information for IRP investment for the prior year. The Staff, CAD, and other parties should be allowed to conduct discovery on this information for purposes of determining whether costs were prudently incurred, and should be allowed to submit testimony challenging any imprudently incurred costs. The Commission, after a hearing, could disallow any imprudent

J. Kennedy and Associates, Inc.
investment costs. Using this process will ensure that ratepayers are protected from unjust and unreasonable IRP investment costs.

Q. Do you agree with a volumetric charge to collect the costs associated with WVAW's IRP?

A. No. Consistent with my Rebuttal Testimony in the Company's last rate case, the costs subject to collection through the proposed IRP are all fixed costs. As such, they do not vary with water consumption. Thus, they should not be collected in a volumetric charge.

In addition, there are significant inter-class and intra-class inequities that are likely to occur using a volumetric rate. The problem is that high load factor customers will pay more than their fair share of costs and, conversely, lower load factor customers will pay less than their fair share. This is because high load factor customers use more water for a given level of demand than lower load factor customers.

A simple example will illustrate how this inequity occurs. Assume two large industrial customers with a maximum daily demand of 34,000 gallons each. Further assume that Customer 1 uses an average of 27,200 gallons per day and that Customer 2 uses an average of 13,600 gallons per day. Both have the same maximum demand (34,000 gallons), but Customer 1 has a higher load factor (80%) than Customer 2 (40%).

In terms of cost responsibility, Customers 1 and 2 have the same responsibility for WVAWC's IRP costs because their peak demands are the same. But since Customer 2
consumes less water in relation to its maximum daily demand, it will pay less than its fair share of the Company's IRP costs due to the use of a volumetric charge. On the flip side of the coin, Customer 1 will pay more than its fair share due to its relatively higher Mcf consumption.

If the Commission considers approval of an IRP, then costs should be collected through a fixed monthly charge per customer.

Q. How should the fixed monthly charge be structured?

A. Since I recommend that only smaller sized mains be included in an IRP, my recommendation at this time is for the same fixed monthly charge to be applied to all customers. This is because replacement of smaller mains will most likely benefit lower consumption users compared to high volume users that take service from larger sized mains. I understand that this may not be the preferred approach for some customer classes, but it is the correct means for collecting these demand-related costs. Unfortunately, the Company employs a unified rate for all customers, so a division by customer class – which I am aware the Commission has adopted in other surcharge contexts – is not easily feasible, short of the Company developing class-specific rate schedules.

Q. Does this conclude your Direct Testimony?

A. Yes.
At a session of the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA in the City of Charleston on the 2nd day of December 2016.

CASE NO. 16-0550-W-DSIC

WEST VIRGINIA-AMERICAN WATER COMPANY
Petition for approval of the 2017 Infrastructure Replacement Program surcharge mechanism

COMMISSION ORDER

The Commission approves a Joint Stipulation and Agreement for Settlement that authorizes West Virginia-American Water Company (WVAWC) to implement an infrastructure replacement cost recovery mechanism.

BACKGROUND

WVAWC provides water utility service to about 168,000 customers in nineteen West Virginia counties.

In the Commission Order resolving the most recent base rate filing of WVAWC, the Commission directed WVAWC to seek Commission authorization in a separate proceeding for an infrastructure replacement program and surcharge mechanism if it wished to do so. West Virginia-American Water Co., Case No. 15-0676-W-42T, Commission Order February 24, 2015 (Rate Case Order) at 27.

On April 29, 2016, WVAWC filed an application for approval of a 2017 system improvement plan (Application). The Application also provided for an associated corresponding surcharge mechanism, or Distribution System Improvement Charge (DSIC). The Application had several attachments, including the pre-filed direct testimonies of Jeffery L. McIntyre, Brett W. Morgan and John S. Tomac. The Application also included the WVAWC projected and budgeted investment in DSIC

1 The filings in this case have referred to an Infrastructure Replacement Plan, or IRP. To avoid confusion with the use of the term “integrated resource plan” in the context of electric utilities, the annual WVAWC filing will be referred to as its “Distribution System Improvement Charge” Plan, or “DSIC Plan,” and the rate component under the DSIC Plan will be referred to as a “DSIC” or “DSIC Rate Component.”
facilities through year 2020, monthly forecasts of 2016 and 2017 DSIC expenditures, detailed lists of 2016 and 2017 DSIC projects by service area, a map of the WVAWC districts and service areas, proposed rate components, and proposed tariff sheets with a proposed effective date of January 1, 2017. WVAWC represented that it modeled its application after Senate Bill 390 enacted during the 2015 legislative session, codified at W.Va. Code §24-2-1k, under which natural gas utilities may, upon Commission approval, recover specified infrastructure-related costs — incremental rate of return, related income taxes, depreciation and property taxes on the infrastructure replacement and expansion investment — through an expedited process.

WVAWC proposed to implement the DSIC Plan to invest approximately $32.5 million for infrastructure replacement and system upgrades during 2016 and 2017. The DSIC Plan included the replacement of transmission and distribution mains, valves, hydrants, and services, but WVAWC also proposed to apply the DSIC to other categories of utility plant replacement, improvements and extensions of service in the future.

WVAWC proposed to recover costs associated with the investments through a separate rate component on customer bills, calculated as a percentage of the total monthly bill for service (comprised of both the minimum meter charge and the volumetric rate component). The DSIC rates proposed for 2016 and 2017 were identified in the Application. Under the rates filed in the Application, an average residential customer using 3,204 gallons per month, would pay an increase of $0.89 monthly, representing a 1.90 percent rate increase in January 2017.

The Consumer Advocate Division (CAD), SWVA, Inc. (SWVA), West Virginia Energy Users Group (WVEUG), the Kanawha County Commission, Regional Development Authority (KCC RDA), and the City of Charleston (Charleston) all filed petitions to intervene in this case.

On June 7, 2016, Staff filed an Initial Joint Staff Memorandum recommending that the Commission provide notice of the filing and grant the pending petitions to intervene.

On June 8, 2016, CAD filed a Motion to Dismiss the Application on grounds that the West Virginia Legislature has asserted jurisdiction over accelerated infrastructure replacement programs by enacting Senate Bill 390 with respect to gas utilities in 2015, and House Bill 4435 with respect to electric utilities in 2016. CAD stated that the Legislature has not created an infrastructure recovery mechanism for water utilities. CAD argued that it would be unreasonable to treat water utilities differently from gas and electric utilities.

On June 21, 2016, WVAWC filed a response in opposition to the CAD Motion to Dismiss.
By Order entered on June 24, 2016, the Commission denied the CAD motion to dismiss, ordered WVAWC to provide public notice of the filing, and granted the pending petitions to intervene.

By Order issued July 22, 2016, the Commission adopted a procedural schedule, including a public comment and evidentiary hearing date, and ordered WVAWC to publish notice of the hearings. The Commission also suspended the tariff sheets filed with the Application until further order of the Commission.

By Order issued August 15, 2016, the Commission revised the hearing date for this proceeding to November 2, 2016, and set new briefing dates. On August 31, 2016, the Commission extended the pre-filed testimony due dates by one week.

On September 19, 2016, WVAWC filed Affidavits of Publication evidencing publication of the Notice of Filing in each of the counties in which WVAWC provides service. WVAWC also filed Affidavits of Publication evidencing publication of the Notice of Hearing.

On November 2, 2016, WVAWC filed a Joint Stipulation and Agreement for Settlement (Joint Stipulation) between WVAWC, Staff, and CAD (Stipulating Parties).

During the evidentiary hearing on November 3, 2016, the Commission admitted the Joint Stipulation into evidence as Joint Ex. 1. Although WVEUG, SWVA, KCC RDA, and Charleston did not execute the Joint Stipulation, they stated at the evidentiary hearing that they did not oppose the Joint Stipulation and that it would be reasonable for the Commission to approve and adopt the Joint Stipulation.

On November 30, 2016, WVAWC filed a proposed Order that had been circulated to all parties.

In reviewing this matter, the Commission considered the Application, the Joint Stipulation, the direct and rebuttal testimonies of all witnesses, the testimony and representations offered at the evidentiary hearing, and the proposed Order.

**DISCUSSION**

WVAWC proposed a system improvement plan that included non-revenue producing, non-expense reducing investments in utility plant, as well as potential expansion projects approved by the Commission. Application at 5. As part of its initial filing, WVAWC proposed to recover costs associated with facilities placed into service from February 25, 2016, through the end of the 2017 calendar year, including the
incremental rate of return, related income taxes, depreciation and property taxes on the DSIC investment, as well as the West Virginia business and occupation tax. Id. at 10.

In the Joint Stipulation, the Stipulating Parties recommended that the Commission authorize a 2017 revenue increase of $1,510,891, using the amounts and calculation methods shown in Attachment A to the Joint Stipulation. Joint Stipulation at ¶ 9(b); November 3, 2016 Hearing Transcript (Tr.) at 10. The Joint Stipulation urges that the 2017 revenue increase of $1,510,891, calculated using the amounts and methods shown in Attachment A to the Joint Stipulation, is fair, reasonable and in the public interest.

The Stipulating Parties recommended that the Commission approve for DSIC rate recovery the WVAWC projected 2017 investments as set forth in Attachments B and C to Joint Stipulation. As compared with the projected 2017 investment proposed in the Application, Attachments B and C to the Joint Stipulation:

a. Exclude all of the $16,525,125 in 2016 investment initially proposed for recovery in the Application;

b. Exclude the $4 million in 2017 investment identified as “Weston to Webster Springs Interconnect” on Exhibits 2 and 3 of the Application (“WWS Project”) and rededicate that $4,000,000 to additional 2017 main replacement;

c. Add $5 million in investment in main replacement (over and above the $4 million rededicated above);

d. Add $7 million for the construction of two tanks near Amandaville (representing a combined 8 million gallons of storage) previously planned to reinforce the west end of the Kanawha Valley distribution system; and

e. Reflect that approximately 76 percent of the 2017 DSIC investments proposed are dedicated to distributions mains, services, laterals, valves, and hydrants.

Joint Stipulation at ¶ 9(c); Tr. at 12-13.

The changes to the investment levels contemplated by the Joint Stipulation reduced the 2017 DSIC Rate Component revenue requirement by $1,081,492, to $1,510,891 from $2,592,383 originally proposed in the Application. Joint Stipulation at ¶ 9(c); Tr. at 18. This represents an increase of 1.09 percent over current base rates, as compared with the 1.90 percent increase proposed in the Application. Joint Stipulation at ¶ 9(c). For an average residential customer, the monthly increase is reduced to $0.52 from the $0.89 increase proposed in the Application. Id. The Joint Stipulation...
states that WVAWC will file future applications for DSIC recovery and true-up no later than July 1st of each year. Id. at ¶ 9(d).

To reach a settlement, the Stipulating Parties engaged in substantial compromise regarding the WVAWC DSIC investments. Mr. McIntyre testified that the removal of the 2016 investments and the WWS Project from the DSIC Plan were “major elements of achieving the settlement.” Tr. at 14. By excluding the 2016 investments, WVAWC will forego recovery of any earnings on those investments under the DSIC Plan but may seek to recover them in its next rate case. Id. Mr. McIntyre testified that although WVAWC agreed to exclude the WWS Project from the DSIC Plan, it anticipates filing a certificate case in the future. Tr. at 24. If approved, Mr. McIntyre noted that WVAWC may then seek rate recovery under the DSIC mechanism. Tr. at 24, 32.

WVAWC represented in the Joint Stipulation that it “recognizes that distribution system renewal and replacement is a significant priority and in the public interest” and that it “will continue to employ a process to identify and prioritize distribution system main replacement through the DSIC.” Joint Stipulation at ¶ 9(e). Mr. McIntyre also reiterated WVAWC’s commitment to main replacement at the hearing. Tr. at 15.

The Stipulating Parties agreed that the Commission should not establish distinct categories of utility investment eligible for DSIC rate recovery at this time. However, in future DSIC cases, parties may take a position on whether certain investments should be eligible for DSIC rate recovery or whether one or more distinct categories of utility investment eligible for DSIC rate recovery should be established. Joint Stipulation at ¶ 9(f); Tr. at 19-21.

The Stipulating Parties recommended that the Commission approve Original Sheet No. 26 and the various other tariff sheets to incorporate by reference Original Sheet No. 26, all substantially in the forms attached as Exhibit 10 to the Application, to be effective for service rendered on and after January 1, 2017. Joint Stipulation at ¶ 10.

WVAWC also agreed to include several consumer protections as part of its DSIC program. Joint Stipulation at ¶ 9(g); Tr. at 21-23. The protections address the DSIC program’s relationship to base rate cases, provide for annual and cumulative caps, and establish an earnings test. Id.

This was a difficult proceeding, and the Commission appreciates the efforts of the parties to reach a just and reasonable settlement. Stipulations can resolve cases in a prompt, fair, reasonable, cost effective and expedited fashion based on arms-length negotiations. Settlements can significantly reduce litigation costs for the benefit of all parties and the ratepayers.
The Commission must balance the interests of the parties, ratepayers and the State based on a review of all of the evidence, not just evidence submitted in favor of the Joint Stipulation. The full record in this case supports the DSIC and the associated DSIC Rate Component as being fair, reasonable and in the public interest. Accordingly, the Commission will adopt the Joint Stipulation attached to this Order in resolution of the issues presented in this case.

Each of the Stipulating Parties recommended that the Commission adopt the Joint Stipulation as being in the public interest. Joint Stipulation at ¶ 14. Mr. McIntyre testified at the hearing that the settlement was fair, reasonable, and in the public interest, and asked the Commission to accept it. Tr. at 25-26. Staff and CAD also recommended at the hearing that the Commission adopt the Joint Stipulation, indicating that it was fair and reasonable, in the public interest, and a result of substantial compromise. Tr. at 37, 43-44. Counsel for SWVA, WVEUG, Charleston, and KCC RDA stated that while they could not join the Joint Stipulation, the settlement was the result of negotiated compromise and that it would be reasonable for the Commission to adopt it. Tr. at 48-50.

**FINDINGS OF FACT**


2. WVAWC published notice of filing and notice of hearing in each of the counties where it provides service and provided evidence of proper notice to the Commission. September 19, 2016 and November 2, 2016 Affidavits of Publication Filings.


4. The Stipulating Parties recommended that the Commission authorize WVAWC's 2017 DSIC revenue requirement in the amount of $1,510,891. Joint Stipulation at ¶ 9(b).

5. The Stipulating Parties supported the Joint Stipulation as a reasonable resolution of this case. Joint Stipulation at ¶ 9.
CONCLUSIONS OF LAW

1. The terms and conditions of the Joint Stipulation are just, reasonable and in the public interest.

2. The 2017 revenue increase of $1,510,891, calculated using the amounts and methods shown in Attachment A to the Joint Stipulation, is fair, reasonable and in the public interest.

3. The Joint Stipulation properly balances the interests of WVAWC, its customers, and the State.

ORDER

IT IS THEREFORE ORDERED that the Joint Stipulation attached to this Order as Appendix A is approved and adopted in full resolution of this case.

IT IS FURTHER ORDERED that WVAWC shall prepare and file, within fifteen days of the date of this Order, an original and six copies of its DSIC tariff sheet, to be effective for all services rendered on and after January 1, 2017, reflecting the approved DSIC Rate Component of each tariff schedule.

IT IS FURTHER ORDERED that the style of this case is revised to read “2017 Distribution System Improvement Charge” filing and the case identifier “P” in the case number of this proceeding is revised to “DSIC.”

IT IS FURTHER ORDERED that the Executive Secretary of the Commission shall use the case identifier “DSIC” when docketing future DSIC filings by WVAWC.

IT IS FURTHER ORDERED that this case be removed from the Commission docket of active cases on entry of this Order.
IT IS FURTHER ORDERED that the Executive Secretary of the Commission serve a copy of this Order by electronic service on all parties of record who have filed an e-service agreement, by United States First Class Mail on all parties of record who have not filed an e-service agreement, and on Staff by hand delivery.

A True Copy, Teste,

[Signature]

Ingrid Ferrell
Executive Secretary
Pursuant to W. Va. Code § 24-1-9(f) and Procedural Rule 13(d), West Virginia-American Water Company ("Company"), the Staff of the Public Service Commission of West Virginia ("Staff"), and the Consumer Advocate Division of the Commission ("CAD") (collectively, the "Parties") join in this Joint Stipulation and Agreement for Settlement ("Joint Stipulation").

In this Joint Stipulation, the Parties propose a comprehensive settlement of the Company’s pending application for approval of an infrastructure replacement cost recovery mechanism. The Parties recommend that the Commission approve the Joint Stipulation without modification, to approve a system improvement plan for the Company for 2017 and a corresponding 2017 Distribution System Improvement Charge ("DSIC").

The filings in this case have referred to an Infrastructure Replacement Plan, or IRP. To avoid confusion with the use of the term "integrated resource plan" in the context of electric utilities, the Parties recommend that the Company’s annual filing be referred to as its "Distribution System Improvement Charge" Plan, or "DSIC Plan," and the rate component under the DSIC Plan be referred to as a "DSIC" or "DSIC Rate Component." In this Joint Stipulation, the Parties use these terms to refer to the program and charge recommended in this case, even where earlier filings used the "IRP" terms.
Introduction and Procedural History

1. In the Company’s 2015 Rate Case, the Commission directed the Company “to seek authorization for a surcharge mechanism, if it chooses to do so,” in a separate proceeding.

2. On April 29, 2016, the Company filed an Application ("Application") for approval of its 2017 Infrastructure Replacement Plan, supported by prefiled direct testimony and exhibits.

3. CAD, SWVA, WVEUG, the City, and KCC RDA filed Petitions to Intervene on May 11, 2016, June 3, 2016, June 6, 2016, June 23, 2016, and June 23, 2016, respectively.

4. In its June 24, 2016 Order, the Commission approved the petitions to intervene, dismissed a motion to dismiss filed by CAD on June 8, 2016, directed the Company to publish a notice of filing in each of the counties in which it provides service, and required the parties to submit a jointly-proposed procedural schedule.

5. By Commission Order issued July 22, 2016, the Commission adopted a procedural schedule, including public comment hearing and evidentiary hearing dates, and ordered the Company to publish notice of the hearings. The Commission also suspended the tariff sheets filed with the Application until further order of the Commission.

6. On August 15, 2012 the Commission issued a revised procedural schedule and directed the Company to publish a revised notice of hearings in each of the counties in which it provides service. The Commission again revised the procedural schedule in its August 31, Order.
7. The Parties filed the testimony of these witnesses:

Company: Jeffrey L. McIntyre, Brett W. Morgan, John S. Tomac, and John R. Wilde

Staff: Jonathan M. Fowler, David L. Pauley, and Terry R. Eads

CAD: Ralph C. Smith

WVEUG: Richard A. Baudino

City: Danny Jones

KCC: Dave Hardy

SWVA did not file testimony.

8. The Parties undertook an investigation of the Application and its various attachments, and the Staff and CAD filed data requests to clarify aspects of the filing. Based on their respective analyses of these materials, and after meetings and the exchange of various settlement proposals and counter-proposals, the Parties now recommend approval of the 2017 DSIC and implementation of the 2017 DSIC Rate Component, subject to the terms and conditions set forth in this Joint Stipulation.
Settlement Terms

9. The Parties agree and recommend that the Commission adopt the Joint Stipulation as a basis for its resolution of this case. The terms and conditions of the Joint Stipulation, each of which is an essential and integral element of a fair and reasonable resolution of this case in the public interest, are set forth below:

   a. The 2017 DSIC should be established to become effective January 1, 2017.
   
   b. The 2017 DSIC Rate Component revenue requirement calculation should be $1,510,891, as set forth in a revised version of Schedules A through G of Exhibit 7 to the Application, attached to this Joint Stipulation as Attachment A.
   
   c. The Commission should approve for DSIC rate recovery the Company's projected 2017 investments as set forth in revised versions of Exhibit 7, "2017 SCEP," and Exhibit 4 to the Application, attached to this Joint Stipulation as Attachment B and Attachment C, respectively. As compared with the projected 2017 investment proposed in these Application exhibits, Attachments B and C to this Joint Stipulation:

   1. exclude all of the $16,525,125 in 2016 investment initially proposed for recovery in the Application;
   
   2. exclude the $4,000,000 in 2017 investment identified as "Weston to Webster Springs Interconnect" on Exhibits 2 and 3 of the Application ("WWS Project") and rededicate that $4,000,000 to additional 2017 main replacement;
   
   3. add $5,000,000 in investment in main replacement (over and above the $4,000,000 rededicated above);
4. add $7,000,000 for the construction of two tanks near Amandaville (representing a combined 8 million gallons of storage) previously planned to reinforce the west end of the Kanawha Valley distribution system; and

5. reflect that approximately 76% of the 2017 DSIC investment shall be dedicated to distributions mains, services, laterals, valves, and hydrants.

These changes increase the projected 2017 DSIC investment to $28,994,235 from $16,993,235. As compared with the 2017 DSIC rate base in the Application of $18,371,825, the revised 2017 DSIC rate base is $12,077,522. The Company commits to making this level of investment in 2017, but expects that its DSIC investment in future years will be more in line with the capital plan set forth in Exhibit 2 to the Application.

Attachments B and C to this Joint Stipulation also detail the $9,000,000 in additional 2017 main replacement projects contemplated above (the $4,000,000 rededicated amount in item (2) and the new $5,000,000 amount in item (3)).

The change in investments covered by the 2017 DSIC reduces the 2017 DSIC Rate Component revenue requirement by $1,081,492, to $1,510,891 from $2,592,383. This represents an increase of 1.09% over current base rates, as compared with the 1.90% increase proposed in the Application. For an average residential customer, the monthly increase is reduced to $0.52 from the $0.89 increase proposed in the Application.

d. The Company will file future applications for DSIC recovery and true-up no
later than July 1st and include schedules in the format and substance of Attachments B and C, showing the level and detail of the proposed DSIC investment.

e. The Company recognizes that distribution system renewal and replacement is a significant priority and in the public interest. The Company will continue to employ a process to identify and prioritize distribution system main replacement through the DSIC.

f. At paragraph 9 of the Application, the Company proposed that a definition of "IRP Facilities" be established. The Parties now agree and recommend that at this time, the Commission should not establish distinct categories of utility investment eligible for DSIC rate recovery (or by omission, not eligible for it). In future DSIC cases, the Parties may take whatever positions they choose on whether a proposed investment should be eligible for DSIC rate recovery or whether one or more distinct categories of utility investment eligible for DSIC rate recovery should be established.

g. The DSIC will be subject to the following consumer protections:

1. Relationship to Base Rate Cases. At no point will there be (i) utility plant assets that are simultaneously included in base rates and a DSIC Rate Component or (ii) a base rate that provides or will provide the Company with recovery of revenues associated with the revenue requirement on investments for which an DSIC Rate Component provides or will provide simultaneous recovery (and vice versa). Calculations of utility plant in service and revenue requirements in each base rate case and annual DSIC filing will include appropriate adjustments to
ensure these outcomes do not occur. Notwithstanding these requirements, the Company may have a base rate case and a DSIC filing simultaneously pending before the Commission, and the pendency of one such case will not preclude or delay the Company’s filing of the other or the Commission’s adjudication of it.

2. Annual Cap of 3.75%. In each annual DSIC filing or amendment to an DSIC filing, the DSIC Rate Component proposed to be collected in the succeeding annual period (inclusive of the impact of any reconciliation scheduled for implementation during that period) will be limited to an amount that does not exceed three and three-quarters percent (3.75%) of the revenue requirement authorized in the most recent base rate case.

3. Cumulative Cap of 7.5%. In each annual DSIC filing or amendment to an DSIC filing, the DSIC Rate Component proposed to be collected in the succeeding annual period (inclusive of the impact of any reconciliation scheduled for implementation during that period) will be limited to an amount that, when combined with the percentage increase(s) implemented through previous DSIC filings since the most recent rate case, does not exceed seven and one-half percent (7.5%) of the revenue requirement authorized in the most recent base rate case.

4. Earnings Test. The Company will not be permitted to implement a DSIC Rate Component after an DSIC investment base reset following a base rate case order or, if an annual DSIC Rate Component is already in place, to increase the existing DSIC Rate Component with a subsequent calendar year’s incremental projected investment in DSIC Facilities, if the Company’s achieved return on
average equity investment, as reflected in its audited financial statements for the preceding calendar year prepared using generally accepted accounting principles and measured on a calendar year basis, exceeds the authorized return on common equity set in the Company's most recent base rate case. If one of these situations occurs, then the Company will still make its DSIC filing for purposes of maintaining the existing DSIC Rate Component (if any) and addressing any needed reconciliations of costs and revenues from previous years.

h. If the Company wishes to include investment in the WWS Project in a future DSIC, it will first seek certification of the project under W. Va. Code §24-2-11. The mechanism for and timing of rate recovery for the WWS Project (whether through a DSIC, base rates, special project step rates, or otherwise) will be determined in the certificate proceeding.

i. The Parties recommend that the Commission revise the style of this case as "2017 Distribution System Improvement Charge" filing and to substitute "DSIC" for "P" in the case number suffix. The Parties also recommend that the "DSIC" suffix be used in future Company DSIC filings.

10. The Parties agree and recommend that the Commission approve Original Sheet No. 26 and the various other tariff sheets to incorporate by reference Original Sheet No. 26, all substantially in the forms attached as Exhibit 10 to the Application, to be effective for service rendered on and after January 1, 2017.
General Provisions

11. The Parties support this Joint Stipulation and represent that each of its provisions acceptably resolves all issues raised in this case. Based on the record, the Parties recommend that the Commission accept this Joint Stipulation in resolution of this case.

12. The Parties represent that the Parties' pre-filed evidence and exhibits, as well as the testimony to be offered in sponsorship of this Joint Stipulation, is adequate to support the Joint Stipulation. The Parties ask that the pre-filed testimony and exhibits be admitted into the evidentiary record without the necessity of each witness's sponsorship or attendance at hearing.

13. This Joint Stipulation results from a review of all evidence and filings in this case, the Parties' analyses of the Application, exhibits, and testimony, and good faith negotiation. The Joint Stipulation is proposed to expedite and simplify the resolution of this case in the context of an overall settlement.

14. The Parties recommend that the Commission adopt this Joint Stipulation as being in the public interest, without adopting or recommending the adoption of any of the compromise positions set forth herein as ratemaking principles applicable to future regulatory proceedings, except as may otherwise be provided herein. The terms of this Joint Stipulation reflect a negotiated compromise among the Parties and do not establish a precedent on any matter other than as provided herein. Each component of the Joint Stipulation (including this paragraph) is integral to and inseparable from the others, and no Party advocates the Commission's resolution of any issue proposed in this Joint Stipulation other than in the context of its support for the Joint Stipulation as a whole. The Parties to the Joint Stipulation are free to
take whatever positions they deem appropriate in any future DSIC proceedings, and do not waive and questions of fact or law that were presented in this case.

15. This Joint Stipulation is subject to the Commission’s acceptance and approval. It will be ineffective until and unless approved by the Commission in all of its material terms and without modification. If the Commission does not grant that approval, then the Parties reserve their rights to fully advocate their positions, unlimited by the terms of the Joint Stipulation.

WHEREFORE, the Parties respectfully recommend and request that the Commission make appropriate findings of fact and conclusions of law adopting and approving the Joint Stipulation in its entirety, including its attachments.

Dated and effective on November 2, 2016.
PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

CASE NO. 16-0550-W-P

WEST VIRGINIA-AMERICAN WATER COMPANY

2017 Infrastructure Replacement Program

CERTIFICATE OF SERVICE

I certify service of Joint Stipulation and Agreement for Settlement on November 3, 2016, by United States First Class Mail, postage prepaid, as addressed:

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700 Union Building
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Christopher L. Callas

Christopher L. Callas
### WEST VIRGINIA AMERICAN WATER COMPANY

**CALCULATION OF PROPOSED IRP COMPONENT**

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<td>Total Investment Base for the IRP</td>
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<td>$12,077,522</td>
</tr>
<tr>
<td>7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Rate of Return on Investment Base</td>
<td>C</td>
<td>7.310%</td>
</tr>
<tr>
<td>9</td>
<td>Cost of Investments</td>
<td>D</td>
<td>$882,867</td>
</tr>
<tr>
<td>10</td>
<td>Depreciation Expense</td>
<td></td>
<td>252,514</td>
</tr>
<tr>
<td>11</td>
<td>Property Tax</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>12</td>
<td>State Tax</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>13</td>
<td>FIT</td>
<td>F</td>
<td>291,698</td>
</tr>
<tr>
<td>14</td>
<td>Revenue Requirement before B&amp;O Tax</td>
<td></td>
<td>$1,427,079</td>
</tr>
<tr>
<td>15</td>
<td>Gross-up for B&amp;O Tax (100% - 4.4%)</td>
<td></td>
<td>95.60%</td>
</tr>
<tr>
<td>16</td>
<td>Revenue Requirement</td>
<td></td>
<td>$1,492,761</td>
</tr>
<tr>
<td>17</td>
<td>Gross-up factor for Uncollectible Expense (100%-1.1990%)</td>
<td></td>
<td>98.80%</td>
</tr>
<tr>
<td>18</td>
<td>Total Revenue Requirement</td>
<td></td>
<td>$1,510,891</td>
</tr>
<tr>
<td>19</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Allowed Revenues - Order:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>Metered Water Sales</td>
<td>G</td>
<td>$136,393,303</td>
</tr>
<tr>
<td>22</td>
<td>Less: Sales for Resale</td>
<td>G</td>
<td>1,948,500</td>
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<tr>
<td>23</td>
<td>Add: Metered Sales for Resale</td>
<td>G</td>
<td>653,121</td>
</tr>
<tr>
<td>24</td>
<td>Add: Private Fire Service</td>
<td>G</td>
<td>1,526,017</td>
</tr>
<tr>
<td>25</td>
<td></td>
<td></td>
<td>$136,623,541</td>
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</table>

**IRP Component - 2017**

1.09%
## ESTIMATED ANNUAL INVESTMENT FOR USE IN THE IRP COMPONENT

### Schedule B

#### Settlement

<table>
<thead>
<tr>
<th>Capital Expenditures</th>
<th>2017 Stand Alone</th>
<th>Average 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 T &amp; D MAINS</td>
<td>$18,060,975</td>
<td>$9,030,488</td>
</tr>
<tr>
<td>2 HYDRANTS</td>
<td>799,679</td>
<td>399,840</td>
</tr>
<tr>
<td>3 STANDPIPES</td>
<td>7,000,000</td>
<td>3,500,000</td>
</tr>
<tr>
<td>4 SERVICES</td>
<td>3,133,581</td>
<td>1,566,791</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$28,994,235</strong></td>
<td><strong>$14,497,118</strong></td>
</tr>
</tbody>
</table>

*Please see 2017 SCEP tabs for details*
## COST OF CAPITAL

<table>
<thead>
<tr>
<th>Line No.</th>
<th>Description</th>
<th>Weight</th>
<th>Rate</th>
<th>Weighted Rate</th>
<th>With Tax Gross-up</th>
<th>1/</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>ST Debt</td>
<td>6.470%</td>
<td>0.560%</td>
<td>0.036%</td>
<td>0.036%</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>LT Debt</td>
<td>47.502%</td>
<td>5.870%</td>
<td>2.788%</td>
<td>2.788%</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Preferred Stock</td>
<td>0.190%</td>
<td>8.930%</td>
<td>0.017%</td>
<td>0.028%</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Common Equity</td>
<td>45.838%</td>
<td>9.750%</td>
<td>4.469%</td>
<td>7.354%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>100.000%</td>
<td></td>
<td>7.31%</td>
<td>10.206%</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>ROR</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>.1/</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>State Tax Rate (STR)</td>
<td></td>
<td>0.065</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Federal Tax Rate (FTR)</td>
<td></td>
<td>0.35</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Gross up factor = 1 / ((1-STR) - (1-STR) x FTR)</td>
<td></td>
<td></td>
<td></td>
<td>1.6454</td>
<td></td>
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</table>
### DEPRECIATION EXPENSE - 2017

<table>
<thead>
<tr>
<th>Line No.</th>
<th>T&amp;D Mains</th>
<th>Hydrants</th>
<th>Services</th>
<th>Standpipes</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Total Projected Capital Expenditure</td>
<td>$28,060,975</td>
<td>$7,999,679</td>
<td>$3,133,581</td>
<td>$7,000,000</td>
</tr>
<tr>
<td>2</td>
<td>Average Investment</td>
<td>$9,030,488</td>
<td>$3,999,840</td>
<td>$1,546,791</td>
<td>$3,500,000</td>
</tr>
<tr>
<td>3</td>
<td>Annual Depreciation Rates</td>
<td>1.25%</td>
<td>1.83%</td>
<td>1.68%</td>
<td>3.08%</td>
</tr>
<tr>
<td>4</td>
<td>$111,075</td>
<td>$7,317</td>
<td>$25,322</td>
<td>$107,800</td>
<td>$252,814</td>
</tr>
<tr>
<td></td>
<td>Depreciation Expense Included in Case No. 15-0676-W-42T</td>
<td>$2,493,529</td>
<td>$117,524</td>
<td>$695,276</td>
<td>$762,200</td>
</tr>
<tr>
<td>5</td>
<td>Order Depreciation Expense</td>
<td>$2,493,529</td>
<td>$117,524</td>
<td>$695,276</td>
<td>$762,200</td>
</tr>
<tr>
<td>6</td>
<td>Offset Year One 2017</td>
<td></td>
<td></td>
<td></td>
<td>$2,034,265</td>
</tr>
</tbody>
</table>
## Attachment A

### Book and Tax Depreciation - 2017

<table>
<thead>
<tr>
<th>Asset Description</th>
<th>Average Book Depreciation</th>
<th>Tax Depreciation Rate</th>
<th>Tax Depreciation Expense</th>
<th>Tax Additions</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 T&amp;D Masts</td>
<td>$18,060,975</td>
<td>1.250%</td>
<td>$11,175</td>
<td>$43,156</td>
<td>2.00%</td>
</tr>
<tr>
<td>2 Hydrants</td>
<td>799,570</td>
<td>1.250%</td>
<td>9,995</td>
<td>7,917</td>
<td>0.80%</td>
</tr>
<tr>
<td>4 Standpipes</td>
<td>7,009,000</td>
<td>3.250%</td>
<td>229,163</td>
<td>101,900</td>
<td>0.80%</td>
</tr>
<tr>
<td>5 Services</td>
<td>2,133,811</td>
<td>1.400%</td>
<td>29,833</td>
<td>14,577</td>
<td>0.80%</td>
</tr>
<tr>
<td>6 Total</td>
<td>$29,064,335</td>
<td></td>
<td>$521,214</td>
<td>$241,170,393</td>
<td></td>
</tr>
</tbody>
</table>

### Bonus Tax Depreciation - 2017

<table>
<thead>
<tr>
<th>Bonus Tax Depreciation Rate</th>
<th>Tax Depreciation Expense</th>
<th>Tax Additions</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$12,089,146</td>
<td>$241,793</td>
<td>$12,330,582</td>
<td>$12,650,415</td>
</tr>
</tbody>
</table>

Projected increase in ADIT Liability - 2017: ($4,727,445)

### Computation of ADIT for 2017

#### ADIT Analysis

Per Schedule F, Taxable Loss due to bonus depreciation

Current Tax to move to Deferred Tax due to NOL

ADIT Limited to Income before taxes.

#### 2017 Cumulative

<table>
<thead>
<tr>
<th>Month</th>
<th>ADIT</th>
<th>Prorated ADIT</th>
<th>($206,713)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan</td>
<td>35</td>
<td>0.81781</td>
<td>35,12,817</td>
</tr>
<tr>
<td>Feb</td>
<td>31</td>
<td>0.86110</td>
<td>26,445</td>
</tr>
<tr>
<td>Mar</td>
<td>31</td>
<td>0.75611</td>
<td>10,581</td>
</tr>
<tr>
<td>Apr</td>
<td>30</td>
<td>0.65767</td>
<td>18,283</td>
</tr>
<tr>
<td>May</td>
<td>31</td>
<td>0.58000</td>
<td>14,618</td>
</tr>
<tr>
<td>Jun</td>
<td>30</td>
<td>0.56085</td>
<td>12,311</td>
</tr>
<tr>
<td>Jul</td>
<td>31</td>
<td>0.42857</td>
<td>18,954</td>
</tr>
<tr>
<td>Aug</td>
<td>31</td>
<td>0.36469</td>
<td>12,606</td>
</tr>
<tr>
<td>Sep</td>
<td>30</td>
<td>0.25479</td>
<td>12,980</td>
</tr>
<tr>
<td>Oct</td>
<td>31</td>
<td>0.16606</td>
<td>4,129</td>
</tr>
<tr>
<td>Nov</td>
<td>30</td>
<td>0.09767</td>
<td>2,332</td>
</tr>
<tr>
<td>Dec</td>
<td>31</td>
<td>0.00000</td>
<td>0</td>
</tr>
</tbody>
</table>

#### Total:

2017 ADIT: $130,137
### CALCULATION OF FEDERAL AND STATE INCOME TAXES

<table>
<thead>
<tr>
<th>Line No.</th>
<th>Description</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Investment Base for IRP</td>
<td>$12,077,522</td>
</tr>
<tr>
<td>2</td>
<td>Rate of Return</td>
<td>7.21%</td>
</tr>
<tr>
<td>3</td>
<td>Return on Rate Base</td>
<td>$982,667</td>
</tr>
<tr>
<td>4</td>
<td>Adjustments</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Interest Expense</td>
<td>(613,162)</td>
</tr>
<tr>
<td>6</td>
<td>Temporary Deductions</td>
<td>(12,078,413)</td>
</tr>
<tr>
<td>7</td>
<td>Federal Tax Rate</td>
<td>35%</td>
</tr>
<tr>
<td>8</td>
<td>Current Federal Tax</td>
<td>($4,093,841)</td>
</tr>
<tr>
<td>9</td>
<td>Add Deferred Federal Tax @ 35%</td>
<td>4,327,415</td>
</tr>
<tr>
<td>10</td>
<td>Total Federal Tax</td>
<td>$189,504</td>
</tr>
<tr>
<td>11</td>
<td>Gross-up Federal Income Tax</td>
<td>$291,698</td>
</tr>
<tr>
<td>12</td>
<td>Interest Expense</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Investment Base for IRP</td>
<td>$12,077,522</td>
</tr>
<tr>
<td>14</td>
<td>Weighted Cost of Debt</td>
<td>2.82%</td>
</tr>
<tr>
<td>15</td>
<td>State Taxable Income</td>
<td>($12,077,522)</td>
</tr>
<tr>
<td>16</td>
<td>Federal Taxable Income</td>
<td>($12,077,522)</td>
</tr>
<tr>
<td>17</td>
<td>Gross-up Federal Tax</td>
<td>291,698</td>
</tr>
<tr>
<td>18</td>
<td>State Taxable Income</td>
<td>($12,077,522)</td>
</tr>
<tr>
<td>19</td>
<td>Tax Gross-up Rate (100.0 - 8.5%)</td>
<td>0.935</td>
</tr>
<tr>
<td>20</td>
<td>Gross-up Taxable</td>
<td>($12,077,522)</td>
</tr>
<tr>
<td>21</td>
<td>State Tax Amount (Line 19 less Line 17)</td>
<td>($781,727)</td>
</tr>
<tr>
<td>22</td>
<td>Negative State Tax - Use zero</td>
<td>0</td>
</tr>
<tr>
<td>23</td>
<td>Deferred Tax Asset - Net</td>
<td>$4,093,841</td>
</tr>
<tr>
<td>24</td>
<td>Cumulative Balance</td>
<td>$4,093,841</td>
</tr>
</tbody>
</table>

*Note: Line 9 Current Federal Tax is a negative number and as a result a deferred tax asset will be charged for this amount.*
## OTHER WATER UTILITY BILL CLASS

<table>
<thead>
<tr>
<th>No.</th>
<th>Per Books</th>
<th>Goring Level</th>
<th>Order</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rates</td>
<td></td>
<td>Rates</td>
</tr>
<tr>
<td></td>
<td>Billing</td>
<td>Effective</td>
<td>October 11, 2013</td>
</tr>
<tr>
<td></td>
<td>Determinants</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>5/8-inch meter</td>
<td>13</td>
<td>$23</td>
</tr>
<tr>
<td>2</td>
<td>3/4-inch meter</td>
<td>23.20</td>
<td>23.20</td>
</tr>
<tr>
<td>3</td>
<td>1-inch meter</td>
<td>56.86</td>
<td>56.86</td>
</tr>
<tr>
<td>4</td>
<td>1 1/2-inch meter</td>
<td>112.94</td>
<td>112.94</td>
</tr>
<tr>
<td>5</td>
<td>2-inch meter</td>
<td>180.29</td>
<td>180.29</td>
</tr>
<tr>
<td>6</td>
<td>3-inch meter</td>
<td>337.38</td>
<td>337.38</td>
</tr>
<tr>
<td>7</td>
<td>4-inch meter</td>
<td>561.79</td>
<td>561.79</td>
</tr>
<tr>
<td>8</td>
<td>6-inch meter</td>
<td>1,122.83</td>
<td>1,122.83</td>
</tr>
<tr>
<td>9</td>
<td>8-inch meter</td>
<td>1,796.10</td>
<td>1,796.10</td>
</tr>
<tr>
<td>10</td>
<td>First 1,000 gallons</td>
<td>623</td>
<td>584</td>
</tr>
<tr>
<td>11</td>
<td>Next 23,500 gallons</td>
<td>11,090</td>
<td>10,265</td>
</tr>
<tr>
<td>12</td>
<td>Next 87,000 gallons</td>
<td>323,053</td>
<td>298,503</td>
</tr>
<tr>
<td>13</td>
<td>Next 8,100,000 gallons</td>
<td>707,870</td>
<td>651,700</td>
</tr>
<tr>
<td>14</td>
<td>All over 9,000,000 gallons</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>15</td>
<td>Subtotal</td>
<td>1,042,636</td>
<td>961,072</td>
</tr>
<tr>
<td>16</td>
<td>Add Aqua Water</td>
<td>2,441,800</td>
<td>2,441,800</td>
</tr>
<tr>
<td>17</td>
<td>Add Hurricane</td>
<td>67.61</td>
<td>67.61</td>
</tr>
<tr>
<td>18</td>
<td>Add Linville</td>
<td>2,223.27</td>
<td>2,223.27</td>
</tr>
<tr>
<td>19</td>
<td>Add Jane Law</td>
<td>571.265</td>
<td>571.265</td>
</tr>
<tr>
<td>20</td>
<td>Add Lincoln</td>
<td>79.395</td>
<td>79.395</td>
</tr>
<tr>
<td>21</td>
<td>Less: Corrections and Allowances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>Total Per Bill Analysis</td>
<td>6,425,468</td>
<td>6,432,779</td>
</tr>
<tr>
<td>23</td>
<td>Correction Factor</td>
<td>0.99995058</td>
<td>1.00000000</td>
</tr>
<tr>
<td>24</td>
<td>Per Books</td>
<td>6,425,468</td>
<td>6,432,779</td>
</tr>
</tbody>
</table>
# Depreciation Offset

<table>
<thead>
<tr>
<th>Line No.</th>
<th>Item</th>
<th>Year</th>
<th>Investment Type</th>
<th>Amount</th>
<th>IRP%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>T &amp; D MAINS</td>
<td>2017</td>
<td>IRP</td>
<td>18,060,975</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>2017</td>
<td>Non-IRP</td>
<td>5,583,509</td>
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</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>23,644,484</td>
<td>76.39%</td>
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<tr>
<td>2</td>
<td>Order Depreciation Expense - 15-0674-WS-D</td>
<td></td>
<td></td>
<td>$3,264,398</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Offset Amount</td>
<td></td>
<td></td>
<td>2,493,529</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>HYDRANTS</td>
<td>2017</td>
<td>IRP</td>
<td>799,679</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>2017</td>
<td>Non-IRP</td>
<td>121,500</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>921,179</td>
<td>86.81%</td>
</tr>
<tr>
<td>5</td>
<td>Order Depreciation Expense - 15-0674-WS-D</td>
<td></td>
<td></td>
<td>$135,380</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Offset Amount</td>
<td></td>
<td></td>
<td>117,524</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>SERVICES</td>
<td>2017</td>
<td>IRP</td>
<td>3,133,581</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>2017</td>
<td>Non-IRP</td>
<td>1,520,240</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4,653,821</td>
<td>67.33%</td>
</tr>
<tr>
<td>8</td>
<td>Order Depreciation Expense - 15-0674-WS-D</td>
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### Attachment A

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<th>B</th>
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<th>E</th>
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<td>24,178,293</td>
<td>24,178,293</td>
<td>12,089,146</td>
<td>12,089,146</td>
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Note that the repairs % is based on an 8 year average excluding the 2015 tax return adjustment.
### Attachment B

#### STRATEGIC CAPITAL EXPENDITURE PLAN

**Project:**

Investment Recovery Program

**Time Span:**

2027 FYP

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<th>Project Title</th>
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<th>Recap 2</th>
<th>Recap 3</th>
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Approximately $6.3 billion of long-term debt affected

New York, April 01, 2019 -- Moody's Investors Service ("Moody's") downgraded the long-term Issuer Rating of American Water Works Company, Inc. (American Water) and the senior unsecured debt issued by its financing vehicle American Water Capital Corp. (AWCC) to Baa1 from A3 reflecting a consolidated financial profile that will continue to weaken over the next 12-18 months. Moody's also affirmed AWCC's P-2 short-term commercial paper rating. The outlooks for both companies are stable.

RATINGs RATIONALE

"American Water's financial profile is declining due to debt-funded capital spending and growing shareholder dividends amidst near-term cash flow pressures from tax reform" said Ryan Wobbrock, Vice President -- Senior Credit Officer. "These trends will push the ratio of funds from operations (FFO) to net debt to around 14% at the same time that structural subordination of holding company debt has increased, with approximately 25% of total debt at the holding company" added Wobbrock.

The financial profile of the company has steadily declined since 2014 with free cash flow deficits and debt issuance having outpaced cash flow growth, as the company took on nearly $6.5 billion of capital spending. For example, free cash flow deficits have grown at a compound annual growth rate (CAGR) of around 62%, debt has grown at over 9% CAGR and FFO at roughly a 6% CAGR. For most of this time, the company was benefitting from bonus depreciation, which resulted in no cash tax payments. However, 2017 federal tax reform undid these benefits, which has also contributed in key ratios declining, such as funds from operations (FFO) to net debt dropping from 18% in 2014 to 16% in 2018 and retained cash flow (RCF) to net debt falling from 15% in 2014 to just above 12% in 2018.

Over the next 12-18 months, we expect these ratios to be around 14% and 10%, respectively, as the company spends around $1.7 billion in capital investments, pays a dividend of about $350 million and generates about $1.4 billion in funds from operations on a last twelve month basis. These are below the grid scoring ranges outlined for A rated companies in our Regulated Water Utilities rating methodology. American Water is not planning any equity issuance over the next five years to help fund over $8.0 billion of capital spending and dividend growth of about 10% per annum.

The financial decline has come despite improved cost recovery provisions across American Water's regulatory footprint, including several infrastructure riders and trackers that make cost recovery more certain and reduce regulatory lag, which support the company's stable outlook. The strong regulatory support for operating and capital expenditure cost recovery continues to be a qualitative benefit for the company, since we estimate that over 60% of annual capex is placed into rate base each year.

American Water's Baa1 unsecured credit profile is underpinned by its market position as the largest US investor-owned water utility holding company and strong regulatory and operational diversity across 16 states.

Factors that could lead to an upgrade

American Water could be upgraded if consolidated FFO to net debt were to return to levels consistently above 15%. Reduced holding company leverage and the improved credit quality of its two primary subsidiaries in Pennsylvania and New Jersey would also help to provide ratings lift.

Factors that could lead to a downgrade

FFO to net debt or retained cash flow to net debt around 12% and 7%, respectively, could place downward pressure on American Water's rating. Similarly, continued growth in holding company leverage or any materially adverse regulatory developments or operational set-backs could also lead to a downgrade.
Downgrades:
..Issuer: American Water Capital Corp.
....Issuer Rating, Downgraded to Baa1 from A3
....Senior Unsecured Regular Bond/Debenture, Downgraded to Baa1 from A3
..Issuer: American Water Works Company, Inc.
....Issuer Rating, Downgraded to Baa1 from A3
..Issuer: Berks County Industrial Development Auth., PA
....Senior Unsecured Revenue Bonds, Downgraded to Baa1 from A3
..Issuer: California Pollution Control Financing Auth.
....Senior Unsecured Revenue Bonds, Downgraded to Baa1 from A3
..Issuer: Illinois Development Finance Authority
....Senior Unsecured Revenue Bonds, Downgraded to Baa1 from A3
..Issuer: Illinois Finance Authority
....Senior Unsecured Revenue Bonds, Downgraded to Baa1 from A3
..Issuer: Indiana Finance Authority
....Senior Unsecured Revenue Bonds, Downgraded to Baa1 from A3
..Issuer: MARICOPA COUNTY INDUSTRIAL DEVELOPMENT AUTHORITY, AZ
....Senior Unsecured Revenue Bonds, Downgraded to Baa1 from A3
..Issuer: Owen (County of) KY
....Senior Unsecured Revenue Bonds, Downgraded to Baa1 from A3

Outlook Actions:
..Issuer: American Water Capital Corp.
....Outlook, Changed To Stable From Negative
..Issuer: American Water Works Company, Inc.
....Outlook, Changed To Stable From Negative

Affirmations:
..Issuer: American Water Capital Corp.
....Senior Unsecured Commercial Paper, Affirmed P-2

The principal methodology used in these ratings was Regulated Water Utilities published in June 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES
For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support
provider and in relation to each particular credit rating action for securities that derive their credit ratings from
the support provider’s credit rating. For provisional ratings, this announcement provides certain regulatory
disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be
assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms
have not changed prior to the assignment of the definitive rating in a manner that would have affected the
rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this
credit rating action, and whose ratings may change as a result of this credit rating action, the associated
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disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated
entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related
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Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody’s legal
entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures
for each credit rating.

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VP-Sr Credit Officer
Infrastructure Finance Group
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250 Greenwich Street
New York, NY 10007
U.S.A.
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Source: Board of Governors of the Federal Reserve System (US) myf.red/g/nSrE
COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Kentucky Industrial Utility Customers, Inc.  
Complainant  

v.  
Case No. 2018-00035  

Kentucky Power Company  
Defendant  

TESTIMONY OF
MATTHEW A. HORELED
ON BEHALF OF KENTUCKY POWER COMPANY
IN SUPPORT OF THE SETTLEMENT AGREEMENT
SETTLEMENT TESTIMONY OF
MATTHEW A. HORELED
ON BEHALF OF KENTUCKY POWER COMPANY
BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND POSITION WITH KENTUCKY POWER COMPANY.

A. My name is Matthew A. Horeled. My position is Director of Regulatory Services, Kentucky Power Company. My business address is 855 Central Avenue, Suite 200, Ashland, Kentucky 41101.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A: I received a Bachelor of Arts, Honors degree in History from Loyola University Chicago in May 2001, a Master of Business Administration degree with a concentration in Finance from Loyola University Chicago in August 2004, and a Juris Doctorate from Valparaiso University School of Law in May 2005.

I began my utility industry career with American Electric Power Service Corporation in September 2007 as a Risk & Insurance Management Analyst with responsibilities for managing numerous insurance programs. I transferred to the Corporate Planning and Budgeting Department in April 2010 as a Financial Analyst with emphasis on operating company forecasts. In that role, I prepared and reviewed short- and long-term forecasts for Kentucky Power and Indiana Michigan Power ("I&M") as well as monthly analyses of budget to actual variances. In April 2014, I was promoted to Financial Analyst Principal. In March 2015, I transferred to I&M as Regulatory Analysis
and Case Manager for I&M. In that role, I was responsible for the supervision, preparation, and filing of rate and regulatory matters in Indiana and Michigan. In February 2017, I transferred and was promoted to Director of Business Operations Support for Kentucky Power with responsibility for all corporate budgeting, financial management, and continuous improvement for the company. In April 2018, I assumed my current position as Director of Regulatory Services for Kentucky Power. I am responsible for the supervision and direction of Kentucky Power's Regulatory Services Department, which has responsibility for all rate and regulatory matters.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN ANY REGULATORY PROCEEDINGS?

A. Yes, I have submitted testimony before the Indiana Utility Regulatory Commission in Cause No. 38702-FAC72; Cause No. 38702-FAC73; Cause No. 38702-FAC74; Cause No. 43775 OSS-6; and Cause No. 44511-SPR1.

Q. DID YOU PARTICIPATE IN THE NEGOTIATIONS WHICH LED TO THE SETTLEMENT AGREEMENT THAT IS BEING SUBMITTED FOR CONSIDERATION AND APPROVAL BY THE COMMISSION?

A. Yes. I participated in the April 10, 2018 informal conference at which settlement was discussed and an agreement in principle with the complainant, Kentucky Industrial Utility Customers, Inc., was reached. In addition, I have been involved through counsel in the subsequent discussions regarding documentation of the settlement. The Settlement Agreement is attached as EXHIBIT MAH-S1.
Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?
A. My testimony summarizes the settlement process leading to the agreement. I explain and support the terms of the Settlement Agreement as well as demonstrate why the terms of the Settlement Agreement will produce fair, just, and reasonable rates in connection with the issues before the Commission in this case. In this regard, I discuss the importance of amortizing the Company's excess unprotected accumulated deferred income taxes ("ADIT") over an 18-year period. I also identify the settlement issues addressed by Company Witnesses Kelly and Vaughan in testimony filed today in this case.

II. THE PROCEEDINGS
Q. PLEASE DESCRIBE THE EVENTS LEADING TO THE SETTLEMENT AGREEMENT.
A. President Trump signed the Tax Cut and Jobs Act ("Tax Act") on December 22, 2017. The Tax Act reduced the maximum federal corporate income tax rate from 35 percent to 21 percent effective January 1, 2018. Among its effects on Kentucky Power Company was to reduce the Company’s current federal income tax expense. It also resulted in the creation of excess ADIT.

On December 21, 2017, Kentucky Industrial Utility Customers, Inc. filed a complaint with the Commission against the four Kentucky investor-owned electric utilities. The complaint asked the Commission to reduce the rates of the four defendants to reflect the reduction of the utilities’ current federal income tax expense and the amortization of any excess ADIT. In its January 18, 2018 order in the Company’s base rate case, Case No. 2017-00179, the Commission reduced the Company’s Commission-adjusted annual revenue requirement, and the rates based on that revenue requirement, to
reflect the reduction in the Company’s current federal corporate income tax expense as a result of the Tax Act. The Commission reserved for what eventually became this case any further reduction of the Company’s revenue requirement (and rates) as a result of the amortization of the excess ADIT resulting from the Tax Act. By orders entered January 25, 2018, the Commission severed the claims against the individual utilities. This case was established to resolve KIUC’s claims against Kentucky Power regarding the amortization of the excess ADIT and resulting rate reduction flowing from the Tax Act.

Q. ARE THERE ANY INTERVENORS IN THIS CASE?
A. Yes. In addition to the Company and KIUC, the Attorney General is a party to this case.

Q. HAS DISCOVERY BEEN TAKEN IN THIS CASE?
A. Yes. Data requests were served on Kentucky Power by Staff, KIUC, and the Attorney General. The Company filed its responses on April 12, 2018.

Q. ARE FURTHER PROCEEDINGS SCHEDULED IN THIS CASE?
A. The current procedural schedule provides for the filing of simultaneous testimony on April 27, 2018. Kentucky Power is filing this testimony in support of the Settlement Agreement with KIUC in fulfillment of that requirement. The schedule also provides for another round of discovery to be filed on May 8, 2018. Responses to that second round of discovery are due May 18, 2018.

Q. HAVE KENTUCKY POWER, KIUC, AND THE ATTORNEY GENERAL MET TO CONSIDER SETTLEMENT IN THIS CASE?
A. Yes, the parties, along with Staff, met at the Commission offices on April 10, 2018 to address settlement of KIUC’s claims against Kentucky Power. Subsequently, KIUC and Kentucky Power executed the Settlement Agreement. The Attorney General, who is the
only other party to this case, was offered the opportunity to join the settlement but is not joining at this time.

III. THE SETTLEMENT AGREEMENT

Q. DOES THE SETTLEMENT AGREEMENT REPRESENT THE COMPLETE SETTLEMENT BETWEEN THE COMPANY AND KIUC OF THE REMAINING ISSUES RAISED BY KIUC IN ITS COMPLAINT?

A. Yes. There are no agreements or understandings regarding the issues pending on rehearing that are not reflected in the Settlement Agreement. The agreements and terms in the Settlement Agreement represent the sum total of the give and take of the KIUC and Kentucky Power. Further, there are no agreements nor understandings with the Attorney General or any other non-party relating to the subject matter of the issues pending on rehearing.

Q. IS THE COMMISSION STAFF A PARTY TO THE SETTLEMENT AGREEMENT?

A. No. Commission Staff attended the April 10, 2018 informal conference but made clear that it could not be a party to any agreement, that it was not speaking for the Commission, and that its participation in no way would bind the Commission to the agreement.

IV. THE TERMS OF THE SETTLEMENT AGREEMENT

Q. PLEASE DESCRIBE THE PRINCIPAL TERMS OF THE SETTLEMENT AGREEMENT.

A. The Settlement Agreement contains the following substantive provisions:

• The Settlement Agreement provides for the return to Kentucky Power’s customers of the estimated $175,272,905 in retail excess ADIT for the Company’s
generation and distribution functions. The estimated excess ADIT will be amortized over specified periods and the resulting credit will appear on customers’ bills as a billing line item. The $175,272,905 is the Company’s current estimate of the total ADIT to be credited through this proceeding.

- Kentucky Power currently estimates that the total retail excess “protected” ADIT for the Company’s generation and distribution functions is $82,226,674. The Settlement Agreement, in conformity with the requirements of federal law, provides that the Company’s excess “protected” excess ADIT will be amortized over the remaining life of the assets using the Average Rate Assumption Method (“ARAM”) beginning January 1, 2018.

- Kentucky Power currently estimates that the total retail excess “unprotected” ADIT for the Company’s generation and distribution functions is $93,046,231. The Settlement Agreement provides that the Company’s excess “protected” ADIT will be amortized over an 18-year period beginning January 1, 2018.

- The excess ADIT will be flowed back to customers through a Federal Tax Cut Credit that will appear as a billing line item.

A. The Allocation Of Total Excess Generation And Distribution Function ADIT Between Protected And Unprotected ADIT.

Q. WHAT ARE PROTECTED AND UNPROTECTED EXCESS ADIT, AND WHY IS THE ALLOCATION OF THE TOTAL EXCESS ADIT BETWEEN THE TWO CLASSES IMPORTANT?

A. Company Witness Kelly addresses the differences between the two types of excess ADIT in his testimony. For purpose of the Settlement Agreement, the important differences are those resulting from the differing rules for flowing back excess protected ADIT and excess unprotected ADIT to customers. Under federal law, excess protected ADIT is required to be flowed back to customers over the estimated remaining book life of the related assets as calculated in accordance with ARAM. Because the amortization is tied to the estimated remaining life of specific assets, the excess protected ADIT is not flowed back ratably. Company Witness Kelly currently estimates that the excess protected ADIT will be flowed back to customers over an approximately 50-year period. Excess
unprotected ADIT, by contrast, may be flowed back to customers ratably over a period
determined by the Commission.

Q. ARE THERE ADVERSE CONSEQUENCES TO FAILING TO FLOW BACK
PROTECTED EXCESS ADIT IN ACCORDANCE WITH ARAM?
A. Yes. Company Witness Kelly addresses those consequences, and the resulting higher
costs to customers, resulting from failing to flow back excess protected ADIT in
accordance with federal law.

B. The Calculation Of The Federal Tax Cut Credit

Q. HAS THE COMPANY CALCULATED THE FEDERAL TAX CUT CREDIT TO
BE PROVIDED TO CUSTOMERS?
A. Yes. The calculation for 2018, 2019, and 2020 is provided as Attachment 2 to the
Settlement Agreement. Company Witness Vaughan describes in his testimony the
methodology used to calculate the federal tax rate credit to be provided to customers
through the amortization of excess ADIT resulting from the Tax Act. By way of
summary:

(a) A separate per kWh federal tax cut rate credit is calculated for the
Company’s residential and non-residential customers;

(b) If approved by the Commission, the federal tax cut rate credits will begin
July 1, 2018. The twelve months of rate credit for 2018 will be provided over the final
six months of 2018.

(c) Beginning in 2019, the residential class federal tax cut credit will be
“shaped” to provide a higher credit to residential customers during the winter heating
months (the billing months of January, February, March, and December).
(d) The federal tax cut credit will appear as a billing line item on the customers’ bills.

Q. WHY IS THE COMPANY PROPOSING TO “SHAPE” THE FEDERAL TAX CUT RATE CREDIT FOR ITS RESIDENTIAL CUSTOMERS?

A. Kentucky Power’s service territory includes a higher than average incidence of residential customers who employ electric resistance heating. Many of these customers face high electric bills during the winter heating season. By shaping the credit to provide approximately 75 percent of the credit during the winter heating season the Settlement Agreement aids these customers when their need for a rate credit is greatest. Many non-residential customers, by contrast, do not face the same sort of elevated electric bills during the winter heating season.

Q. WHEN DOES THE FEDERAL TAX CUT RATE CREDIT TERMINATE?

A. The credit will continue until the effective date of rates established in the Company’s next general rate case. Absent the extraordinary circumstances identified in paragraph 5(c) of the Settlement Agreement in Case No. 2017-00179, this means the credit will continue until at least the first cycle of the January 2021 billing cycle.

Q. HAS THE COMPANY PREPARED THE FEDERAL TAX CUT RATE CREDIT TARIFF?

A. Yes. It is attached as Exhibit 1 to EXHIBIT MAH-S1 (the Settlement Agreement).

C. The Reasonableness Of The 18-Year Period To Amortize Kentucky Power’s Excess Unprotected ADIT.

Q. EXPLAIN WHY THE SETTLEMENT AGREEMENT PROPOSES TO AMORTIZE THE COMPANY’S EXCESS UNPROTECTED ADIT OVER AN 18-YEAR PERIOD?
A. Each dollar of the federal tax cut credit reduces the Company’s cash flow by a dollar without a compensating reduction in the Company’s expenses. For example, as illustrated in Attachment 2 to Exhibit MAH-S1, the Company estimates, assuming unprotected ADIT is amortized over an 18-year period, its cash flow will be reduced in 2018 by $10.2 million, in 2019 by $10.3 million, and in 2020 by $10.5 million. A shorter amortization period would only increase the amount of these annual reductions in Kentucky Power’s cash flow. But even at 18 years, this reduction in Kentucky Power’s cash flow places significant pressure on the Company’s credit metrics and ultimately the cost of the Company’s capital.

Q. HOW DOES THE REDUCTION OF THE COMPANY’S CASH FLOW AFFECT ITS CREDIT METRICS?

A. Moody’s Investors Service evaluates Kentucky Power’s credit on a stand-alone company basis. Moody’s reviews multiple financial metrics and factors when evaluating companies such as Kentucky Power. These include the company’s regulatory framework and environment, the company’s ability to recover costs and earn returns, the Company’s diversification and financial strength, liquidity, and certain key financial metrics. Among the more important financial metrics Moody’s uses in assigning a credit rating to Kentucky Power is the Company’s ratio of cash flow from operations (excluding changes in working capital) to the Company’s debt.

Q. WHAT IS THE RATIO OF CASH FLOW FROM OPERATIONS (EXCLUDING CHANGES IN WORKING CAPITAL) TO DEBT AND WHAT IS IT INTENDED TO MEASURE?
A. It provides a measure of cash flow generated by the Company’s operations that is available to service a company’s debt. As cash flow decreases, as will occur with the amortization of the Company’s excess ADIT, Kentucky Power has less cash “available” to service debt payments. At some point, a decrease in the ratio may cause Moody’s to lower its credit rating for Kentucky Power.

Q. WHY IS THE COMPANY’S CREDIT RATING OF IMPORTANCE AT THIS TIME?

A. There are two reasons. The first has arisen recently; the second is of importance over the longer term. The first reason is that although Moody’s on March 21, 2018 maintained the Company’s Baa2 credit rating, it revised its credit outlook for the Company from stable to negative. The Moody’s website indicates that a negative outlook indicates a higher likelihood of a credit rating change over the medium term.\(^1\) Moody’s website also indicates that historically, approximately one-third of issuers assigned a negative outlook have been downgraded within 18 months of the assignment of a negative outlook. As a result, the recent assignment of a negative outlook by Moody’s underscores the importance of maintaining, or preferably improving, Kentucky Power’s credit metrics, particularly its ratio of cash flow from operations (excluding changes in working capital) to the Company’s debt. The amortization of the Company’s excess unprotected ADIT over a period of 18 years will help Kentucky Power maintain its credit rating while providing meaningful rate relief to the Company’s customers. Conversely, the use of a shorter period will increase the stress on the Company’s credit metrics and ultimately its credit rating.

Q. WHAT IS THE SECOND REASON THE COMPANY’S CREDIT RATING IS IMPORTANT?

A. Kentucky Power’s credit rating can affect its cost of capital – both debt and equity. The Company’s cost of debt tends to be directly related to its credit rating. All other things being equal, a company with a lower credit rating many times will have a higher cost of debt than a company with a higher credit rating. In addition, a company’s cost of equity bears a relationship – albeit perhaps less direct – to its credit rating. Again, all other things being equal, a company with a lower credit rating many times will have a higher cost of equity than a company with a higher credit rating. A utility’s cost of capital – both in terms of its cost of debt and its cost of equity – in turn affects the rates customers pay.

Q. WHAT IS KENTUCKY POWER’S CURRENT MOODY’S CREDIT RATING?

A. Moody’s currently assigns a Baa2 credit rating to Kentucky Power. That is the second to lowest investment grade rating. Stated otherwise, it is two steps above non-investment grade rating.

Q. DO YOU HAVE REASON TO BELIEVE THAT ACCELERATED AMORTIZATION (AN AMORTIZATION PERIOD OF LESS THAN 18 YEARS) OF EXCESS UNPROTECTED ADIT COULD LEAD TO A CREDIT RATING DOWNGRADE?

A. Although I participated in discussions with Moody’s as recently as March 15, 2018 concerning the Company’s credit rating, I am not, of course, privy to all of its deliberations. Nevertheless, an amortization period of less than 18 years could stress the Company’s credit metrics and consequent credit rating. In this regard, Moody’s March
21, 2018 press release in connection with its downgrade of the outlook for Kentucky Power, attached as EXHIBIT MAH-S2, provides insight into Moody’s decision to assign Kentucky Power a negative credit outlook. In particular, in describing the shift from a stable to a negative outlook for Kentucky Power, Moody’s explained:

“The negative outlook reflects the combination of the utility’s economically weak service territory, its latest rate case outcome, and recently enacted tax reform policy, which will put pressure on credit metrics over the next twelve to eighteen months” added Schumacher. Although we anticipate that the company will seek to compensate for these adverse developments through cost containment and financial policy, including the ability to retain cash flow for investment, we also expect the utility’s increasing capital program will add to its debt burden.

The health of KPCo's service territory in eastern Kentucky, which has high exposure to the energy and mining sectors, has impacted the utility's revenue and load growth as well as recent rate case outcomes. The area continues to lag the state in terms of economic trends, and KPCo’s retail load has declined in each of the past three years, putting downward pressure on earnings and cash flow.

(emphasis supplied). Significantly, among the factors cited for the downgrade, only cost containment and management of financial policy is subject to the Company’s control within the next few years. The Company’s rates are “frozen” until January 2021, while the fruits of the Kentucky Power’s economic development efforts to improve the economics of its service territory and stem customer loss are several years out. It thus is critical that the Company, and the Commission, use the one tool available — a reasonable amortization period for the excess unprotected ADIT — to avoid a credit downgrade.

Q. THE 18-YEAR AMORTIZATION PERIOD FOR KENTUCKY POWER’S UNPROTECTED ADIT IS AT THE LONG END OF THE AMORTIZATION PERIODS EITHER PRESENTED TO OR APPROVED BY THE COMMISSION. CAN YOU JUSTIFY THE DIFFERENT AMORTIZATION PERIODS?
A. Most certainly. Although uniformity in treatment can be important, the Commission's decisions are based upon the record developed in each case and must address the specific circumstances of each utility. A one-size-fits-all approach is not appropriate given the differences among the size and finances of the four investor-owned electric utilities in the Commonwealth, their very disparate service territories, and the amount of their excess unprotected ADIT. As paragraph 2(b) of the Settlement Agreement expressly acknowledges, the 18-year amortization period was agreed upon by KIUC and Kentucky Power with these differences in mind:

The Settling Parties' conclusion regarding the reasonableness of an 18-year period to amortize Kentucky Power's excess unprotected ADIT is informed by the Company's specific financial and operating characteristics, including, but not limited to, the following:

(a) the amount of Kentucky Power's excess unprotected ADIT as a percentage of Kentucky Power's total equity (14.2 percent);

(b) the percentage of Kentucky Power's total debt as a percentage of total capitalization (56.75 percent);

(c) the Company's Moody's Investor Service credit rating (Baa2);

(d) the recent negative outlook assigned the Company by Moody's; and

(e) the decrease in Kentucky Power Company's load and customer base over the past ten years.

Q. HOW DOES KENTUCKY POWER COMPARE TO THE OTHER THREE INVESTOR-OWNED UTILITIES IN KENTUCKY IN THESE RESPECTS?

A. Counsel for KIUC on April 17, 2018 provided staff and the parties with the following chart comparing as of December 31, 2017 the four investor-owned electric utilities with respect to many of these metrics:
<table>
<thead>
<tr>
<th></th>
<th>KU</th>
<th>LG&amp;E</th>
<th>Duke</th>
<th>Kentucky Power</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unprotected Excess ADIT (12/31/2017)</strong></td>
<td>$12,762,150</td>
<td>$24,282,660</td>
<td>$33,032,786</td>
<td>$95,282,425</td>
</tr>
<tr>
<td><strong>Commission-Approved/Proposed Amortization Period</strong></td>
<td>15 years</td>
<td>15 years</td>
<td>10 years</td>
<td>18 years</td>
</tr>
<tr>
<td><strong>Total Equity (12/31/2017) ($000)</strong></td>
<td>$3,357,000</td>
<td>$2,527,000</td>
<td>$319,052&lt;sup&gt;2&lt;/sup&gt;</td>
<td>$670,263</td>
</tr>
<tr>
<td><strong>Unprotected Excess ADIT as Percent of Equity</strong></td>
<td>0.38%</td>
<td>0.96%</td>
<td>10.35%</td>
<td>14.2%</td>
</tr>
<tr>
<td><strong>Moody’s Credit Rating</strong></td>
<td>A3 Stable</td>
<td>A3 Stable</td>
<td>Baa1 Stable</td>
<td>Baa2 Negative</td>
</tr>
<tr>
<td><strong>Total Debt/Total Capitalization (12/31/2017)</strong></td>
<td>41.41%</td>
<td>43.02%</td>
<td>46.87%</td>
<td>56.75%</td>
</tr>
<tr>
<td><strong>Retail Sales (12/31/2016)</strong></td>
<td>18,881,364 MWH</td>
<td>11,947,052 MWH</td>
<td>4,099,199 MWH</td>
<td>5,862,697 MWH</td>
</tr>
</tbody>
</table>

1 Based on the information provided by KIUC, Kentucky Power’s excess unprotected ADIT is almost seven and one-half times larger than that of the much larger (as measured by retail sales and total equity) Kentucky Utilities Company. Louisville Gas and Electric Company, which has MWh sales nearly twice those of Kentucky, has excess unprotected ADIT approximately one-quarter the size of Kentucky Power’s excess unprotected ADIT.

2 The Company’s excess unprotected ADIT is nearly three times larger than the excess

<sup>2</sup> Per Case 2017-00321, electric common equity.
unprotected ADIT of Duke Energy Kentucky, which is closest in size to Kentucky Power.

The service territories of Duke, Kentucky Utilities, and Louisville Gas and Electric have not experienced the serious economic downturn or loss of customers endured by Kentucky Power. Indeed, the service territories, or substantial portions of the service territories, of all three lie within the "Golden Triangle." Also supporting the Company's request is that the credit ratings of all three of the other investor-owned electric utilities in Kentucky are stronger than Kentucky Power's Baa2 rating. Particularly significant is the fact that unlike Kentucky Power none are facing a negative credit outlook.

In sum, Kentucky Power lacks the financial and operational wherewithal to amortize its excess unprotected ADIT over the periods the other three investor-owned electric utilities may be required to use.

V. REASONABLENESS OF THE SETTLEMENT AGREEMENT

Q. DOES THE SETTLEMENT AGREEMENT FAIRLY BALANCE THE INTERESTS OF THE COMPANY AND ITS CUSTOMERS?

A. Yes. The Settlement Agreement provides meaningful rate relief to the Company's customers in the form of a rate credit equal to more than $10 million a year. It does so while helping to minimize the risk of a credit downgrade and the resulting increased capital costs that ultimately would be borne by Kentucky Power's customers. This is a win-win for the Company and its customers.
Q. DO YOU HAVE A RECOMMENDATION FOR THE COMMISSION?

A. Yes. The Settlement Agreement should be approved by the Commission without modification. In addition, the Commission should establish rates and charges in conformity with the agreement.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.
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*Denotes Served by Email  
Service List for Case 2018-00358