COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF KENTUCKY-AMERICAN WATER COMPANY TO AMEND TARIFF TO REVISE QUALIFIED INFRASTRUCTURE PROGRAM CHARGE	))))	CASE NO. 2021-00090

<u>O R D E R</u>

On March 26, 2021, Kentucky-American Water Company (Kentucky-American) filed its second Qualified Infrastructure Program (QIP) Rider (QIP 2) seeking authority to implement a surcharge for recovery of certain capital expenses to replace a portion of its aging water system infrastructure. Kentucky-American proposed an effective date of July 1, 2021, for the QIP 2 tariff.

There are no intervenors in this proceeding. Kentucky-American responded to three rounds of discovery. A formal hearing was held on June 2, 2021. Kentucky-American responded to post-hearing discovery and filed a post-hearing brief. This matter now stands submitted to the Commission for a decision.

<u>BACKGROUND</u>

In Case No. 2018-00358, Kentucky-American requested approval of a QIP Rider to make incremental capital improvements to replace its aging mains that otherwise would not be replaced in a timely manner.[1] In that proceeding, Kentucky-American stated that it would prioritize the replacement of cast iron and galvanized steel mains, which

[1] Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (Ky. PSC June 27, 2019), Order at 73–74. According to Kentucky-American, its infrastructure was deteriorating at a faster rate than the replacement rate.

represented 15 percent of the distribution system but accounted for 64.2 percent of annual main breaks.[2] Kentucky-American further stated that the QIP would utilize a "systematic replacement plan" with a 25-year replacement cycle, and provided a list of QIP-eligible projects for the first five years of the QIP.[3]

In approving the QIP Rider, the Commission established a filing schedule, calculation methodology, and filing contents. QIP applications are filed on an annual basis on or before April 2, have a 90-day review period that can be extended for good cause, are based on a forecasted test period of July 1 to June 30, and have an annual true-up filing of projected costs and actual costs.

The QIP Rider is based upon a revenue requirement that is the sum of the pre-tax return for qualified additions and removal expenditures, plus the depreciation and property tax for the proposed projects in the forecasted test year. The QIP surcharge percentage is calculated as the amount of the QIP revenue requirement divided by the $98,880,622 authorized revenue requirement established in Case No. 2018-00358.[4] The QIP Rider is applied as a percentage to all water revenue, excluding other surcharges or taxes, and is displayed as a separate line item on customer bills. The QIP Rider is reset to zero when the next base rates are approved because the next base rates will include recovery of the annual costs previously recovered through the QIP.

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[2] *Id.* at 76.

[3] *Id.* at, Direct Testimony of Brent E. O'Neill (O'Neill Testimony), Exhibit 1 and Exhibit 2 at 12.

[4] Direct Testimony of Elaine K. Chambers (Chambers Testimony) at 10.

In the first QIP tariff (QIP 1), Case No. 2020-00027, Kentucky-American proposed 60 percent main replacement projects and 40 percent non-main plant replacement projects that were stand-alone projects and not incidental to main replacement.[5] The Commission rejected most of the non-main plaint replacement, finding that QIP-eligible plant other than replacement of aging main "may be included in the QIP only if such plant is replaced incidental to the replacement of aging main."[6]

Due to confusion regarding what plant is eligible to be included in the QIP, the Commission finds it necessary to clarify these issues to prevent future misapprehensions and misinterpretations of the Commission's decisions regarding the QIP. In doing so, the Commission seeks to better align Kentucky-American's QIP proposals with the Commission's Orders to reasonably accelerate the systematic replacement of deteriorating mains that otherwise would not be timely replaced, and thus would hamper service reliability.

PROPOSED QIP

QIP Rider Surcharge Amount

In its application, Kentucky-American requested a cumulative 3.49 percent QIP 2 surcharge,[7] which would result in an increase of $0.94 per month for average residential customers.[8] Kentucky-American proposed $22,333,833 in plant additions for QIP 2,

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[5] Case No. 2020-00027, *Electronic Application of Kentucky-American Water Company to Amend Tariff for the Establishment of Qualified Infrastructure Program Charge* (Ky. PSC June 17, 2020).

[6] *Id.* at 17.

[7] The proposed QIP 2 cumulative surcharge consisted of a 0.97 percent surcharge for the first year QIP 1 projects and 2.52 percent for QIP 2 projects.

[8] Chambers Testimony at 9.

which, after retirements, would result in a net change to rate base totaling $20,028,974, and a QIP 2 revenue requirement of $2,494,576.[9] In response to a request to recalculate QIP 2 based upon a 13-month average rather than ending balance, Kentucky-American calculated that the cumulative QIP surcharge that includes all proposed Budget Line items would be 2.21 percent,[10] with a QIP 2 revenue requirement of $2,186,515 based upon a net change to rate base totaling $19,503,218.[11]

Kentucky-American used a composite retirement rate of 7.03 percent for calculating the retirement expense associated with QIP 2 related plant additions during the forecasted year and a composite depreciation rate of 1.80 percent to calculate depreciation expense for QIP 2 related plant during the forecasted test year.[12]

Kentucky-American proposed certain adjustments totaling $686,601 based upon corrections for errors made in calculating the QIP 1 rider that were discovered while preparing calculations for QIP 2.[13] Kentucky-American explained that it reduced the QIP 2 net plant additions by $217,861 to update an incorrect retirement ratio in QIP 1; by $47,922 to update the incorrect composite depreciation rate used in QIP 1; by $2,505 to update the calculation of property tax in QIP 1; and by $418,413 to update for the tax repair percent on transmission plant and book depreciation rate in deferred tax

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[9] *Id.* at 8–9.

[10] Based upon a 13-month average, the revised QIP 2 cumulative surcharge consisted of a 0.97 percent surcharge for the first year QIP 1 projects and 1.24 percent for QIP 2 projects.

[11] Kentucky-American's Response to Commission Staff's Post-Hearing Request for Information (Staff's Post-Hearing Request)(filed June 11, 2021), Item 3.

[12] Chambers Testimony at 7–8.

[13] *Id.* at 3–4; Kentucky-American Response to Commission Staff's First Request for Information (Staff's First Request)(filed Apr. 16, 2021), Item 28.

calculations in QIP 1. Kentucky-American asserted that it was appropriate to make the adjustments to the QIP 2 calculation rather than wait until the September 2021 reconciliation filing because the errors were discovered while preparing QIP 2. Kentucky-American stated that it will true up the projected amounts to actual amounts in the September 2021 reconciliation filing.

QIP Projects

Kentucky-American proposed a strategic capital expenditures plan (SCEP) for QIP2 that included four budget line items deemed "recurring projects"[14] that will be constructed with internal labor or with pre-qualified contractors to whom Kentucky-American submitted requests for proposals.[15] Kentucky-American explained that the projects were not developed for QIP2 specifically, but instead were projects previously identified as part of Kentucky-American's larger plan to systematically accelerate spending on replacing aging infrastructure.[16]

Kentucky-American explained it used the same prioritization matrix to identify QIP 2 projects that was used to develop proposed QIP SCEPs in Case Nos. 2018-00358 and 2020-00027. The prioritization matrix criteria includes the amount of water pressure, number of breaks or leaks, main age, main material type, main size, and water quality, and are evaluated along with external drivers, such as customer impact and scheduled

[14] Direct Testimony of Kurt A. Stafford (Stafford Testimony) at 3. Kentucky-American capital projects are either recurring projects, which include a defined type of work that occurs every year, or investment projects, which are major projects with a capital cost of $250,000 or more.

[15] Stafford Testimony at 8–9; Kentucky-American's Response to Staff's First Request, Items 1–3; Hearing Video Transcript (HVT) of the June 2, 2021 Hearing at 11:24:59 and 14:18:38.

[16] Stafford Testimony at 3–4 and Exhibit A1.

paving by other governmental entities, to develop a final project list and schedule.[17] Kentucky-American further explained that the prioritization matrix and external drivers are evaluated annually, which may impact the QIP projects to be included each year due to changed circumstances, such as an increase in breaks and leaks, reduced water quality, or new paving schedules.[18]

Based on what Kentucky-American understood was the Commission's intent in previous cases, Kentucky-American accelerated the replacement cycle in QIP 2 from a 25-year cycle to a 20-year cycle, and increased the amount expended on main replacement from $7,623,282 in net plant additions approved in Case No. 2020-00027 to $20,028,974 requested by Kentucky-American in this proceeding.[19]

The projects Kentucky-American proposed for the QIP 2 SCEP are as follows:

- Budget Line B: QIP Mains Replaced/Restored. This budget line includes the scheduled replacement or improvement of 14.9 miles of existing water mains at a capital cost of $19,700,000 in 20 projects.[20] In addition to water mains, the plant replaced in this budget line includes valves, hydrants, and service lines incidental to the main replacement that reached the end of their useful life or cause service problems to adjacent area serviced by the main.[21]

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[17] Kentucky-American's Response to Staff's First Request, Item 10.

[18] Kentucky-American's Response to Commission Staff's Second Request for Information (Staff's Second Request)(filed May 3,2021), Item 3; HVT of the June 2, 2021 Hearing.

[19] Chambers Testimony at 8; Case No. 2020-00027, (Ky. PSC June 17, 2020) Order at 19.

[20] Stafford Testimony at 8.

[21] *Id.*

Kentucky-American stated that the majority of replaced main in this budget line is cast iron and galvanized main that represent 15.9 percent of the total inventory of main that represent 60 percent of all breaks.[22] Kentucky-American explained that the break per mile for cast iron main is 1.1 breaks per mile of main compared to ductile iron, which has a break rate of 0.04 breaks per mile of main between January 2012 and December 2016.[23] Kentucky-American asserted that replacing aging water main infrastructure on a proactive, accelerated basis would result in a direct customer benefit of improved and sustained water quality, reducing water leaks and water main breaks, improved fire protection, fewer service disruptions, and lower operating and maintenance costs.[24]

- Budget Line C: Mains Unscheduled. This budget line includes the unscheduled replacement or restoration of existing water mains, including valves and other appurtenances necessary to perform the work, with unexpected break or failure that requires replacement of a section of main that extends the service life of the main instead of repairing failure with a temporary clamp and replacing the main in the future.[25] Kentucky-American's forecasted budget for this budget line is $981,000, based upon historic averages expended for unscheduled main replacement.[26] Kentucky-American asserted that including unscheduled main replacement in the QIP projects would provide a customer benefit because the replaced main would be more stable, which would permit

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[22] *Id.* at 11.

[23] *Id.*

[24] *Id.*at 8.

[25] *Id.*at 12–13.

[26] *Id.*at 13.

Kentucky-American to concentrate on replacement of mains with a larger history of breaks.[27]

- Budget Line F: Hydrants and Valves Replaced. Kentucky-American budgeted $800,000 to replace hydrants and valves in standalone projects that are not incidental to aging main replacement, and thus not included in Budget Line B or C projects.[28] Budget Line F projects are scheduled replacements that are based on inspections that identified leaking, failed, or obsolete hydrants and valves owned by Kentucky-American.[29] Kentucky-American scheduled replacement of 37 valves at a capital cost of $674,000, and 23 hydrants at a capital cost of $126,000.[30] Kentucky-American contended that customers will benefit from the replacement of hydrants and valves because, by replacing hydrants not functioning properly, Kentucky-American can ensure adequate and reliable service and maintain public safety through functioning hydrants.[31]

- Budget Line H: Services Lines Replaced. Kentucky-American budgeted $530,000 to replace services and laterals in unscheduled, standalone projects that are not incidental to the replacement of aging main.[32] Based on historical averages, Kentucky-American expects to replace up to 242 service lines and laterals that connect Kentucky-American's customers to Kentucky-American's distribution main.[33] Kentucky-

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[27] *Id.*at 12–13.

[28] *Id.*at 13–14; Kentucky-American's Response to Staff's First Request, Item 20.

[29] Stafford Testimony at 13–14; Kentucky-American's Response to Staff's First Request, Item 20.

[30] Stafford Testimony at 13–14.

[31] *Id.*at 13.

[32] *Id.*at 14; Kentucky-American's Response to Staff's First Request, Item 21.

[33] Stafford Testimony at 14.

American maintained that customers would benefit because replacing aging service lines that reduce water service or impact water quality will result in safe, adequate, and reliable water service.[34]

Reconciling QIP2 Project Spending and Surcharge Collections

Under the terms of the QIP Rider tariffs, Kentucky-American will file an annual reconciliation in September 2022 that will true up projected and actual costs of projects between July 1, 2021, and June 30, 2022. The reconciliation filing includes a progress report for work completed, the amount of progress payment, and costs of removal of old pipes.

DISCUSSION AND FINDINGS

QIP-Eligible Plant

Based upon Kentucky-American's misapprehension of eligible plant to be included in the QIP, the Commission finds it necessary to define what constitutes QIP-eligible plant and the reasoning for the Commission's decision in initially approving the QIP. The Commission approved Kentucky-American's QIP for the sole purpose of ensuring that Kentucky-American's aging cast iron and galvanized steel mains were systematically replaced in a timely manner in order to improve the reliability of water service for customers. The Commission approved the accelerated replacement of aging cast iron main that, in the normal course of business, would otherwise take 57.4 years to replace and, based upon the significant number of leaks and breaks in that type of main, was deteriorating faster than it could be replaced.[35]

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[34] *Id.*

[35] Case No. 2018-00358, (Ky. PSC June 27, 2019) Order at 74. At that time, 29% of Kentucky-American's cast iron and galvanized steel main was installed between 1885 and 1970. The Commission

In reaching the decision to approve the QIP, the Commission balanced the need to systematically replace aging main to improve service reliability against the cost that Kentucky-American's ratepayers would bear for the necessary main replacement. Kentucky-American proposed a 25-year replacement cycle that would replace 10–13 miles of aging main per year at an annual estimated cost of $6.9 to $12.6 million. The Commission found that the 25-year cycle for replacing aging main proposed in Case No. 2018-00348 at the estimated amounts was a reasonable alternative with smaller, more gradual rate increases as opposed to the risk of rate shock due to significant rate increases to recover several years of capital investment in replacing aging infrastructure.[36]

The Commission also approved including categories of plant other than mains, such as service lines, valves, and hydrants, in the QIP for the sole purpose of replacing such plant <u>incidental</u> to the replacement of aging main. The Commission did not intend to approve replacement of plant other than mains as standalone projects; the Commission approved the QIP to accelerate the replacement of aging mains. Including other plant categories in the accounts allowable for recovery in the QIP was not an invitation for Kentucky-American to turn a mechanism proposed to address a discrete problem (e.g. aged mains of a certain material that cause the majority of system impacts) into a general distribution system capital rider. This is consistent with Kentucky-American's

further noted that at Kentucky-American's current pace of replacing aged mains in general, it would take approximately 377 years to replace the entire main in the system. It goes without being said, but given aged mains' impact to Kentucky-American's system, and in particular the impact of cast iron mains, Kentucky-American's previous pace and practice of main replacement was inadequate and detrimental to its customers and service.

[36] *Id.* at 81.

replacement program report filed in Case No. 2018-00358 that focused exclusively on main replacement, with next to no mention of non-main plant replacement.

Because the primary purpose of the QIP is to replace aging main, the Commission finds that including the replacement of non-main plant in the QIP is reasonable only if the non-main plant is replaced incidental to the accelerated replacement of aging main. When determining whether the replacement is incidental, the bright-line test is whether the primary purpose of a project is to replace aging main. For example, if Kentucky-American identified hydrants, valves, or service lines on a designated street that warranted being replaced while planning a project with the primary purpose of replacing aging main on that designated street, then those hydrants, valves, or services lines could be included in the QIP. If Kentucky-American identified hydrants, valves, or services lines that may warrant being replaced, but justify the project simply because the plant is attached to an aging main that is not scheduled to be replaced, then that project cannot be included in the QIP. This is because it is a more efficient and effective use of resources to replace non-main plant adjacent to mains at the same time Kentucky-American is replacing the mains on a planned, systematic basis.

To sum up, the Commission reviews QIP projects proposed by Kentucky-American and determines whether, based on sufficient evidence, each project is reasonably related to the systematic replacement of aging main that would otherwise not be replaced in a timely manner and whether the replacement of plant other than aging mains is proposed incidental to the replacement of aging mains.

Based upon the case record and being otherwise sufficiently advised, the Commission finds that Kentucky-American established that Budget Line B for scheduled main replacement is reasonably related to the purpose of the QIP because the projects, which include replacement of aging main and plant incidental to the replacement of aging main, are precisely the type of scheduled projects for which the Commission approved the QIP. Although Kentucky-American misapprehended and increased the amount of main replaced to 14.9 miles, the Commission will approve Budget Line B as set forth in the application but for this year only. For all future QIP applications after QIP 2, the Commission finds that the amount of main replacement included in QIP projects should be consistent with the amount proposed and approved in Case No. 2018-00358, and should be based on a 25-year replacement cycle and not a 20-year replacement cycle. The Commission further finds that, based on the 25-year replacement cycle, Kentucky-American should limit future QIP scheduled main replacement to 10–13 miles of main replaced each year. Any future deviations from the QIP approved by the Commission, such as an accelerated replacement cycle, accelerated spending totals, or including standalone non-main plant replacement projects, will be looked upon with extreme disfavor.

Although the Commission approved Budget Line C, unscheduled main replacement, to be included in QIP 1, the Commission concludes that this was erroneous finding because Budget Line C projects are not reasonably related to the systematic replacement of aging mains. This is because Budget Line C consists solely of unscheduled main replacements. In its QIP proposal, Kentucky-American stated that the QIP represented "a systematic replacement plan to ensure that the right mains were being replaced at the right time."[37] The Commission approved the QIP based upon the proposal

[37] *Id.*, O'Neill Testimony, Exhibit 2 at 12.

of a systematic, planned replacement program. Unscheduled main replacements are antithetical to the stated purpose of the QIP as ensuring that the right mains are replaced at the right time based upon a systematic plan. For this reason, the Commission finds that Budget Line C projects should be excluded from QIP 2 and from future QIP proposals.

Finally, the Commission finds that Kentucky-American did not establish that Budget Line F to replace hydrants and valves, and Budget Line H to replace service lines are incidental to replacing aging mains. While aging main may be attached to the plant in Budget Line F and H, the substantial evidence of record demonstrates that the primary purpose of these projects is to replace hydrants, valves, and services lines, and not to replace the aging main to which this plant is attached.[38] Because Budget Line F and Budget Line H projects are outside the scope of the purpose of the QIP, these projects should excluded from QIP 2 and all future QIP proposals.

The Commission strongly urges Kentucky-American to take notice that eligible plant other than the scheduled replacement of aging main may be included in the QIP only if such plant is replaced <u>incidental</u> to the replacement of aging main. If the primary purpose of a project is to replace hydrants, valves, and service lines, then that project should not be included in a QIP proposal. The Commission will not require any changes to the QIP-eligible plant included in the QIP tariff because non-main plant may be replaced incidental to the replacement of aging main. Kentucky-American is cautioned not to consider the Commission's unwillingness to remove non-main plant from the tariff as permission to include standalone non-main plant projects in future QIPs. Any future

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[38] *See* Kentucky-American's Response to Staff's Second Request, Item 1. Kentucky-American stated that 10% of Budget Line F is attributed to replacing mains connected to hydrants and valves, with 90% attributed to replacing the hydrants and valves. Kentucky-American's argument that services lines are "small diameter water mains" and thus should be included in the QIP strains credulity.

requests to include replacement of non-main plant other than plant replaced incidental to the replacement of aging main will be looked upon with extreme disfavor. Failure to follow the very clear directions in this Order will result in the QIP being limited to the systematic replacement of aging mains and the removal of all non-main plant accounts from the tariff.

QIP as a Systematic Replacement Plan

As discussed above, Kentucky-American proposed the QIP as a systematic replacement plan for aging main in Case No. 2018-00358 and provided a list of projects for the first five years of the QIP. However, when asked to provide data regarding QIP years 3 through 5, Kentucky-American declined, stating that it had not yet identified QIP projects for those years. Kentucky-American explained that it re-evaluates the projects on the SCEP annually using the prioritization matrix criteria and external drivers.

The Commission questions whether Kentucky-American actually has a systematic plan for QIP projects given Kentucky-American's inability or unwillingness to identify projects for the next QIP, which will be filed within nine months. The Commission finds that, in the next QIP filing in 2022, Kentucky-American must provide specific details as to how each proposed project meets the prioritization matrix and external drivers, including the score for each project's matrix criteria and the aggregate score, and the external drivers, with a detailed narrative how each driver impacted the decision process for each project.

Reasonableness of Forecasted QIP Costs in This Case

The Commission has strong concerns regarding the significant increase in QIP construction costs and Kentucky-American's deliberate effort to minimize those construction cost increases. In Case No. 2018-00358, Kentucky-American projected QIP projects' all-in costs at $150 per foot based on historical averages.[39] However, in QIP 2, Kentucky-American proposed to replace 14.9 miles of main at an estimated cost of $19,700,000, which is $250 per foot.[40] Kentucky-American offered then retracted several potential reasons for the difference before admitting it failed to consider relevant cost drivers in the project planning. First, Kentucky-American attributed the cost increase to the passage of time from when the estimates were first prepared.[41] Next, Kentucky-American attributed the cost increase to a March 2019 paving restoration ordinance enacted by Lexington-Fayette County Urban Government (LFCUG), which could not have been anticipated at the time the QIP was proposed in 2018, and to increased corrosion control.[42] Kentucky-American subsequently stated that the LFUCG Ordinance in March 2019 was not related to the purported increase in paving restoration costs, and that an ordinance enacted in the September 2017 established new paving restoration criteria at issue.[43] Kentucky-American never acknowledged that the purported increase in paving restoration costs should have been known because they were placed into effect approximately nine months before Kentucky-American filed its QIP proposal. Further, the minutes of the utility coordinating committee meetings between LFUCG and utilities, including Kentucky-American, do not reflect that Kentucky-American ever raised an issue regarding alleged increased costs for paving restoration, despite LFUCG repeated

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[39] Kentucky-American's Response to Staff's First Request, Item 18.

[40] 14.9 miles is 78,800 feet. Dividing $19,700,000 by 78,800 results in a quotient of $250 per foot.

[41] Kentucky-American Response to Staff's First Request, Item 18.

[42] *Id.*

[43] Kentucky-American's Response to Commission Staff's Third Request for Information (Staff's Third Request)(filed May 25, 2021), Item 4; HVT of the June 2, 2021 Hearing at 11:38:26.

requests for utility input.[44] Ultimately, Kentucky-American acknowledged that paving restoration was not the primary driver of the $100 per foot cost increase, nor was corrosion control, which adds approximately $2–$3 per foot.[45] Kentucky-American conceded that the estimated costs of QIP main replacement were a “miss” and that it misstated costs in the original QIP proposal.[46] Kentucky-American admitted that the average main replacement cost, including pavement restoration, was $222 per foot in 2015-2017, and not $150 per foot, while the average cost in 2018-2019 was $341 per foot, and not $250 per foot.[47] Kentucky-American explained that it based the QIP cost projections on less complex main replacement projects.[48] However, much of the QIP aging main replacement is in older sections of Lexington, Kentucky, and that due to limited right-of-ways, such mains are typically located in the street in those sections, which greatly increases the complexity of the project, and thus increases the cost.[49] Kentucky-American asserted that, despite knowing the location of the projects, it did not plan for the more complex construction required, which adversely impacted the cost estimates.[50]

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[44] Kentucky-American’s Response to Commission Staff’s Post-Hearing Request for Information, Item 2.

[45] Kentucky-American Response to Staff’s Second Request, Item 7.b; Kentucky-American’s Response to Commission Staff’s Third Request, Item 4; HVT of the June 2, 2021 Hearing at 11:16:39.

[46] Kentucky-American’s Response to Staff’s Third Request, Item 4; HVT of the June 2, 2021 Hearing at 11:15:44.

[47] Kentucky-American’s Response to Staff’s Third Request, Item 4; HVT of the June 2, 2021 Hearing at 11:14:12.

[48] HVT of the June 2, 2021 Hearing at 11:15:52.

[49] *Id.*

[50] *Id.*

The Commission is further concerned that Kentucky-American's contractor selection and contract award process similarly has an adverse impact on cost. Kentucky-American uses pre-qualified contractors on its capital projects that cannot be constructed by Kentucky-American employees. However, only 12 pipeline contractors are pre-qualified to work on QIP projects.[51] Although Kentucky-American terms its process as competitive bidding, Kentucky-American does not provide general notice of its request for bids, and instead accepts bids only from pre-qualified contractors.[52] Further Kentucky-American chooses which pre-qualified contractor will receive a request for bids, rather than open bidding to all pre-qualified contractors.[53]

The Commission reminds Kentucky-American that it bears the burden of proof that the construction costs are reasonable, and thus may be recovered through the QIP. Despite repeated questioning in discovery and in the hearing, Kentucky-American displayed little-to-no concern regarding the increase in construction costs, nor did Kentucky-American provide any evidence of steps it has taken to control such costs. Kentucky-American must demonstrate that it is more proactive in planning for and managing construction costs, and relaying accurate data to the Commission, given that costs that are not found to be reasonable cannot be recovered from ratepayers. As one example, limiting the number of contractors inherently leaves open the potential for inflated pricing, especially if requests to bid are offered only to contractors hand-picked by Kentucky-American. In the next QIP filing in 2022, Kentucky-American should be

[51] Kentucky-American's Response to Staff's Second Request, Item 2.

[52] *Id.*

[53] HVT of the June 2, 2021 Hearing at 2:16:44.

prepared to demonstrate what efforts they have implemented with contractors, suppliers, local transportation and engineering officials, and other utilities to contain and manage project costs.

Adjustment to QIP 1

The Commission concurs with Kentucky-American that is was more appropriate to make corrections for QIP 1 calculation errors in the QIP 2 filing, rather than wait until the reconciliation filing September 2021, given that the adjustments reduce the amount requested for net plant additions in QIP 2. The Commission finds that that the QIP 1 adjustments should be included in the QIP 2 calculation because the adjustments provide Kentucky-American customers with the benefit a few months earlier than if Kentucky-American waited until September 2021 to make the adjustment in the reconciliation filing.

QIP Revenue Requirement

The Commission is concerned that Kentucky-American is recovering for investments it has not made through the QIP. To calculate the QIP rate base, Kentucky-American used net plant based on the total QIP-eligible plant additions and retirements for a 12-month period ending June 30, 2022, which is the ending balance of its gross QIP plant as of that date. Because Kentucky-American uses a forecasted ending balance of gross plant in calculating the QIP instead of a 13-month average, Kentucky-American will collect, on average, a return on investments it has not yet made.[54] Further, using an ending balance is inconsistent with Kentucky-American's use of a 13-month average to calculate rate base when base rates are established using a forecasted test year and with 807 KAR 5:001, Section 16(6)(c), which requires utilities requesting a general rate

[54] Kentucky-American Response to Staff's Post-Hearing Request, Item 3.

adjustment based on a forecasted test year to calculate their rate base using a 13-month average.

The Commission finds that it is unreasonable to allow Kentucky-American to continue to use an erroneous methodology to calculate QIP rate based until its next base rate case because it results in Kentucky-American overearning on the QIP. Based upon information provided by Kentucky-American and removing the plant that is not eligible to be included in the QIP, the Commission calculated the QIP rate base using the 13-month average of gross plant in Budget Line B during the forecasted period.

With these adjustments, the Commission finds that Kentucky-American's QIP net rate base is $15,046,786 and its QIP revenue requirement is $2,019,358, as shown in the Appendix to this Order. The Commission further finds that Kentucky-American should include language in its tariff stating that the QIP rate base in any forecasted period will be calculated in a manner consistent with 807 KAR 5:001, Section 16(6)(c).

QIP Surcharge

Based upon the above findings, the Commission finds that the proposed 3.49 percent QIP Rider is not reasonable because it includes proposed projects that are outside the scope of the purpose of the QIP to replace aging mains.

Based upon plant in Budget Line B, which are the proposed projects that are in the scope of the purpose of the QIP to replace aging mains, the Commission finds that the QIP Rider of 2.04 percent is reasonable and therefore should be approved.[55]

QIP Projects are Extensions in the Ordinary Course of Business

KRS 278.020(1) requires a utility to obtain a Certificate of Public Convenience or Necessity (CPCN) prior to constructing any new facility that is intended to furnish regulated utility services to the public. However, this statute also provides an exemption from the certificate requirements if the new facility is an ordinary extension of existing systems in the usual course of business. Commission regulation 807 KAR 5:001, Section 15(3), defines an ordinary extension in the usual course of business as an extension that does not create wasteful duplication of plant or conflict with existing certificates of other utilities operating in the same area and under the jurisdiction of the Commission, and does not involve sufficient capital outlay to materially affect the existing financial condition of the utility or will not result in increased charges to its customers.

Kentucky-American asserted that the proposed QIP projects are replacement projects that do not require a CPCN because they are extensions in the ordinary course of business pursuant to KRS 278.020(1) and 807 KAR 5:001, Section 15(3). Kentucky-American stated that the facilities do not result in the wasteful duplication of utility plant because they are replacement facilities and do not compete with the facilities of existing

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QIP Revenue Requirement Rate Adj	$ 963,160	$ 1,056,198	$ 2,019,358
Divide By: Authorized Revenues 2018-0358	$ 98,880,622	$ 98,880,622	$ 98,880,622
QIP Rider Charge	0.97%	1.07%	2.04%

public utilities because they are replacement of Kentucky-American's own facilities. Kentucky-American further asserted that none of the proposed projects involve a substantial level of investment or capital outlay, and do not represent a significant alteration or addition to the normal operation of Kentucky-American's facilities.

Having reviewed the record and being sufficiently advised, the Commission finds that the QIP projects approved in this Order are ordinary extensions in the usual course of business, and therefore exempt from the requirements of a CPCN pursuant to KRS 278.020(1). The QIP projects approved in this Order do not create a wasteful duplication of plant.

QIP 3 Filing Date

Based upon the proceedings in Case No. 2020-00027 and this proceeding, the Commission finds that additional time is required to thoroughly review Kentucky-American's QIP applications given the number of projects that have been denied and the need to closely evaluate those projects that are QIP eligible given Kentucky-American's inability to identify future projects and their estimated costs. For future QIP filings, the Commission finds that Kentucky-American should file its QIP application no later than March 1 each year for QIP Rider that is effective July 1 of that year. This will allow 120 days to review the QIP application. The Commission reserves the right to continue any QIP proceeding beyond 120 days for good cause.

IT IS THEREFORE ORDERED that:

1. The QIP Rider of 3.49 percent proposed by Kentucky-American is denied.

2. The QIP Rider of 2.04 percent is approved.

3. The QIP Rider of 2.04 percent is fair, just and reasonable, and is approved for service rendered on and after July 1, 2021, through June 30, 2022.

4. Beginning on March 1, 2022, Kentucky-American shall file annual QIP applications no later than March 1 for the QIP Rider that is effective July 1 of the same year. The Commission may extend the QIP proceeding beyond 120 days for good cause.

5. Within 20 days of the date of this Order, Kentucky-American shall, using the Commission's electronic Tariff Filing System, file its revised tariffs setting out the rates authorized in this Order and the revised QIP Rider and reflecting they were approved pursuant to this Order, and stating that Kentucky-American's QIP rate base in any forecasted period will be calculated in a manner consistent with 807 KAR 5:001, Section 16(6)(c).

6. This case is now closed and removed from the Commission's docket.

By the Commission

ENTERED

JUN 21 2021 rcs

KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

for

Executive Director

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2021-00090 DATED JUN 21 2021

Line No.		QIP 1 July 2020 - June 2021	QIP 2 July 2021 - June 2022	Total QIP
1	QIP Plant Additions	$8,218,500	$8,757,692	$16,976,192
2	Retirements	(595,218)	(402,114)	(997,332)
3	Retirement Adjustment to QIP 1		217,861	217,861
4	**Net Change to Gross Plant**	7,623,282	8,573,439	16,196,722
5				
6	Cost of Removal	567,070	875,769	1,442,839
7	Retirements	595,218	402,114	997,332
8	Retirement Adjustment to QIP 1		(217,861)	(217,861)
9	Depreciation Accrual - QIP 1	(167,791)	(119,969)	(287,761)
10	Depreciation Accrual Adjustment to QIP 1		47,822	47,822
11	Depreciation Accrual - QIP 2		(63,920)	(63,920)
12	**Net Change to Accum Depr**	994,496	923,955	1,918,451
13				
14	**Net Change to Net Plant**	8,617,779	9,497,394	18,115,173
15	Accumulated Deferred Taxes - QIP 1	(993,413)	(1,796)	(995,209)
16	Accumulated Deferred Taxes Adjustment to QIP 1		(418,413)	(418,413)
17	Accumulated Deferred Taxes - QIP 2		(1,654,765)	(1,654,765)
18	**Net Change to Rate Base**	7,624,365	7,422,420	15,046,786
19	Pre-Tax Rate of Return	9.28%	9.28%	9.28%
20	QIP Revenue on Net Change to Rate Base	707,701	688,956	1,396,658
21	QIP Depreciation Expense - QIP 1	167,791		167,791
22	QIP Depreciation Expense Adjustment to QIP 1		(47,822)	(47,822)
23	QIP Depreciation Expense - QIP 2		127,840	127,840
24	QIP Property Taxes - QIP 1	87,668	18,819	106,486
25	QIP Property Taxes Adjustment to QIP 1		2,505	2,505
26	QIP Property Taxes - QIP 2		265,899	265,899
27				
28	QIP Revenue Requirement Rate Adj	$963,160	$1,056,198	$2,019,358
29	Divide By: Authorized Revenues 2018-0358	$98,880,622	$98,880,622	$98,880,622
30				
31	QIP Rider Charge	0.97%	1.07%	2.04%

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