

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF KENTUCKY-)	
AMERICAN WATER COMPANY FOR A)	CASE NO.
REVISION OF ITS QUALIFIED)	2024-00272
INFRASTRUCTURE PROGRAM CHARGE)	

ORDER

On August 30, 2024, Kentucky-American Water Company (Kentucky-American) filed its sixth Qualified Infrastructure Program (QIP) Rider (QIP 6) seeking authority to implement a surcharge for recovery of certain capital expenses to replace a portion of its aging water system infrastructure.¹ Kentucky-American proposed an effective date of January 1, 2025.² On October 30, 2024, an informal conference was conducted between Commission Staff and Kentucky-American to discuss Kentucky-American’s QIP 6 proposal and answer Commission Staff’s questions.³ On November 8, 2024, the Commission issued a procedural schedule along with Commission Staff’s First Request for Information.⁴ On November 21, 2024, Kentucky-American filed its responses to Commission Staff’s First Request.⁵ This matter now stands submitted to the Commission for decision.

¹ Application (filed Aug. 30, 2024).

² Application at 3, paragraph 5.

³ Informal Conference Memorandum (filed Nov. 8, 2024).

⁴ Order (Ky. PSC Nov. 8, 2024).

⁵ Kentucky-American’s Response to Commission Staff’s First Request for Information (Response to Staff’s First Request) (filed Nov. 21, 2024).

BACKGROUND

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.⁶ In that proceeding, Kentucky-American stated that it would prioritize the replacement of cast iron and galvanized steel mains, which represented 15 percent of the distribution system but accounted for 64.2 percent of annual main breaks.⁷ 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.⁸

With the approval of the QIP Rider, the Commission established a filing schedule, calculation methodology, and filing contents. These requirements stated that QIP applications were to be 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. However, in Case No. 2023-00300, the Commission found that moving the QIP filing schedule to a calendar year, as shown below, would be more beneficial for Kentucky-American.⁹

⁶ 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.

⁷ Case No. 2018-00358, June 27, 2019 Order at 76.

⁸ Case No. 2018-00358, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates* (filed Nov. 28, 2018) Direct Testimony of Brent E. O’Neill (O’Neill Direct Testimony), Exhibit 1 and Exhibit 2 at 12.

⁹ Case No. 2023-00300, *Electronic Application of Kentucky-American Water Company for a Balancing Adjustment for its QIP Charge*, (Ky. PSC Aug. 12, 2024), Order at 6.

Filing	Filing Date	QIP Period Start / Rates Effective	QIP Period End	Balancing Adjustment
QIP 5*	5/31/2024	9/1/2024	12/31/2024	None*
QIP 6	8/31/2024	1/1/2025	12/31/2025	QIP 4
QIP 7	8/31/2025	1/1/2026	12/31/2026	QIP 5
QIP 8	8/31/2026	1/1/2027	12/31/2027	QIP 6

*Filing to remove QIP 3 Balancing Adjustment and proposing no new QIP investments.

Therefore, the filing requirements were updated, and Kentucky-American is now required to file all future QIP applications no later than August 31 of each year for the QIP Rider which would be effective on January 1 of the next year. However, the Commission reserves the right to continue any QIP proceeding beyond 120 days for good cause.¹⁰

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 \$119,828,211 authorized revenue requirement established in Case No. 2023-00191.¹¹ 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.

In the first QIP tariff (QIP 1), Case No. 2020-00027, Kentucky-American proposed QIP investment that consisted of 60 percent main replacement projects and 40 percent

¹⁰ 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), Order at 21.

¹¹ Case No. 2023-00191, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates, a Certificate of Public Convenience and Necessity for Installation of Advanced Metering Infrastructure, Approval of Regulatory and Accounting Treatments, and Tariff Revisions* (Ky. PSC Nov. 6, 2024), Order.

non-main plant replacement projects which were stand-alone projects and not incidental to main replacement.¹² In the final Order for Case No. 2020-00027, the Commission emphasized that the primary reason it approved Kentucky-American’s QIP was to replace aging water mains that were reaching the end of their service life and were contributing to Kentucky-American’s unaccounted-for water loss.¹³ The Commission rejected stand-alone projects for non-main plant replacement, finding that QIP-eligible plant other than replacement of aging mains “may be included in the QIP only if such plant is replaced incidental to the replacement of aging main.”¹⁴

In Case No. 2021-00090,¹⁵ the QIP 2 tariff rider (QIP 2) application, Kentucky-American proposed a strategic capital expenditures plan (SCEP) for QIP 2 that included four budget line items deemed “recurring projects”¹⁶ that were not developed for the QIP 2 specifically, but instead were projects previously identified as part of Kentucky-American’s larger plan to systematically accelerate spending on replacing aging infrastructure.¹⁷ Based upon its interpretation of the Commission’s intent in Case No. 2020-00027, Kentucky-American accelerated the replacement cycle of its main replacements in QIP 2 from a 25-year cycle to a 20-year cycle.¹⁸ The proposed reduction in the main

¹² 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).

¹³ Case No. 2020-00027, June 17, 2020 Order at 15.

¹⁴ Case No. 2020-00027, June 17, 2020 Order at 17.

¹⁵ Case No. 2021-00090, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (Ky. PSC Jun. 21, 2021).

¹⁶ Case No. 2021-00090, June 21, 2021 Order at 3.

¹⁷ Case No. 2021-00090, June 21, 2021 Order at 3.

¹⁸ Case No. 2021-00090, June 21, 2021 Order at 6.

replacement cycle increased Kentucky-American's projected main replacement spending from \$7,623,282 in net plant additions approved in Case No. 2020-00027 to \$20,028,974 requested in QIP 2.¹⁹

In the final Order of Case No. 2021-00090, the Commission found that Kentucky-American's main replacement projects in future QIP applications should be based on a 25-year replacement cycle, be limited to annual main replacements of 10 to 13 miles, and be for QIP projects that are consistent with the amount proposed and approved in Case No. 2018-00358.²⁰ The Commission directed Kentucky-American to be prepared to explain how each proposed project meets the prioritization matrix and external drivers in its 2022 QIP filing, and demonstrate what efforts Kentucky-American has implemented with contractors, suppliers, local transportation and engineering officials, and other utilities to contain and manage project costs.²¹ Additionally, the Commission ordered Kentucky-American to provide any evidence of the steps it has taken to control such costs.²²

Further, in Case No. 2021-00090, the Commission found that 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.²³ As one example, limiting the number of contractors inherently leaves open the potential for inflated pricing, especially

¹⁹ Case No. 2021-00090, June 21, 2021 Order at 6.

²⁰ Case No. 2021-00090, June 21, 2021 Order at 12.

²¹ Case No. 2021-00090, June 21, 2021 Order at 13.

²² Case No. 2021-00090, June 21, 2021 Order at 17.

²³ Case No. 2021-00090, June 21, 2021 Order at 17.

if requests to bid are offered only to contractors hand-picked by Kentucky-American.²⁴ The Commission requested that in the 2022 QIP filing Kentucky-American should include what efforts they have implemented with contractors, suppliers, local transportation and engineering officials, and other utilities to contain and manage project costs.²⁵

Kentucky-American proposed expenditures for QIP 3 that were limited to the budget line item B: QIP Mains Replaced/Restored,²⁶ and the items were to be constructed with internal labor or with pre-qualified contractors to whom Kentucky-American submitted requests for proposals.²⁷ Kentucky-American explained that the projects are based on a 10 to 13 mile per year replacement rate to meet its 25-year replacement goal.²⁸ Specifically, the investments included in the proposed QIP 3 were intended to replace aging infrastructure that is non-revenue producing.²⁹

Kentucky-American explained it used the same prioritization matrix to identify QIP 3 projects that was used to develop proposed QIP projects in Case Nos. 2018-00358, 2020-00027, and 2021-00090.³⁰ 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

²⁴ Case No. 2021-00090, June 21, 2021 Order at 17.

²⁵ Case No. 2021-00090, June 21, 2021 Order at 18.

²⁶ Case No. 2022-00032, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (filed Mar. 1, 2022), Direct Testimony of Krista Citron (Citron Direct Testimony) at 4.

²⁷ Case No. 2022-00032, Citron Direct Testimony at 4.

²⁸ Case No. 2022-00032, Citron Direct Testimony at 4.

²⁹ Case No. 2022-00032, Citron Direct Testimony at 4.

³⁰ Case No. 2022-00032, Citron Direct Testimony at 7–8.

scheduled paving by other governmental entities, to develop a final project list and schedule.³¹

Kentucky-American stated that the majority of replaced mains in this budget line are cast iron and galvanized mains and these mains represent 15.9 percent of the total inventory and 64 percent of all breaks.³² 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 2016.³³ Kentucky-American asserted that replacing cast iron and galvanized steel water main infrastructure would result in a direct customer benefit of improved and sustained water quality and ensure reliability of water service to Kentucky-American customers.³⁴ In accordance with the final Order in Case No. 2021-00090, Kentucky- American provided detailed descriptions of how each proposed project included in QIP 3 addresses the aspects of its prioritization matrix in its selection.³⁵

In the final Order of Case No. 2023-00030, the Commission directed Kentucky-American in all future QIP filings to include detailed, supporting documentation justifying how Kentucky-American develops its scope of work and cost estimates for each project, including an itemized breakdown for material, labor, and paving and reasoning for each

³¹ Case No. 2022-00032, Citron Direct Testimony at 7–8.

³² Case No. 2022-00032, Citron Direct Testimony at 6.

³³ Case No. 2022-00032, Citron Direct Testimony at 6–7.

³⁴ Case No. 2022-00032, Citron Direct Testimony at 7.

³⁵ Case No. 2022-00032, Citron Direct Testimony, Exhibit 3.

variance from the original estimate.³⁶ Accordingly, the Commission put Kentucky American on notice that, in future QIP applications, it would hold the utility accountable for cost overruns that are a result from Kentucky-American's actions or inactions.³⁷

In Case No. 2023-00300 Kentucky-American made assumptions in its application that QIP 4 would be recovered through base rates and no longer apart of the QIP rider charge based on its proposal in its 2023-00191 rate case.³⁸ In its QIP balancing adjustment application, Kentucky-American did not include QIP 4 in its adjustment calculations and made its adjustment only on the under recovery of the QIP 3 period.³⁹ In the final Order in Case No. 2023-00191 QIP 4 was not removed from the QIP rider charge.⁴⁰ This resulted in Kentucky-American filing its QIP 5 on May 31, 2024.

In Case No. 2024-00173, Kentucky-American proposed no new projects for QIP 5 and a four-month effective period of September 1, 2024, to December 31, 2024, to allow future QIP periods to align with a calendar year.⁴¹ Kentucky-American's proposed QIP Rider is 6.41 percent including the removal of the QIP 3 balancing adjustment and requested rehearing revenues of \$120,635,314 from Case No. 2023-00191.⁴² When the Order was issued, Kentucky-American's request for rehearing in Case No. 2023-00191

³⁶ Case No. 2023-00030, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Charge* (Ky. PSC Sept. 29, 2023), final Order at 12–13.

³⁷ Case No. 2023-00030, Sept. 29, 2023 final Order at 12–13.

³⁸ Case No. 2023-00300 Application, Jeffrey Newcomb Testimony at 4.

³⁹ Case No. 2023-00300 Application, Exhibit 2.

⁴⁰ See Case No. 2023-00191, May 3, 2024 final Order.

⁴¹ Case No. 2024-00173, *Electronic Application of Kentucky-American Water Company to Amend Tariff to Revise Qualified Infrastructure Program Charge* (filed May 31, 2024), Newcomb Direct Testimony and Exhibits, Ex. 1-2 at 3.

⁴² Case No. 2024-00173, May 31, 2024 Newcomb Workpapers.

was still pending before the Commission. Consequently, the Commission found that Kentucky-American's proposed QIP 5 Rider of 6.41 relied upon revenue numbers that were not known or measurable. Commission rejected Kentucky-American's proposed 6.41 percent QIP Rider and found that a Kentucky-American QIP Rider of 6.29 percent⁴³ was reasonable based upon the authorized revenues from the final Order of Case No. 2023-00191 of \$122,919,594⁴⁴ and removing the QIP 3 balancing adjustment.

QIP Year 6 Projects

For its QIP Year 6 projects, Kentucky-American proposed only Budget Line B: QIP Mains Replaced/Restored projects.⁴⁵ The total length of the proposed projects is 10.02 miles.⁴⁶ Those projects are based on a 10-13 miles per year rate to meet the 25-year replacement goal.⁴⁷ These investments are to replace aging infrastructure that is non-revenue producing.

Kentucky-American explained it used the same prioritization model to identify QIP 6 projects used to develop proposed QIP projects in the previous line of cases.⁴⁸ The pavement condition rating is a measure of how much useful life is remaining on any given section of roadway. Kentucky-American also considered the pavement condition rating

⁴³ 0.83 (QIP 1) +1.87% (QIP 2) + 2.55% (QIP 3) +1.05% (QIP 4) +0.00% (QIP 5) = 6.29% (Total QIP).

⁴⁴ Case No. 2023-00191, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates, a Certificate of Public Convenience and Necessity for Installation of Advanced Metering Infrastructure, Approval of Regulatory and Accounting Treatments, and Tariff Revisions* (Ky. PSC May 3, 2024), Order.

⁴⁵ Direct Testimony of Shelley Porter (Porter Direct Testimony) at 4.

⁴⁶ Porter Direct Testimony at 4.

⁴⁷ Porter Direct Testimony at 4.

⁴⁸ Porter Direct Testimony at 5–6.

from LFUCG.⁴⁹ Kentucky-American stated that the goal of including this factor in its analysis is to identify segments of main located within roadways that are likely to be paved in the near future to better coordinate paving restoration requirements with LFUCG.⁵⁰ Kentucky-American stated that the realignment of the QIP construction period to a calendar year will better align with LFUCG paving planning.⁵¹

Kentucky-American provided its prioritization model for its QIP projects along with descriptions of any over or under budget runs for each project from QIP 1 through QIP 4.⁵² Kentucky-American stated that, in response to the Environmental Protection Agency's Lead and Copper Rule Improvements in effective on October 8, 2024, if several projects are scored similarly based on the prioritization model, but there are projects that include mains installed prior to the 1930's, these projects will receive a higher priority. Kentucky-American stated that lead service lines present within the Kentucky American system are largely present in areas where the water main was installed prior to the 1930's.⁵³

In its application, Kentucky-American requested a QIP 6 charge of 11.29 percent⁵⁴ based on requested rehearing revenues of \$120,65,314 from its rate Case No. 2023-00191.⁵⁵ On November 6, 2024, the Commission issued a final Order approving

⁴⁹ Porter Direct Testimony at 6–7.

⁵⁰ Porter Direct Testimony at 6.

⁵¹ Porter Direct Testimony at 10.

⁵² Response to Commission Staff's First Request, Item 4 and Item 6.

⁵³ Response to Commission Staff's First Request, Item 5.

⁵⁴ $6.41\%(\text{QIP 5}) + 1.84\%(\text{Incremental QIP}) + 3.04\%(\text{QIP 4 Balancing}) = 11.29\%$

⁵⁵ Application at 3.

revenues of \$119,828,211 in Case No. 2023-00191.⁵⁶ On November 21, 2024, Kentucky-American filed an updated QIP 6 proposed charge using the approved revenues of \$119,828,211.⁵⁷ Kentucky-American calculated an updated QIP 6 charge of 11.06 percent.⁵⁸

QIP 6 Rider Surcharge Amount

Based upon the above findings, the Commission rejects Kentucky-American's proposed 11.29 percent QIP Rider and finds that a Kentucky-American QIP Rider of 11.06 percent to be reasonable based upon the authorized revenues from the final Order of Case No. 2023-00191 of \$119,828,211.⁵⁹ The calculation of the Commission's QIP rider for Kentucky-American is set forth in the Appendix to this Order.

QIP 6 Projects are Extensions in the Ordinary Course of Business

KRS 278.020(1) requires a utility to obtain a Certificate of Public Convenience of 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.⁶⁰ Commission regulation 807 KAR 5:001, Section 15(3), defines an ordinary extension in the usual course of business as an

⁵⁶ Case No. 2023-00191, *Electronic Application of Kentucky-American Water Company for an Adjustment of Rates, a Certificate of Public Convenience and Necessity for Installation of Advanced Metering Infrastructure, Approval of Regulatory and Accounting Treatments, and Tariff Revisions* (Ky. PSC Nov. 6, 2024), Order at Appendix A.

⁵⁷ Response to Commission Staff's First Request, Item 1.

⁵⁸ $6.29\%(\text{QIP 5}) + 1.85\%(\text{Incremental QIP}) + 2.92\%(\text{QIP 4 Balancing}) = 11.06\%$

⁵⁹ Case No. 2023-00191, Nov. 6, 2024 Order.

⁶⁰ KRS 278.020(1)(a)(2).

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.

Having reviewed the record and being sufficiently advised, the Commission finds that Kentucky-American's proposed QIP 6 projects approved in this Order are replacement projects of ordinary distribution facilities that do not require a CPCN because they would be classified as extensions in the ordinary 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.

IT IS THEREFORE ORDERED that:

1. The QIP Rider of 11.29 percent as proposed by Kentucky-American is rejected.
2. The QIP Rider of 11.06 percent is approved for service rendered on and after January 1, 2025, through July 1, 2025.
3. In all future QIP filing applications, Kentucky-American shall include detailed, supporting documentation justifying how it develops its scope of work and cost estimates for each project, including an itemized breakdown for material, labor, and paving as well as reasoning for each variance from the original estimate.
4. 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 revised QIP Rider and reflecting it was approved pursuant to this Order.
5. This case is now closed and removed from the Commission's docket.


PUBLIC SERVICE COMMISSION



Chairman



Commissioner



Commissioner

ATTEST:



Executive Director *RP*

ENTERED
DEC 26 2024 AH
KENTUCKY PUBLIC
SERVICE COMMISSION

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2024-00272 DATED DEC 26 2024

Line No.		QIP 6 January - December 2025
1	13-Month Average Rate Base	\$82,249,891
2		
3	After-Tax Rate of Return - Debt	2.16%
4	After-Tax Rate of Return - Equity	5.10%
5	After-Tax Rate of Return - Total	7.26%
6		
7	After-Tax Return - Debt (Line 1 x Line 3)	\$1,776,598
8	After-Tax Return - Equity (Line 1 x Line 4)	4,194,744
9	After-Tax Return - Total (Line 7 + Line 8)	\$5,971,342
10		
11	Gross Revenue Conversion Factor - Debt & Expense	100.7396%
12	Gross Revenue Conversion Factor - Equity	134.2300%
13		
14	Pre-Tax Return - Debt (Line 7 x Line 11)	\$1,789,738
15	Pre-Tax Return - Equity (Line 8 x Line 12)	5,630,606
16	Pre-Tax Return - Total (Line 7 + Line 8)	\$7,420,344
17		
18	After-Tax Expense - Depreciation	\$1,274,298
19	After-Tax Expense - Property Tax	1,236,656
20	After-Tax Expense - Total	\$2,510,954
21		
22	Pre-Tax Expense Total (Line 20 x Line 11)	\$2,529,526
23		
24	Total QIP Revenue Requirement (Line 16 + Line 22)	\$9,949,870
25		
26	Prior QIP Revenue Requirement	\$7,735,980
27	Incremental QIP Revenue (Line 24 - Line 26)	2,213,890
28	Balancing Adjustment	3,499,506
29		
30	Revenues - Rehearing Order in Case No. 2023-00191	\$119,828,211
31		
32	Prior QIP Charge (Line 26 / Line 30)	6.29%
33	Incremental QIP Charge (Line 27 / Line 30)	1.85%
34	Balancing Adjustment (Line 28 / Line 30)	2.92%
35	Total QIP Charge (Line 32 + Line 33 + Line 34)	11.06%
36		

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