COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES OF KENTUCKY-AMERICAN WATER COMPANY	)	CASE NO. 2004-00103
	)	

ORDER

The Attorney General ("AG") has moved for disclosure of all communications between the Commission and its employees and Kentucky-American Water Company ("Kentucky-American") relating to the merits of this proceeding in which representatives of his office were not present or which occurred prior to the establishment of this proceeding.[1] We grant the motion.

The Commission, through the Commission's General Counsel, has reviewed communications between the Commission and Kentucky-American. He interviewed persons who are currently employed with the Commission and will serve in a decision-making or advisory capacity for this proceeding. A list of those communications that relate to the merits of this proceeding in which a representative of the AG's office was not present or which occurred prior to the establishment of this proceeding is appended to this Order at Appendix A. The documents related to those communications are set forth at Appendix B.

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[1] Early in this proceeding the Commission consolidated Case No. 2003-00478 with Case No. 2004-00103. All references to "this proceeding" refer to both proceedings.

The only direct meeting between Kentucky-American and the Commission that involved any issue remotely related to the current proceedings occurred three years ago and involved only members of the Commission Staff. This meeting, which involved the establishment of regulatory assets, did not address substantive issues and resulted in no action by the Commission or Commission Staff.[2] No effort was made to conceal this meeting.

The only other significant contact between Kentucky-American and the Commission involved Kentucky-American's written request to the Commission for a favorable opinion on the establishment of certain regulatory assets. The communications between Commission Staff and Kentucky-American were primarily in writing. These communications, a copy of which is contained in Appendix B, were provided to the AG and Lexington-Fayette Urban County Government shortly after they occurred. Moreover, Commission Staff disclosed these communications to the news media.[3] Commission Staff ultimately denied the request. Kentucky-American subsequently formally petitioned the Commission for relief.

The Commission finds no merit to the AG's contention that Commission Staff's meeting on October 25, 2001 was inconsistent with our Order of November 27, 2000 in Case No. 2000-00120. In that Order, the Commission directed that Kentucky-American

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[2] See Case No. 2003-00103, Direct Testimony of Michael M. Miller at 13 ("The Company filed a letter with the Commission dated September 6, 2001 requesting to defer a number of items as required in the Order in Case No. 2000-120, including the transition cost to the Shared Services and Customer Care Centers. The Company did not receive a response to that letter.").

[3] See, e.g., John Stamper, Utility Can't Bill Customers For Its Defense, Herald-Leader, Oct. 21, 2003, *available at* http://www.kentucky.com/mld/kentucky/news/7063784.htm.

should not establish a regulatory asset without formally applying and obtaining Commission approval of such action. There is no evidence that Kentucky-American, as a result of the meeting, established a regulatory asset nor is there any evidence that Commission Staff approved such conduct or advised Kentucky-American to proceed with Commission approval.[4] The provisions of the Order of October 25, 2001 did not prohibit discussions between Kentucky-American and Commission Staff.

We further find no support for the AG's implied argument that he must be included as a matter of law in all discussions between Commission Staff and any other party. No statute or administrative regulation establishes that the AG shall automatically be a party to every Commission formal or informal proceeding. While the AG clearly has the right to intervene in Commission proceedings where a consumer interest is present,[5] he must apply for intervention.

While we find no evidence of improper or unlawful communications, we are of the opinion the AG's exclusion from the October 25, 2001 meeting was ill advised. As the subject matter of the meeting involved issues raised in a previous Commission proceeding, the AG and other parties who had participated in Kentucky-American's previous rate case proceeding should have been invited to attend. Their attendance would have added to the transparency of the meeting and perhaps have added to the quality of the discussions. At a minimum, it would have quelled any suspicions about

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[4] We find no evidence to support the AG's assertion that Commission Staff engaged in negotiations with Kentucky-American during the meeting of October 25, 2001.

[5] See KRS 367.150(8).

the meeting. We have directed Commission Staff that, absent extenuating circumstances, parties that have historically intervened, or are likely to intervene, in Commission proceedings involving a utility should be given the opportunity to attend conferences in which the merits of anticipated Commission proceeding will likely be discussed.

Based upon the above discussion, the Commission HEREBY ORDERS that the AG's Motion for Disclosure is granted.

Done at Frankfort, Kentucky, this 5th day of November, 2004.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2004-00103 November 5, 2004.

Communications Related To The Merits Of This Proceeding In Which A Representative Of The AG's Office Was Not Present Or Which Occurred Prior To The Establishment Of This Proceeding

- September 6, 2001 – Letter from Lindsey Ingram, Kentucky-American Water Company, to Thomas Dorman, Executive Director of the Public Service Commission, requesting approval of the establishment of regulatory assets to accrue certain expenses.

- October 6, 2001 – Telephone Conversation between Lindsey Ingram, Kentucky-American Water Company, and Commission Staff member Aaron Greenwell to arrange an informal conference between representatives of Kentucky-American Water Company and Commission Staff.

- October 17, 2001 – Telephone Conversation between Lindsey Ingram, Kentucky-American Water Company, and Commission Staff member Aaron Greenwell to arrange an informal conference between representatives of Kentucky-American Water Company and Commission Staff.

- October 25, 2001 – Meeting between representatives of Commission Staff and Kentucky-American Water Company at Public Service Commission's offices. Present for Kentucky-American Water Company were: Lindsey Ingram, Mike Miller, Linda Bridwell, and Nick Rowe. Commission Staff members present were: Aaron Greenwell, Mark Frost, Gerald Wuetcher, Scott Lawless, Dennis Jones, and James Rice.

- July 31, 2003 – Telephone Conversation between Lindsey Ingram, Kentucky-American Water Company, and Commission Staff member Mark Frost to discuss a filing deficiency in Kentucky-American Water Company's application in Case No. 2003-00270. This case involved an application for a Certificate of Public Convenience and Necessity to construct a three million gallon water storage tank. Ratemaking treatment for the cost of this storage tank is an issue in Case No. 2004-00103.

- August 1, 2003 – Electronic mail message from Lindsey Ingram, Kentucky-American Water Company, to Commission Staff member Mark Frost requesting assistance regarding a filing deficiency in Kentucky-American Water Company's application in Case No. 2003-00270.

- August 4, 2003 - Telephone Conversation between Lindsey Ingram, Kentucky-American Water Company, and Commission Staff member Scott Lawless to discuss a filing deficiency in Kentucky-American Water Company's application in Case No. 2003-00270. This case involved an application for a Certificate of Public Convenience and Necessity to construct a three million gallon water storage tank. Ratemaking treatment for the cost of this storage tank is an issue in Case No. 2004-00103.

- August 4, 2003 - Telephone Conversation between Lindsey Ingram, Kentucky-American Water Company, and Commission Staff member George Wakim to discuss a filing deficiency in Kentucky-American Water Company's application in Case No. 2003-00270. This case involved an application for a Certificate of Public Convenience and Necessity to construct a three million gallon water storage tank. Ratemaking treatment for the cost of this storage tank is an issue in Case No. 2004-00103.

- September 24, 2003 – Letter from Lindsey Ingram, Kentucky-American Water Company, to Thomas Dorman, Executive Director of the Public Service Commission, requesting authorization to establish regulatory assets to accrue post-September 11, 2001 enhanced security costs and expenses incurred for litigating the proposed condemnation of Kentucky-American Water Compnay's assets by Lexington-Fayette Urban County Government.

- October 15, 2003 – Letter from Thomas Dorman, Executive Director of the Public Service Commission, to Lindsey Ingram, Kentucky-American Water Company, denying request for authorization.

- November 18, 2003 - Letter from Lindsey Ingram, Kentucky-American Water Company, to Thomas Dorman, Executive Director of the Public Service Commission, requesting reconsideration of Commission Staff's position.

- November 21, 2003 - Letter from Thomas Dorman, Executive Director of the Public Service Commission, to Lindsey Ingram, Kentucky-American Water Company, responding to request for reconsideration.

- December 8, 2003 - – Telephone Conversation between Lindsey Ingram, Kentucky-American Water Company, and Aaron Greenwell, Commission Staff, in which Commission Staff advised Kentucky-American Water Company that Commission Staff intended to treat Kentucky-American Water Company's request for reconsideration as a request for the establishment of a formal proceeding.

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2004-00103

EXHIBIT A

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LINDSEY W. INGRAM, JR.
859-231-3033
ingramjr@skp.com

RECEIVED
SEP - 7 2001
KENTUCKY AMERICAN WATER COMPANY

September 6, 2001

Mr. Tom Dorman
Public Service Commission
211 Sower Blvd.
Frankfort, Kentucky 40601

RE: Kentucky-American Water Company – Deferrals

Dear Tom:

By Order dated November 27, 2000, in Case No. 2000-120, the Commission ordered Kentucky-American to apply for the approval of the accruing of expenses as regulatory assets. The purpose of this letter is to request Commission approval of the establishment of regulatory assets to accrue the following expenses:

1. Acquisitions. Kentucky-American incurs costs in acquiring and attempting to acquire water utilities. Typically the costs would include engineering, financial, legal, appraising, accountanting, and efforts to comply with contractual, regulatory and permitting requirements. To date Kentucky-American has incurred costs relative to five potential acquisitions as follows:

Entity	Accruals
Municipality A	$54,954.44
Municipality B	$12,255.01
Municipality C	$15,664.79
Water Company A	$45,341.92
Water Association A	$ 3,751.75

If the Commission is interested in the specific identification of the entities, Kentucky-American will be glad to provide that information subject to confidential treatment by the Commission.

2. Preliminary Service and Design. Kentucky-American incurs costs for water main extensions and installations such as engineering, legal, surveying, geotechnical, environmental, appraisal and land acquisition costs. At the present time Kentucky-American requests specific approval for the deferral of $73,453.61 incurred to date for the North Broadway project and $80,000 projected to be incurred for the Leestown Road project.

The North Broadway project involves the replacement of a 6-inch cast iron main extending from Short Street to Loudon Avenue which was installed in 1885. Initially Kentucky-American intended to install an 8-inch main but the project has been temporarily deferred pending a study of future water demands in the area and associated fire flow requirements. The Leestown Road extension is scheduled for construction in 2002 and involves the installation of a 16-inch main from Sandersville Road to the end of the urban services area. The size and length of this facility is currently under review pending the resolution of any regional source of supply issues.

3. Tank Painting. Consistent with the treatment afforded Kentucky-American in rate orders, Kentucky-American projects a cost of $305,000 to paint the Tates Creek elevated storage tank.

4. Sludge Removal. Again, consistent with prior orders Kentucky-American seeks to defer $200,000 as the project costs for the removal of sludge from the Kentucky River treatment plant.

5. Customer Service Consolidation. American Water Works has established a Call Center in Alton, Illinois, and Kentucky-American plans to utilize those facilities in the third quarter of 2002. Service to Kentucky-American's customers will be greatly improved. All customer contacts, billing inquiries, service issues, and field service emergencies can be handled by the Alton Call Center by telephone on a 24-hour per day, 7-day per week basis. At the present time telephone customer service is provided only during normal working hours. Kentucky-American anticipates transition costs of approximately $525,000. The deferred expenses will be reduced by savings in operating costs in the future as they are realized. Any unamortized deferred expense can be considered in Kentucky-American's next rate case if savings have not eliminated the deferral at that time.

6. Financial Service Consolidation. American Water Works is in the process of establishing a shared Service Center in New Jersey to provide accounting, finance, human resources and rate assistance and analysis in the first quarter of 2002. Kentucky-American anticipates a transition cost of $918,000. As with the Call Center, Kentucky-American anticipates the deferred expense will be reduced by savings in operating costs over time and any

unamortized deferred expense will be considered in Kentucky-American's next rate case if the then accumulated savings have not eliminated the deferred costs at that time.

As usual, we will be glad to supply any additional information that the Commission or staff may require.

With best regards, I am

Very truly yours,

STOLL, KEENON & PARK, LLP

By_____
Lindsey Ingram, Jr.

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EXHIBIT B

Wuetcher, Jerry (PSC)

From: LINDSEY INGRAM [ingramjr@skp.com]
Sent: Friday, August 01, 2003 9:29 AM
To: mcfrost@mail.state.ky.us
Cc: bridwell@kawc.com
Subject: Case 2003-00270

Attachments: 2003-00270 Application.pdf; 2003-00270 Deficiencies.pdf

2003-00270 Application.pdf (22.. 2003-00270 Deficiencies.pdf (5..

Mark -

Attached is the application I spoke to you about yesterday wherein KAWC seeks a certificate to build a 3 MG tank next to an existing tank on Tates Creek Pike in Jessamine County.

The Notice of Deficiency is also attached which is what I need some advice about. In order the alleged deficiencies are:

(1) Copies of franchises or permits if any are needed. None are needed as the tank is in Jessamine County and counties do not sell franchises. The facility is exempt from planning and zoning requirements.

(2) Financing details are set forth in paragraph 11 which has been sufficient for all previous requests. As usual, financing will be from available funds or short term borrowings and later converted to permanent financing.

(3) The estimated cost of operation is dealt with in paragraph 12. It would be very difficult to be more specific and this is the allegation that we typically make.

(4) The engineer signature deficience is correct and Linda is in process of getting me a signed copy of the plans.

Please let me know what you think I should do under these circumstances.

Thanks for your help. Lindsey

Lindsey W. Ingram, Jr.
Stoll, Keenon & Park, LLP
300 West Vine Street, Suite 2100
Lexington, Kentucky 40507-1801
Telephone 859-231-3033
Facsimile 859-253-1093

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EXHIBIT C

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LINDSEY W. INGRAM, JR.
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September 24, 2003

RECEIVED
SEP 24 2003
PUBLIC SERVICE COMMISSION

Via Hand Delivery

Mr. Thomas Dorman
Executive Director
Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

RE: Kentucky-American Water Company - Deferrals

Dear Tom:

As we have previously done by letter dated September 6, 2001, and discussed in a conference with members of the staff on October 25, 2001, the purpose of this letter is to request Commission approval of the establishment of two additional regulatory assets to accrue expenses as required by the Commission's Order dated November 27, 2002, in Case No. 2000-120:

1. SECURITY COSTS. Kentucky-American became aware that post-September 11, 2001 enhanced security measures were essential for the continued provision of potable water to its customers. Security measures that, pre September 11, were designed primarily to address deterrence of vandalism or accident avoidance had to be reassessed in light of a substantially heightened risk profile that now include organized terrorist groups intent on deliberately inflicting as much harm to life and property as possible. In light of these new threats it was prudent and necessary for Kentucky-American to implement measures to prevent raw and finished water contamination, infrastructure attacks, and computerized tampering. Kentucky-American sought recovery of the costs associated with the protection of its assets by a tariff filed with the Commission on November 28, 2001, Case 2001-440. Condition 2 in the Commission's order of May 30, 2002, in Case 2002-00018, subsequently accepted by the parties, ordered the withdrawal of the Asset Protection Charge Tariff with consideration for the recovery of costs associated with the protection of water utility assets to occur only in cases for the adjustments of general rates for water service. On June 10, 2002 Kentucky-American filed its notice of the withdrawal of its asset protection tariff. On July 8, 2002 Case 2001-440 was removed from the Commission's docket. Continued protection of the assets devoted to the provision of water

service is critical. As recently as September 4, 2203, the Department of Homeland Security advised that "Al-Qaeda views critical infrastructure targets in the US as attractive attack options because of their potentially significant economic and psychological impacts. These targets include:...Water reservoirs and systems, including dams." To protect its customers Kentucky-American has incurred security expenses through August 22, 2003 of $2,619,640.88.

2. **CONDEMNATION COSTS**. On July 3, 2003, the Lexington-Fayette Urban County Government filed a Verified Petition in the Fayette Circuit Court seeking to acquire by eminent domain all of the real and personal property of Kentucky-American used in connection with, or reasonably necessary or desirable in connection with the provision of water service in Fayette, Bourbon, Clark, Harrison, Jessamine, Owen, Scott and Woodford Counties, Kentucky. Thereafter, on July 17, 2003, Kentucky-American Water Company filed a Complaint against the Lexington-Fayette Urban County Government alleging that Resolution No. 326-2003 of the Lexington-Fayette Urban County Council authorizing the eminent domain proceeding was invalid. The cost and expenses attendant to these lawsuits will be incurred for the benefit of the customers of Kentucky-American as it is not in their best interest that the local government take over the assets of Kentucky-American and thereby remove governmental regulation of the rates and services to over 105,000 customers. All of the cost and expenses incurred in litigating the attempted takeover should be classified as a regulatory asset.

We will be glad to supply any additional information that the Commissioner's staff may require.

With best regards, I am

Very truly yours,

STOLL, KEENON & PARK, LLP

By Lindsey
Lindsey Ingram, Jr.

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EXHIBIT D

Paul E. Patton, Governor

Janie A. Miller, Secretary
Public Protection and
Regulation Cabinet

Thomas M. Dorman
Executive Director
Public Service Commission

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Martin J. Huelsmann
Chairman

Gary W. Gillis
Vice Chairman

Robert E. Spurlin
Commissioner

October 15, 2003

The Honorable Lindsey W. Ingram, Jr.
Stoll, Keenon & Park, LLP.
300 West Vine Street, Suite 2100
Lexington, Kentucky 40507-1801

RE: Kentucky-American Water Company – Deferrals

Dear Mr. Ingram:

The Commission Staff has reviewed your September 24, 2003 letter requesting authorization for Kentucky-American to establish two regulatory assets to accrue expenses as required by the Commission in its Order in Kentucky-American's last rate case. Specifically, you request authorization to establish regulatory assets to accrue post-September 11, 2001 enhanced security costs and to accrue expenses incurred for litigating the proposed condemnation of Kentucky-American by the Lexington-Fayette Urban County Government (LFUCG).

Based on the information contained in your September 26, 2003 letter, the Commission Staff has concluded that it is not appropriate to grant the authorization you request.

As you point out in your letter, RWE, Thames, AWWC and KAWC accepted Condition 2 of the Commission's May 30, 2002 Order in Case No 2002-00018 which authorized the transfer of control of Kentucky-American. In addition to the withdrawal of the Asset Protection Tariff, Condition 2 prohibited Kentucky-American from applying ".... for the recovery of costs associated with the protection of water utility assets except through adjustments in its general rates ...." for five years from the date of the Order. The Staff finds that authorization to establish a regulatory asset to accrue such costs would be a violation of that condition and should not be allowed.

In your letter, you also state that the costs associated with the condemnation lawsuits "Will be incurred for the benefit of the customers of Kentucky-American as it is not in their best interest that the local government take over the assets of Kentucky-

EDUCATION PAYS

AN EQUAL OPPORTUNITY EMPLOYER M/F/D

American and thereby remove governmental regulation of the rates and services to over 105,000 customers." Although the Commission has authorized the acquisition by RWE, it has made no findings regarding the proposed condemnation by LFUCG. Accordingly, the Staff finds the request to establish a regulatory asset to accrue such costs should not be allowed.

Normally, requests to defer expenses or establish regulatory assets are addressed informally at the Staff level. However, as always, if you desire to pursue this matter, you may petition the Commission for formal consideration of your request.

Feel free to contact me at anytime if you have any questions.

Sincerely,

Thomas M. Dorman,
Executive Director

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EXHIBIT E

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November 18, 2003

Via Hand Delivery

Mr. Thomas Dorman
Executive Director
Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

RE: Kentucky American Water - Deferrals

Dear Tom:

Please consider this request of Kentucky American Water for the Staff of the Commission to review the conclusions set forth in your letter of October 15, 2003, and one of my the requests contained in my letter of September 24, 2003.

SECURITY COSTS. Your letter stated the Staff conclusion that approval to establish an account to accrue the deferral of security costs incurred after September 11, 2001, would constitute a violation of Condition 2 of Appendix A of the Commission's Order in Case No. 2002-00317. That condition is:

> "At no time prior to May 30, 2007, will KAWC apply to the Commission for recovery of costs associated with the protection of water utility assets except through adjustments in its general rates for water service."

My letter of September 24, 2003, requesting approval for the establishment of an account to accrue expenses incurred after September 11, 2001, for enhanced security measures was not a request for "recovery of costs" as prohibited by Condition No. 2. Prior to the applications for approval of the Change of Control of Kentucky American Water (Cases No. 2002-00018 and 2002-00317), Kentucky American Water filed an "Asset Protection Charge Tariff" establishing a procedure for the recovery of post-September 11, 2001, enhanced security measures. The requested procedure would have allowed a quarterly adjustment in Kentucky American Water's

rates to recover its enhanced security costs. As a part of the approval of the requested change of control, the Commission found that changes in operating practices would likely produce changes in cost of service.[1] The Commission specifically found that, in view of anticipated changes in operating practices, maintenance of Kentucky American Water's rates was in the public interest until March 16, 2004, or one year following the date of the closing of the merger, whichever occurred later. The maintenance of Kentucky American Water's rates then in effect required the withdrawal of the Asset Protection Charge Tariff or its denial. Having found that the public interest would be served by the maintenance of the existing structure, the Commission found "that the introduction of any new rate mechanism regarding security costs at this time is inappropriate and that KAWC's proposal for such mechanism, which is currently under view in Case No. 2001-00440, should be withdrawn until KAWC's integration with Thames is complete."[2]

The purpose of the Commission's Condition 2 was to freeze the rates of Kentucky American Water until March 16, 2004, or one year after the closing. The requested approval for the establishment of a deferred asset will not affect the existing rates of Kentucky American Water at all. The propriety of the inclusion of any of the post-September 11, 2001 enhanced securities costs can be fully addressed and examined in Kentucky American Water's next general rate case.

The matter of the treatment of post-September 11, 2001 enhanced security costs has been examined by the Missouri Public Service Commission in Case No. WO-2002-273. Missouri-American Water Company filed an application for an Accounting Authority Order for its post-September 11, 2001 enhanced security costs. By way of explanation the Missouri Commission stated:

> "An AAO is an order of the Commission authorizing an accounting treatment for a transaction or group of transactions other than that prescribed by the Uniform System of Accounts. It is an accounting mechanism that is generally used to permit deferral of costs from one period to another. The items deferred are booked as a regulatory asset rather than as an expense, thus improving the financial picture of the utility in question during the deferral period. <u>During a subsequent rate case, the Commission determines what portion, if any, of the deferred amounts will be recovered in rates</u>." (Citations omitted, emphasis added.)[3]

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[1] Case No. 2002-00018, Order, May 30, 2002, p. 17.
[2] *Id.* at 18.
[3] Missouri Public Service Commission, Case No. WO-2002-273, Report and Order, December 20, 2002, page 3.

In approving the request, the Commission carefully pointed out that its actions did not change rates.

> "By seeking an AAO, Missouri-American seeks to preserve the possibility—not the certainty—of recovering some of the expenditures made to upgrade security from the very ratepayers protected thereby. It is true that the management of Missouri-American chose to make the expenditures under consideration in this case; it was not required to do so by any governmental agency or Act of God. However, that point is simply one of the circumstances that the Commission must consider, as is the fact that the decision was made in the light of the events of 9-11 and the various governmental responses to those events. For these reasons, the Commission concludes that an AAO is reasonable under all of the circumstances and should be granted."[4]

In like fashion, the Idaho Public Utilities Commission made it clear that its authorization of a deferral does not change rates and does not constitute any abdication of the Commission's right to judge the amount of the deferral that should be subsequently recovered. In Case No. UWI-W-01-2, United Water Idaho Inc. requested the deferral of some electric power costs it was going to incur as a result of a rate increase from its electrical supplier. The Commission concluded:

> "The Commission finds it reasonable to authorize such a deferral. The Company also proposes to apply a carrying charge on the unamortized deferral balances at a rate equal to the customer's deposit rate. The Commission finds it reasonable to reserve judgment on the recovery of the amount deferred as well as the appropriateness of any carrying charge until actual recovery is requested."[5]

The Pennsylvania Public Utility Commission has also approved Pennsylvania-American Water's request for deferred accounting treatment for a post-September 11, 2001 incremental security costs.[6] The Pennsylvania Commission concluded:

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[4] *Id.*, p. 30.
[5] Order, July 31, 2001, p. 3.
[6] Pennsylvania Public Utility Commission, Case R-00027983, Opinion and Order entered July 24, 2003, currently on appeal.

> "However, we will adopt the ALJ's recommendation that we grant the Petition at Docket No. R-00027983 with respect to deferred accounting treatment for the company's claimed incremental security costs incurred between September 11, 2001 and the resolution of the company's upcoming general base rate case. We note that the Company has attempted to enhance security at its intrastate facilities in an effort to safeguard the quality and reliability of its water operations. However, approval of deferred accounting treatment is not an assurance of future rate recovery of the claims incremental security costs. It is incumbent upon the Company to demonstrate its right of rate recovery of the claimed incremental security costs, or portions thereof, in its pending general base rate case through the submission of additional evidence; . . ."[7]

On March 5, 2001, West Virginia-American Water Company filed an application with the Public Service Commission of West Virginia for an increase in its rates. During the pendency of that case, and after September 11, 2001, West Virginia-American Water Company requested the Commission's consideration of the allowance of enhanced security costs. The Commission declined to include the enhanced security costs in the pending rate case but did authorize the deferral for consideration in the next rate case.

> "The Commission is concerned about the very real possibility of harm to the State's utility infrastructure in light of the events of September 11, 2001. To this end, the Commission sees the need for heightened security. The Commission is also aware that heightened security may well lead to higher costs. Furthermore, the Commission is also acutely aware of the need not to publicize steps being taken by the company to insure the safety of the public water supply. However, the Commission is not prepared at this time to grant rate recover to the company in the form of a surcharge or rider to the rates contained in the current ongoing rate case. Instead, since the Commission will consider the initial amount, carrying costs and timing of recovery of all security related costs that are unusual or extraordinary (as compared to costs that represent normal historic operations) in the Company's next rate case, we shall direct the Company to defer the actual costs of additional security. The Commission directs this deferral in recognition of the fact that we shall provide the Company with the opportunity to recover its deferred costs in future rates. Accordingly, the Company may request recovery of these deferred costs when it files its next rate case. This will give the Commission and interested parties an

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[7] *Id.*, pp. 8-9.

> opportunity to review the reasonableness and prudence of the Company's actions, the actual level of plant additions and operating costs incurred and the extent to which deferred costs are unusual or extraordinary as compared to normal, historic operations. The Commission will allow recovery of reasonable deferred costs in future rate cases after our review of the actual level of unusual or extraordinary security costs, the prudence of the costs and the appropriate timing for such recovery, but only to the extent that the Commission finds the costs are reasonable, necessary and prudent."[8]

In West Virginia-American Water Company's next rate case, Case No. 03-0353-W-42T, currently pending before the West Virginia Public Service Commission, James W. Ellars, Chief Utilities Manager in the Commission's Engineering Division reviewed the deferred security costs and made his recommendation in his prepared direct testimony:

> "Based on the Company's records that were made available for review, it is my opinion that the deferred expenses of $5,015,224 incurred by the Company since September 11, 2001, are prudent, reasonable and necessary to insure the security of the Company's facilities."[9]

Kentucky American Water respectfully asks the Staff to reconsider its position because (1) the approval of the deferral will not violate any Commission condition prohibiting changes in rates and (2) the approval will not affect the Commission's authority to determine the reasonableness and prudency of enhanced security costs in the next general rate case.

If the members of the Staff involved in the determination which I ask be reconsidered need any additional information, please let me know.

Very truly yours,

STOLL, KEENON & PARK, LLP

By Lindsey Ingram, Jr.
Lindsey Ingram, Jr.

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[8] West Virginia Public Service Commission, Case No. 01-0326-W-42T, Order, December 21, 2001, p. 12.
[9] Direct testimony of James W. Ellars, p. 7.

EXHIBIT F

Paul E. Patton, Governor

Janie A. Miller, Secretary
Public Protection and
Regulation Cabinet

Thomas M. Dorman
Executive Director
Public Service Commission

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Martin J. Huelsmann
Chairman

Gary W. Gillis
Vice Chairman

Robert E. Spurlin
Commissioner

November 21, 2003

Hon. Lindsey Ingram, Jr.
Stoll, Keenon & Park, LLP
300 West Vine Street
Suite 2100
Lexington, Kentucky 40507-1801

RE: Kentucky-American Water Company - Deferrals

Dear Mr. Ingram:

The Staff is reviewing your November 18 letter and is giving additional consideration to Kentucky-American's request for approval to establish a regulatory asset for accruing deferred post September 11, 2001 security costs.

To aid in this review, Staff requests the following information:

- The final order issued in the Missouri Public Service Commission Case No. WO-2002-273.
- The final order issued in the Pennsylvania Public Utility Commission Case No. R-00027983.
- The final order issued in the West Virginia Public Service Commission Case No. 03-0353-W-42T.
- A copy of the petitions filed by Kentucky-American's sister corporations in each of the above-referenced cases.
- A copy of any intervenor or other third party comments made regarding the establishment of a regulatory asset in the above-referenced cases.

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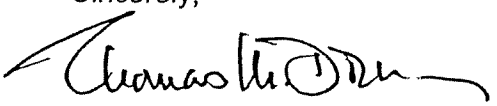
If you have any questions concerning this request or any other matter in which the Commission may be of assistance, please contact Aaron Greenwell or Dennis Jones of the Commission's staff at any time.

Sincerely,



Thomas M. Dorman
Executive Director

cc: David Holmes, LFUCG
David Spenard, Office of the Attorney General

Attachments