

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

IN THE MATTER OF:)
)
NOTICE OF ADJUSTMENT OF THE RATES OF) **CASE NO. 2008-00427**
KENTUCKY-AMERICAN WATER COMPANY)
EFFECTIVE ON AND AFTER NOVEMBER 30, 2008)

DIRECT TESTIMONY OF PATRICK L. BARYENBRUCH
October 31, 2008

KENTUCKY AMERICAN WATER COMPANY

1 **1. Q. Please state your name and business address.**

2 A. Patrick L. Baryenbruch, 2832 Claremont Road, Raleigh, North Carolina 27608.

3 **2. Q. Please describe your educational and professional background.**

4 A. I received a Bachelors degree in accounting from the University of Wisconsin-
5 Oshkosh in 1974 and a Masters in Business Administration degree from the
6 University of Michigan in 1979.

7 I am a financial consultant and am a member of the American Institute of Certified
8 Public Accountants and the North Carolina Association of Certified Public
9 Accountants.

10 I began my career as a staff accountant with Arthur Andersen & Company where I
11 performed financial audits of utilities, banks and finance companies. After three
12 years I left to pursue an M.B.A. degree. Upon graduation from business school, I
13 worked with the consulting firms of Theodore Barry & Associates and Scott,
14 Madden & Associates.

15 During my consulting career, I have performed consulting assignments for
16 approximately 50 utilities and 10 public service commissions. I have participated
17 as project manager, lead or staff consultant for 24 commission-ordered
18 management and prudence audits of public utilities. Of these, I have been
19 responsible for evaluating the area of affiliate charges and allocation of corporate
20 expenses in the Commission-ordered audits of Connecticut Light and Power,
21 Connecticut Natural Gas, General Water Corporation (Pennsylvania Operations),
22 Philadelphia Suburban Water Company (now Aqua America) and Pacific Gas &
23 Electric Company.

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1 My firm has performed the commission-ordered audit of Southern California
2 Edison's 2002, 2003, 2004 and 2005 transactions with its non-regulated affiliate
3 companies.

4 **3. Q. What are your duties and responsibilities in your current position?**

5 A. I am the President of my own consulting practice, Baryenbruch & Company, LLC,
6 which was established in 1985. In that capacity, I provide consulting services to
7 utilities and their regulators.

8 **4. Q. Please describe the reason for your testimony in this case.**

9 A. I am presenting the results of my study which evaluated the services provided by
10 American Water Service Company ("Service Company") during the 12 months
11 ended July 31, 2008 to Kentucky American Water (KAWC). This study was
12 undertaken in conjunction with KAWC's rate case and is true to the best of my
13 knowledge and belief. The study is attached as Exhibit PLB-1.

14 **5. Q. What were the objectives of your study?**

15 A. This study was undertaken to answer four questions concerning the services
16 provided by American Water Works Service Company, Inc. ("Service Company")
17 to Kentucky American Water Company ("KAWC"), each of which bears on the
18 reasonableness of those charges as incurred during the 12 months ended July 31,
19 2008. First, was KAWC charged the lower of cost or market for managerial and
20 professional services provided by the Service Company during 12 months ended
21 July 31, 2008? Second, was the 12 months ended July 31, 2008 cost of the
22 Service Company's customer account services, including those of the National
23 Call Centers, reasonable? Third, are the services KAWC receives from Service
24 Company necessary? Fourth, were the Service Company's charges to KAWC

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1 during the 12 months ended July 31, 2008 comparable to other utility service
2 companies?

3 **6. Q. What conclusions were you able to draw concerning question number 1,**
4 **whether KAWC was charged the lower of cost or market services provided**
5 **by the Service Company?**

6 A. I was able to draw the following conclusions:

7 (1) KAWC was charged the lower of cost or market for managerial and
8 professional services during the 12 months ended July 31, 2008.

9 (2) On average, the hourly rates for outside service providers are 28% higher
10 than the Service Company's hourly rates.

11 (3) The managerial and professional services provided by the Service
12 Company are vital and could not be procured externally by KAWC without
13 careful supervision on the part of KAWC. If these services were
14 contracted entirely to outside providers, KAWC would have to add at least
15 one position to manage activities of outside firms. This position would be
16 necessary to ensure the quality and timeliness of services provided.

17 (4) If all the managerial and professional services now provided by the
18 Service Company had been out-sourced during the 12-months ended July
19 31, 2008, KAWC and its ratepayers would have incurred an **additional**
20 **\$1.7 million** in expenses. This amount includes the higher cost of outside
21 providers and the cost of a KAWC position needed to direct the
22 outsourced work.

23 (5) This study's hourly rate comparison actually understates the cost
24 advantages that accrue to KAWC from its use of the Service Company.
25 Outside service providers generally bill for every hour worked. Service

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1 Company managerial and professional personnel, on the other hand,
2 charge a maximum 8 hours per day even when they work more. If the
3 overtime hours of Service Company personnel had been factored into the
4 hourly rate calculation, the Service Company would have had an even
5 greater annual dollar advantage than the \$1.7 million cited above.

6 (6) It would be difficult for KAWC to find local service providers with the same
7 specialized water industry expertise as that possessed by the Service
8 Company staff. Service Company personnel spend substantially all their
9 time serving operating water companies. This specialization brings with it
10 a unique knowledge of water utility operations and regulation that is most
11 likely unavailable from local service providers.

12 (7) Service Company fees do not include any profit markup. Only its actual
13 cost of service is being recovered from KAWC ratepayers.

14 **7. Q. What conclusions were you able to draw concerning question number 2,**
15 **whether the 12 months ended July 31, 2008 costs of the Service Company's**
16 **customer account services, including those of the National Call Centers,**
17 **were reasonable?**

18 A. I was able to determine that the cost of the Service Company's customer accounts
19 services, including those provided by the National Call Center, **is close to the**
20 **average of the neighboring electric utility comparison group.** As will be
21 explained further herein, this group of companies provides a reasonable proxy
22 group for comparison to a regulated utility of the size and scope of KAWC. During
23 the 12-months ended July 31, 2008, the customer accounts cost for KAWC
24 customers was \$28.07 compared to the 2007 average of \$27.99 for neighboring

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1 electric utilities. The highest comparison group per customer cost was \$39.81 and
2 the lowest \$13.71.

3 **9. Q. What conclusions were you able to draw concerning question number 3,**
4 **whether the services KAWC receives from the Service Company are**
5 **necessary?**

6 A. I was able to draw the following conclusions:

7 (1) The services that the Service Company provides are necessary and would
8 be required even if KAWC were a stand-alone water utility.

9 (2) There is no redundancy or overlap in the services provided by the Service
10 Company to KAWC.

11 **10. Q. What conclusions were you able to draw concerning question number 4,**
12 **whether the Service Company charges to KAWC were comparable to other**
13 **utility service companies?**

14 A. I was able to draw the following conclusions:

15 (1) The Service Company provides KAWC with services similar to those
16 provided by other utility service companies. This determination was based
17 on service company information included in the Form 60, which must be filed
18 with the Federal Energy Regulatory Commission ("FERC") by electric and
19 combination electric/gas utility holding companies.

20 (2) The Service Company's 12 months ended July 31, 2008 cost per KAWC
21 customer was reasonable compared to cost per customer for electric and
22 combination electric/gas service companies. During the 2008 test period,
23 KAWC was charged an average of \$60 per customer by the Service
24 Company compared to an average of \$121 per customer for service
25 companies reporting to the FERC.

WITNESS: P.BARYENBRUCH

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1 **10. Q. Does this complete your testimony?**

2 A. Yes.

**Assessment of Service Company Charges to
Kentucky American Water Company
12-Months Ended July 31, 2008**

**Kentucky American Water Company
Assessment of Service Company Charges
12-Months Ended July 31, 2008**

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I - Introduction

Purpose Of This Study

This study was undertaken to answer four questions concerning the services provided by American Water Works Service Company, Inc. ("Service Company") to Kentucky American Water Company ("KAWC"), each of which bears on the reasonableness of those charges as incurred during the 12 months ended July 31, 2008:

1. Was KAWC charged the lower of cost or market for managerial and professional services provided by the Service Company during this test period?
2. Was the 12 months ended July 31, 2008 cost of the Service Company's customer accounts services, including those of the National Call Centers, comparable to those of other utilities?
3. Are the services KAWC receives from Service Company necessary?
4. Were the Service Company's charges to KAWC during the 12-months ended July 31, 2008 comparable to other utility service companies?

Study Results

Concerning question 1, the following conclusions can be drawn from this study:

- KAWC was charged the lower of cost or market for managerial and professional services during the 12-months ended July 31, 2008.
- On average, the hourly rates for outside service providers are 28% higher than the Service Company's hourly rates.
- The managerial and professional services provided by the Service Company are vital and could not be procured externally by KAWC without careful supervision on the part of KAWC. If these services were contracted entirely to outside providers, KAWC would have to add at least one position to manage activities of outside firms. This position would be necessary to ensure the quality and timeliness of services provided.
- If all the managerial and professional services now provided by the Service Company had been outsourced during the 12-months ended July 31, 2008, KAWC and its ratepayers would have incurred nearly \$1,745,000 in additional expenses. This amount includes the higher cost of outside providers and the cost of an additional KAWC position needed to direct the outsourced work.
- This study's hourly rate comparison actually understates the cost advantages that accrue to KAWC from its use of the Service Company. Outside service providers generally bill for every hour worked. Service Company exempt personnel, on the other hand, charge a maximum of 8 hours per day even when they work more hours. If the overtime hours of Service Company personnel were factored into the hourly rate calculation, the Service Company would have had an even greater annual dollar advantage than the \$1,745,000 cited above. For instance, if Service Company overtime is conservatively estimated at 5% (2 hours per week), then that work would have cost an estimated \$80,000 in additional charges from outside providers.

- It would be difficult for KAWC to find local service providers with the same specialized water industry expertise as that possessed by the Service Company staff. Service Company personnel spend substantially all their time serving operating water companies. This specialization brings with it a unique knowledge of water utility operations and regulation that is most likely unavailable from local service providers.
- Service Company fees do not include any profit markup. Only its actual cost of service is being recovered from KAWC ratepayers.

Concerning question 2, it was determined that the cost of the Service Company's customer accounts services, including those provided by the National Call Centers, is close to the average of the neighboring electric utility comparison group. As will be explained further herein, this group of companies provides a reasonable proxy group for comparison to a regulated utility of the size and scope of the Service Company and KAWC. During the 12-months ended July 31, 2008, the customer accounts cost for KAWC customers was \$28.07 compared to the 2007 average of \$27.99 for neighboring electric utilities. The highest comparison group per customer cost was \$39.81 and the lowest \$13.71.

Concerning question 3, the following conclusions can be drawn:

- The services that the Service Company provides are necessary and would be required even if KAWC were a stand-alone water utility.
- There is no redundancy or overlap in the services provided by the Service Company to KAWC. For all of the services listed in Schedule 10, there was only one entity that was primarily responsible for the service.

Concerning question 4, the following conclusions were reached:

- The Service Company provides KAWC with services similar to those provided by other utility service companies. This determination was based on service company information included in the Form 60, which must be filed with the Federal Energy Regulatory Commission ("FERC") by electric and combination electric/gas utility holding companies.
- The Service Company's 12 months ended July 31, 2008 cost per KAWC customer was reasonable compared to cost per customer for electric and combination electric/gas service companies. During the 2008 test period, KAWC was charged an average of \$60 per customer by the Service Company compared to an average of \$121 per customer for service companies reporting to the FERC.

II - Background

Overview Of American Water Works Service Company

American Water's Service Company exists to provide certain shared services to American Water subsidiaries. It follows a service company model used by many utility holding companies that own multiple regulated utilities. By consolidating executive and professional services into a single service company, utility holding companies are able to realize the following benefits for ratepayers:

- **Purchasing Economies** – Common costs (e.g., insurance, chemicals, piping) can be procured on a much larger scale thereby providing greater bargaining power for the combined entity compared to individual utility operating companies. A service company facilitates corporate-wide purchasing programs through its procurement and contract administration functions.
- **Operating Economies of Scale** – A service company is able to deliver services more efficiently because workloads can be balanced across more persons and facilities. For instance, American Water's Service Company is able to maintain one principal data center for the entire corporation. This is much more cost-efficient than each operating utility funding its own data center with its large fixed hardware, software and staffing costs.
- **Continuity of Service** – Centralizing service company personnel who perform similar services facilitates job cross-training and sharing of knowledge and expertise. This makes it easier to deal with staff turnover and absences and to sustain high levels of service to operating utilities. An individual operating utility might experience considerable disruption if a key professional left and it was necessary to hire outside to fill the vacancy.
- **Maintenance of Corporate-Wide Standards** – Personnel in American Water's Service Company establish standards for many functions (e.g., engineering designs, operating procedures and maintenance practices). It is easier to ensure these standards are followed by every operating utility because their implementation is overseen by the Service Company.
- **Improved Governance** – American Water's Service Company provides another dimension of management and financial oversight that supplements local operating utility management. The Service Company facilitates standard planning and reporting that help ensure operating utilities meet the requirements of their customers in a cost effective manner.
- **Retention of Personnel** – A service company organization provides operating utility personnel with another career path beyond what may be available on a local level. These opportunities tend to improve employee retention.

American Water follows the model for other utility service companies in another important regard. Its services are provided to affiliate operating utilities, like KAWC, at cost. American Water's Service Company is not a profit-making entity. It assigns only its actual expenses to the American Water subsidiaries it services.

The Service Company provides services to American Water operating companies from the following locations:



- Corporate Office – Includes American Water's executive management and personnel from the various corporate support services. American Water's corporate office is located in Voorhees, New Jersey.
- National Call Centers – Perform customer service functions, including: customer call processing, service order processing, correspondence processing, credit and collections. American Water maintains two call centers: one in Alton, Illinois that went into operation in 2001 and a second in Pensacola, Florida that went into operation in 2005. Prior to the establishment of these national call centers, customer service functions were performed by employees of KAWC, which incurred the expense on its books.
- National Shared Services Center – The Shared Services Center, located in Cherry Hill, New Jersey, provides various financial, accounting and treasury functions that had been performed by individual operating companies. This arrangement has improved and streamlined the Company's financial processes and allowed operating companies to focus on providing utility service.
- Regional Offices – Regional offices provide operating companies with certain support services that can be performed more effectively on a regional basis because individual operating company/center workloads are not sufficient to warrant a full-time staff for these activities. At the same time, these services require closer proximity to operating companies served so they are not provided by the National Shared Services Center. Examples of regional office services include rates and revenues, engineering and operations.
- Belleville Lab – The national trace substance laboratory is located in Belleville, Illinois, and performs testing for all American Water operating companies.
- Information Technology Service Centers – American Water's principal data center, located in Hershey, Pennsylvania, supports the IT infrastructure required to run corporate and operating company business applications and the communications systems. IT personnel rotate, as needed, throughout the regional offices and operating companies.

Service Company Expense Categories

The Service Company renders a monthly bill to American Water's operating companies. Charges are broken down into the following expense categories:

- Labor – base pay (salaries) of managerial and professional employees
- Labor-Related Overheads - employee benefit costs (payroll taxes, medical coverage, pensions, disability insurance) and other general expenses
- Support - wages and salaries of office support personnel, including secretaries, clerical personnel, telephone operators and mail clerks
- Office Expenses - office rent, equipment leases, telephone, electric, office supplies, property taxes, office maintenance
- Vouchers/Journal Entries – (1) travel expenses incurred by Service Company personnel, (2) other items submitted for reimbursement by employees, including professional association dues, (3) outside service contracts for such things as actuarial services, and (4) various other expenditures, including data center expenses for software licenses and hardware maintenance.

Service Company expenses can be directly charged and allocated to operating companies, as shown in the table below.

| Expense Category | Direct | | Comments |
|-------------------------|---------|-----------|---|
| | Charged | Allocated | |
| Labor | X | X | Professional personnel working for one or several operating companies |
| Labor-Related Overheads | X | X | These are primarily employee benefit costs that relate directly to labor |
| Support | | X | Administrative personnel support the professional staff, thus support costs are allocated on the basis of professional labor |
| Office Expense | | X | Are all allocated on the basis of professional labor |
| Vouchers/Journals | X | X | May be either directly in support of one operating company (e.g., an engineer traveling from the Corporate Office to the operating company) or allocated to several operating companies |

A direct charge occurs when Service Company work or expenses are incurred in support of only one operating company. Direct charge examples include work in support of an operating company's rate case, engineering design work on an operating company's project and the preparation of an operating company's financial statements.

Service Company expenses are allocated when more than one operating company benefits from the underlying work. Examples include assessments of new Federal water quality regulations, development of the company-wide materials procurement contracts and creation of company-wide engineering design standards.

Charging and Assignment Of Service Company Time and Expenses

Service Company transactions are assigned with the following information so there is a proper accounting and eventual charging to an operating company:

- Operating company number, if transaction is a direct charge
- Formula number if transaction is allocated
- Employee hours worked
- Account number for non-labor charges

Charges can originate from the following systems:

- Payroll System
- RVI System (outside vendor payments)
- PCard System (credit card payments)
- Internal Purchase Order System
- Journal entries

The Service Company's time reporting process enables labor and support charges to be assigned to the proper operating company. Labor charges are based on the time reported by managerial and professional Service Company employees. Every week, Service Company professional employees complete an electronic time sheet that shows:

- Operating company (for direct charge)
- Formula number (for allocation)
- Work order (where applicable)
- Authorization number (where applicable)

At month-end, time report information is processed and direct and allocated professional labor hours tabulated for each operating company. Dollar charges are then calculated using the hourly rate of each Service Company professional employee based upon their base salary (i.e., an employee's hours times their hourly rate of pay).

Support (administrative) personnel charge their time to the activity "General Admin." As described in the table on page 4, their labor charges are allocated to operating companies based upon how their office's professional personnel labor charges are assigned. For instance, if 20% of American Water's Southeast Region's professional labor is assigned to KAWC during a month, then 20% of that office's monthly administrative labor charges also are assigned to the operating company.

The overhead cost category is next assigned based on professional and administrative labor costs. Thus, if 20% of the Southeast Region's accumulated professional and support labor is charged to KAWC during the month, then 20% of that month's overhead expenses will be assigned to KAWC.

Each Service Company location's office expenses are allocated to operating companies based on how professional labor charges for that office have been assigned. For instance, if 2% of professional labor from one Service Company office is assigned to KAWC, then 2% of that office's office expenses would be assigned to KAWC. Thus, office expenses are allocated in the very same way as administrative labor.

Vouchers/journal entries may be charged directly or allocated, depending on who benefits from the expenditure. For instance, the cost of a continuing professional education course taken by a professional in a regional office is allocated to the operating companies served by that office. Travel expenses by that same professional to a rate case proceeding are charged directly to the operating company whose case is being heard.

III – Service Company Cost Comparison Approach

During the 12 months ended July 31, 2008, the Service Company billed KAWC \$8,347,528 in O&M-related charges, \$486,878 in capital-related charges and \$1,114 in other charges. Included in the O&M amount are certain non-recurring expenses and non-Southeast Region charges which are excluded from this market study. As calculated in the table below, net Service Company charges of \$7,552,811 were subjected to a market cost comparison.

| | |
|--|---------------------|
| Reconciliation to Testable Service Company Charges | |
| Total Management Fees (O&M) | \$ 7,859,536 |
| Non-Recurring Items: | |
| Business Change - Corporate | \$ (23,400) |
| Business Change - Regions | \$ (9,111) |
| Divestiture & SOX - Corp | \$ (729,860) |
| Divestiture & SOX - Regions | \$ 17,854 |
| Less: Non-Southeast Region Charges | \$ (50,041) |
| Net Testable O&M | \$ 7,064,978 |
| Total Capital | \$ 486,878 |
| Total Other | \$ 1,114 |
| Total Testable Svc Co Charges | \$ 7,552,970 |

For purposes of comparing these charges to outside benchmarks, Service Company services were placed into two categories:

- Managerial and Professional Services – Includes such services as management, accounting, legal, human resources, information technology, and engineering.
- Customer Accounts Services – Includes customer-related services, such as call center, credit, billing, collection and payment processing.

Total test period Service Company charges break down between management/professional services and customer account services as follows:

| | 12 Months Ended July 31, 2008 | |
|--------------------------------------|-------------------------------|--------|
| | Amount | Hours |
| Management and Professional Services | \$ 5,724,142 | 48,123 |
| Customer Account Services | \$ 1,828,827 | 43,730 |
| Total Service Company Charges | \$ 7,552,970 | 91,853 |

This study's first question—whether Service Company 12 months ended July 31, 2008 charges were charged at the lower of cost or market—was evaluated by comparing the cost per hour for managerial and professional services provided by Service Company personnel to hourly billing rates that would be charged by outside providers of equivalent services. Service Company costs per hour were based on actual charges to KAWC during the 12 months ended July 31, 2008. Outside providers' billing rates came from surveys or other information from professionals that could perform the services now provided by the Service Company.

The second question—whether Service Company 12 months ended July 31, 2008 customer account services charges, including those of the National Call Center costs, were comparable to other utilities—was addressed by comparing KAWC's customer accounts services expenses to those of neighboring electric utilities. This approach was selected because the costs of outside providers of call center services are not publicly available. However, electric utility customer

account services expenses can be obtained from the FERC Form 1. The availability and transparency of FERC data adds to the validity of its use in this comparison.

The third question—the necessity of Service Company services—was first investigated by determining the services provided to KAWC. A determination was then made as to whether these services would be required if KAWC were a stand-alone utility.

The fourth question—whether Service Company 12 months ended July 31, 2008 charges were reasonable by other comparative measures—was determined by comparing KAWC's net testable O&M Service Company charges per customer to those of electric and combination electric/gas utilities that file FERC Form 60 – Annual Report of Service Companies.

IV – Managerial And Professional Services Hourly Rate Comparison

Methodology

The lower-of-cost-or-market comparison is accomplished by comparing the cost per hour for Service Company managerial and professional services to those of outside service providers to whom these duties could be assigned. Based on the nature of the Service Company services it was determined that the following outside providers could perform the categories of services indicated below:

- Management Consultants – executive and administrative management, risk management services, human resources and communications services
- Attorneys – legal services
- Certified Public Accountants – accounting, financial, information technology and rates and revenues services
- Professional Engineers – engineering, operations and water quality services.

The services provided by the Belleville lab are assumed to be transferable to professional engineers for purposes of this cost comparison. This was done for two reasons. First, there is no readily available survey of hourly billing rates for testing services such as those performed by Belleville. Second, Belleville personnel have similar, scientific educational backgrounds as Service Company engineering personnel. Thus, it is valid to compare the hourly rates of Belleville services to those of outside engineering firms.

The Service Company's hourly rate were calculated for each of the four outside service provider categories, based on the dollars and hours charged to KAWC during the 12 months ended July 31, 2008. Hourly billing rates for outside service providers were developed using third party surveys or directly from information furnished by outside providers themselves.

It should be noted that by using the Service Company's hours charged KAWC during the 12 months ended December 31, 2008, its hourly rates are actually overstated because Service Company personnel charge a maximum 8 per day even when they work more. Outside service providers generally bill for every hour worked. If the overtime hours of Service Company personnel had been factored into the hourly rate calculation, then Service Company hourly rates would have been lower.

The last step in the market cost comparison was to compare the Service Company's average cost per hour to the average cost per hour for outside providers.

Service Company Hourly Rates

Schedule 1 (page 11) details the assignment of 12 months ended July 31, 2008 management and professional Service Company charges by outsider provider category. Schedule 2 (page 12) shows the same assignment for Service Company management and professional hours charged to KAWC during the 12 months ended July 31, 2008.

Certain adjustments to these dollar amounts were necessary to calculate Service Company hourly rates that are directly comparable to those of outside providers. Adjustments were made to the following 2008 test period non-labor Service Company charges:

- **Contract Services** – 12 months ended July 31, 2008 Service Company charges to KAWC include over \$383,000 in expenses associated with the use of outside professional firms to perform certain corporate-wide services (e.g., legal, financial audit, actuarial services). These professional fees are excluded from the Service Company hourly rate calculation because the related services have effectively been out-sourced already.
- **Travel Expenses** – In general, client-related travel expenses are not recovered by outside service providers through their hourly billing rate. Rather, actual out-of-pocket travel expenses are billed to clients in addition to fees for professional services. Thus, it is appropriate to remove these Service Company charges from the hourly rate calculation.
- **Computer Hardware and Software Expenses** – Included in the 12 months ended July 31, 2008 Service Company charges to KAWC are charges for outside expenses related to leases and maintenance fees related to mainframe, server and network infrastructure, corporate business applications and the communications systems. An outside provider that would take over operation of a data center would recover these expenses over and above the labor necessary to operate the data center.

Schedule 3 (page 13) shows how contract services, travel expenses and computer hardware/software-related Service Company charges are assigned among the four outside provider categories.

Based on the assignment of expenses and hours shown in Schedules 1 and 2 and the excludable items shown in Schedule 3, the Service Company's equivalent costs per hour for the 12 months ended July 31, 2008 are calculated below.

| | Attorney | Management Consultant | Certified Public Accountant | Professional Engineer | Total |
|--|-----------------|----------------------------------|--|----------------------------------|--------------|
| Total testable management & professional charges | \$ 291,662 | \$ 2,209,038 | \$ 2,416,857 | \$ 806,585 | \$ 5,724,142 |
| Less: | | | | | |
| Contract services | \$ 9,655 | \$ 116,547 | \$ 232,727 | \$ 24,523 | \$ 383,452 |
| Travel expenses | \$ - | \$ 22,123 | \$ 54,548 | \$ 20,286 | \$ 96,958 |
| Computer hardware/software | \$ 3,387 | \$ 56,059 | \$ 43,833 | \$ 46,985 | \$ 150,264 |
| Net Service Charges (A) | \$ 278,619 | \$ 2,014,309 | \$ 2,085,749 | \$ 714,791 | \$ 5,093,468 |
| Total Hours (B) | 3,599 | 9,514 | 26,141 | 8,870 | 48,123 |
| Average Hourly Rate (A / B) | \$ 77 | \$ 212 | \$ 80 | \$ 81 | |

Kentucky American Water Company
Analysis of 12 Months Ended July 31, 2008 Service Company Charges By Location And Function

| Location | Function | 12 Months Ended July 31, 2008 Service Company Charges | | | | Total | |
|------------------------------|------------------------|---|-----------------------|-----------------------------|-----------------------|---------------------|------------|
| | | Attorney | Management Consultant | Certified Public Accountant | Professional Engineer | | |
| Belleville Lab | Water Quality | | | | \$ 186,737 | \$ 186,737 | |
| Call Center | Human Resources | | \$ 33,855 | | | \$ 33,855 | |
| Corporate | Accounting | | | \$ 336,339 | | \$ 336,339 | |
| | Administration | | \$ 718,676 | | | \$ 718,676 | |
| | Audit | | | \$ 48,650 | | \$ 48,650 | |
| | Communications | | \$ 66,004 | | | \$ 66,004 | |
| | Engineering | | | | \$ 24,295 | \$ 24,295 | |
| | Finance | | | \$ 137,954 | | \$ 137,954 | |
| | Human Resources | | \$ 178,942 | | | \$ 178,942 | |
| | Legal | \$ 67,808 | | | | \$ 67,808 | |
| | Operations | | \$ 115,054 | | \$ 189,616 | \$ 304,670 | |
| | Rates & Revenue | | | \$ 16,035 | | \$ 16,035 | |
| | Risk Management | | \$ 85,250 | | | \$ 85,250 | |
| | Water Quality | | | | \$ 49,779 | \$ 49,779 | |
| | Regional Offices | Accounting | | | \$ 25,276 | | \$ 25,276 |
| | | Administration | | \$ 438,197 | | | \$ 438,197 |
| Communications | | | \$ 95,236 | | | \$ 95,236 | |
| Engineering | | | | | \$ 95,059 | \$ 95,059 | |
| Finance | | | | \$ 280,782 | | \$ 280,782 | |
| Human Resources | | | \$ 193,549 | | | \$ 193,549 | |
| Legal | | \$ 223,854 | | | | \$ 223,854 | |
| Operations | | | \$ 118,985 | | \$ 241,196 | \$ 360,181 | |
| Risk Management | | | \$ 39,935 | | | \$ 39,935 | |
| Water Quality | | | | | \$ 19,903 | \$ 19,903 | |
| Information Technology | Information Technology | | | \$ 1,159,787 | | \$ 1,159,787 | |
| Shared Services | Accounting | | | \$ 342,329 | | \$ 342,329 | |
| | Administration | | \$ 125,357 | | | \$ 125,357 | |
| | Finance | | | \$ 43,125 | | \$ 43,125 | |
| | Rates & Revenue | | | \$ 26,580 | | \$ 26,580 | |
| Total Dollars Charged | | \$ 291,662 | \$ 2,209,038 | \$ 2,416,857 | \$ 806,585 | \$ 5,724,142 | |

Kentucky American Water Company
Analysis of 12 Months Ended July 31, 2008 Service Company Hours By Location And Function

| Location | Function | 12 Months Ended July 31, 2008 Service Company Hours | | | | Total | |
|----------------------------|------------------|---|-----------------------|-----------------------------|-----------------------|---------------|-------|
| | | Attorney | Management Consultant | Certified Public Accountant | Professional Engineer | | |
| Belleville Lab | Water Quality | | | | 2,185 | 2,185 | |
| Call Center | Human Resources | | 430 | | | 430 | |
| Corporate | Accounting | | | 3,786 | | 3,786 | |
| | Administration | | 175 | | | 175 | |
| | Audit | | | 401 | | 401 | |
| | Communications | | 412 | | | 412 | |
| | Engineering | | | | 153 | 153 | |
| | Finance | | | 1,070 | | 1,070 | |
| | Human Resources | | 1,770 | | | 1,770 | |
| | Legal | 286 | | | | 286 | |
| | Operations | | 551 | | 1,861 | 2,412 | |
| | Rates & Revenue | | | 90 | | 90 | |
| | Risk Management | | 439 | | | 439 | |
| | Water Quality | | | | 695 | 695 | |
| | Regional Offices | Accounting | | | 397 | | 397 |
| | | Administration | | 86 | | | 86 |
| Communications | | | 1,299 | | | 1,299 | |
| Engineering | | | | | 1,138 | 1,138 | |
| Finance | | | | 2,246 | | 2,246 | |
| Human Resources | | | 2,313 | | | 2,313 | |
| Legal | | 3,313 | | | | 3,313 | |
| Operations | | | 1,119 | | 2,604 | 3,723 | |
| Risk Management | | | 423 | | | 423 | |
| Water Quality | | | | | 234 | 234 | |
| Information Technology | | Information Technology | | | 9,358 | | 9,358 |
| Shared Services | Accounting | | | 7,301 | | 7,301 | |
| | Administration | | 499 | | | 499 | |
| | Finance | | | 1,180 | | 1,180 | |
| | Rates & Revenue | | | 312 | | 312 | |
| Total Hours Charged | | 3,599 | 9,514 | 26,141 | 8,870 | 48,123 | |

Kentucky American Water Company
12 Months Ended July 31, 2008 Service Company Charges Excludable From The Hourly Rate Calculation

| Charges By Function | Exclusions From Hourly Rate Calculation | | | |
|------------------------|---|------------------|-------------------|-------------------|
| | Contract Services | Travel Expenses | Computer HW/SW | Total |
| Accounting | \$ 103,793 | \$ 1,612 | \$ 10,773 | \$ 116,178 |
| Administration | \$ 38,800 | \$ 36 | \$ 6,738 | \$ 45,573 |
| Audit | \$ 8,416 | \$ 27 | \$ 1,984 | \$ 10,427 |
| Communications | \$ 11,565 | \$ 143 | \$ 9,410 | \$ 21,119 |
| Engineering | \$ (339) | \$ 169 | \$ 1,892 | \$ 1,722 |
| Finance | \$ 44,540 | \$ 276 | \$ 10,732 | \$ 55,547 |
| Human Resources | \$ 45,503 | \$ 2,998 | \$ 15,490 | \$ 63,990 |
| Information Technology | \$ 75,880 | \$ 52,634 | \$ 18,173 | \$ 146,686 |
| Legal | \$ 9,655 | | \$ 3,387 | \$ 13,042 |
| Operations | \$ 16,214 | \$ 12,932 | \$ 53,636 | \$ 82,783 |
| Rates & Revenue | \$ 99 | | \$ 2,171 | \$ 2,271 |
| Risk Management | \$ 19,739 | \$ 15,537 | \$ 8,828 | \$ 44,104 |
| Water Quality | \$ 9,588 | \$ 10,596 | \$ 7,048 | \$ 27,233 |
| Total | \$ 383,452 | \$ 96,958 | \$ 150,264 | \$ 630,674 |

| Outside Service Provider Category |
|-----------------------------------|
| Certified Public Accountant |
| Management Consultant |
| Certified Public Accountant |
| Management Consultant |
| Professional Engineer |
| Certified Public Accountant |
| Management Consultant |
| Certified Public Accountant |
| Attorney |
| Management Consultant, |
| Professional Engineer |
| Certified Public Accountant |
| Management Consultant |
| Professional Engineer |

| Recap By Outside Provider | Exclusions From Hourly Rate Calculation | | | |
|-----------------------------|---|------------------|-------------------|-------------------|
| | Contract Services | Travel Expenses | Computer HW/SW | Total |
| Attorney | \$ 9,655 | \$ - | \$ 3,387 | \$ 13,042 |
| Management Consultant | \$ 116,547 | \$ 22,123 | \$ 56,059 | \$ 194,730 |
| Certified Public Accountant | \$ 232,727 | \$ 54,548 | \$ 43,833 | \$ 331,108 |
| Professional Engineer | \$ 24,523 | \$ 20,286 | \$ 46,985 | \$ 91,794 |
| Total | \$ 383,452 | \$ 96,958 | \$ 150,264 | \$ 630,674 |

Outside Service Provider Hourly Rates

The next step in the cost comparison was to obtain the average billing rates for each outside service provider. The source of this information and the determination of the average rates are described in the paragraphs below.

It should be noted that professionals working for 3 of the 4 outside provider categories may be licensed to practice by state regulatory bodies. However, not every professional working for these firms is licensed. For instance, among certified public accounting firms within Kentucky's regions, only more experienced staff are predominantly CPAs, as shown in the table below. Some employees of the Service Company also have professional licenses. Thus, it is valid to compare the Service Company's hourly rates to those of the outside professional service providers included in this study.

| Position | Firm Size | | |
|--------------------------------------|-----------|--------|-------|
| | Small | Medium | Large |
| Partners/Owners | 97.8% | 96.6% | 98.1% |
| Directors (over 10 years experience) | na | 72.7% | 78.0% |
| Managers (6-10 years experience) | na | 50.0% | 91.9% |
| Sr Associates (4-5 years experience) | 100.0% | 20.0% | 72.2% |
| Associates (1-3 years experience) | na | 40.0% | 31.4% |
| New Professionals | na | 0.0% | 15.0% |

Attorneys

The Kentucky Bar Association does not survey its members as to their hourly billing rates. In addition, publicly available billing rate information could not be found for Kentucky attorneys. Therefore, an estimate of Kentucky attorney rates was developed from a survey of Michigan lawyers conducted annually by the Michigan Lawyers Weekly. As presented in Schedule 4, the average rate for each Michigan firm respondent was adjusted for the cost of living differential between their location and Lexington, Kentucky. The survey includes rates that were in effect during 2007.

Management Consultants

The cost per hour for management consultants was developed from the 2007 annual survey performed by the Association of Management Consulting Firms, an industry trade organization. The first step in the calculation, presented in Schedule 5, was to determine an average rate by consultant position level. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position level. This survey includes rates that were in effect during 2006 for firms in the United States. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison. The survey 2006 average rate was escalated to January 31, 2008—the midpoint of the 12 months ended July 31, 2008.

Certified Public Accountants

The average hourly rate for Kentucky certified public accountants was developed from a 2006 survey performed by the American Institute of Certified Public Accountants (AICPA). Hourly rates in the AICPA survey are the average of firms in Kentucky's region. The average hourly rate was calculated for a set of typical accountant positions, as shown in Schedule 6. Based on a typical staff assignment by each accountant position, a weighted average hourly rate was calculated. This survey covered hourly rates in effect during 2005. Thus, the 2005 average rate was escalated to January 31, 2008, the midpoint of the 12 months ended July 31, 2008.

Professional Engineers

The Service Company provided hourly rate information for outside engineering firms that could have been used by KAWC in 2007 and 2008. As presented in Schedule 7, an average rate was developed for each engineering position level. Then, using a typical percentage mix of project time by engineering position, a weighted average cost per hour was calculated.

**Kentucky American Water Company
Estimated Billing Rates For Kentucky Attorneys Based On
Michigan Attorney Billing Rates**

| Billing rates as of December 31, 2007 (Note A) | | | | | | | | | |
|--|-------------------|------------------------|--------------------|--------|---------|--------|---------|---------------------------|---------------|
| Firm | Michigan Location | Number Of Mich Lawyers | Billing Rate Range | | | | Average | Cost of Living Adjust (C) | Adjusted Rate |
| | | | Associate | | Partner | | | | |
| | | | Low | High | Low | High | | | |
| Dickinson Wright PLLC | Detroit | 229 | \$ 170 | \$ 275 | \$ 260 | \$ 530 | \$ 309 | 86% | \$ 361 |
| Dykema | Detroit | 222 | \$ 185 | \$ 390 | \$ 245 | \$ 625 | \$ 361 | 86% | \$ 422 |
| Butzel Long | Detroit | 209 | \$ 165 | \$ 400 | \$ 220 | \$ 550 | \$ 334 | 86% | \$ 390 |
| Bodman LLP | Detroit | 128 | \$ 125 | \$ 215 | \$ 210 | \$ 495 | \$ 261 | 86% | \$ 305 |
| Jaffe Raitt Heuer & Weiss, PC | Southfield | 100 | \$ 165 | \$ 225 | \$ 225 | \$ 500 | \$ 279 | 98% | \$ 285 |
| Trott & Trott, PC | Bingham Farms | 64 | \$ 170 | \$ 170 | \$ 235 | \$ 235 | \$ 203 | 127% | \$ 160 |
| Brooks Kushman PC | Southfield | 52 | \$ 160 | \$ 275 | \$ 250 | \$ 505 | \$ 298 | 98% | \$ 304 |
| Kemp, Klein, Umphrey, Edelman & May PC | Troy | 36 | \$ 150 | \$ 190 | \$ 200 | \$ 340 | \$ 220 | 112% | \$ 196 |
| Pepper Hamilton LLP | Detroit | 33 | \$ 200 | \$ 315 | \$ 340 | \$ 615 | \$ 368 | 86% | \$ 430 |
| Hertz, Schram & Saretsky, PC | Bloomfield Hills | 29 | \$ 175 | \$ 260 | \$ 275 | \$ 400 | \$ 278 | 140% | \$ 198 |
| Strobl & Sharp, PC | Bloomfield Hills | 28 | \$ 110 | \$ 210 | \$ 200 | \$ 300 | \$ 205 | 140% | \$ 146 |
| Kupelian Ormond & Magy, PC | Southfield | 25 | \$ 165 | \$ 195 | \$ 235 | \$ 320 | \$ 229 | 98% | \$ 234 |
| Rader, Fishman & Grauer, PLLC | Bloomfield Hills | 25 | \$ 130 | \$ 250 | \$ 275 | \$ 495 | \$ 288 | 140% | \$ 205 |
| McShane & Bowie PLC | Grand Rapids | 22 | \$ 160 | \$ 275 | \$ 250 | \$ 375 | \$ 265 | 97% | \$ 273 |
| Overall Average 2007 Billing Rate | | | | | | | | | \$ 279 |

Note A: Source is Michigan Lawyers Weekly, April 2008

Note B: Source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiat.txt>)

Note C: Source is Sperling's Best Places (<http://www.bestplaces.net/col/col.aspx>). This number represents the cost of living difference between the Michigan city and Lexington, Ky. A number over 100% indicates the Michigan city's cost of living is higher than Lexington. A number less than 100% indicates Lexington's cost of living is higher.

**Kentucky American Water Company
Billing Rates of U.S. Management Consultants**

A. Calculation of Average Hourly Billing Rate by Consultant Position
Survey billing rates were those in effect in 2006 (Note A)

| | | Average Hourly Rates (Note A) | | | | |
|---------|--|-------------------------------|----------------------|-------------------|----------------|----------------|
| | | Entry-Level Consultant | Associate Consultant | Senior Consultant | Junior Partner | Senior Partner |
| Average | | \$ 142 | \$ 187 | \$ 235 | \$ 306 | \$ 358 |

B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement

| | | Entry-Level Consultant | Associate Consultant | Senior Consultant | Junior Partner | Senior Partner | |
|---|--|------------------------|----------------------|-------------------|----------------|----------------|------------------|
| Average Hourly Billing Rate (from above) | | \$ 142 | \$187 | \$235 | \$306 | \$358 | |
| Typical Percent of Time Spent on a Consulting Project | | 30% | 30% | 20% | 10% | 10% | Weighted Average |
| | | \$ 43 | \$ 56 | \$ 47 | \$ 31 | \$ 36 | \$ 212 |

Escalation to Midpoint of July 31, 2008 Test Period (Note B)

| | |
|--|---------------|
| CPI at December 31, 2006 | 201.8 |
| CPI at January 31, 2008 | 211.1 |
| Inflation/Escalation | 4.6% |
| Average Hourly Billing Rate For Management Consultants At January 31, 2008 | \$ 222 |

Note A: source: "Operating Ratios For Management Consulting Firms, 2007 Edition" Association of Management Consulting Firms

Note B: source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt>)

**Kentucky American Water Company
Billing Rates Of Kentucky Certified Public Accountants**

| | | | | |
|---|--------------------------------------|----------------------|--|-------------------------------------|
| A. Calculation of Average Hourly Billing Rate by Public Accounting Position Survey billing rates were those in effect in 2005 (Note A) | | | | |
| | Average Hourly Billing Rate (Note A) | | | |
| Type of Firm | Staff Accountant | Senior Accountant | Manager | Partner |
| Average Hourly Rate | \$ 65 | \$ 77 | \$ 112 | \$ 150 |
| B. Calculation of Overall Average Accountant Billing Rate Based Upon Typical Distribution of Time on an Engagement | | | | |
| | Staff Accountant | Senior Accountant | Manager | Partner |
| Average Hourly Billing Rate (From Above) | \$ 65 | \$ 77 | \$ 112 | \$ 150 |
| Typical Percent of Time Spent on an Accounting Assignment | 30% | 30% | 20% | 20% |
| | \$ 20 | \$ 23 | \$ 22 | \$ 30 |
| | | | | Weighted Average \$ 95 |
| | | | CPI at December 31, 2005 | 196.8 |
| | | | CPI at January 31, 2008 | 211.1 |
| | | | Inflation/Escalation | 7.3% |
| | | | Average Hourly Billing Rate For CPAs At January 31, 2008 | \$ 102 |

Note A: Source is AICPA's 2006 National PCPS/TSCPA Management of an Accounting Practice Survey

Note B: source is US Bureau of Labor Statistics (<ftp://ftp.bls.gov/pub/special.requests/cpi/cpi.txt>)

**Kentucky American Water Company
Billing Rates Of Kentucky Engineers**

Note: Billing rates were those in effect in 2007 and 2008

A. Calculation of Average Hourly Rate by Engineer Position

| Name of Firm | Average Hourly Billing Rates | | | |
|--------------|------------------------------|-------------------------------------|-------------------|--------------------|
| | Technician | Engineer | Project Manager | Officer |
| | Senior Technician | Design Engineer Project Engineer | Sr. Mgr. Engineer | Principal Engineer |
| Firm #1 | \$73 | \$85 | \$136 | \$175 |
| Firm #2 | \$76 | \$84 | \$134 | \$164 |
| Firm #3 | \$80 | \$102 | \$162 | \$207 |
| Firm #4 | \$60 | \$80 | \$127 | \$162 |
| Firm #5 | \$70 | \$73 | \$112 | \$160 |
| Firm #6 | \$55 | \$86 | \$139 | \$190 |

B. Calculation of Overall Average Engineering Hourly Billing Rate

| | CAD Drafter | Engineer | Project Manager | Officer | Weighted Average |
|---|---------------|--|--|--------------------|---------------------|
| | Engineer Tech | Design Engineer Project Engineer Elect Proj Engineer | Project Associate Sr. Mgr. Engineer | Principal Engineer | |
| Average Hourly Billing Rate (From Above) | \$69 | \$85 | \$135 | \$176 | |
| Typical Percent of Time on an Engineering Assignment | 30% | 35% | 25% | 10% | |
| | \$21 | \$30 | \$34 | \$18 | \$102 |

Source: Information provided by American Water Works Service Company

Service Company Versus Outside Provider Cost Comparison

As shown in the table below, Service Company costs per hour are considerably lower than those of outside providers.

| Service Provider | 12 Months Ended July 31, 2008 | | |
|-----------------------------|-------------------------------|------------------|--|
| | Service Company | Outside Provider | Difference-- Service Co. Greater(Less) Than Outside |
| Attorney | \$ 77 | \$ 279 | \$ (202) |
| Management Consultant | \$ 212 | \$ 222 | \$ (10) |
| Certified Public Accountant | \$ 80 | \$ 102 | \$ (22) |
| Professional Engineer | \$ 81 | \$ 102 | \$ (21) |

Based on these cost per hour differentials and the number of managerial and professional services hours billed to KAWC during the 12-months ended July 31, 2008, outside service providers would have cost \$1,595,514 more than the Service Company (see table below). Thus, on average, outside provider's hourly rates are 28% higher than those of the Service Company (\$1,595,514 / \$5,724,142).

| Service Provider | 12 Months Ended July 31, 2008 | | |
|---|---|--|----------------------|
| | Hourly Rate Difference-- Service Co. Greater(Less) Than Outside | Service Company Hours Charged | Dollar Difference |
| Attorney | \$ (202) | 3,599 | \$ (726,242) |
| Management Consultant | \$ (10) | 9,514 | \$ (98,587) |
| Certified Public Accountant | \$ (22) | 26,141 | \$ (583,251) |
| Professional Engineer | \$ (21) | 8,870 | \$ (187,433) |
| Service Company Less Than Outside Providers | | | \$ (1,595,514) |

If KAWC were to use outside service providers rather than the Service Company for managerial and professional services, it would incur other additional expenses besides those associated with higher hourly rates. Managing outside firms who would perform 48,123 hours of work (around 32 full-time equivalents at 1,500 "billable" hours per FTE per year) would add a significant workload to the existing KAWC management team. Thus, it would be necessary for KAWC to add at least one position to supervise the outside firms and ensure they delivered quality and timely services. The individual that would fill this position would need a good understanding of each profession being managed. They must also have management experience and the authority necessary to give them credibility with the outside firms. As calculated in the table below, this position would add another \$149,400 per year to KAWC's personnel expenses.

Cost of Adding a Professional Position To KAWC's Staff

| | Total |
|----------------------------------|------------|
| New Position's Salary | \$ 100,000 |
| Benefits (49.4%) | \$ 49,400 |
| Office Expenses (15.2%) | \$ 15,200 |
| Total Cost of Full Time Position | \$ 149,400 |

Thus, the total effect on the ratepayers of KAWC of contracting all services now provided by the Service Company would be an increase in their costs of \$1,744,914 (\$1,595,514 + \$149,400).

Based on the results of this comparison, it is possible to conclude that the Service Company charged KAWC at the lower of cost or market for services provided during the 12 months ended July 31, 2008.

Other Cost Comparisons

Every year, the Belleville Lab conducts a comparison of its cost for performing major tests to the cost of using outside testing laboratories. Over the past several years, these surveys have shown the following results been as follows:

| Year | Number of Major Tests Surveyed | Percent Belleville Lower Than Outside Labs |
|------|--------------------------------|--|
| 2000 | 26 | 15% |
| 2001 | 25 | 19% |
| 2002 | 24 | 16% |
| 2003 | 23 | 10% |
| 2004 | 24 | 9% |
| 2005 | 24 | 25% |
| 2006 | 24 | 31% |

These studies provide additional evidence that the Service Company arrangement is the lowest-cost alternative for KAWC.

V – Customer Account Services Cost Comparison

Background

It is difficult to compare the cost of American Water's National Call Centers with outside providers of the same call center-related services. Call center survey data is proprietary and expensive to obtain. For this reason, KAWC's National Call Center costs are compared to those of neighboring electric utilities because the data necessary to make this comparison is readily available to the public.

Electric utility cost information comes from the FERC Form 1 that each must file. FERC's chart of accounts is defined in chapter 18, part 101 of Code of Federal Regulations. FERC accounts that contain call center-related expenses and are used in this study's comparison are:

- Account 903 Customer Accounts Expense – Records and Collection Expense
- Account 905 Customer Accounts Expense – Miscellaneous Customer Accounts Expense.

In addition, labor-related overheads charged to the following FERC accounts must be added to the labor components of Accounts 903 and 905.

- Account 926 Employee Pension and Benefits
- Account 408 Taxes Other Than Income (employer's portion of FICA).

Schedule 8 provides FERC's description of what should be charged to these accounts. In questioning the controller of a large Southeastern electric utility, it was determined that expenses of the activities described below are recorded in the designated FERC accounts.

903 Records and Collection Expense

- Customer Call Center – customer calls/contact, credit, order taking/disposition, bill collection efforts, outage calls
- Call Center IT – maintenance of phone banks, voice recognition units, call center software applications, telecommunications
- Customer billing – bill printing, stuffing and mailing
- Remittance processing – processing of customer payments received in the mail
- Bill payment centers – locations where customers can pay their bills in person

905 Miscellaneous Customer Accounts Expense

- Customer Information System IT – maintenance and support of the customer information system

This study assumes the FERC accounts for other electric and gas utilities contain expenses for the same activities.

**Kentucky American Water Company
FERC Account Descriptions**

903 – Customer Records and Collection Expenses

This account shall include the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints.

Labor

1. Receiving, preparing, recording and handling routine orders for service, disconnections, transfers or meter tests initiated by the customer, excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
2. Investigations of customers' credit and keeping of records pertaining thereto, including records of uncollectible accounts written off.
3. Receiving, refunding or applying customer deposits and maintaining customer deposit, line extension, and other miscellaneous records.
4. Checking consumption shown by meter readers' reports where incidental to preparation of billing data.
5. Preparing address plates and addressing bills and delinquent notices.
6. Preparing billing data.
7. Operating billing and bookkeeping machines.
8. Verifying billing records with contracts or rate schedules.
9. Preparing bills for delivery, and mailing or delivering bills.
10. Collecting revenues, including collection from prepayment meters unless incidental to meter reading operations.
11. Balancing collections, preparing collections for deposit, and preparing cash reports.
12. Posting collections and other credits or charges to customer accounts and extending unpaid balances.
13. Balancing customer accounts and controls.
14. Preparing, mailing, or delivering delinquent notices and preparing reports of delinquent accounts.
15. Final meter reading of delinquent accounts when done by collectors incidental to regular activities.
16. Disconnecting and reconnecting services because of nonpayment of bills.
17. Receiving, recording, and handling of inquiries, complaints, and requests for investigations from customers, including preparation of necessary orders, but excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
18. Statistical and tabulating work on customer accounts and revenues, but not including special analyses for sales department, rate department, or other general purposes, unless incidental to regular customer accounting routines.
19. Preparing and periodically rewriting meter reading sheets.
20. Determining consumption and computing estimated or average consumption when performed by employees other than those engaged in reading meters.

Materials and expenses

21. Address plates and supplies.
22. Cash overages and shortages.
23. Commissions or fees to others for collecting.
24. Payments to credit organizations for investigations and reports.
25. Postage.
26. Transportation expenses, including transportation of customer bills and meter books under centralized billing procedure.
27. Transportation, meals, and incidental expenses.
28. Bank charges, exchange, and other fees for cashing and depositing customers' checks.
29. Forms for recording orders for services, removals, etc.
30. Rent of mechanical equipment.

**Kentucky American Water Company
FERC Account Descriptions**

905 – Miscellaneous Customer Accounts Expenses

This account shall include the cost of labor, materials used and expenses incurred not provided for in other accounts.

Labor

1. General clerical and stenographic work.
2. Miscellaneous labor.

Materials and expenses

3. Communication service.
4. Miscellaneous office supplies and expenses and stationery and printing other than those specifically provided for in accounts 902 and 903.

Comparison Group

Electric utilities included in the comparison group are shown in the table below. These are companies whose FERC Form 1 shows amounts for accounts 903 and 905.

| | | |
|---------------|---|---|
| Kentucky | <ul style="list-style-type: none"> • Duke Energy – Kentucky • Kentucky Power | <ul style="list-style-type: none"> • Kentucky Utilities • Louisville Gas & Electric |
| West Virginia | <ul style="list-style-type: none"> • Wheeling Power | |
| Virginia | <ul style="list-style-type: none"> • Appalachian Power | <ul style="list-style-type: none"> • Virginia Electric Power |
| Ohio | <ul style="list-style-type: none"> • Cleveland Electric • Columbus Southern Power • Dayton Power & Light • Duke Energy – Ohio | <ul style="list-style-type: none"> • Ohio Edison • Ohio Power • Toledo Edison |
| Missouri | <ul style="list-style-type: none"> • Aquila • Kansas City Power & Light | <ul style="list-style-type: none"> • Union Electric |
| Indiana | <ul style="list-style-type: none"> • Duke Energy – Indiana • Indiana Michigan Power | <ul style="list-style-type: none"> • Indianapolis Power & Light • NIPSCO |
| Illinois | <ul style="list-style-type: none"> • Central Illinois Light • Central Illinois Public Service • Commonwealth Edison | <ul style="list-style-type: none"> • Illinois Power • Interstate Power & Light • MidAmerica Energy |
| Tennessee | <ul style="list-style-type: none"> • Kingsport Power | |

Comparison Approach

The basis for this comparison is customer account services expenses per customer. KAWC's cost pool was developed to include the same expenses included in electric utility's FERC accounts 903 and 905. As shown in the graphic below, KAWC's resultant cost pool contains the expenses of Service Company locations and certain operating company expenses.

| American Water |
|-----------------------------------|
| <u>Service Company</u> |
| Pensacola & Alton Call Centers |
| a. Customer contact |
| b. Customer order processing |
| c. Billing information processing |
| d. Collections |
| e. Correspondence processing |
| f. Customer payment processing |
| <u>Operating Company</u> |
| a. Postage and forms |

| Electric Utilities |
|---|
| FERC Acct 903 - Records and Collection Expense and FERC Acct 905 - Misc Customer Accounts Expense |
| a. Customer contact |
| b. Customer order processing |
| c. Bill preparation and mailing |
| d. Collections |
| e. Payment processing |
| f. Correspondence processing |

KAWC Cost Per Customer

In order to make a valid comparison to neighboring electric utilities, certain adjustments had to be made to the applicable Service Company charges to KAWC. It was necessary to adjust the National Call Center call handling charges because electric utilities experience an average of 2.50 calls per customer compared to American Water's 1.33 calls per customer. Thus, National Call Center call handling charges had to be increased for comparison purposes, to reflect its costs at a 2.50 calls per customer level. As shown below, KAWC's adjusted annual expense per customer is \$28.07—the number that can be compared to neighboring electric utilities' expenses. KAWC's 12 months ended July 31, 2008 unadjusted annual expense per customer is \$23.22.

| Kentucky-American Cost Per Customer | | Year Ended 7/31/2008 | Adjustment Fewer Service Co Calls For | Adjusted |
|---|---|-------------------------|--|-------------------|
| Cost Component | | Charges | Water Cos. (A) | |
| Service Company | | | | |
| Call Centers | Call processing, order processing, credit, bill collection | \$ 1,648,336 | \$ 567,707 | \$ 2,216,043 |
| Regional Offices | | \$ 180,491 | | \$ 180,491 |
| Operating Company | Customer payment processing | | | \$ 166,689 Note B |
| Operating Company | Postage & forms | | | \$ 724,532 |
| Cost Pool Total | | | | \$ 3,287,755 |
| Total Customers | | | | 117,119 |
| 12 Months Ended July 31, 2008 Cost Per KAWC Customer | | | | \$ 28.07 |

Note A: Adjustment for American Water's fewer calls per customer

This adjustment is necessary because water utilities experience fewer calls per customer than do electric utilities

| | | |
|--|------|------------|
| Call handling expenses | | \$ 643,808 |
| Electric utility industry's avg calls/customer | 2.50 | |
| American Water's avg calls/customer | 1.33 | |
| Percent different | 88% | 88% |
| Total Adjustment | | \$ 567,707 |

Note B: Estimated customer payment processing expenses

| | |
|----------------------------------|------------|
| Number of customers | 117,119 |
| Number of payments/customer/year | 12 |
| Total payments processed/year | 1,405,428 |
| Bank charge per item | \$ 0.1186 |
| Total estimated annual expense | \$ 166,689 |

Electric Utility Group Cost Per Customer

Schedule 9 shows the actual 2007 customer accounts expense per customer calculation for the electric utility comparison group. All of the underlying data were taken from each utility's FERC Form 1.

Summary Of Results

As shown in the table below, KAWC's cost per customer is close to the average of the neighboring electric utility comparison group. It can therefore be concluded that KAWC's 12 months ended July 31, 2008 customer accounts-related expenses, including those of the Alton and Pensacola Call Centers, assigned by the Service Company to KAWC are reasonable compared to those of other utilities.

| Average Customer Accounts Expense Per Customer | | |
|---|-----------|--------------|
| Louisville Gas & Electric | \$ | 13.71 |
| Interstate Power & Light | \$ | 15.86 |
| Virginia Electric Power | \$ | 15.89 |
| Ohio Edison | \$ | 19.04 |
| Dayton Power & Light | \$ | 19.15 |
| Illinois Power | \$ | 19.83 |
| Indianapolis Power & Light | \$ | 20.62 |
| Cleveland Electric Illuminating | \$ | 21.33 |
| Union Electric | \$ | 23.46 |
| Aquila | \$ | 23.72 |
| Kansas City Power & Light | \$ | 25.09 |
| Toledo Edison | \$ | 25.77 |
| Kentucky Utilities | \$ | 25.91 |
| Central Illinois Public Service | \$ | 26.50 |
| MidAmerican Energy | \$ | 27.50 |
| Comparison Group Average | \$ | 27.99 |
| Kentucky American Water | \$ | 28.07 |
| Wheeling Power | \$ | 28.08 |
| Northern Indiana Public Service | \$ | 28.32 |
| Indiana Michigan Power | \$ | 31.74 |
| Duke Energy Indiana | \$ | 32.14 |
| Kingsport Power | \$ | 32.31 |
| Central Illinois Light | \$ | 34.22 |
| Duke Energy Kentucky | \$ | 34.88 |
| Appalachian Power | \$ | 34.99 |
| Ohio Power | \$ | 35.00 |
| Duke Energy Ohio | \$ | 36.10 |
| Kentucky Power | \$ | 37.59 |
| Columbus & Southern Power | \$ | 38.57 |
| Commonwealth Edison | \$ | 39.81 |

It should be noted that comparison group per customer costs at the low end are unusually low given the nature of Customer Accounts expenses. For instance, the annual cost of forms and postage alone is around \$6.20 per customer for KAWC. It would be expected that this cost would be the same for every utility in the comparison group because all likely mail customer bills monthly. Thus, for a low-end cost utility like Louisville Gas & Electric, that leaves only \$7.51 (\$13.71-\$6.20) to cover labor and information technology expenses that Customer Accounts services require. It is possible that the very low end cost utilities record the cost of supporting their customer information systems to an A&G FERC account rather than to a Customer Accounts FERC account (903).

**Kentucky American Water Company
Comparison Group 2007 Actual Customer Accounts Expense Per Customer**

| | Kentucky | | | | West Virginia | Virginia | |
|--|----------------------|---------------------|----------------------|---------------------------|---------------------|----------------------|-------------------------|
| | Duke Energy Kentucky | Kentucky Power | Kentucky Utilities | Louisville Gas & Electric | Wheeling Power | Appalachian Power | Virginia Electric Power |
| Customer Account Services Cost Pool | | | | | | | |
| FERC Account Balances: | | | | | | | |
| Acct 903 - Customer Records & Collection (page 322, line 161) | \$ 3,247,759 | \$ 6,205,360 | \$ 11,681,015 | \$ 4,642,565 | \$ 1,083,477 | \$ 31,314,061 | \$ 32,253,336 |
| Acct 905 - Misc Customer Accounts (page 322, line 163) | \$ 75,852 | \$ 2,888 | \$ 173,641 | \$ 215,534 | \$ 1,480 | \$ 18,238 | \$ - |
| Subtotal | \$ 3,323,611 | \$ 6,208,248 | \$ 11,854,656 | \$ 4,858,099 | \$ 1,084,957 | \$ 31,332,299 | \$ 32,253,336 |
| Add: Employee Benefits & Employer FICA (not included in above amounts) | | | | | | | |
| Account 926 - Employee Pension & Benefits | Note A \$ 1,080,370 | \$ 285,983 | \$ 1,738,946 | \$ 542,390 | \$ 55,868 | \$ 1,429,385 | \$ 3,831,664 |
| Account 408 - Taxes Other Than Income (Employer's Portion of FICA) | Note B \$ 264,982 | \$ 111,009 | \$ 230,888 | \$ 94,002 | \$ 19,665 | \$ 534,319 | \$ 1,451,975 |
| Total Cost Pool | \$ 4,668,963 | \$ 6,605,240 | \$ 13,824,490 | \$ 5,494,491 | \$ 1,160,489 | \$ 33,296,003 | \$ 37,536,975 |
| Total Customers (page 304, line 43) | 133,868 | 175,705 | 533,512 | 400,703 | 41,332 | 951,693 | 2,362,318 |
| Customer Account Services Expense per Customer | \$ 34.88 | \$ 37.59 | \$ 25.91 | \$ 13.71 | \$ 28.08 | \$ 34.99 | \$ 15.89 |
| Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt | | | | | | | |
| Account 926 - Employee Pension & Benefits (page 323, line 187) | \$ 9,725,767 | \$ 4,466,809 | \$ 22,618,725 | \$ 20,138,689 | \$ 369,460 | \$ 21,499,955 | \$ 120,865,073 |
| Total O&M Payroll (page 355, line 65) | \$ 31,182,162 | \$ 22,664,819 | \$ 39,257,367 | \$ 45,624,056 | \$ 1,699,949 | \$ 105,057,647 | \$ 598,702,458 |
| Benefits as Percent of Payroll | 31.2% | 19.7% | 57.6% | 44.1% | 21.7% | 20.5% | 20.2% |
| Payroll Applicable to Customer Account Services | | | | | | | |
| Total Payroll Charged to Customer Accounts Function | | | | | | | |
| Electric (page 354, line 7) | \$ 1,323,882 | \$ 1,702,053 | \$ 4,110,913 | \$ 960,068 | \$ 357,852 | \$ 8,227,618 | \$ 25,945,148 |
| Gas (page 354, line 37) | \$ 3,112,805 | | | \$ 771,056 | | | |
| Total Payroll Charged to Customer Accounts | \$ 4,436,687 | \$ 1,702,053 | \$ 4,110,913 | \$ 1,731,124 | \$ 357,852 | \$ 8,227,618 | \$ 25,945,148 |
| Percent Applicable to Customer Accounts Services (903 and 905): | | | | | | | |
| Acct 903 - Customer Records & Collection (page 322, line 161) | \$ 3,247,759 | \$ 6,205,360 | \$ 11,681,015 | \$ 4,642,565 | \$ 1,083,477 | \$ 31,314,061 | \$ 32,253,336 |
| Acct 905 - Misc Customer Accounts (page 322, line 163) | \$ 75,852 | \$ 2,888 | \$ 173,641 | \$ 215,534 | \$ 1,480 | \$ 18,238 | \$ - |
| Subtotal - Total Charges Applicable to Customer Accounts Services | \$ 3,323,611 | \$ 6,208,248 | \$ 11,854,656 | \$ 4,858,099 | \$ 1,084,957 | \$ 31,332,299 | \$ 32,253,336 |
| Acct 902 - Meter Reading Expenses (page 322, line 160) | \$ 933,492 | \$ 1,073,679 | \$ 4,292,201 | \$ 1,986,061 | \$ 425,426 | \$ 5,576,254 | \$ 11,835,960 |
| Total Charges Applicable to Customer Accounts Svcs & Meter Reading | \$ 4,257,103 | \$ 7,281,927 | \$ 16,146,857 | \$ 6,844,160 | \$ 1,510,383 | \$ 36,908,553 | \$ 44,089,296 |
| Percent Applicable to Customer Accounts Services (903 and 905) | 78.1% | 85.3% | 73.4% | 71.0% | 71.8% | 84.9% | 73.2% |
| Customer Account Services Portion of Total Payroll | \$ 3,463,816 | \$ 1,451,095 | \$ 3,018,139 | \$ 1,228,781 | \$ 257,057 | \$ 6,984,565 | \$ 18,980,062 |
| Pension & Benefits Pertaining to Customer Accounts Services | \$ 1,080,370 | \$ 285,983 | \$ 1,738,946 | \$ 542,390 | \$ 55,868 | \$ 1,429,385 | \$ 3,831,664 |
| Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services | | | | | | | |
| Customer Account Services Portion of Total Payroll | \$ 3,463,816 | \$ 1,451,095 | \$ 3,018,139 | \$ 1,228,781 | \$ 257,057 | \$ 6,984,565 | \$ 18,980,062 |
| Employer's Portion of FICA (6.20%) and Medicare (1.45%) | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% |
| Estimated Employer's Portion of FICA | \$ 264,982 | \$ 111,009 | \$ 230,888 | \$ 94,002 | \$ 19,665 | \$ 534,319 | \$ 1,451,975 |

Kentucky American Water Company
Comparison Group 2007 Actual Customer Accounts Expense Per Customer

| | | Ohio | | | | | | |
|--|--|---------------------------|-----------------------|----------------------|----------------------|----------------------|----------------------|---------------------|
| | | Cleveland Electric Illum. | Columbus Southern Pwr | Dayton Power & Light | Duke Energy - Ohio | Ohio Edison | Ohio Power | Toledo Edison |
| Customer Account Services Cost Pool | | | | | | | | |
| FERC Account Balances: | | | | | | | | |
| Acct 903 - Customer Records & Collection (page 322, line 161) | | \$ 14,571,985 | \$ 27,013,658 | \$ 8,528,580 | \$ 18,251,514 | \$ 20,280,096 | \$ 23,346,691 | \$ 6,786,566 |
| Acct 905 - Misc Customer Accounts (page 322, line 163) | | \$ 493,177 | \$ 30,647 | \$ - | \$ 7,279 | \$ 507,437 | \$ 36,717 | \$ 156,298 |
| Subtotal | | \$ 15,065,162 | \$ 27,044,305 | \$ 8,528,580 | \$ 18,258,793 | \$ 20,787,533 | \$ 23,383,408 | \$ 6,942,864 |
| Add: Employee Benefits & Employer FICA (not included in above amounts) | | | | | | | | |
| Account 926 - Employee Pension & Benefits | | \$ 836,948 | \$ 1,264,559 | \$ 991,292 | \$ 5,237,196 | \$ (1,424,285) | \$ 1,098,295 | \$ 982,446 |
| Account 408 - Taxes Other Than Income (Employer's Portion of FICA) | | \$ 274,236 | \$ 428,016 | \$ 333,191 | \$ 1,290,860 | \$ 450,184 | \$ 418,833 | \$ 150,795 |
| Total Cost Pool | | \$ 16,176,347 | \$ 28,736,880 | \$ 9,853,063 | \$ 24,786,849 | \$ 19,813,432 | \$ 24,900,536 | \$ 8,076,105 |
| Total Customers (page 304, line 43) | | 758,319 | 745,133 | 514,405 | 686,578 | 1,040,662 | 711,406 | 313,413 |
| Customer Account Services Expense per Customer | | \$ 21.33 | \$ 38.57 | \$ 19.15 | \$ 36.10 | \$ 19.04 | \$ 35.00 | \$ 25.77 |
| Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt | | | | | | | | |
| Account 926 - Employee Pension & Benefits (page 323, line 187) | | \$ 7,650,920 | \$ 11,597,859 | \$ 18,464,446 | \$ 52,482,158 | \$ (11,505,519) | \$ 22,732,455 | \$ 7,749,820 |
| Total O&M Payroll (page 355, line 65) | | \$ 32,770,179 | \$ 51,314,234 | \$ 81,127,271 | \$ 169,094,889 | \$ 47,537,720 | \$ 113,320,078 | \$ 15,549,239 |
| Benefits as Percent of Payroll | | 23.3% | 22.6% | 22.8% | 31.0% | -24.2% | 20.1% | 49.8% |
| Payroll Applicable to Customer Account Services | | | | | | | | |
| Total Payroll Charged to Customer Accounts Function | | | | | | | | |
| Electric (page 354, line 7) | | \$ 4,890,691 | \$ 6,589,685 | \$ 6,193,463 | \$ 8,774,665 | \$ 8,447,511 | \$ 6,727,321 | \$ 2,640,178 |
| Gas (page 354, line 37) | | | | | \$ 13,561,352 | | | |
| Total Payroll Charged to Customer Accounts | | \$ 4,890,691 | \$ 6,589,685 | \$ 6,193,463 | \$ 22,336,017 | \$ 8,447,511 | \$ 6,727,321 | \$ 2,640,178 |
| Percent Applicable to Customer Accounts Services (903 and 905): | | | | | | | | |
| Acct 903 - Customer Records & Collection (page 322, line 161) | | \$ 14,571,985 | \$ 27,013,658 | \$ 8,528,580 | \$ 18,251,514 | \$ 20,280,096 | \$ 23,346,691 | \$ 6,786,566 |
| Acct 905 - Misc Customer Accounts (page 322, line 163) | | \$ 493,177 | \$ 30,647 | \$ - | \$ 7,279 | \$ 507,437 | \$ 36,717 | \$ 156,298 |
| Subtotal - Total Charges Applicable to Customer Accounts Services | | \$ 15,065,162 | \$ 27,044,305 | \$ 8,528,580 | \$ 18,258,793 | \$ 20,787,533 | \$ 23,383,408 | \$ 6,942,864 |
| Acct 902 - Meter Reading Expenses (page 322, line 160) | | \$ 5,488,077 | \$ 4,808,046 | \$ 3,599,111 | \$ 5,910,289 | \$ 9,052,734 | \$ 5,348,894 | \$ 2,356,336 |
| Total Charges Applicable to Customer Accounts Svcs & Meter Reading | | \$ 20,553,239 | \$ 31,852,351 | \$ 12,127,691 | \$ 24,169,082 | \$ 29,840,267 | \$ 28,732,302 | \$ 9,299,200 |
| Percent Applicable to Customer Accounts Services (903 and 905) | | 73.3% | 84.9% | 70.3% | 75.5% | 69.7% | 81.4% | 74.7% |
| Customer Account Services Portion of Total Payroll | | \$ 3,584,790 | \$ 5,594,986 | \$ 4,355,441 | \$ 16,873,984 | \$ 5,884,763 | \$ 5,474,942 | \$ 1,971,180 |
| Pension & Benefits Pertaining to Customer Accounts Services | | \$ 836,948 | \$ 1,264,559 | \$ 991,292 | \$ 5,237,196 | \$ (1,424,285) | \$ 1,098,295 | \$ 982,446 |
| Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services | | | | | | | | |
| Customer Account Services Portion of Total Payroll | | \$ 3,584,790 | \$ 5,594,986 | \$ 4,355,441 | \$ 16,873,984 | \$ 5,884,763 | \$ 5,474,942 | \$ 1,971,180 |
| Employer's Portion of FICA (6.20%) and Medicare (1.45%) | | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% |
| Estimated Employer's Portion of FICA | | \$ 274,236 | \$ 428,016 | \$ 333,191 | \$ 1,290,860 | \$ 450,184 | \$ 418,833 | \$ 150,795 |

Kentucky American Water Company
Comparison Group 2007 Actual Customer Accounts Expense Per Customer

| | Missouri | | | Indiana | | | |
|--|----------------------|---------------------------|----------------------|----------------------|----------------------|----------------------------|----------------------|
| | Aquila | Kansas City Power & Light | Union Electric | Duke Energy Indiana | Indiana Mich Power | Indianapolis Power & Light | NIPSCO |
| Customer Account Services Cost Pool | | | | | | | |
| FERC Account Balances: | | | | | | | |
| Acct 903 - Customer Records & Collection (page 322, line 161) | \$ 7,864,226 | \$ 10,445,176 | \$ 23,559,069 | \$ 20,424,866 | \$ 17,077,474 | \$ 7,808,040 | \$ 7,640,560 |
| Acct 905 - Misc Customer Accounts (page 322, line 163) | \$ 3,970 | \$ 6,055 | \$ 393,593 | \$ 71,323 | \$ 101,472 | \$ 67,688 | \$ 148,310 |
| Subtotal | \$ 7,868,196 | \$ 10,451,231 | \$ 23,952,662 | \$ 20,496,189 | \$ 17,178,946 | \$ 7,875,728 | \$ 7,788,870 |
| Add: Employee Benefits & Employer FICA (not included in above amounts) | | | | | | | |
| Account 926 - Employee Pension & Benefits | Note A \$ 2,740,462 | \$ 2,054,257 | \$ 2,890,852 | \$ 3,670,837 | \$ 927,402 | \$ 1,466,355 | \$ 3,921,459 |
| Account 408 - Taxes Other Than Income (Employer's Portion of FICA) | Note B \$ 531,626 | \$ 393,973 | \$ 833,653 | \$ 710,258 | \$ 360,378 | \$ 306,353 | \$ 1,159,163 |
| Total Cost Pool | \$ 11,140,285 | \$ 12,899,461 | \$ 27,677,167 | \$ 24,877,285 | \$ 18,466,726 | \$ 9,648,436 | \$ 12,869,492 |
| Total Customers (page 304, line 43) | 469,707 | 514,210 | 1,179,789 | 773,954 | 581,882 | 467,864 | 454,471 |
| Customer Account Services Expense per Customer | \$ 23.72 | \$ 25.09 | \$ 23.46 | \$ 32.14 | \$ 31.74 | \$ 20.62 | \$ 28.32 |
| Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt | | | | | | | |
| Account 926 - Employee Pension & Benefits (page 323, line 187) | \$ 36,497,609 | \$ 60,859,546 | \$ 84,255,317 | \$ 64,187,707 | \$ 31,214,137 | \$ 35,834,278 | \$ 29,700,994 |
| Total O&M Payroll (page 355, line 65) | \$ 92,551,964 | \$ 152,573,359 | \$ 317,610,780 | \$ 162,345,980 | \$ 158,555,087 | \$ 97,863,363 | \$ 114,764,234 |
| Benefits as Percent of Payroll | 39.4% | 39.9% | 26.5% | 39.5% | 19.7% | 36.6% | 25.9% |
| Payroll Applicable to Customer Account Services | | | | | | | |
| Total Payroll Charged to Customer Accounts Function | | | | | | | |
| Electric (page 354, line 7) | \$ 6,278,707 | \$ 6,966,789 | \$ 15,228,065 | \$ 12,278,547 | \$ 5,707,798 | \$ 6,869,864 | \$ 7,923,830 |
| Gas (page 354, line 37) | \$ 4,539,711 | | \$ 3,584,281 | | | | \$ 12,737,067 |
| Total Payroll Charged to Customer Accounts | \$ 10,818,418 | \$ 6,966,789 | \$ 18,812,346 | \$ 12,278,547 | \$ 5,707,798 | \$ 6,869,864 | \$ 20,660,897 |
| Percent Applicable to Customer Accounts Services (903 and 905): | | | | | | | |
| Acct 903 - Customer Records & Collection (page 322, line 161) | \$ 7,864,226 | \$ 10,445,176 | \$ 23,559,069 | \$ 20,424,866 | \$ 17,077,474 | \$ 7,808,040 | \$ 7,640,560 |
| Acct 905 - Misc Customer Accounts (page 322, line 163) | \$ 3,970 | \$ 6,055 | \$ 393,593 | \$ 71,323 | \$ 101,472 | \$ 67,688 | \$ 148,310 |
| Subtotal - Total Charges Applicable to Customer Accounts Services | \$ 7,868,196 | \$ 10,451,231 | \$ 23,952,662 | \$ 20,496,189 | \$ 17,178,946 | \$ 7,875,728 | \$ 7,788,870 |
| Acct 902 - Meter Reading Expenses (page 322, line 160) | \$ 4,380,613 | \$ 3,687,007 | \$ 17,397,091 | \$ 6,609,800 | \$ 3,635,670 | \$ 5,634,982 | \$ 2,831,519 |
| Total Charges Applicable to Customer Accounts Svcs & Meter Reading | \$ 12,248,809 | \$ 14,138,238 | \$ 41,349,753 | \$ 27,105,989 | \$ 20,814,616 | \$ 13,510,710 | \$ 10,620,389 |
| Percent Applicable to Customer Accounts Services (903 and 905) | 64.2% | 73.9% | 57.9% | 75.6% | 82.5% | 58.3% | 73.3% |
| Customer Account Services Portion of Total Payroll | \$ 6,949,364 | \$ 5,149,971 | \$ 10,897,423 | \$ 9,284,421 | \$ 4,710,822 | \$ 4,004,614 | \$ 15,152,462 |
| Pension & Benefits Pertaining to Customer Accounts Services | \$ 2,740,462 | \$ 2,054,257 | \$ 2,890,852 | \$ 3,670,837 | \$ 927,402 | \$ 1,466,355 | \$ 3,921,459 |
| Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services | | | | | | | |
| Customer Account Services Portion of Total Payroll | \$ 6,949,364 | \$ 5,149,971 | \$ 10,897,423 | \$ 9,284,421 | \$ 4,710,822 | \$ 4,004,614 | \$ 15,152,462 |
| Employer's Portion of FICA (6.20%) and Medicare (1.45%) | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% |
| Estimated Employer's Portion of FICA | \$ 531,626 | \$ 393,973 | \$ 833,653 | \$ 710,258 | \$ 360,378 | \$ 306,353 | \$ 1,159,163 |

**Kentucky American Water Company
Comparison Group 2007 Actual Customer Accounts Expense Per Customer**

| | Illinois | | | | | | Tennessee | Group Average |
|--|----------------------------|------------------------------|-----------------------|----------------------|--------------------------|----------------------|---------------------|-----------------------|
| | Central Illinois Light | Central Illinois Pub Service | Commonwealth Edison | Illinois Power | Interstate Power & Light | MidAmerica Energy | Kingsport Power | |
| Customer Account Services Cost Pool | | | | | | | | |
| FERC Account Balances: | | | | | | | | |
| Acct 903 - Customer Records & Collection (page 322, line 161) | \$ 5,596,991 | \$ 8,716,470 | \$ 120,610,588 | \$ 10,989,619 | \$ 6,841,367 | \$ 14,254,909 | \$ 1,473,454 | |
| Acct 905 - Misc Customer Accounts (page 322, line 163) | \$ 223,985 | \$ 302,592 | | \$ 568,738 | \$ 28,667 | \$ 309,674 | \$ 401 | |
| Subtotal | \$ 5,820,976 | \$ 9,019,062 | \$ 120,610,588 | \$ 11,558,357 | \$ 6,870,034 | \$ 14,564,583 | \$ 1,473,855 | |
| Add: Employee Benefits & Employer FICA (not included in above amounts) | | | | | | | | |
| Account 926 - Employee Pension & Benefits | Note A \$ 1,037,533 | \$ 812,658 | \$ 25,649,317 | \$ 69,710 | \$ 1,133,450 | \$ 3,583,729 | \$ 44,764 | |
| Account 408 - Taxes Other Than Income (Employer's Portion of FICA) | Note B \$ 334,233 | \$ 442,805 | \$ 5,100,185 | \$ 541,271 | \$ 372,012 | \$ 1,552,522 | \$ 20,029 | |
| Total Cost Pool | \$ 7,192,743 | \$ 10,274,525 | \$ 151,360,089 | \$ 12,169,339 | \$ 8,375,496 | \$ 19,700,834 | \$ 1,538,648 | \$ 563,120,389 |
| Total Customers (page 304, line 43) | 210,178 | 387,776 | 3,802,140 | 613,536 | 528,093 | 716,315 | 47,624 | 20,116,586 |
| Customer Account Services Expense per Customer | \$ 34.22 | \$ 26.50 | \$ 39.81 | \$ 19.83 | \$ 15.86 | \$ 27.50 | \$ 32.31 | \$ 27.99 |
| Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt | | | | | | | | |
| Account 926 - Employee Pension & Benefits (page 323, line 187) | \$ 8,354,060 | \$ 8,570,858 | \$ 115,712,143 | \$ 870,134 | \$ 23,724,694 | \$ 38,097,558 | \$ 234,574 | |
| Total O&M Payroll (page 355, line 65) | \$ 35,179,031 | \$ 61,047,440 | \$ 300,765,220 | \$ 88,316,487 | \$ 101,787,427 | \$ 215,743,804 | \$ 1,371,988 | |
| Benefits as Percent of Payroll | 23.7% | 14.0% | 38.5% | 1.0% | 23.3% | 17.7% | 17.1% | |
| Payroll Applicable to Customer Account Services | | | | | | | | |
| Total Payroll Charged to Customer Accounts Function | | | | | | | | |
| Electric (page 354, line 7) | \$ 3,140,575 | \$ 5,666,365 | \$ 85,366,508 | \$ 7,085,972 | \$ 6,582,592 | \$ 16,414,627 | \$ 297,440 | |
| Gas (page 354, line 37) | \$ 2,647,376 | \$ 2,677,418 | | \$ 4,384,260 | \$ 2,494,279 | \$ 14,720,361 | | |
| Total Payroll Charged to Customer Accounts | \$ 5,787,951 | \$ 8,343,783 | \$ 85,366,508 | \$ 11,470,232 | \$ 9,076,871 | \$ 31,134,988 | \$ 297,440 | |
| Percent Applicable to Customer Accounts Services (903 and 905): | | | | | | | | |
| Acct 903 - Customer Records & Collection (page 322, line 161) | \$ 5,596,991 | \$ 8,716,470 | \$ 120,610,588 | \$ 10,989,619 | \$ 6,841,367 | \$ 14,254,909 | \$ 1,473,454 | |
| Acct 905 - Misc Customer Accounts (page 322, line 163) | \$ 223,985 | \$ 302,592 | \$ - | \$ 568,738 | \$ 28,667 | \$ 309,674 | \$ 401 | |
| Subtotal - Total Charges Applicable to Customer Accounts Services | \$ 5,820,976 | \$ 9,019,062 | \$ 120,610,588 | \$ 11,558,357 | \$ 6,870,034 | \$ 14,564,583 | \$ 1,473,855 | |
| Acct 902 - Meter Reading Expenses (page 322, line 160) | \$ 1,890,408 | \$ 3,981,834 | \$ 33,825,388 | \$ 7,179,283 | \$ 5,953,252 | \$ 7,779,904 | \$ 200,527 | |
| Total Charges Applicable to Customer Accounts Svcs & Meter Reading | \$ 7,711,384 | \$ 13,000,896 | \$ 154,435,976 | \$ 18,737,640 | \$ 12,823,286 | \$ 22,344,487 | \$ 1,674,382 | |
| Percent Applicable to Customer Accounts Services (903 and 905) | 75.5% | 69.4% | 78.1% | 61.7% | 53.6% | 65.2% | 88.0% | |
| Customer Account Services Portion of Total Payroll | \$ 4,369,063 | \$ 5,788,301 | \$ 66,669,082 | \$ 7,075,439 | \$ 4,862,904 | \$ 20,294,407 | \$ 261,818 | |
| Pension & Benefits Pertaining to Customer Accounts Services | \$ 1,037,533 | \$ 812,658 | \$ 25,649,317 | \$ 69,710 | \$ 1,133,450 | \$ 3,583,729 | \$ 44,764 | |
| Note B: Calculation of Employer's FICA Pertaining to Customer Accounts Services | | | | | | | | |
| Customer Account Services Portion of Total Payroll | \$ 4,369,063 | \$ 5,788,301 | \$ 66,669,082 | \$ 7,075,439 | \$ 4,862,904 | \$ 20,294,407 | \$ 261,818 | |
| Employer's Portion of FICA (6.20%) and Medicare (1.45%) | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% | 7.65% | |
| Estimated Employer's Portion of FICA | \$ 334,233 | \$ 442,805 | \$ 5,100,185 | \$ 541,271 | \$ 372,012 | \$ 1,552,522 | \$ 20,029 | |

VI - Need For Service Company Services

Analysis Of Services

The third aspect of this study was an assessment of whether the services that are provided to KAWC by the Service Company would be necessary if KAWC were a stand-alone water utility. The first step in this evaluation was to determine specifically what the Service Company does for KAWC. Based on Baryenbruch & Company, LLC's experience working with the Service Company and information from Service Company personnel, the matrix in Schedule 10 was created showing which entity—KAWC or a Service Company location—is responsible for each of the functions KAWC requires to ultimately provide service to its customers. This matrix was reviewed to determine: (1) if there was redundancy or overlap in the services being provided by the Service Company and (2) if Service Company services are typical of those needed by a stand-alone water utility.

Upon review of Schedule 10, the following conclusions can be drawn:

- The services that the Service Company provides are necessary and would be required even if KAWC were a stand-alone water utility.
- There is no redundancy or overlap in the services provided by the Service Company to KAWC. For all of the services listed in Schedule 10, there was only one entity that was primarily responsible for the service.

**Kentucky American Water Company
 Designation Of Responsibility For Water Utility Functions**

| Water Company Function | Primarily Responsible P Provides Support S | KAWC | Performed By: | | | | | |
|--|---|------|--------------------------------|-----------------|-----------------|------------------|--------------------|----------------|
| | | | American Water Service Company | | | | | |
| | | | Customer Call Center | Regional Office | Shared Services | Corporate Office | IT Service Centers | Belleville Lab |
| Engineering and Construction Management | | | | | | | | |
| CPS Preparation | P | | | | | S | | |
| Five-Year System Planning | P | | | | | S | | |
| Engineering Standards & Policies Development | | | | | | P | | |
| Project Design | | | | | | | | |
| Major Projects (e.g., new treatment plant) | P | | | | | S | | |
| Special Projects | P | | | | | S | | |
| Minor Projects (e.g., pipelines) | P | | | | | | | |
| Construction Project Management | | | | | | | | |
| Major Projects | P | | | | | S | | |
| Special Projects | P | | | | | S | | |
| Minor Projects | P | | | | | | | |
| Hydraulics Review | P | | | | | S | | |
| Developers Extensions | P | | | | | | | |
| Tank Painting | P | | | | | | | |
| Water Quality and Purification | | | | | | | | |
| Water Quality Standards Development | | | | S | | S | | P |
| Research Studies | S | | | | | S | | P |
| Water Quality Program Implementation | P | | | | | S | | |
| Water Treatment Operations & Maintenance | P | | | | | S | | |
| Compliance Tracking and Chemical Testing | P | | | | | | | S |
| Sample Collection and Other Testing | S | | | | | S | | P |
| Transmission and Distribution | | | | | | | | |
| Preventive Maintenance Program Development | P | | | | | | | |
| System Maintenance | P | | | | | | | |
| Leak Detection | P | | | | | | | |
| Customer Service | | | | | | | | |
| Community Relations | P | | | S | | S | | |
| Customer Contact | S | | P | | | | | |
| Call Processing | | | P | | | | | |
| Service Order Creation | S | | P | S | | | | |
| Service Order Processing | P | | S | | | | | |
| Customer Credit | | | P | | | | | |
| Meter Reading | P | | | | | | S | |
| Customer Bill Preparation | | | S | | | | P | |
| Bill Collection | S | | P | | | | S | |
| Customer Payment Processing | S | | | | P | | | |
| Meter Standards Development | S | | | | | P | | |
| Meter Testing, Maintenance & Replacement | P | | | | | | | |

**Kentucky American Water Company
Designation Of Responsibility For Water Utility Functions**

| Water Company Function | KAWC | Performed By: | | | | | |
|---|------|--------------------------------|-----------------|-----------------|------------------|--------------------|----------------|
| | | American Water Service Company | | | | | |
| | | Customer Call Center | Regional Office | Shared Services | Corporate Office | IT Service Centers | Belleville Lab |
| Financial Management | | | | | | | |
| Financial Planning | S | | P | | S | | |
| Financings—Equity | S | | P | | S | | |
| Financings--Long Term Debt & Preferred (A) | S | | P | | | | |
| Short Term Lines of Credit Arrangements (A) | S | | | | P | | |
| Investor Relations | | | S | | P | | |
| Insurance Program Administration | S | | | | P | | |
| Loss Control/Safety Program Administration | P | | | | S | | |
| Pension Fund Asset Management | | | | | P | | |
| Cash Management/Disbursements | | | | P | | | |
| Internal Auditing | | | | | P | | |
| Budgeting and Variance Reporting | | | | | P | | |
| Corporate Guidelines & Instructions | | | | | P | | |
| Regional Guidelines & Instructions | | | P | | | | |
| Budget Preparation | | | | | | | |
| Revenue | P | | S | | | | |
| O&M | P | | S | | | | |
| Depreciation and Interest Expense | S | | S | P | | | |
| Budget Preparation--Service Company Charges | S | S | P | S | S | S | |
| Capital Budget Preparation—Projects | P | | | | | | |
| Capital Budget Preparation—Non-Project Work | P | | | | | | |
| Prepare Monthly Budget Variance Report (“Budget/Plan Analysis”) | P | | | | | | |
| Prepare Capital Project Budget Status Report | P | | | | | | |
| Year-End Projections (A) | P | | | | | | |
| Accounting and Taxes | | | | | | | |
| Accounts Payable Accounting | S | | | P | | | |
| Payroll Accounting | S | | | P | | | |
| Work Order Accounting | S | | | P | | | |
| Fixed Asset Accounting | S | | | P | | | |
| Journal Entry Preparation--Billing Corrections | S | | | P | | | |
| Journal Entry Preparation--All Others | S | | | P | | | |
| Financial Statement Preparation | S | | | P | | | |
| State Commission Reporting | S | | S | P | | | |
| Income Taxes—State | | | | P | | | |
| Income Taxes—Federal | | | | P | | | |
| Property Taxes | S | | S | P | | | |
| Gross Receipts Taxes | S | | S | P | | | |

Note A: Financings and lines of credit are the responsibility of American Capital Corporation

**Kentucky American Water Company
 Designation Of Responsibility For Water Utility Functions**

| Water Company Function | KAWC | Performed By: | | | | | |
|---|------|--------------------------------|-----------------|-----------------|------------------|--------------------|----------------|
| | | American Water Service Company | | | | | |
| | | Customer Call Center | Regional Office | Shared Services | Corporate Office | IT Service Centers | Belleville Lab |
| Rates | | | | | | | |
| Rate Studies & Tariff Change Administration | S | | P | | | | |
| Rate Case Planning and Preparation | S | | P | | | | |
| Rate Case Administration | S | | P | | | | |
| Commission Inquiry Response | S | | P | | | | |
| Legal | | | P | | S | | |
| Purchasing and Materials Management | | | | | | | |
| Specification Development | S | | S | S | P | | |
| Bid Solicitation | S | | | P | | | |
| Contract Administration | S | | | P | | | |
| Ordering | P | | | | | | |
| Inventory Management | P | | | S | | | |
| Human Resources Management | | | | | | | |
| Benefit Program Development | | | | | P | | |
| Benefits Program Administration | S | | P | | | | |
| Management Compensation Administration | | | | | P | | |
| Wage & Salary Program Design | | | | | P | | |
| Wage & Salary Administration | P | | S | | | | |
| Labor Negotiations--Wages | P | | S | | | | |
| Labor Negotiations--Benefits | | | | | P | | |
| Labor Negotiations--Work Rules | S | | P | | | | |
| Training Program Development | S | | S | | P | | |
| Training--Course Delivery | P | | | | | | |
| Affirmative Action/EEO--Plan Development | P | | | | | | |
| Affirmative Action/EEO--Implementation | P | | | | | | |
| Information Systems Services | | | | | | | |
| Service Company Data Centers | | | | | | | |
| System Operations & Maintenance | | | | | | P | |
| Software Maintenance | | | | | | P | |
| Network Administration | | | P | | | S | |
| PC Acquisition & Support | | | P | | | S | |
| Help Desk | | | S | | | P | |

Governance Practices Associated With Service Company Charges

There are several ways by which KAWC exercises control over Service Company services and charges. The most important of these are described below.

- **President of Regulated Operations Oversight** – The President of Regulated Operations is on the Executive Management Team (EMT) of American Water. This position is responsible for the overall performance of each operating company in American Water. As part of the EMT, the President of Regulated Operations has equal say with other EMT members in major business decisions of American Water and has the ability to monitor Service Company performance quality and spending. The President of Regulated Operations also has dialogue with each operating company president to address local concerns.
- **Regional Vice President & Treasurer** – The Regional Vice President and Treasurer of the southeast states is responsible for the financial reporting, performance and internal controls of each of the operating companies in the region. The Vice President and Treasurer monitors the performance and reporting from the Service Company and follows up on instances where the quality and timeliness of services are not as expected. The operating company interacts with the Regional VP & Treasurer to discuss any concerns with billings, etc.
- **Operating Company Board Oversight** – KAWC board of directors includes members of American Water's EMT, members of the regional management team and business and community leaders from outside the Company. KAWC's president is Chairman of the KAWC board. This helps ensure that KAWC's needs are a factor in the delivery of Service Company services.
- **Service Company Budget Review/Approval** – The President of Regulated Operations sits on the Service Company board and that board must formally approve the budget for Service Company charges for the next year. These budgeted charges are consolidated with the operating company's own spending into an overall budget which must be approved by the operating company's board of directors. KAWC's president also sits on the Service Company board.
- **Major Project Review And Approval** – Major projects undertaken by the Service Company must first be reviewed by American Water's Executive Management Team, which includes the President of Regulated Operations. With input from the local presidents and Regional Vice President & Treasurer, they have the ability to impact all new initiatives and projects before they are authorized.
- **Service Company Bill Scrutiny** – Southeast Region Finance personnel review the monthly Service Company bill for accuracy and reasonableness on a monthly basis. KAWC's financial analyst has dialogue with regional office personnel concerning the monthly bill and any mistakes or overcharges are credited on a subsequent billing. The Southeast Region Finance unit prepares an actual to budget comparison of management fees each month for use in identifying unusual variances. Service Company actual to budget comparison is included in the monthly FRP. Unusual variances are researched, explanations are provided and any corrections are made, as necessary.
- **Service Company Budget Variance Reporting** – Each month, a summary variance analysis is prepared that explains differences between budgeted and actual Service Company spending. In addition, a more detailed monthly variance report, called the "Statement of Expenses and Billed Charges," is produced by Service Company location and shows actual spending for the month.

- **Operating Company Budget Variance Reporting** – The “Budget/Plan Analysis,” produced monthly, has a line item for Management Fees (i.e., Service Company charges). In this way, Service Company budget versus actual charges can be monitored for the month and year-to-date. Additional information exists that allows more detailed analysis of "Regional" and "Corporate" Management Fees.
- **Capital Investment Management (“CIM”)** – CIM is one of American Water’s primary business planning processes. It covers capital and asset planning and is employed throughout American Water. CIM provides a full range of governance practices, including a formal protocol for assessing system needs, prioritizing expenditures, managing the capital program, approving project spending, delivering projects and measuring outputs. CIM ensures that:
 - Capital expenditure plans are aligned with the strategic intent of the business
 - The impact of capital expenditure and income plans are fully reflected in operating expense plans
 - The impacts of these plans are understood and affordable, and
 - Effective controls are in place over budgets (through business plans) and individual capital projects (through appropriate authorization thresholds, management and reporting processes).

The CIM process was designed to optimize the effectiveness of asset investment. The process is managed at two levels for all American Water companies, including all KAWC Operating Units. Monthly meetings of the CIM are held to review capital spending compared to plan, review new project requests, and review updates or modifications to existing projects. The President of KAWC, VP Finance, and others participate as necessary (e.g. KAWC operations managers and Rates Manager) and provide the data used in the monthly review schedules.

VII – Other Comparative Measures Of Reasonableness Of Service Company Charges

KAWC's Service Company Cost Per Customer

During the 12 months ended July 31, 2008, KAWC was charged \$60 per customer in O&M expenses by the Service Company. As shown in the table below, this calculation is based on net testable O&M, which eliminates certain O&M items for which KAWC has not requested cost recovery.

| | |
|---|-------------------------------------|
| | 12 Months Ended July 31, 2008 |
| Net Testable Service Company O&M Expenses | \$ 7,064,978 |
| KAWC American Customers (12/31/07) | 117,119 |
| KAWC American Cost Per Customer | \$ 60 |

Comparison Group Cost Per Customer

Every centralized service company in a holding company system must file a Form 60 in accordance with the Public Utility Holding Company Act of 2005, Section 1270, Section 390 of the Federal Power Act and 18 C.F.R. paragraph 366.23. This report is designed to collect financial information from service companies that are subject to regulation by the FERC.

Twenty-three utility holding companies filed a Form 60 for 2007. All but two were included in the comparison group. The service company for PNM Resources, Inc. was excluded because its 2007 service company cost per regulated utility customer was clearly an anomaly as a negative number. This result is likely due to the unique manner by which PNM's service company expenses are reported on Form 60. Duke Energy was also excluded from the comparison group because one of its two service companies did not provide numbers for its Form 60. Thus, it was not possible to develop Duke's consolidated service company cost per customer for 2007.

Schedule 11 compares the services provided by American Water's Service Company to the services provided by comparison group service companies. In general, the types of services provided by American Water's Service Company are similar to those provided by comparison group service companies.

O&M expenses charged to utility affiliates for the comparison group service companies were obtained from Schedule XVII – Schedule of Expense Distribution by Department or Service Function (p. 305 to 305c) of each entity's FERC Form 60. This schedule shows charges by category of service (e.g., accounting, information technology) and type of cost (e.g., labor, benefits, outside services). The following were eliminated from the comparison group's total expenses because they are not in American Water Service Company's 2007 charges to KAWC:

- All electric- and gas-specific services
- Income taxes (account 409), provision for deferred income taxes (account 410), provision for deferred income taxes – credit (account 411) and investment tax credit (account 411.5).
- Donations (account 426.1)
- Interest on long-term debt (account 427), interest on debt to associate companies (account 430) and other interest expense (account 431)

Comparison group service company 2007 expenses were also adjusted to remove charges to non-regulated affiliates from the cost pool used to calculate the cost per regulated service customer. This determination was made using information from the FERC Form 60 schedule: Account 457 – Analysis of Billing – Associate Companies.

Schedule 12 shows KAWC's 12 months ended July 31, 2008 Service Company cost per customer of \$60 to be considerably lower than the average of \$121 per customer for the comparison group service companies. Only 3 of 21 comparison group service companies had a lower 2007 cost per customer than KAWC. These results further support the conclusion that the Service Company's 2007 charges to KAWC were reasonable.

**Kentucky American Water Company
Analysis of Service Company Services**

| Service Category | American Water | AEP | Allegheny | Alliant | Ameren | Black Hills | Dominion | Energy East | Entergy | E-On | Exelon | First Energy | Great Plains | KeySpan | NiSource | Northeast | PHI | Progress | SCANA | Southern Co | Unitil | Xcel |
|-------------------------|----------------|-----------|-----------|-----------|-----------|-------------|-----------|-------------|----------|-----------|-----------|--------------|--------------|-----------|-----------|-----------|-----------|-----------|-----------|-------------|----------|-----------|
| Accounting | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | | | X | | | X | X |
| Audit Services | X | X | X | X | | X | X | X | | X | | X | X | X | X | | | X | | X | | X |
| Corporate Planning | X | X | X | | X | X | X | | | X | | X | | X | X | X | | X | X | | | X |
| Customer Service | X | X | X | X | | X | X | | | X | X | X | | X | X | X | X | | X | | X | X |
| Engineering | X | X | | X | | | | | | | | | | X | X | | | | | X | X | X |
| Environmental | | X | | X | X | X | X | | | X | | X | | X | X | | X | | X | X | | |
| Executive | X | X | X | X | X | X | X | X | | X | X | X | X | X | X | X | X | X | X | X | X | X |
| External Affairs | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X |
| Facilities Management | | | | X | | | | | | | X | X | | X | | | | | X | | | X |
| Finance | X | X | X | X | X | X | | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X |
| Human Resources | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X |
| Information Technology | X | X | X | X | X | X | X | X | X | X | X | X | | X | X | | X | X | X | X | X | X |
| Investor Relations | X | X | | X | | X | X | | | | | X | | | X | | | X | X | | | X |
| Legal | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X | X |
| Operations | X | | | | | | | | | | | | | X | X | | | | | | | |
| Regulatory Services | X | X | X | X | X | X | X | X | | X | X | X | | X | X | | | X | X | | X | X |
| Risk Management | X | X | X | | | X | X | X | | X | | X | | X | X | | | | | | | X |
| Security | | | X | | | | | | | X | X | | | | | | | | | | | |
| Service Co Overhead | | X | | | X | X | X | | | X | X | | X | X | X | | X | | | | | |
| Shared Services | X | X | | | X | X | X | | | X | X | | | X | X | X | | X | | | | |
| Supply Chain | X | X | X | X | X | | X | X | | X | X | X | | X | X | | X | | X | X | | X |
| Transportation Services | | | | X | | | | | | X | | | | | | | | | | | | X |
| Treasury | X | | X | | X | | X | | | X | | X | | X | X | | | X | | | | |
| Total Services | 18 | 18 | 15 | 16 | 14 | 16 | 17 | 11 | 6 | 19 | 14 | 17 | 8 | 20 | 20 | 8 | 10 | 13 | 13 | 10 | 7 | 17 |

**Kentucky American Water Company
Comparison of Service Company Annual Costs Per Customer**

