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Mark David Goss
Chairman

John W. Clay
Commissioner

June 12, 2007

PARTIES OF RECORD

Re: Case No. 2007-00185

Attached is a copy of the memorandum which is being filed in the record of the above-referenced case. If you have any comments you would like to make regarding the contents of the informal conference memorandum, please do so within five days of receipt of this letter. If you have any questions, please contact Gerald E. Wuetcher at 502/564-3940, Extension 259.

Sincerely,

A handwritten signature in black ink, appearing to read "Beth O'Donnell", written over a large, stylized oval flourish.

Beth O'Donnell
Executive Director

Attachment

INTRA-AGENCY MEMORANDUM

KENTUCKY PUBLIC SERVICE COMMISSION

TO: Case File

FROM: Gerald Wuetcher
Assistant General Counsel

DATE: June 12, 2007

RE: Case No. 2007-00185
Informal Conference of May 30, 2007

On May 30, 2007, the Commission held a conference in this case in the Commission's offices in Frankfort, Kentucky. Present were:

Lindsey Ingram III	-	Kentucky-American Water Company
Michael Miller	-	Kentucky-American Water Company
Nick Rowe	-	Kentucky-American Water Company
A.W. Turner	-	Kentucky-American Water Company
Mark Frost	-	Commission Staff
Tom Griswold	-	Commission Staff
David Samford	-	Commission Staff
Gerald Wuetcher	-	Commission Staff

Kentucky-American Water Company ("Kentucky-American") requested the conference.

Beginning the conference, Mr. Wuetcher stated that Commission Staff would prepare minutes of the conference for the case record, that a copy of these minutes would be provided to all parties, and that all parties would be given an opportunity to submit written comments upon those minutes.

Mr. Rowe apologized to Commission Staff for the incident. He stated that Kentucky-American recognizes and respects the Commission's role in utility regulation and that its recent actions should not be interpreted as a lack of respect on the utility's part. He further stated that Kentucky-American acknowledges an error occurred, that this error has forced the Commission to divert scarce resources from important regulatory tasks, and that the utility deeply regrets the error.

Mr. Ingram reviewed the events leading to Kentucky-American's issuance of unauthorized evidences of indebtedness. He noted that Kentucky-American has made three issuances of long-term indebtedness since the Commission's approval of Kentucky-American's entry into a financial services agreement with American Water Capital Corporation ("AWCC") in 2000. When approving Kentucky-American's entry,

the Commission authorized Kentucky-American to issue long-term debt with a cumulative amount not exceeding \$41.5 million. The debt issuance in question occurred in March 2004 – after the transfer of control of American Water Works Company and Kentucky-American to RWE Aktiengesellschaft (“RWE”) and after prior issuances of debt totaling \$39.5 million. When reviewing the regulatory requirements necessary for the third issuance of evidences of indebtedness, Kentucky-American officials mistakenly assumed that the \$41.5 million ceiling referred to debt issued after the RWE acquisition. Kentucky-American did not realize that the third issuance exceeded the Commission-imposed limits until September 2006, when it began preparations to seek continued participation in the financial services agreement with AWCC. Upon realizing that the third debt issuance was not consistent with the Commission’s authorization, Kentucky-American’s outside counsel immediately notified the Commission.

Mr. Ingram, while acknowledging that the assessment of a penalty might be appropriate, stated several reasons why the assessment of a large penalty was not appropriate under the circumstances. First, he noted Kentucky-American’s actions to advise the Commission of the error immediately upon discovery. Second, he noted that Kentucky-American had never concealed the issuances of indebtedness and that these issuances were the subject of discovery in Case No. 2006-00197. Third, Kentucky-American and its ratepayers benefited from the transaction by permitting Kentucky-American to access funds at a low interest rate. Fourth, the debt incurred was for a lawful purpose. Fifth, there are more serious offenses that are deserving of the highest monetary sanction.

In response to Commission Staff inquiries, Kentucky-American officials noted that the failures that led to the violation occurred in Kentucky-American’s Lexington and Charleston, West Virginia offices. Officials in both locations reviewed the transaction. The Charleston office identified the need for the debt issuance. Other offices within the American Water Works Company were not involved.

Mr. Miller acknowledged a role in the decision to issue the \$14.5 million debt issuance and admitted responsibility for the utility’s action. He stated that the utility was focused on the identification of synergies resulting from the RWE acquisition of AWWC. This focus caused Kentucky-American officials to view the Commission’s limitation on debt issuance as a limitation on post-transaction debt. Mr. Miller stated that the review process suffered from several defects that prevented Kentucky-American officials from realizing their error.

Mr. Turner then described a new process that Kentucky-American had initiated to avoid future incidents. A description of the process is attached. Mr. Turner and Mr. Rowe invited Commission Staff to comment on the new process and stated that the utility would seriously consider these comments. Mr. Rowe stated that Kentucky-

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American's Board of Directors had not formally acted on the new procedures. He noted that the procedures would be implemented under his authority as Chairman of the Board and President of Kentucky-American. The Board would be informed of the procedures.

Commission Staff and Kentucky-American officials discussed possible resolution of the outstanding issues presented in this case. At the conclusion of the conference, they had reached an agreement in principle and agreed to work towards the preparation of a written agreement that could be presented to the Commission for its review and approval.

The conference then adjourned.



KENTUCKY AMERICAN WATER POLICY AND PROCEDURE ISSUANCE OF LONG-TERM DEBT

PROCESS 1 –

At least sixty days prior to the issuance of Long-Term Debt, the Treasurer of the Company will review all General Mortgage Indentures, Public Service Commission Orders and other internal documents as required to ascertain the issuance of any Long-Term Debt is in compliance with General Mortgage Indenture covenants, PSC Orders, and Board of Director's Resolutions. The Treasurer will provide a written document to the Corporate Counsel of the Company that outlines the findings of the analysis and provides the recommendation of the date and amount of the Long-Term Debt Issue.

PROCESS 2 –

The Corporate Counsel will review the data supplied by the Treasurer and perform such independent analysis as necessary to ascertain the Long-Term Debt issuance is in compliance with General Mortgage Indenture Covenants, Public Service Commission Orders, Board of Director's resolutions and Kentucky State Law. At Least forty-five days prior to the issuance of Long-Term Debt, the Corporate Counsel and Treasurer of the Company will issue a written joint recommendation to the President of the Company concerning the upcoming Long-Term Debt Issue.

PROCESS 3 –

The President of the Company will review the information provided by the Corporate Counsel and Treasurer and provide written documentation authorizing the Corporate Counsel and Treasurer to proceed with the Long-Term Debt Issue.

PROCESS 4 –

At least 15 days prior to the issuance of Long-Term Debt, the Corporate Counsel of the Company will provide written notification to the Public Service Commission of the Company's plan to issue Long-Term Debt and certify that the issuance of such Long-Term Debt is in compliance with Public Service Commission Orders and Directives.

PROCESS 5 –

Once authorization from the President and notification from the Corporate Counsel of the filing at the Public Service Commission is made, the Treasurer will execute the Notes between Kentucky American Water and American Water Capital Corporation to consummate the transaction. The Treasurer will take the steps as necessary to ascertain that the interest rates and issuance costs for the Long-Term Debt Issue from AWCC is at or below the cost the Company could obtain for the Long-Term Debt if it were to issue the Long-Term Debt to an independent third party.