

case that the \$502,353 deferred cost balance should *not* be considered "political advertising" as defined in 807 KAR 5:016, Section 4(2)(a). For that reason, I recommend that this deferred cost balance be excluded from rates in this case.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE COMPANY'S PROPOSED FORECAST PERIOD RATE BASE AND AFTER-TAX INCOME?

A. As shown on Schedule RJH-3, line 18, my recommendation reduces the Company's rate base by \$452,115. Schedule RJH-21, lines 1-5 shows that my recommendation also increases the Company's forecasted period after-tax income by \$59,921.

#### C. OPERATING INCOME

Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED AND YOUR RECOMMENDED PRO FORMA OPERATING INCOME FOR THE FORECASTED PERIOD IN THIS CASE.

A. The Company's proposed and my recommended pro forma operating income positions are summarized on Schedule RJH-4. The starting point on that schedule is KAWC's proposed net operating income for the forecasted period of \$10,661,141. I then adjusted this Company-proposed income number with a large number of operating income adjustments in order to arrive at the

recommended pro forma operating income level of \$11,575,330 for the forecasted period. Each of the recommended operating income adjustments listed on Schedule RJH-4 represent revenue, expense or tax adjustments that have been stated on an after-tax net income basis, as explained and quantified in more detail in the supporting operating income schedules referenced on Schedule RJH-4. They will be discussed in detail in the subsequent sections of this testimony.

- Residential Net Revenue Adjustment

Q. IN PROJECTING ITS RESIDENTIAL SALES AND REVENUES FOR THE FORECASTED PERIOD, DID THE COMPANY CONSIDER THE DIFFERENCE BETWEEN THE ACTUAL AND BUDGETED LEVEL OF RESIDENTIAL BILLS AS OF JANUARY 2000?

A. Yes. As shown on the top part of Schedule RJH-11, the Company's actual residential customers were 129 less than its budgeted residential customers in January 2000. As a result of this, the intent of the Company's projection methodology was to subtract 129 residential bills for each month in its forecasted period ended November 2001. This would have resulted in total forecasted period residential bills of 1,085,595. However, on W/P 2-1, page 9 the Company by mistake actually added 1,548 (129 x 12 months) bills and calculated its forecasted residential sales and revenues based on 1,088,691 residential bills. In its response to AG 1-205, the Company shows that the correction for this error would decrease its proposed forecasted period residential revenues by \$57,053.

Q. HAS THE DIFFERENCE BETWEEN ACTUAL AND BUDGETED RESIDENTIAL BILLS

CHANGED BETWEEN JANUARY 2000 AND TO DATE?

A. Yes, this is shown at the top of Schedule RJH-11. Between January 2000 and June 2000, the difference between the actual and budgeted residential bills changed from an actual residential bill deficit of 129 to an actual residential bill excess of 239.

Q. WHAT IS YOUR RECOMMENDATION BASED ON THIS INFORMATION?

A. Consistent with the Company's forecasting approach, I recommend that 239 residential bills be added to each month in the forecasted period. As shown on Schedule RJH-11, lines 1-3, this results in a total pro forma forecasted period number of residential bills of 1,090,011. Comparing this to the 1,088,691<sup>12</sup> number of forecasted period residential bills reflected in the Company's filing indicates that the Company's proposed residential revenues must be increased to reflect 1,320 additional customer bills.

Q. HOW DOES YOUR RECOMMENDATION IMPACT THE COMPANY'S PROPOSED FORECASTED PERIOD NET AFTER-TAX INCOME?

A. As shown on Schedule RJH-11, my recommendation increases the Company's proposed net after-tax income by \$13,517. It should be noted that in deriving this income adjustment, I have offset the calculated gross revenue adjustment with the appropriate variable O&M expenses, revenue taxes,

---

<sup>12</sup> While the 1,088,691 represents the wrong (overstated) number under the assumption that the actual monthly residential customers are 129 lower than the budgeted monthly residential customers, it is still the correct number to use in this comparative analysis in order to calculate the appropriate adjustment to the Company's as-filed residential revenues.

PSC fees and income taxes.

- Industrial Net Revenue Adjustment

Q. WHAT IS THE BASIS FOR THE COMPANY'S FORECASTED PERIOD INDUSTRIAL SALES AND REVENUES?

A. As stated on page 4 of Mr. Ware's testimony, "[actual] Calendar year 1999 [industrial sales] was used because it was both the most current billing information available to us and because we believed that there would be no significant changes in the consumption for these customers during the forecast period." Thus, the Company's proposed forecasted period industrial sales was based on actual industrial sales of 1,421,899 CCF and associated revenues of \$1,726,523 booked during the year 1999.

Q. WHAT IS THE FORECAST PERIOD INDUSTRIAL SALES AND REVENUE LEVEL AS PROJECTED IN THE COMPANY'S OWN SALES AND OPERATING BUDGET FOR THE YEAR 2001?

A. As shown on Schedules I-2, page 1 and I-4, page 1 of the Company's filing, the Company's own sales and operating budget has projected industrial sales of 1,461,315 and revenues of \$1,772,811 for both the years 2000 and 2001.<sup>13</sup>

---

<sup>13</sup> Since the forecasted period runs from December 2000 through November 2001, the same numbers would apply to this period.

Q. WHO PREPARED AND APPROVED THE COMPANY'S SALES AND OPERATING BUDGETS FOR THE YEARS 2000 AND 2001?

A. As confirmed in the response to AG 2-37B, "the forecast was prepared based upon KAWC's 2000 Business Plan which was prepared and/or supervised by Mr. Coleman Bush and was ultimately approved by the Board of Directors."

Q. WHAT CONCLUSIONS HAVE YOU DRAWN FROM THE FOREGOING INFORMATION?

A. I do not agree with the Company's conclusion that the actual industrial sales for the year 1999 is a better indicator of the sales level to be experienced during the forecasted period than the industrial sales projection for the forecasted period based on the Company's own Board of Directors-approved sales and operating budget for 2000 and 2001. Moreover, for purposes of projecting other revenue sources in this case (e.g., Sales for Resale) the Company has assumed that actual 1999 sales level is abnormal and that actual 1998 sales should be used instead. Schedules I-2, page 1 and I-4, page 1 of the Company's filing show that if actual industrial sales and revenues for the year 1998 were used as the indicator for the forecasted period industrial sales, this would have resulted in sales of 1,525,944 CCF and associated revenues of \$1,848,126. These sales and revenue levels are substantially higher than the actual 1999 numbers used by the Company and are also higher than the forecasted period industrial sales and revenue numbers from the Company's own sales and operating budget.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THIS ISSUE BASED ON THE AFOREMENTIONED INFORMATION?

A. I recommend that the forecasted period industrial sales and revenues to be recognized for rate making purposed in this case be based on the projections for this period made in the Company's own sales and operating budget. As shown on Schedule RJH-12, lines 5 - 10, my recommendation increases the Company's proposed forecasted period net after-tax income by \$23,836.

- OPA Net Revenue Adjustment

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED OPA SALES AND REVENUES FOR THE FORECASTED PERIOD IN THIS CASE.

A. As described on pages 4 and 5 of Mr. Ware's testimony, the Company projected the sales and revenues for all but the largest three of its OPA customers based on the weather-normalized sales per customer level determined by Dr. Spitznagel. For two of the largest three customers (the University of Kentucky and Federal Medical Center), the Company used the actual per books sales levels and for the third large customer (Bluegrass Army Station) the Company used an adjusted actual 1999 sales level for the forecasted period.

Q. HOW DOES THE SO-DETERMINED OPA SALES LEVEL FOR THE FORECASTED PERIOD COMPARE TO THE FORECASTED PERIOD OPA SALES DETERMINED BASED ON THE COMPANY'S OWN BOARD OF DIRECTOR-APPROVED SALES AND

OPERATING BUDGET?

A. The Company's proposed forecasted period OPA sales level is 1,836,074 CCF. This is 138,167 CCF lower than the forecasted period OPA sales level of 1,974,241<sup>14</sup> determined based on the Company's own Board of Director-approved sales and operating budget.

Q. IN YOUR OPINION, WHAT IS THE MAJOR REASON FOR THIS DIFFERENCE OF 138,167 CCF?

A. I believe that the major reason for this difference resides in the Company's proposed forecasted period sales for the three largest OPA customers. As shown in line 1 of Schedule RJH-13, the Company has proposed forecasted period sales of 848,274 for the University of Kentucky ("UK"), 171,310 CCF for the Federal Medical Center ("FMC") and 25,351 CCF for the Bluegrass Army Station ("BAS"). As shown in footnote 2 of Schedule RJH-13, the sales numbers for UK and FMC represent the actual 1999 sales levels. The response to AG 1-145A indicates that the 25,331 CCF for BAS represents the actual sales for the second quarter of 1998 and the first, third and fourth quarters of 1999. The Company used this forecasting method because it believes that the second quarter of 1999 BAS sales is abnormal.

Q. DO YOU BELIEVE THAT THE COMPANY'S PROPOSED METHOD TO PROJECT THE FORECASTED PERIOD SALES FOR THE OPA CUSTOMERS UK, FMC AND BAS IS

---

<sup>14</sup> See filing Schedule I-4, page 1

REASONABLE?

- A. No, I do not. A careful review of the underlying data shows the unreasonableness of the Company's forecasting method.

First, the 1999 sales for FMC of 171,310 CCF appears to be abnormal when compared to the historic annual sales levels for the last 10 years. Footnote 2 of Schedule RJH-13 clearly shows that the annual FMC sales level during the last 10 years has never been lower than 209,123 CCF.

One of the reasons for this abnormal 1999 sales level is the very low FMC sales that was recorded by the Company in July of 1999, as shown on W/P 2-1, page 20. While the July sales level for all of the ten years prior to 1999 has been in the range of 18,000 to 28,000 CCF, in July 1999 the recorded sales level was only 5,424 CCF.

As confirmed in the response to AG 2-36, the 2nd quarter 1999 BAS sales of 13,271

CCF was 5,760 CCF higher than the 2nd quarter 1998 BAS sales of 7,511 CCF, and since the Company determined that the 2nd quarter 1999 BAS sales number was abnormally high, it used the lower 2nd quarter 1998 BAS sales of 7,511 CCF. However, the response to AG 2-36 also confirms that FMC sales for the 2nd quarter of 1999 -- due to the abnormality in July 1999 previously discussed -- was 19,044 CCF lower than the 2nd quarter 1998 FMC sales. However, the Company chose not to reflect the more "normal" 2nd quarter 1998 FMC sales results as it did for its BAS sales projection.

All of this leads me to believe that the Company has used an inconsistent "cherry picking" approach in order to minimize the OPA sales projection for the forecasted period.



Q. DO YOU RECOMMEND A MORE APPROPRIATE ALTERNATIVE PROJECTION METHOD FOR THE FORECASTED PERIOD SALES FOR THESE THREE LARGE OPA CUSTOMERS?

A. Yes. A review of the historical sales data in footnote 2 of Schedule RJH-13 indicates that the annual sales for UK and FMC have fluctuated upwards and downwards with no clearly discernable trend. For that reason, I believe that the most recent 10-year average UK and FMC sales levels are better indicators of the normalized forecasted period sales levels than the actual sales levels that the Company happened to experience during the single year 1999. Based on this forecasting approach, the recommended forecasted period sales level for UK is 879,358 CCF and for FMC is 236,191 CCF.

With regard to BAS, the historical data in footnote 2 show somewhat of a discernable trend. Specifically, the annual sales levels for the years 1990 - 1996 are quite a bit higher than the annual sales levels for the most recent three years 1997 - 1999. I have determined that it would therefore not be appropriate to use a 10-year average approach to approximate the normalized future sales level for this OPA customer. A more reasonable approach would be to determine this OPA customer's normalized sales for the forecasted period based on the average sales level for the most recent three-year period. As shown in footnote 2 of Schedule RJH-13, this normalized sales level is 32,081 CCF.

In summary, as shown in line 1 of Schedule RJH-13, my recommended normalized forecasted period sales levels for these three large OPA customers amounts to 1,147,630 which is 102,695 CCF higher than the Company's proposed sales level. Increasing the Company's proposed

forecasted period OPA sales with this additional sales of 102,695 would result in total OPA sales of 1,938,769 CCF.<sup>15</sup> This is very close to the forecasted period OPA sales level of 1,974,241 determined by the Company's own Board of Directors-approved sales and operating budget shown on filing Schedule I-4, page 1.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE COMPANY'S FORECASTED PERIOD NET AFTER-TAX INCOME IN THIS CASE?

A. As shown on lines 1 - 10 of Schedule RJH-13, my recommendation increases the Company's forecasted period net after-tax income by \$76,159.

- Sales For Resale Net Revenue Adjustment

Q. IN THE PRIOR CASE, THE COMPANY PROJECTED TOTAL SALES FOR RESALE VOLUME OF 377,879 CCF FOR THE FORECASTED PERIOD ENDED SEPTEMBER 30, 1998 EVEN THOUGH THE MOST RECENT DATA AVAILABLE AT THAT TIME INDICATED ACTUAL SALES VOLUMES FOR 1996 OF 396,621 CCF. HOW DID THIS PROJECTED SALES LEVEL OF 377,879 COMPARE TO THE ACTUAL SALES LEVELS FOR 1997 AND 1998?

A. The actual Sales for Resale volumes for 1997 and 1998 were 424,177 and 526,059, respectively.

---

<sup>15</sup> KAWC's proposed forecasted period total OPA sales of  $1,836,074 + 102,695 = 1,938,769$  CCF.

Thus, the actual sales volume for 1998 of 526,059 CCF was 148,180 CCF, or almost 40% higher than the 377,879 CCF sales level projected by the Company for the forecasted period ended 9/30/98 in the prior case.

One of the reasons for this very large differential is that the sales to Spears turned out to be much higher than was projected by the Company. The Company had projected Spears sales for the prior case forecasted period of 47,276 CCF while the AG had proposed to increase this sales projection to approximately 66,000 CCF. In actuality, the Spears sales for 1997 and 1998 turned out to be 71,563 and 82,839, respectively.

Another very significant reason for the large sales differential is the sales to GMWSS.<sup>16</sup>

The sales contract between KAWC and GMWSS was executed October 18, 1996 and actual sales to GMWSS started in October 1997, the start of the forecasted period in the prior case. However, the Company's Sales for Resale projections for the forecasted period in the prior case did not reflect (or even mention) any potential sales to GMWSS. As it turned out, the actual sales to GMWSS during 1998 was 59,849 CCF.

Q. WHAT HAVE BEEN THE ACTUAL SALES FOR RESALE SALES VOLUMES THE LAST FIVE YEARS AND THE MOST RECENT 12-MONTH PERIOD ENDED JUNE 30, 2000 AND WHAT IS THE COMPANY'S SALES PROJECTION FOR THE FORECASTED PERIOD?

A. This information is summarized at the top of Schedule RJH-14. As shown there, the actual total Sales

---

<sup>16</sup> GMWSS stands for Georgetown Municipal Water and Sewer Service

for Resale volumes and the Company's projected sales volumes for the forecasted period are as follows:

1995 - Actual	347,669 CCF
1996 - Actual	396,621 CCF
1997 - Actual	424,177 CCF
1998 - Actual	526,059 CCF
1999 - Actual	719,059 CCF
12-mos. Ended 6/30/00	757,193 CCF
Forecasted Period - KAWC Proj.	567,837 CCF

Q. WHAT CONCLUSIONS HAVE YOU DRAWN FROM THE DATA IN THE ABOVE TABLE?

A. The data in the above table shows that the Company's actual Sales for Resale volumes have more than doubled from 1995 through the 12-month period ended 6/30/00. It also shows that each and every year during the most recent 6-year period the Company's actual Sales for Resale volumes have experienced significant growth. However, despite this overwhelming evidence of continued and consistent growth in the Company's annual Sales for Resale volumes, the Company is again doing what it did in the prior case: it has projected Sales for Resale volumes for the forecasted period that are significantly lower than the most recent actual annual Sales for Resale volumes. Specifically, it has projected a Sales for Resale volume for the forecasted 2001 period of 567,837 which is 189,356 CCF, or 25% lower than the most recent actual annual Sales for Resale volume for the 12-month period ended 6/30/2000. The Company has used a number of rationales to justify its projection for the significant downturn in its Sales for Resale for the forecasted period. One reason used by the Company is that 1999 was a year that included a drought period and, therefore, is not representative

of what can be expected on an ongoing basis. Another reason used by the Company is that GMWSS and Versailles experienced "supply problems" in 1999. Based on these reasons, the Company used all kinds of different forecasting methods for its Sales for Resale customers. For example, as shown in the response to AG 1-139 F, the forecasted period sales level for JSE, Midway and North Middletown are based on the actual 1998 sales levels; the forecasted period sales level for Versailles is based on the actual 5-year average for the period 1994 - 1998; the forecasted period sales level for GMWSS is based on the monthly average sales experienced during the first 5 months of 1999; and the forecasted period sales level for Spears is based on a projection method that takes the 4 months ending February 2000 as the starting point and then uses some kind of ratio analysis to extrapolate this into annual results.

In summary, the end result of this "hodge-podge" projection method is a projected sales level for the 2001 forecasted period that is significantly lower than the most recent actual sales levels.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THIS ISSUE BASED ON THE FOREGOING INFORMATION?

A. Based on the information previously discussed, I recommend that the Company's proposed projection method and associated sales level for its forecasted period Sales for Resale be rejected in this proceeding. We know from experience in the prior case that the Company has a tendency to be pessimistic and under-project its Sales for Resale. It is no different in the instant proceeding. Based on the overwhelming Sales for Resale growth evidence shown in the above table, I believe that the actual sales experience for the most recent 12-month period available at this time is a much better

indicator of what can be expected on an ongoing basis then the annual sales level determined based on KAWC's hodge-podge projection method.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE COMPANY'S FORECASTED PERIOD AFTER-TAX INCOME?

A. As shown on lines 1 - 10 of Schedule RJH-14, my recommendation increases the Company's proposed forecasted period after-tax income by \$133,592.

- AFUDC Adjustment

Q. PLEASE EXPLAIN THE AFUDC INCOME ADJUSTMENT SHOWN ON SCHEDULE RJH-4, LINE 6.

A. This AFUDC income adjustment was discussed in detail in the prior "CWIP and AFUDC" section of this testimony.

- Labor Expense Adjustment

Q. HAVE YOU MADE A LABOR EXPENSE ADJUSTMENT TO REFLECT A LOWER LEVEL OF EMPLOYEES THAN WAS REFLECTED BY THE COMPANY FOR RATE MAKING PURPOSES IN THIS CASE?

A. Yes, the details for this adjustment are shown on Schedule RJH-15. The Company's proposed labor

expenses for the forecasted period are based on an assumed employee level of 153 full-time equivalent positions. However, as recent as June 30, 2000 the Company only had 147 full-time equivalent positions on its payroll. In PSC 3-22, the Company was asked to reconcile the difference between the projected 153 and current actual 147 full-time equivalent positions. The Company's response indicated that 2 full-time equivalent positions that are currently vacant will not be filled. These positions involve a senior financial analyst (1), part-time accountant (1/2), and part-time CSR clerk (1/2). The salaries charged to O&M expenses for these 2 full-time equivalent positions can be found in the response to PSC 3-22 and are reflected on Schedule RJH-15, lines 1-4. In order to reflect all related payroll tax and employee benefit expense savings, I have applied the appropriate labor overhead rate of 37.60% to the salary expense savings.

In summary, I recommend that the labor expenses in this case be based on 151 full-time equivalent positions. As detailed on Schedule RJH-15, this recommendation increases the Company's proposed forecasted period after-tax income by \$70,195.

- Incentive Compensation Adjustment

Q. WHAT ARE THE PERFORMANCE GOALS AND PERFORMANCE AWARD CRITERIA UNDERLYING THE COMPANY'S TWO INCENTIVE COMPENSATION PLANS?

A. As indicated in the response to PSC 1-59, the performance goals for the LTIP incentive plan are 100% based on earnings per share growth and total return to stockholders. Response to data request AG 1-77 in Case No. 97-034 further states that the purpose of the LTIP is as follows:

“The purpose of the Plan is to promote the success of the Company by linking incentive opportunities to stockholder gains and enabling the Company to attract and retain individuals of outstanding ability”.

With regard to the AIP incentive plan, response to data request AG 1-77 in Case No. 97-034 states that the objective of this plan is as follows:

“This annual incentive program is based upon achieving performance levels that will increase value for shareholders and assure safe, reliable water service that meets customer requirements and expectations”.

Response to PSC 1-59 of the current case further clarifies that the performance goals of the AIP are 50% for financial goals (earnings per share, return to stockholders, etc.) and 50% for customer service and operational goals.

Q. IN THE COMPANY'S PRIOR CASE NO. 97-034, DID YOU RECOMMEND THAT THE COMPANY'S INCENTIVE COMPENSATION EXPENSES CLAIMED IN THAT CASE BE SHARED 50/50 BETWEEN SHAREHOLDERS AND RATEPAYERS?

A. Yes. I made this recommendation primarily because 100 % of the LTIP and 50% of the AIP incentive compensation payments only get triggered when certain pre-determined financial performance goals such as earnings per share growth and return on stockholder equity are met or exceeded. Once these financial goals are reached or exceeded, the stockholder would be a primary beneficiary as this would tend to increase the value of his/her investment in the Company. Moreover, one could argue that attracting and/or retaining outstanding management people benefits ratepayers and shareholders alike. In summary, I recommended in Case No. 97-034 that the incentive compensation expenses in that case be shared equally between stockholders and ratepayers because



of my belief that these expenses would be of equal benefit to the Company's stockholders and ratepayers.

Q. HAVE YOU CHANGED YOUR POSITION ON THIS ISSUE IN THE CURRENT CASE?

A. No. Notwithstanding the fact that the PSC allowed 100% of the Company's incentive compensation expenses for rate making purposes in Case No. 97-034, due to the magnitude of the current incentive compensation expenses claimed by KAWC, I feel even stronger about this issue in the instant proceeding.

Q. COULD YOU ELABORATE ON THIS LATTER POINT?

A. Yes. As shown on the top of Schedule RJH-16, the incentive compensation expenses at issue in the prior Case No. 97-034 totaled \$79,626, consisting of \$1,770 for LTIP expenses, \$14,100 for AIP expenses and \$63,756 of LTIP and AIP expenses allocated by the corporate and regional affiliates of KAWC. By contrast, in the current case the Company's total incentive compensation expense claim has increased to \$223,000, consisting of \$32,147 for LTIP expenses, \$124,200 for AIP expenses and \$66,546 of LTIP and AIP expenses allocated by the corporate and regional affiliates of KAWC. This represents an incentive compensation expense increase of \$143,267, or 280%, from the expense level claimed in Case No. 97-034 less than 3 years ago.

Q. WHAT ARE THE AVERAGE ANNUAL SALARY INCREASES THAT HAVE RECENTLY BEEN GRANTED TO THE SAME TEN KAWC OFFICERS FOR WHOM THE COMPANY

HAS CLAIMED THE ABOVE-REFERENCED INCENTIVE COMPENSATION PAYMENTS IN THIS CASE?

A. The response to AG 2-45 shows that the average annual salary increases granted to these same 10 KAWC officers for the approximate 3-year period 1998 through the forecasted period is 5% per year. Considering that the inflation rate during this same period has ranged between 2% and 3%, these annual 5% increases are already quite generous.

Q. WHAT IS THE GROWTH IN THE INCENTIVE COMPENSATION EXPENSES FROM 1998 THROUGH THE FORECASTED PERIOD FOR THESE SAME TEN KAWC OFFICERS?

A. The response to AG 2-46 shows that the total incentive compensation expenses for these same 10 KAWC officers was approximately \$85,000 in 1998 and this expense has grown to \$156,347 for the forecasted period. This represents an average annual growth for the approximate 3-year period from 1998 through the forecasted period of approximately 23% per year. And this average annual compensation growth rate of 23% is on top of the average annual salary rate increases of 5% for the approximate 3-year period from 1998 through the forecasted period.

Q. DID THE COMPANY USE A COMPENSATION STUDY IN DEVELOPING ITS INCENTIVE COMPENSATION PLANS AND IN DETERMINING THE MAGNITUDE OF THE INCENTIVE COMPENSATION EXPENSE LEVEL CLAIMED FOR THE FORECASTED PERIOD IN THIS CASE?

A. No, it did not. This was confirmed by the Company in its response to PSC 3-23.

Q. BASED ON THE PREVIOUSLY DISCUSSED FACTS, WHAT IS YOUR RECOMMENDATION REGARDING THE RATE MAKING TREATMENT OF THE COMPANY'S PROPOSED INCENTIVE COMPENSATION EXPENSES IN THE CURRENT CASE?

A. I continue to take the position that the Company's claimed incentive compensation expenses should be shared on a 50/50 basis between ratepayers and stockholders for rate making purposes. I believe this recommendation is particularly appropriate given (1) the size of the incentive compensation expense claim in this case, (2) the growth in these expenses from the prior case, and (3) the fact that these large incentive compensation awards are being given to KAWC officers who have already averaged annual salary increases of 5% from 1998 through the forecasted period

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE COMPANY'S PROPOSED FORECASTED PERIOD AFTER-TAX INCOME?

A. As shown on Schedule RJH-16, the Company's proposed incentive compensation expenses of \$222,893 must first be reduced by \$22,645 to reflect an LTIP expense revision provided by the Company in response to PSC 3-26. The 50/50 sharing of the remaining expenses of \$200,248 results in the expense level of \$100,124 which the AG recommends for rate recognition in this case. Lines 6 - 8 of Schedule RJH-16 show that the difference between this recommended expense level of \$100,124 and the Company's filed expense number of \$222,893 has the impact of increasing the Company's proposed forecasted period after-tax income by \$73,216.

**KAWC - CASE NO. 2000-120  
INCENTIVE COMPENSATION**

CURRENT CASE AS COMPARED TO PRIOR CASE NO. 97-034:

	Prior Case (1)	Current Case (2)	Increase	
			Dollars	Percent
- AIP Incentive Plan Expenses	\$14,100	\$124,200		
- LTIP Incentive Plan Expenses	1,770	32,147		
- Corporate/Region Incentive Plan Exp.	63,756	66,546		
- Total Incentive Plan Expenses	<u>\$79,626</u>	<u>\$222,893</u>	<u>\$143,267</u>	<u>280%</u>

RECOMMENDED INCENTIVE COMPENSATION EXPENSE  
ADJUSTMENT:

1. Total KAWC-Proposed Pro Forma Incentive Plan Exp.	\$222,893	
2. Expense Correction	<u>(22,645)</u>	(3)
3. KAWC Proposed Position As Corrected	200,248	
4. Sharing of Incentive Compensation Expenses @50%	<u>(100,124)</u>	
5. AG-Recommended Incentive Compensation Expense to be Recognized for Rate Making Purposes	100,124	
6. Incentive Expense Adjustment (L5 - L1)	(122,769)	
7. After-Tax Income Factor	<u>59.6375%</u>	
8. Impact on Net Income	<u>\$73,216</u>	

(1) Schedule RJH-24 and page 55 of Mr. Henkes' testimony in Case No. 97-034

(2) W/P 3-1, p.44 and response to AG 1-181

(3) Response to PSC 3-26

- Insurance Other Than Group Expense Adjustment

Q. WHAT IS THE ISSUE WITH REGARD TO THE COMPANY'S PROPOSED INSURANCE OTHER THAN GROUP EXPENSES IN THIS CASE?

A. Contrary to its approach in prior rate case, in the instant case the Company has not offset its proposed insurance other than group expenses with insurance expense credits from retroactive adjustments. The Company has consistently experienced such retroactive adjustments and, for that reason, these insurance expense credits should be considered recurring events. For example, the retroactive adjustments booked by the Company during the last 8 years<sup>17</sup>:

1992	\$ (45,375)	Expense credit
1993	\$(181,941)	Expense credit
1994	\$(202,659)	Expense credit
1995	\$ (90,465)	Expense credit
1996	\$ (96,793)	Expense credit
1997	\$(193,608)	Expense credit
1998	\$(145,722)	Expense credit
1999	\$ (95,419)	Expense credit

For the year 2000, the Company expects retroactive adjustments of \$0. For this reason, the Company has assumed that it will have no retroactive adjustments during the forecasted period ended November 2001 and beyond.

Q. DOES THE COMPANY KNOW AT THIS TIME THAT ITS RETROACTIVE ADJUSTMENTS

---

<sup>17</sup> For 1992 through 1995 see response to AG 1-91 Case No. 97-034; for 1996 - 1999 see response to AG 1-162 of current case.

FOR THE FORECASTED PERIOD AND BEYOND WILL BE \$0?

- A. No. In its response to AG 1-163, the Company confirmed that at this time it does not know what its retroactive adjustments will be for the year 2001.

Q. BASED ON THE FOREGOING INFORMATION, WHAT IS YOUR RECOMMENDATION REGARDING THIS ISSUE?

- A. As I mentioned before, the expense credits from retroactive adjustments have proven to be annual recurring events for KAWC, at least during the last 9 years from 1992 through 1999. The fact that the Company may not experience any retroactive adjustments for the year 2000 should not mean that this will be the experience on an ongoing basis for the Company. I believe that the average experience of the Company regarding its retroactive adjustments during the last 9 years<sup>18</sup> would be an appropriate indicator of what the "normalized" annual retroactive adjustments can expected to be on an ongoing basis. As shown on Schedule RJH-17, the 9-year average expense credit level amounts to approximately \$117,000. To be on the conservative side, I have reflected a normalized retroactive adjustment expense credit level of \$100,000 for the forecasted period. Schedule RJH-17, lines 1 -3 show that my recommendation increases the Company's proposed after-tax income for the forecasted period by \$59,638.

- Group Insurance Expense Adjustment

---

<sup>18</sup> The year 1992 is the earliest year for which the AG has retroactive adjustment data available .

Q. PLEASE EXPLAIN THE GROUP INSURANCE EXPENSE ADJUSTMENT SHOWN ON SCHEDULE RJH-4, LINE 10.

A. As confirmed in the response to AG 1-205 (3), because the Company's forecasted increase in group insurance rates did not occur due to an increase in the reserves in the trust funds, the Company's proposed forecasted period group insurance expenses must be reduced by \$91,103. After taking into account the associated income tax impact, this would result in an income increase of \$54,332 as shown in footnote 2 of Schedule RJH-4, line 10.

- Regulatory Expense Adjustment

Q. PLEASE DESCRIBE THE PSC'S EMPLOYED RATE MAKING POLICIES WITH REGARD TO RATE CASE EXPENSES RELATED TO PRIOR RATE CASES THAT ARE NOT YET FULLY AMORTIZED AND COLLECTED IN RATES BY THE TIME THE COMPANY FILES ITS NEXT RATE CASE?

A. In those circumstances, the PSC has consistently allowed the Company to make up for these unamortized and uncollected prior rate case expenses by claiming them in the rates for the new rate case.

Q. COULD YOU GIVE RECENT EXAMPLES OF THIS PSC RATE MAKING POLICY?

A. Yes. In the Company's prior Case No. 97-034, the Company still had an unamortized balance of

\$178,739 for Case No. 95-554 rate case expenses that had not yet been collected in the Case No. 95-554 rate effective period by the time that the rates from Case No. 97-034 became effective. The PSC allowed KAWC to collect this unamortized cost balance of \$178,739 through the inclusion of a monthly amortization of \$14,895<sup>19</sup> in the Case No. 97-034 rates.

---

<sup>19</sup>  $\$178,739 / 12 = \$14,895$  monthly amortization.



Similarly, in the Company's prior Case No. 97-034, the Company still had an unamortized balance of \$42,984 for Case No. 95-554 Billing & Tariff Group and Cost of Service expenses that had not yet been collected in the Case No. 95-554 rate effective period by the time that the rates from Case No. 97-034 became effective. The PSC allowed KAWC to collect this unamortized cost balance of \$42,984 through the inclusion of a monthly amortization of \$3,582<sup>20</sup> in the Case No. 97-034 rates.

As another example, in the current Case No. 2000-120, the Company has included unamortized and uncollected depreciation study costs of \$5,697 that were from Case No. 95-554 but were never fully amortized in the Case No. 95-554 and Case No. 97-034 rates.

Q. ARE THERE ALSO CIRCUMSTANCES WHERE THE OPPOSITE IS TAKING PLACE? IN OTHER WORDS, WHERE THE RATE CASE EXPENSES RELATED TO PRIOR RATE CASES HAVE ALREADY BEEN FULLY AMORTIZED AND COLLECTED IN RATES BUT ARE CONTINUED TO BE COLLECTED IN THE COMPANY'S RATES?

A. Yes. As discussed above, the PSC allowed a monthly amortization of \$3,582 in the Case No. 97-034 rates in order to complete the amortization and rate collection for the unamortized Case No. 95-554 Billing & Tariff Group and Cost of Service balance of \$42,982. As confirmed in the response to AG-159, this balance was fully amortized and collected in rates as of 9/1/99. However, since the Case No. 97-034 rates will not change until 12/1/00, the rate effective date of the instant proceeding,

---

<sup>20</sup> \$42,984 / 12 = \$3,582 monthly amortization.

the Company will continue to collect the monthly amortization amount of \$3,582 for the 15-month period 9/1/99 through 11/30/00. In essence, this means that the Company's Case No. 97-034 rates have over-collected these Billing & Tariff Group and Cost of Service costs by a total amount of \$3,582 x 15 months, or \$53,730.

Similarly, as discussed above, the PSC allowed a monthly amortization of \$14,895 in the Case No. 97-034 rates in order to complete the amortization and rate collection for the unamortized Case No. 95-554 rate case expense balance of \$178,739. As confirmed in the response to AG-160, this balance was fully amortized and collected in rates as of 9/1/98. However, since the Case No. 97-034 rates will not change until 12/1/00, the rate effective date of the instant proceeding, the Company will continue to collect the monthly amortization amount of \$14,895 for the 27-month period 9/1/98 through 11/30/00. In essence, this means that the Company's Case No. 97-034 rates have over-collected these unamortized Case No. 95-554 rate case costs by a total amount of \$14,895 x 27 months, or \$402,165.

Finally, the PSC allowed a monthly amortization of \$16,546 in the Case No. 97-034 rates in order to amortize over a 24-month period the estimated Case No. 97-034 rate case expenses of \$397,100.<sup>21</sup> As confirmed in the response to AG-161, this total estimated cost balance was fully amortized and collected in rates as of 10/1/99. However, since the Case No. 97-034 rates will not change until 12/1/00, the rate effective date of the instant proceeding, the Company will continue to collect the monthly amortization amount of \$16,546 for the 14-month period 10/1/99 through

---

<sup>21</sup> It should be noted that the Company's actual Case No. 97-034 rate case expenses turned out to be \$326,414, or almost 20% lower than the Company's estimated expense level of \$397,100.

11/30/00. In essence, this means that the Company's Case No. 97-034 rates have over-collected the estimated Case No. 97-034 rate case costs by a total amount of \$16,546 x 14 months, or \$231,644.

Thus, as summarized on Schedule RJH-18, page 2 of 2, the Company's Case No. 97-034 rates will have over-collected prior rate case expenses by a total amount of \$687,539 by the time the rates from the instant proceeding will become effective on 12/1/00.

Q. DO YOU BELIEVE THAT THE PSC'S RATE MAKING POLICY REGARDING THE RECOVERY OF RATE CASE EXPENSES RELATED TO PRIOR RATE CASES SHOULD BE APPLIED SYMMETRICALLY?

A. Yes. It would be inappropriate and inequitable to the ratepayers to allow rate recognition for unamortized and under-collected rate case expenses from prior rate cases, but not give equal rate recognition to over-amortized and over-collected rate case expenses from prior rate cases.

For example, it is quite unfair and inappropriate for the Company in this case to claim continued rate collections of \$5,697 for previously under-collected depreciation study expenses from Case No. 95-554 while fully disregarding the fact that its Case No. 97-034 rates over-collected prior rate case expenses to the tune of almost \$700,000.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE PRIOR RATE CASE EXPENSE OVER-COLLECTIONS PREVIOUSLY DISCUSSED?

A. One possible approach would be to return these prior rate case cost over-amortizations of \$687,539

to the ratepayers through an appropriate amortization in the current case. This would be the exact opposite (symmetrical) rate treatment to what the PSC is currently allowing the Company to do in case of prior rate case expense under-amortizations. However, in order to be conservative, I am recommending a less severe rate making treatment. Specifically, I recommend that this total over-collection amount of \$687,539 be used to fund all of the Company's rate case related costs claimed in this case. As shown on Schedule RJH-18, page 1 of 2, the total regulatory costs claimed by KAWC in this case amount to \$415,117, consisting of \$310,420 for estimated rate case expenses, \$60,000 for the demand study, \$39,000 for the cost of service study, and \$5,697 for the unamortized depreciation expense study from Case No. 95-554. This total regulatory cost amount of \$415,117 should be funded with the amounts available from the total rate case expense over-collection fund of \$687,539.

Q. WHAT SHOULD HAPPEN WITH THE REMAINING PORTION OF THE OVER-COLLECTION FUND OF \$687,539 AFTER USING \$415,117 OF THIS FUND TO FINANCE ALL OF THE REGULATORY COSTS CLAIMED IN THIS CASE?

A. The remaining portion of \$272,422 of this over-collection fund could be retained by KAWC's stockholders, consistent with the AG's position that rate case expenses should be appropriately shared between ratepayers and stockholders.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION ON THE COMPANY'S FORECASTED PERIOD AFTER-TAX INCOME?

A. As shown on Schedule RJH-18, page 1, my recommendation increases the Company's proposed forecasted period after-tax income by \$107,768.

- Boonesboro Sewer Revenues, Expenses and Taxes

Q. PLEASE EXPLAIN THE ADJUSTMENT FOR BOONESBORO SEWER REVENUES, EXPENSES AND TAXES SHOWN ON SCHEDULE RJH-4, LINE 12.

A. This recommended income adjustment was discussed in detail in the prior "Boonesboro Sewer Operations" section of this testimony.

- Depreciation Expense Adjustment

Q. PLEASE EXPLAIN THE RECOMMENDED DEPRECIATION EXPENSE ADJUSTMENT SUMMARIZED ON SCHEDULE RJH-4, LINE 13.

A. As shown on Schedule RJH-5, \$35,578 of my recommended depreciation expense adjustments is a direct result of my recommendation to adjust the Company's proposed forecasted plant in service balance and associated forecasted period depreciation expenses for the plant slippage factors discussed previously in this testimony. In addition, I have removed the depreciation expenses of \$2,544 associated with the Boonesboro sewer operations for the reasons discussed in a prior section of this testimony. After taking into account the associated income tax impact, my recommended depreciation expense adjustments result in a net income increase of \$22,735.

- Boonesboro Acquisition Amortization Removal

Q. PLEASE EXPLAIN THE INCOME ADJUSTMENT FOR THE BOONESBORO ACQUISITION AMORTIZATION REMOVAL SHOWN ON SCHEDULE RJH-4, LINE 14.

A. In the prior "Boonesboro Acquisition Adjustment" section of this testimony, I described all of the reasons why this acquisition adjustment should be removed from rate consideration in this case. This income adjustment must be made to remove the amortization expenses of \$18,456 associated with the Boonesboro acquisition adjustment. Since these amortization expenses are not treated as tax-deductible expenses by KAWC, the removal of these expenses would increase net income by the same amount of \$18,456.

- Deferred Debit Amortization Adjustments

Q. PLEASE EXPLAIN THE DEFERRED DEBIT AMORTIZATION ADJUSTMENTS SHOWN ON SCHEDULE RJH-4, LINE 15.

A. This income adjustment has been discussed in detail in the prior "Deferred Debit" section of this testimony.

- KRS Residuals Project Cost Amortization Adjustment

Q. PLEASE EXPLAIN THE KRS RESIDUALS PROJECT COST AMORTIZATION

ADJUSTMENT SHOWN ON SCHEDULE RJH-4, LINE 16.

- A. This income adjustment has been discussed in detail in the prior "KRS Residuals Project Costs" section of this testimony.

- BWP Pipeline Cost Amortization Adjustment

- Q. PLEASE EXPLAIN THE BWP PIPELINE COST AMORTIZATION ADJUSTMENT SHOWN ON SCHEDULE RJH-4, LINE 17.

- A. This income adjustment has been discussed in detail in the prior "BWP Pipeline Costs" section of this testimony.

- Community Education Cost Amortization Adjustment

- Q. PLEASE EXPLAIN THE COMMUNITY EDUCATION COST AMORTIZATION ADJUSTMENT SHOWN ON SCHEDULE RJH-4, LINE 18.

- A. This income adjustment has been discussed in detail in the prior "Community Education Cost" section of this testimony.

- Income Taxes

- Q. PLEASE EXPLAIN THE ADJUSTMENTS YOU HAVE MADE TO THE COMPANY'S

PROPOSED FORECASTED PERIOD INCOME TAXES.

- A. As the starting point, I accepted all of the income tax components and amounts proposed by KAWC for the forecasted period. I then separately reflected the income tax implications of each of my recommended adjustments to the Company's proposed forecasted period revenues, expenses and taxes other than income taxes. However, there are still two income tax adjustments that need to be made, involving interest synchronization and a correction for a tax calculation error reflected in KAWC's forecasted period income taxes.

Interest Synchronization Expense Adjustment

- Q. PLEASE EXPLAIN THE RECOMMENDED INCOME TAX ADJUSTMENT TO ACCOUNT FOR INTEREST SYNCHRONIZATION.

- A. The tax deduction for interest expense that has been used by KAWC for purposes of calculating its proposed income taxes in this case is based on the multiplication of the weighted debt component included in KAWC's proposed overall rate of return times KAWC's proposed rate base. This concept is generally referred to as "interest synchronization." I agree that this is an appropriate method to determine the interest expense deduction for income tax calculation purposes in rate cases. However, because I have recommended a lower rate base and a lower weighted cost of debt than KAWC in this case, the recommended interest deduction amount using this interest synchronization method is less than that reflected by KAWC. This, in turn, results in higher recommended income taxes. As shown on Schedule RJH-22, the use of the interest synchronization method increases the



Company's proposed forecasted period income taxes by \$175,419. This means that the Company's proposed net operating income is decreased by the same amount.

Correction for Income Tax Error

Q. PLEASE EXPLAIN THE ADJUSTMENT YOU HAVE MADE FOR THE INCOME TAX CORRECTION, AS SHOWN ON SCHEDULE RJH-4, LINE 20.

A. In response to data request AG 1-205 (2), the Company confirmed that it made an error in the calculation of its forecasted period income taxes and that the correction for this error would reduce its proposed income taxes by \$23,976. Accordingly, I have increased the Company's forecasted period net operating income by \$23,976.

Q. MR. HENKES, DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

**SUPPORTING SCHEDULES**

**SCHEDULES RJH-1 THROUGH RJH-22**

KAWC - CASE NO. 2000-120  
SUMMARY OF REVENUE REQUIREMENT POSITIONS

	KAWC (1)	Adjustment	AG	
1. Average Rate Base	\$142,427,511	(\$5,276,880)	136,773,631 <del>\$137,150,631</del>	Sch. RJH-3
2. Rate of Return	9.58%		8.716%	Sch. RJH-2
3. Operating Income Requirement	13,644,556		11,921,120 11,953,979	
4. Forecast Year Operating Income	10,661,141	891,729 <del>-914,189</del>	11,552,870 11,575,330	Sch. RJH-4
5. Operating Income Deficiency	2,983,415		368,250 <del>-378,649</del>	
6. Revenue Conversion Factor	1.6874450		1.6874450	
7. Revenue Requirement	\$5,034,349	(4,412,947) <del>(\$4,395,399)</del>	621,402 \$638,950	

**KAWC - CASE NO. 2000-120**  
**SUMMARY OF RATE OF RETURN POSITIONS**

<u>KAWC POSITION (1)</u>	<u>Capital Structure Ratios</u>	<u>Cost Rates</u>	<u>Weighted Cost Rates</u>
Short Term Debt	0.788%	6.525%	0.05%
Long Term Debt	51.244%	7.770%	3.98%
Preferred Stock	4.904%	7.770%	0.38%
Common Equity	<u>43.063%</u>	12.000%	<u>5.17%</u>
Total Capital	<u><u>100.000%</u></u>		<u><u>9.58%</u></u>

<u>AG POSITION</u>	(2)	(3)		(4)
Short Term Debt	4.430%	6.525%		0.289%
Long Term Debt	47.075%	7.603%		3.579%
Preferred Stock	4.958%	7.770%		0.385%
Common Equity	<u>43.537%</u>	10.250%		<u>4.463%</u>
Total Capital	<u><u>100.000%</u></u>			<u><u>8.716%</u></u>

(1) Schedule J-1, Page 1

(2) Dr. Weaver's Schedule 29, adjusted for plant slippage factor:	<u>Weaver Schedule 29</u>	<u>Plt Slippage Factor Adj. (5)</u>	<u>AG's Adkjusted Capital Structure</u>	<u>Ratios</u>
- ST Debt	\$6,450,000	(\$258,006)	\$6,191,994	4.430%
- LT Debt	67,081,727	(1,279,786)	65,801,941	47.075%
- Pref Stock	6,930,821		6,930,821	4.958%
- Common Equity	<u>60,856,850</u>		<u>60,856,850</u>	<u>43.537%</u>
- Total	<u><u>\$141,319,398</u></u>	<u><u>(\$1,537,792)</u></u>	<u><u>\$139,781,606</u></u>	<u><u>100.000%</u></u>

(3) Dr. Weaver's Schedule 32

(4) Mid-point of Dr. Weaver's recommended ROE range of 9.75% - 10.75% on Dr. Weaver's Schedule 32

(5) Response to PSC 2-5, page 7: ST Debt: \$1,113,427 - \$855,421 = \$258,006; LT Debt: \$72,418,300 - \$71,138,514 = \$1,279,786

**KAWC - CASE NO. 2000-120**  
**SUMMARY OF RATE BASE POSITIONS**

	<u>KAWC</u> (1)	<u>Adjustment</u>	<u>AG</u>	
1. Utility Plant in Service	\$232,598,563	(\$1,305,385)	\$231,293,178	Sch. RJH-5
2. Acquisition Adjustment	175,340	(175,340)	0	(2)
3. Accumulated Depreciation	(45,671,737)	71,024	(45,600,713)	Sch. RJH-6
4. Accumulated Amortization	(7,674)		(7,674)	
5. CWIP	5,454,134	(491,105)	4,963,029	Sch. RJH-7, L3
6. Cash Working Capital	1,176,000	(91,000)	1,085,000	(3)
7. Other Working Capital	485,820	(40,141)	445,679	(4)
8. CIAC	(23,864,445)	(363,377) +3,323	(24,228,122) (23,851,122)	Sch. RJH-8
9. Customer Advances	(12,411,002)		(12,411,002)	
10. Deferred Income Taxes	(23,598,127)	2,190,942	(21,407,185)	Sch. RJH-9
11. Deferred ITC	(152,717)		(152,717)	
12. Deferred Maintenance	3,671,619		3,671,619	
13. Deferred Debits	900,227	(620,501)	279,726	Sch. RJH-10
14. Other Rate Base Elements	(1,157,187)		(1,157,187)	
15. KRS II Costs	456,521	(456,521)	0	(2)
16. KRS Residuals Project Costs	561,834	(561,834)	0	(2)
17. BWP Pipeline Costs	3,358,227	(3,358,227)	0	(2)
18. Community Education Costs	452,115	(452,115)	0	(2)
<b>TOTAL NET RATE BASE</b>	<u>\$142,427,511</u>	<u>(5,276,880)</u> (5,653,550)	<u>\$137,150,631</u> 136,773,631	

(1) Schedule B-1, Page 2

(2) Explained in testimony of Mr. Henkes

(3) Error correction. See response to AG 2-205 (1)

(4) Per response to AG 1-90: 24-month average M&S and Chemicals balances from June 1998 through May 2000

**KAWC - CASE NO. 2000-120**  
**SUMMARY OF OPERATING INCOME POSITIONS**

	Impact on Net Income	
1. Forecasted Period Utility Operating Income Proposed By KAWC:	\$10,661,141	(1)
<u>AG Recommended Adjustments:</u>		
2. Residential Net Revenue Adjustment	13,517	Sch. RJH-11
3. Industrial Net Revenue Adjustment	23,836	Sch. RJH-12
4. OPA Net Revenue Adjustment	76,159	Sch. RJH-13
5. Sales for Resale Net Revenue Adjustment	133,592	Sch. RJH-14
6. AFUDC Adjustment	93,777	Sch. RJH-7, L11
7. Labor Expense Adjustment	53,715 <del>70,495</del>	Sch. RJH-15
8. Incentive Compensation Adjustment	73,216	Sch. RJH-16
9. Insurance o/t Group	59,638	Sch. RJH-17
10. Group Insurance Expense Adjustment	54,332	(2)
11. Rate Case Expense Adjustment	107,768	Sch. RJH-18
12. Remove Boonesboro Sewer Revenues, Expenses and Taxes	30,418	Sch. RJH-19
13. Depreciation Expense Adjustment	22,735	Sch. RJH-5, L9
14. Boonesboro Acquisition Amortization Removal	18,456	(3)
15. Deferred Debit Amortization Adjustments	85,438	Sch. RJH-10
16. KRS Residuals Project Cost Amortization Adjustment	37,227	Sch. RJH-20
17. Bluegrass Water Project Cost Amortization Adjustment	105,408	Sch. RJH-21
18. Community Education Cost Amortization Adjustment	59,921	Sch. RJH-21
19. Interest Synchronization Adjustment	(181,399) <del>(175,419)</del>	Sch. RJH-22
20. Correction for Income Tax Error	23,976	(4)
	11,552,570	
21. Forecasted Period Utility Operating Income Recommended By AG:	\$11,575,330	

(1) Schedule C-2, Page 1

(2) Per response to AG 1-205, Item (3): expense reduction of \$91,103 x .596375 (after-tax factor) = \$54,332

(3) Schedule D-1, p.19. L14. Not tax-deductible, as shown on Schedule E 1.3, p.1, L21

(4) Response to AG 1-205, Item (2)

**KAWC - CASE NO. 2000-120  
PLANT IN SERVICE AND DEPRECIATION EXPENSE ADJUSTMENT**

RATE BASE ADJUSTMENT

1. Forecasted Period Average Plant in Service Proposed By KAWC:	\$232,598,563	(1)
---	---------------	-----

AG Recommended Adjustments:

2. Impact on Line 1 due to Plant Slippage Factor Adjustment	(1,254,550)	(2)
---	-------------	-----

3. Boonesboro Sewer Plant	(50,835)	(3)
---------------------------	----------	-----

4. AG Recommended Forecasted Period Average Plant in Service	\$231,293,178	
--	---------------	--

DEPRECIATION EXPENSE ADJUSTMENT

5. Depreciation Expense Adjustment Related to Plt. Slippage Factor	(\$35,578)	(4)
--	------------	-----

6. Boonesboro Sewer Plant Depreciation	(\$2,544)	(5)
--	-----------	-----

7. Total Depreciation Expense Adjustment	(\$38,122)	
--	------------	--

8. After-Tax Income Factor	59.6375%	
----------------------------	----------	--

9. Impact on Net Income	\$22,735	
-------------------------	----------	--

(1) Schedule B-1, Page 2

(2) Response to data request PSC 2-5, page 1: \$232,598,563 - \$231,344,013 = \$1,254,550

(3) Per response to AG 1-76

(4) Per response to PSC 2-5: \$5,409,393 - \$5,373,815 = \$35,578

(5) W/P 1-3, p. 11 and response to PSC 3-19

**KAWC - CASE NO. 2000-120  
ACCUMULATED DEPRECIATION**

1. Forecasted Period Average Acc. Depr. Proposed By KAWC:	(\$45,671,737)	(1)
<u>AG Recommended Adjustments:</u>		
2. Impact on Line 1 due to Plant Slippage Factor Adjustment	35,194	(2)
3. Boonesboro Sewer Accumulated Depreciation	<u>35,830</u>	(3)
4. AG Recommended Forecasted Period Average Acc. Depr.	<u>(\$45,600,713)</u>	

(1) Schedule B-1, Page 2

(2) Response to data request PSC 2-5, page 1:  $\$45,671,737 - \$45,636,543 = \$35,194$

(3) Per response to AG 1-76



**KAWC - CASE NO. 2000-120  
CWIP AND AFUDC**

1. KAWC's Proposed Average Forecasted Period CWIP Balance	\$5,454,134	Sch. B-1, p.2
2. Less: Impact of Plant Slippage Factor	<u>(491,105)</u>	(1)
3. AG's Recommended Average Forecasted Period CWIP Balance	<u>\$4,963,029</u>	to Rate Base
4. Less: Non-AFUDC Bearing CWIP, Adjusted for Plant Slippage Factor	<u>(834,777)</u>	(2)
5. Adjusted Average AFUDC Bearing CWIP	4,128,252	
6. AG's Recommended Overall ROR With Equity Tax Gross-Up	<u>11.997%</u>	(3)
7. Recommended Pro Forma Forecasted Period AFUDC	\$495,263	
8. KAWC's Proposed Forecasted Period AFUDC	<u>338,018</u>	Sch. M-3, p.2
9. Recommended AFUDC Adjustment	\$157,245	
10. After-Tax Income Factor	<u>59.6375%</u>	
11. Impact on Net Income	<u><u>\$93,777</u></u>	

(1) Response to PSC 2-5, page 1:  $\$5,454,134 - \$4,963,029 = \$491,105$ . Slippage factor is 9% ( $\$491,105/\$5,454,134$ )

(2) Unadjusted Non-AFUDC Bearing CWIP	\$917,337	Sch. RJH-7, p.2
Plant Slippage Factor adj. @ 9% (see footnote 1 above)	<u>(82,560)</u>	
Adjusted Non-AFUDC Bearing CWIP	<u><u>\$834,777</u></u>	

(3)		
- Weighted Cost of ST Debt	0.289%	Sch. RJH-2
- Weighted Cost of LT Debt	3.579%	Sch. RJH-2
- Weighted Cost of Preferred Stock	0.385%	Sch. RJH-2
- Weighted Cost of Common Equity	<u>4.463%</u>	Sch. RJH-2
- Total Weighted Cost of Equity	4.848%	
- Equity Tax Gross-Up Factor	<u>1.6767973</u>	(4)
- Weighted Equity Cost grossed up for taxes	<u>8.129%</u>	
- Overall ROR with equity tax gross-up	<u><u>11.997%</u></u>	

(4) Formula:  $1 / (1 - 40.3625\%) = 1.6767973$

**KAWC - CASE NO. 2000-120**  
**ANALYSIS OF KAWC'S PROPOSED AFUDC RATE AND CWIP COMPONENTS**

1. KAWC's Proposed Pro Forma AFUDC	\$338,018	Sch. M-3, p.2
2. KAWC's Proposed AFUDC Rate With Equity Tax Gross-Up	<u>13.336%</u>	(1)
3. KAWC's Proposed AFUDC Bearing CWIP (L1 / L2)	\$2,534,585	
4. KAWC's Proposed Total CWIP Balance	<u>\$5,454,134</u>	Sch. B-1, p.2
5. KAWC's Proposed Non-AFUDC Bearing CWIP (L4 - L3)	<u>\$2,919,549</u>	

NON-AFUDC Bearing CWIP Components:

- Bluegrass Water Project - Design	\$2,000,162
- Other Non-AFUDC Bearing CWIP	<u>919,387</u>
- Total Non-AFUDC Bearing CWIP	<u>\$2,919,549</u>

(1) KAWC's Proposed 9.58% ROR With Equity Tax Gross-Up:

- Weighted Cost of ST Debt	0.050%	Sch. RJH-2
- Weighted Cost of LT Debt	3.980%	Sch. RJH-2
- Weighted Cost of Preferred Stock	0.380%	Sch. RJH-2
- Weighted Cost of Common Equity	<u>5.170%</u>	Sch. RJH-2
- Total Weighted Cost of Equity	5.550%	
- Equity Tax Gross-Up Factor	<u>1.6767973</u>	1-(1- 0.403625)
- Weighted Equity Cost grossed up for taxes	<u>9.306%</u>	
- Overall ROR with equity tax gross-up	<u>13.336%</u>	

**KAWC - CASE NO. 2000-120**  
**CONTRIBUTIONS IN AID OF CONSTRUCTION**

1. Forecasted Period Average CIAC Proposed By KAWC: (\$23,864,445) (1)

AG Recommended Adjustments:

2. Impact on Line 1 due to Plant Slippage Factor Adjustment 13,323

3. AG Recommended Forecasted Period Average CIAC (\$23,851,122) (2)

CIAC Increase per Aug 1-2005,  
updated 8/1/00

(377,000)

(24,228,122)

(1) Schedule B-1, Page 2

(2) Response to data request PSC 2-5, Page 1

**KAWC - CASE NO. 2000-120**  
**ACCUMULATED DEFERRED INCOME TAXES**

1. Forecasted Period Average ADIT Proposed By KAWC:	(\$23,598,127)	(1)
<u>AG Recommended Adjustments:</u>		
2. Impact on Line 1 due to Plant Slippage Factor Adjustment	(8,491)	(2)
3. Remove ADIT Related to KRS II Costs in Rate Base	184,265	(3)
4. Remove ADIT Related to KRS Residuals Costs in Rate Base	226,772	(3)
5. Remove ADIT Related to BMP Pipeline Costs in Rate Base	1,355,464	(3)
6. Remove ADIT Related to Community Education Costs in Rate Base	182,482	(3)
7. Remove ADIT Related to AG's Deferred Debit Rate Base Adjustment	<u>250,450</u>	(4)
8. AG Recommended Forecasted Period Average ADIT Balance	<u><u>(\$21,407,185)</u></u>	

(1) Schedule B-1, Page 2 and Schedule B-6, Page 2 for details

(2) Response to data request PSC 2-5, page 1: \$23,598,127 - \$23,606,618 = \$8,491

(3) Schedule B-6, Page 2

(4) Schedule RJH-3, line 13 "Adjustment" amount x 40.3625%

**KAWC - CASE NO. 2000-120**  
**DEFERRED DEBITS**

	<u>KAWC</u>	<u>Adjustment</u>	<u>AG</u>	
<b><u>Rate Base Deferred Debit Balances:</u></b>	(1)			
1. AMR Study	\$7,050		\$7,050	Previously PSC-Approved
2. Disinfection Byproduct Study I	3,430		3,430	Previously PSC-Approved
3. Lake Ellerslie Dam Study	1,003		1,003	Previously PSC-Approved
4. Meter Deviation Application	14,106		14,106	Previously PSC-Approved
5. Cost of Service Study (2000-120)	35,100		35,100	Similar costs previously approved
6. Cost of Demand Study (2000-120)	54,000		54,000	Similar costs previously approved
7. Waste Disposal I	36,000		36,000	Similar costs previously approved
8. Waste Disposal II	30,769		30,769	Similar costs previously approved
9. Disinfection Byproduct Study II	80,370		80,370	Similar costs previously approved
10. Deferred Acquisition Expense	32,088	(14,190)	17,898	Exclude Georgetown Municipal
11. Cost Containment Program Costs	20,092	(20,092)	0	Totally disallow
12. Y2K Compliance Costs	106,802	(106,802)	0	Disallow rate base treatment only
13. GIS Study	52,892	(52,892)	0	Disallow rate base treatment only
14. Rockwell Sewer Study	3,490	(3,490)	0	Totally disallow
15. Reorganization Costs	164,469	(164,469)	0	Totally disallow
16. KRS Automation Study	25,442	(25,442)	0	Disallow rate base treatment only
17. Deferred Legal/Settlement Costs	173,750	(173,750)	0	Totally disallow
18. Deferred Relocation Expenses	43,394	(43,394)	0	Totally disallow
19. Easement Encroachment	15,980	(15,980)	0	Totally disallow
20. Total Deferred Debits	<u>\$900,227</u>	<u>(\$620,501)</u>	<u>\$279,726</u>	

<b><u>Associated Amortization Expenses:</u></b>	(2)			
1. AMR Study	\$16,294		\$16,294	Previously PSC-Approved
2. Disinfection Byproduct Study I	7,927		7,927	Previously PSC-Approved
3. Lake Ellerslie Dam Study	2,317		2,317	Previously PSC-Approved
4. Meter Deviation Application	5,643		5,643	Previously PSC-Approved
5. Cost of Service Study (2000-120)	7,800		7,800	Similar costs previously approved
6. Cost of Demand Study (2000-120)	12,000		12,000	Similar costs previously approved
7. Waste Disposal I	66,000		66,000	Similar costs previously approved
8. Waste Disposal II	0		0	Similar costs previously approved
9. Disinfection Byproduct Study II	17,860		17,860	Similar costs previously approved
10. Deferred Acquisition Expense	12,835	(5,676)	7,159	Exclude Georgetown Municipal
11. Cost Containment Program Costs	8,037	(8,037)	0	Totally disallow
12. Y2K Compliance Costs	28,734		28,734	Allow amortization, no rate base
13. GIS Study	21,157		21,157	Allow amortization, no rate base
14. Rockwell Sewer Study	1,396	(1,396)	0	Totally disallow
15. Reorganization Costs	65,787	(65,787)	0	Totally disallow
16. KRS Automation Study	10,177		10,177	Allow amortization, no rate base
17. Deferred Legal/Settlement Costs	38,616	(38,616)	0	Totally disallow
18. Deferred Relocation Expenses	17,358	(17,358)	0	Totally disallow
19. Easement Encroachment	6,392	(6,392)	0	Totally disallow
20. Total Amortization Expenses	<u>\$346,330</u>	<u>(\$143,262)</u>	<u>\$203,068</u>	
21. After-Tax Income Factor		<u>59.6375%</u>		
22. Impact on Net Income		<u>\$85,438</u>		

(1) Exhibit EJG-1

(2) W/P 1-12, pp.3-4

**KAWC - CASE NO. 2000-120**  
**RESIDENTIAL REVENUE ADJUSTMENT**

Comparison of Actual versus Budgeted Number of Residential Customers

Per Response to AG 2-40 A:

	<u>Actual</u>	<u>Budgeted</u>	<u>Difference</u>	
Jan 2000	87,211	87,340	(129)	Used by KAWC
Feb 2000	87,229	87,362	(133)	
Mar 2000	87,513	87,565	(52)	
Apr 2000	87,736	87,764	(28)	
May 2000	88,127	87,888	239	
June 2000	88,335	88,096	239	Used by AG

Residential Water Sales Adjustment:

1. Unadjusted Forecasted Period Budget Bills	1,087,143	W/P 2-1, p.9
2. Budget Bills Adjustment: Difference between actual and budgeted number of customers at June 2000 of 239 x 12 months =	2,868	See above AG 2-40 A
3. Total Recommended Forecasted Period Budget Bills	1,090,011	
4. Adjusted Forecasted Period Budget Bills Reflected by KAWC	1,088,691	W/P 2-1, p.9
5. Recommended Budget Bills Adjustment	1,320	
6. Normalized Sales per Bill	5.5949	
7. Recommended Water Sales Adjustment	7,385	
8. Line 7 Equated as CCF (L7 / 75)	9,847	

Residential Water Revenue Adjustment:

9. Number of Bills Adjustment (L5)	1,320	
10. Current 5/8" Meter Rate	\$6.83	
11. Meter Charge Revenue Adjustment		\$9,016
12. Water Sales Adjustment (L8)	9,847	
13. Rate per CCF	\$1.5547	
14. Usage Charge Revenue Adjustment		\$15,309
15. Total Revenue Adjustment		\$24,325
16. Less: Associated Expense Increase: L8 x \$.15302		(1,507) (1)
17. Less: Associated Increases in Uncollectibles and PSC Fees: L15 x .6310%		(153)
18. Net Revenue Increase Before Income Tax		22,664
19. After-Tax Income Factor		59.6375%
20. Impact on Net Income		\$13,517

---

(1) Forecasted period Fuel & Power	\$1,946,339
Chemicals	1,025,251
Waste Disposal	129,150
Total variable costs	\$3,100,740
System Delivery (CCF)	20,263,707
Variable Costs / CCF	\$0.15302

**KAWC - CASE NO. 2000-120**  
**INDUSTRIAL REVENUE ADJUSTMENT**

KAWC's PROPOSED POSITION:

1. Forecasted Period Industrial Water Sales - Based on Actual Industrial Sales for 1999:	1,421,899	(1)
2. Forecasted Period Industrial Water Revenues- Based on Actual Industrial Revenues for 1999:	\$1,726,523	(2)

AG'S RECOMMENDED POSITION:

3. Forecasted Period Industrial Water Sales - Based on KAWC's Own Budget for the Forecasted Period, As Approved by KAWC's Board of Directors	1,461,315	(3)
4. Forecasted Period Industrial Water Sales - Based on KAWC's Own Budget for the Forecasted Period, As Approved by KAWC's Board of Directors	1,772,815	(2)

RECOMMENDED NET REVENUE ADJUSTMENT:

5. Gross Revenue Adjustment (L4 - L2)	\$46,292	
6. Less: Associated Expense Increase: (L3 - L1) x \$.15302	(6,031)	(4)
7. Less: Associated Increases in Uncollectibles and PSC Fees: L5 x .6310%	<u>(292)</u>	
8. Net Revenue Increase Before Income Tax	39,968	
9. After-Tax Income Factor	<u>59.6375%</u>	
10. Impact on Net Income	<u><u>\$23,836</u></u>	

(1) Response to AG 1-149 and Schedule I-4, p.1

(2) Schedule I-4, p.1

(3) Response to AG 2-37

(4) Forecasted period Fuel & Power	\$1,946,339
Chemicals	1,025,251
Waste Disposal	<u>129,150</u>
Total variable costs	\$3,100,740
System Delivery (CCF)	<u>20,263,707</u>
Variable Costs / CCF	<u><u>\$0.15302</u></u>

**KAWC - CASE NO. 2000-120**  
**OPA REVENUE ADJUSTMENT**

	<u>KAWC</u>	<u>Adjustment</u>	<u>AG</u>
	(1)		
1. Sales for Three Large Customers:			
- University of Kentucky	848,274		879,358 (2)
- Federal Medical Center	171,310		236,191 (2)
- Bluegrass Army Station	25,351		32,081 (2)
- Total CCF Sales	<u>1,044,935</u>	102,695	<u>1,147,630</u>
2. Rate per CCF		<u>\$1.4054</u>	
5. Gross Revenue Adjustment (L1 x L2))		\$144,328	
6. Less: Associated Expense Increase: L1 x \$ 15302		(15,714)	
7. Less: Associated Increases in Uncollectibles and PSC Fees: L5 x .6310%		<u>(911)</u>	
8. Net Revenue Increase Before Income Tax		127,702	
9. After-Tax Income Factor		<u>59.6375%</u>	
10. Impact on Net Income		<u>\$76,159</u>	

(1) W/P 2-1, p.9

(2) Historic CCF sales for three large OPA customers per W/P 2-1, pp.20-21:

	<u>UoK</u>	<u>FMC</u>	<u>Bluegrass</u>
1990	866,389	209,123	79,137
1991	916,416	216,843	77,175
1992	881,211	248,681	126,223
1993	897,720	256,908	119,576
1994	925,217	239,899	76,374
1995	915,284	309,525	51,807
1996	850,561	248,788	58,457
1997	817,017	230,336	37,228
1998	875,488	230,496	27,905
1999	848,274	171,310	31,111
10-Yr. Average 1990 - 1999	<span style="border: 1px solid black; padding: 2px;">879,358</span>	<span style="border: 1px solid black; padding: 2px;">236,191</span>	
3-Yr. Average 1997 - 1999			<span style="border: 1px solid black; padding: 2px;">32,081</span>



**KAWC - CASE NO. 2000-120**  
**SALES FOR RESALE REVENUE ADJUSTMENT**

	CCF Sales						Total
	Spears	JSE	Midway	Versailles	Middletown	GMWSS	
<u>Actual:</u>	(1)	(1)	(1)	(1)	(1)	(1)	(1)
1995	47,276	185,878	63,766	4,889	45,860	-	347,669
1996	65,744	196,304	83,872	6,391	44,310	-	396,621
1997	71,563	201,799	77,446	10,415	53,831	9,123	424,177
1998	82,839	204,916	62,181	64,736	51,538	59,849	526,059
1999	104,544	250,287	67,074	111,900	61,921	123,333	719,059
12-mos 6/30/00	134,902	264,354	72,188	103,736	68,410	113,603	757,193
<u>Forecasted Period</u>							
KAWC-Proposed	124,497	204,916	62,181	19,357	51,538	105,348	567,837
AG-Recommended	134,902	264,354	72,188	103,736	68,410	113,603	<u>757,193</u>
1. Recommended OPA Sales Adjustment (CCF)							189,356
2. Rate per CCF							<u>\$1.3445</u>
5. Gross Revenue Adjustment (L1 x L2))							\$254,589
6. Less: Associated Expense Increase: L1 x \$ 15302							(28,975)
7. Less: Associated Increases in Uncollectibles and PSC Fees: L5 x .6310%							<u>(1,606)</u>
8. Net Revenue Increase Before Income Tax							224,007
9. After-Tax Income Factor							<u>59.6375%</u>
10. Impact on Net Income							<u><u>\$133,592</u></u>

**KAWC - CASE NO. 2000-120  
ADJUSTMENT FOR NUMBER OF EMPLOYEES**

O&M Payroll Reductions:

1. Senior Financial Analyst	\$54,094	(1)
2. Part-Time Accountant	16,904	(1)
3. Part-Time Clerk II CSR	<u>14,542</u>	(1)
4. Total O&M Payroll Reductions	85,540	
5. Labor Overhead Rate	<u>1.376</u>	(2)
6. Total Labor Related O&M Expense Reduction	<del>417,703</del> 90,069 *	
7. After-Tax Income Factor	<u>59.6375%</u>	
8. Impact on Net Income	<u>53,715</u> <u>\$70,195</u>	

(1) Response to PSC 3-22

(2) Response to AG 1-156

\* Response to AG 1-205, updated 8/1/2010

**KAWC - CASE NO. 2000-120**  
**INSURANCE O/T GROUP EXPENSE ADJUSTMENT**

Actual Insurance O/T Group "Retrospective Adjustments":

	(1)
1992	\$45,375
1993	181,941
1994	202,659
1995	90,465
1996	96,793
1997	193,608
1998	145,722
1999	95,419
2000 - Proj	0
9-Yr Average 1992-2000:	<u>\$116,887</u>
Forecasted Period - OProposed by KAWC	<u>\$0</u>

1. AG-Recommended Retro Adjustments (Exp. Credit)	\$100,000
2. After-Tax Income Factor	<u>59.6375%</u>
3. Impact on Net Income	<u>\$59,638</u>

(1) For 1992 through 1995 see response to AG 1-91 Case No. 97-034 and for 1996 through 1999 see response to AG 1-162

KAWC - CASE NO. 2000-120  
RATE CASE EXPENSE ADJUSTMENT

<u>KAWC's Proposal:</u>	<u>Total Expense</u> (1)	<u>Amortization</u> [Yrs]	<u>Amortization</u> Expense (1)
1. Estimated Rate Case Expense	\$310,420	2	\$155,208
2. Demand Study	60,000	5	12,000
3. Cost of Service Study	39,000	5	7,800
4. Case 95-554 Depreciation Study	<u>5,697</u>	1	<u>5,697</u>
5. Total Regulatory Costs	\$415,117		\$180,705

Rate Case Over-Collection Fund: \$687,539

Sch. RJH-18, p.2

AG's Recommendation:

6. Total Regulatory Costs After Funding With Rate Case Over-Collection Fund	\$0		<u>\$0</u>
7. Amortization Expense Adjustment (L6-L5)			(\$180,705)
8. After-Tax Income Factor			<u>59.6375%</u>
9. Impact on Net Income			<u><u>\$107,768</u></u>

(1) W/P 3-8, p.1 and response to AG 1-155

**KAWC - CASE NO. 2000-120**  
**RATE CASE EXPENSE OVER-COLLECTION FUND**

CASE 95-554 BAT AND COS COSTS (See Response to AG 1-159)

FACTS:

- Total costs were \$128,951
- monthly amortization of \$3,582 based on 3-year amortization from 9/1/96 - 9/1/99
- prior Case 97-034 rates included the monthly amortization of \$3,582
- total cost of \$128,951 was fully amortized and fully collected in rates as of 9/1/99
- Case 97-034 rates will stay in effect until 12/1/00

THEREFORE:

- Case 97-034 rates for 15-month period 9/1/99 - 12/1/00 will continue to collect the monthly amortization amount of \$3,582 even though this cost was already fully amortized and collected in rates by 9/1/99
- Amount over-collected in Case 97-034 rates until 12/1/00: 15 months x \$3,582 = \$53,730

CASE 95-554 RATE CASE EXPENSES (See Response to AG 1-160)

FACTS:

- Case 97-034 allowed monthly amortization of \$14,895 based on amortization completion at 9/1/98
- Case 95-554 rate case expense was fully amortized and fully collected in rates as of 9/1/98
- Case 97-034 rates will stay in effect until 12/1/00

THEREFORE:

- Case 97-034 rates for 27-month period 9/1/98 - 12/1/00 will continue to collect the monthly amortization amount of \$14,895 even though this cost was already fully amortized and collected in rates by 9/1/98
- Amount over-collected in Case 97-034 rates until 12/1/00: 27 months x \$14,895 = \$402,165

CASE 97-034 RATE CASE EXPENSES (See Response to AG 1-161)

FACTS:

- Total estimated rate case costs were \$397,100
- monthly amortization of \$16,546 based on 2-year amortization from 10/1/97 - 10/1/99
- prior Case 97-034 rates included the monthly amortization of \$16,546
- total cost of \$397,100 was fully amortized and fully collected in rates as of 10/1/99
- Case 97-034 rates will stay in effect until 12/1/00

THEREFORE:

- Case 97-034 rates for 14-month period 10/1/99 - 12/1/00 will continue to collect the monthly amortization amount of \$16,546 even though this cost was already fully amortized and collected in rates by 10/1/99
- Amount over-collected in Case 97-034 rates until 12/1/00: 14 months x \$16,546 = \$231,644

TOTAL RATE CASE EXPENSE OVER-COLLECTIONS:

\$687,539

- This amount should be used to fund the current estimated Case 2000-120 rate case expenses of \$310,420, Cost of Service Study expenses of \$39,000 and the Demand Study expenses of \$60,000.

**KAWC - CASE NO. 2000-120**  
**REMOVAL OF SEWER REVENUES, EXPENSES AND TAXES**

1. Remove Boonesboro Sewer Revenues from Miscellaneous Operating Revenues	<u>(\$28,376)</u>	Sch. M-3, p.2
2. Remove Boonesboro O&M Expenses	(79,023)	AG 1-23
3. Remove Rockwell Sewer Plant Amortization Expenses		Sch. RJH-10, L14
4. Remove Boonesboro Sewer Depreciation Expenses		Sch. RJH-5, L6
5. Remove Boonesboro Property Taxes	<u>(357)</u>	PSC 3-19
6. Total Sewer Expense Removal (L2 + L5)	<u>(79,380)</u>	
7. Pre-Tax Income Increase (L1 - L6)	51,004	
8. After-Tax Income Factor	<u>59.6375%</u>	
9. Impact on Net Income	<u><u>\$30,418</u></u>	

**KAWC - CASE NO. 2000-120**  
**KRS II AND KRS RESIDUAL AMORTIZATIONS**

<u>KRS II:</u>	<u>KAWC</u>	<u>Adjustment</u>	<u>AG</u>
	(1)		
1. Unamortized KRS II Costs	\$507,245		\$507,245
2. Amortization Period (Yrs)	<u>5</u>		<u>5</u>
3. Amortization Expense	<u>\$101,449</u>	<u>\$0</u>	<u>\$101,449</u>
 <u>KRS RESIDUAL:</u>			
4. Unamortized KRS II Costs	\$624,258		\$624,258
5. Amortization Period (Yrs)	<u>5</u>		<u>10</u>
6. Amortization Expense	<u>\$124,848</u>	(\$62,422)	<u>\$62,426</u>
7. After-Tax Income Factor		<u>59.6375%</u>	
8. Impact on Net Income		<u>\$37,227</u>	

(1) W/P 1-13, pp.1 and 2

**KAWC - CASE NO. 2000-120**  
**BLUEGRASS WATER PROJECT AMORTIZATION**

	<u>KAWC</u> (1)	<u>Adjustment</u>	<u>AG</u>
1. Unamortized BWP Costs	\$3,534,975		\$3,534,975
2. Amortization Period (Yrs)	<u>10</u>		<u>20</u>
3. Amortization Expense	<u>\$353,496</u>	(\$176,747)	<u>\$176,749</u>
4. After-Tax Income Factor		<u>59.6375%</u>	
5. Impact on Net Income		<u>\$105,408</u>	

**COMMUNITY EDUCATION COST AMORTIZATION**

	<u>KAWC</u> (2)	<u>Adjustment</u>	<u>AG</u>
1. Unamortized BWP Costs	\$502,353	(\$502,353)	\$0
2. Amortization Period (Yrs)	<u>5</u>		
3. Amortization Expense	<u>\$100,476</u>	(\$100,476)	<u>\$0</u>
4. After-Tax Income Factor		<u>59.6375%</u>	
5. Impact on Net Income		<u>\$59,921</u>	

(1) W/P 1-13, P.3

(2) W/P 1-13, p.4



**KAWC - CASE NO. 2000-120**  
**INTEREST SYNCHRONIZATION ADJUSTMENT**

	<u>KAWC</u>	<u>Adjustment</u>	<u>AG</u>	
1. Rate Base	\$142,427,511		136,773,631 \$137,150,631	Sch. RJH-3
2. Weighted Cost of Debt	<u>4.03%</u>		<u>3.87%</u>	Sch. RJH-2
3. Pro Forma Interest	\$5,739,829 (1)	(449,425) <u>(434,610)</u>	5,290,404 <u>\$5,305,219</u>	
4. Composite State and Federal Income Tax Rate		40.3625% <u>(181,399)</u>		
5. Impact on Net Income		<u><u>(\$175,419)</u></u>		

(1) Schedules E-1.3 and E-1.4, page 1 of 2



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 9: In discussing his rationale for excluding AMRP projects from his calculation of a slippage factor, Mr. Henkes states, on page 17 of his Direct Testimony, that “construction expenditures made under this regulatory concept are potentially much different than...the construction decisions made for the Company’s non-AMRP projects.”

- a. Is Mr. Henkes aware that the AMRP is a program that the Commission approved due to the safety concerns related to the Company’s cast iron and bare steel pipe?
- b. Would Mr. Henkes propose to modify his slippage adjustment if the Commission ultimately approves the continuation of the Rider AMRP as requested by the Company in this proceeding?

Response: a. Yes.

b. No.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 10: Regarding Mr. Henkes' proposed slippage adjustment as discussed on pages 14 through 21, would Mr. Henkes propose to include a slippage adjustment to electric as well if it is demonstrated that there was slippage during the same time frame he uses for his gas slippage adjustment?

Response: If complete electric construction slippage factor data had been available to Mr. Henkes in the same format and detail as the gas slippage factor data shown in the response to PSC-2-105, and Mr. Henkes had had the opportunity to review and perform further discovery on this information prior to the preparation of his direct testimony, Mr. Henkes would have reflected a similar slippage factor adjustment for the proposed electric plant additions projected from the end of the base period to the average of the forecasted period. Since this electric slippage factor data was not available, Mr. Henkes did not reflect such a possible electric plant slippage factor adjustment.

See also Mr. Henkes' response to PSC Question No. 2.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 11: Refer to pages 15 and 16 of Henkes Direct Testimony. Mr. Henkes states that with regard to AMRP plant projects, the slippage factor was 2.850% on a cumulative weighted basis and 0.932% on a mathematic average basis. Would Mr. Henkes agree that based on ULH&P's response to KyPSC-DR-02-105, page 2 of 3, the slippage factor was -2.850% on a cumulative weighted basis and -0.932% on a mathematic average basis?

Response: Yes.





**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 12: If the response to the preceding information request is in the affirmative, does this change Mr. Henkes' recommendation as to the slippage factor adjustment for this case?

Response: No. See Mr. Henkes' response to Question 3.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 13: Refer to page 16 of Henkes Direct Testimony. Mr. Henkes states that with regard to the total non-AMRP and AMRP plant projects, the slippage factor was 2.955% on a cumulative weighted basis and 5.385% on a mathematic average basis. Would Mr. Henkes agree that based on ULH&P's response to KyPSC-DR-02-105, page 3 of 3, the slippage factor was 5.385% on a cumulative weighted basis and 2.955% on a mathematic average basis?

Response: Yes, Mr. Henkes agrees that this transposition of numbers was inadvertently reflected in his testimony and should be changed.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 14: If the response to the preceding information request is in the affirmative, does this change Mr. Henkes' recommendation as to the slippage factor adjustment for this case?

Response: No. Mr. Henkes' recommended slippage factor did not rely on the slippage factors referenced in Question 13.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 15: Please refer to Schedule RJH-5.

- a. Explain in detail why it is appropriate to apply a Non-AMRP Slippage Factor of 6.048% to projected plant additions of \$19,060,000, when these additions include both AMRP and Non-AMRP additions.
- b. Explain in detail why it is not more appropriate to use the total non-AMRP and AMRP plant projects slippage factor of 2.955%.

Response: See Mr. Henkes' response to Question 3.





**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 16: Please provide the basis for the statement at page 17 of your Direct Testimony that the Company's recovery of construction expenditures for the AMRP program is on a "guaranteed, dollar-for-dollar" basis.

Response: Mr. Henkes understands that the Company is allowed to recover in its AMRP rates all actual AMRP-eligible investment, down to the last dollar, incurred by the Company in any particular AMRP Rider year in between the Company's base rate cases. Mr. Henkes also understands that the Company is allowed to start recovering the actual AMRP-eligible investment for any particular AMRP year effective approximately 8 months after the end of that AMRP year.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 17: Refer to page 19, lines 1-3 of Henkes Direct Testimony. Please cite the cases referred to, and provide copies of the calculations referred to.

Response: See response to Question 2. The Commission Orders in the cases listed in response to Question 2 provide details of the slippage factors used and how these slippage factors were determined. This information is publicly available.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 18: Regarding the PSC assessment, is this a payment by the Company for its right to do business during the past, present or upcoming fiscal year?

Response: As indicated on pages 7-9 of the Commission Order in ULH&P's prior rate case, Case No.2001-092, the Commission has always considered PSC Assessments paid by Kentucky utilities, including ULH&P, to be "post-payments" rather than prepayments. Because of this PSC policy, the Commission has rejected the inclusion of the PSC Assessment as a prepayment component of rate base in the most recent four ULH&P rate cases as well in several other rate cases involving Kentucky utilities other than ULH&P. In this regard, the Commission stated on page 9 of its Order on Rehearing in Case No. 2001-092:

"The Commission believes that the payment of the PSC Assessment is more like the payment of tax liability, like income taxes, rather than the payment of an expense, like insurance."

With regard to the above facts, the Company agrees in its response to PSC-3-43 that the amount of PSC Assessment that it will be billed in, for example, July 2005 is based upon the gross revenues reported for calendar year 2004.

Mr. Henkes' position on this matter in this case is not based on his independent review and evaluation of this matter; rather, as stated on page 27 of his direct testimony, Mr. Henkes has removed such claimed prepayment balances from the Company's rate base in order to reflect PSC rate making policy.

In accordance with the above, Mr. Henkes' response to Question 18 is that, based on the Commission's long-standing and well-established rate making policy, the PSC Assessment represents a payment by the Company for its right to do business during the past as opposed to the upcoming fiscal year.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 19: What specific criteria should a company apply to determine whether a payment should be accounted for as a “prepayment” for ratemaking purposes?

Response: See response to Question 18.





**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 20: Is the purpose of the PSC assessment to fund the Commission's operations for the next fiscal year after the fiscal year in which the payment is due?

Response: See response to Question 18.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 21: If the PSC assessment is excluded from the Company's gas jurisdictional rate base, would this result in a matching of the Company's revenues with the expenses incurred by the Company which are used to generate the revenue requirement?

Response: See response to Question 18.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 22: Please summarize Mr. Henkes' prior work experience involving budgeting and forecasting activities for utilities. Indicate the nature of the work, the dates of such work, and the type of utility involved.

Response: Mr. Henkes has never performed consulting work on behalf of utilities and, therefore, has no prior work experience with regard to developing budgets and forecasts for utilities. However, in cases involving future test periods, Mr. Henkes has been involved in the review and analysis of budgeting and forecasting activities of utilities. See also response to Question 23.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 23: List any instances of which Mr. Henkes is aware where a utility developed detailed projections of accumulated deferred income taxes as part of its budget or long-term forecast. Include the name of the utility, the approximate date associated with the example, and a summary of the types of ADITs forecasted.

Response: The only other Kentucky utility utilizing forecasted test years in rate proceedings in which Mr. Henkes has been involved as an expert witness in the prior 10 years is Kentucky American Water Company. Mr. Henkes was the AG expert witness in KAWC's rate proceedings in Case No. 97-034 and Case No. 2000-120. In both these cases, KAWC had developed detailed projections of ADIT as part of the budget included in the forecasted test periods. Mr. Henkes recalls that, for example, in Case No. 2000-120, KAWC's projected ADIT balance included details for such ADIT components as Plant Related ADIT, Deferred Maintenance related ADIT, Deferred Debits related ADIT, KRS II cost related ADIT, KRS Residuals Project related ADIT, BMP Pipeline related ADIT, Community Education cost related ADIT, etc.





**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

- Question 24: Please refer to the statement at page 36, line 1, of Mr. Henkes' Direct Testimony that "the AIP is an incentive plan applicable to manager level employees and up..."
- a. is your recommendation to exclude AIP expenses from the Company's rates based, in part, on the AIP being available only to manager level employees and up?
  - b. if your answer to (a) is in the affirmative, please explain why this forms part of the basis for your recommendation to exclude AIP expenses from the Company's rates.

Response: a. No.

b. Not applicable.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 25: Please provide a copy of your Direct Testimony in KyPSC Case No. 97-034.

Response: This testimony is attached to the response to Question 8.



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 26: In Case No. 97-034, state whether you supported Kentucky-American Water Company recovering any portion of incentive compensation expense through its rates?

Response: Case No. 97-034 was the first KAWC rate case in which Mr. Henkes was involved as a witness for the Kentucky AG. Mr. Henkes reviewed prior Kentucky PSC Orders to get perspective on the ratemaking policy previously espoused by the KPSC regarding KAWC's incentive compensation plan expenses. Mr. Henkes found that in the KAWC rate case (Case No. 95-554) preceding Case No. 97-034, the KPSC had allowed 100% of KAWC's incentive plan expenses. In Case No. 97-034, Mr. Henkes recommended that 50% of KAWC's incentive expenses be disallowed for ratemaking purposes. The reason for this was that 50% of KAWC's incentive compensation plan expenses were directly tied to corporate performance factors and stockholder value. Mr. Henkes also noted in his testimony in Case No. 97-034 that he was aware that his recommendation was not consistent with the ratemaking treatment allowed by the PSC in Case No. 95-554, but that he was "respectfully recommending that the PSC reconsider its treatment of this issue based on the aforementioned reasons which the PSC may not previously have considered."



**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 27: If the answer to the preceding information request is in the affirmative, please state:

- a. what portion of incentive compensation expense you supported for Kentucky-American Water Company to recover through its rates;
- b. what was your reasoning for supporting that the company should recover this portion of incentive compensation expense through its rates;
- c. list any similarities between the incentive compensation plan involved in Case No. 97-034 and ULH&P's AIP; and
- d. list any differences between the incentive compensation plan involved in Case No. 97-034 and ULH&P's AIP.

Response:

- a. See response to Question 26.
- b. See response to Question 26.
- c. While Mr. Henkes kept a copy of his testimony in Case No. 97-034, he no longer has the files for that case. His testimony in Case No. 97-034 does not contain enough specifics regarding KAWC's incentive plan then in existence to allow for a comparison with ULH&P's current AIP plan.
- d. While Mr. Henkes kept a copy of his testimony in Case No. 97-034, he no longer has the files for that case. His testimony in Case No. 97-034 does not contain enough specifics regarding KAWC's incentive plan then in existence to allow for a comparison with ULH&P's current AIP plan.





**Response of the Attorney General to  
Initial Data Request of Union Light Heat & Power Company to the Attorney General  
Union Light Heat & Power Company  
Case No. 2005-00042**

Witness Responsible:  
ROBERT J. HENKES

Question 28: Provide copies of any testimony you have submitted to a state utility commission in which you supported the company's recovery of some or all of its incentive compensation expense through rates.

Response: As part of his answer to Question 8, Mr. Henkes has provided copies of KAWC Case Nos. 97-034 and 2000-120, both of which testimonies contain Mr. Henkes' recommendations that 50% of KAWC's incentive compensation expenses be disallowed.

To Mr. Henkes' knowledge, he has not submitted any other testimonies during the last 10 years, in which he has specifically supported, as part of his testimony, the inclusion of all or a portion of a utility's incentive compensation expenses for ratemaking purposes.

