COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF THE RATES OF KENTUCKY-AMERICAN WATER COMPANY	))	CASE NO. 2000-120

COMMISSION STAFF'S THIRD SET OF INFORMATION REQUESTS TO KENTUCKY-AMERICAN WATER COMPANY

Pursuant to Administrative Regulation 807 KAR 5:001, Commission Staff requests that Kentucky-American Water Company ("Kentucky-American") shall file the original, 3 paper copies, and one electronic copy of the following information no later than July 14, 2000, with a copy to all parties of record. Each copy of the information requested shall be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided. Careful attention shall be given to copied material to ensure its legibility. When the requested information has been previously provided in this proceeding in the requested format, reference may be made to the specific location of that information in responding to this request. When applicable, the requested information shall be provided for total company operations and jurisdictional operations, separately.

1. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Items 1 and 2.

a. Provide a detailed explanation for each variance. (For example, the explanation for the variance in Utility Plant in Service is "Decrease is due to decreased UPIS." Kentucky-American's detailed narrative should state the reasons for decreased UPIS investment.)

b. Why should the Commission rely upon Kentucky-American's forecasts to establish Kentucky-American's rates in light of the variances in Kentucky-American's forecasted financial statements and capital construction budgets in Case No. 97-034?[1]

c. What changes has Kentucky-American made in its forecasting process to ensure that the same budgeting variances that occurred in Case No. 97-034 do not recur in the present case?

2. Refer to Kentucky-American's Response to the Initial Request for Information by the Attorney General ("AG Request"), Item 85.

a. What concerns, if any, does Kentucky-American have about the large number of budgeted projects that are completed behind schedule?

b. Describe the changes implemented by Kentucky-American since the conclusion of Case No. 97-034, if any, to ensure that budgeted projects are completed on schedule.

3. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 10. Why was Investment Project 99-01 initiated and then cancelled?

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[1] Case No. 97-034, Application of Kentucky-American Water Company to Increase Its Rates.

4. Refer to Kentucky-American's Response to Lexington-Fayette Urban County Government's First Request for Information ("LFUCG Request"), Item 16 at 2. Provide a detailed explanation of the expenditures to Media Consultant of $133,265.

5. Refer to Kentucky-American's Response to AG Request, Item 132. With regard to the Community Education costs of $684,870:

a. List each cost included in the total amount of $684,870 and provide a detailed description of the cost.

b. Provide all workpapers used to prepare the response to the AG's request.

c. List all costs that are included in the $182,517 for which Kentucky-American has chosen not to seek rate recovery.

d. List all costs that are included in the $502,353 for which Kentucky-American has chosen to seek rate recovery.

e. What standards did Kentucky-American apply to determine a Community Education cost was potentially "political advertising"?

f. Explain why the full amount should not be considered political advertising.

6. Explain why Kentucky-American should be allowed to receive a return on construction work in progress ("CWIP") and also accrue an allowance for funds used during construction ("AFUDC").

7. Refer to Kentucky-American's Application, Exhibit 37, Schedule 2.2, Adjustment D-3. Provide a detailed calculation of the AFUDC in the amount of $338,018.

8. Provide a detailed calculation of the AFUDC amount to be capitalized during the forecasted test period as included in forecasted test period CWIP.

9. a. List each subsidiary of the American Water Works Company ("AWWC") that provides water service.

b. (1) For each subsidiary listed above, explain whether the state utility commission that regulates that subsidiary's rates allows, for rate-making purposes, the inclusion of CWIP in rate base and/or capitalization of an AFUDC.

(2) In those instances where a state utility regulatory commission allows the inclusion of CWIP in rate base and the capitalization of AFUDC, provide a copy of that commission's most recent rate order permitting this treatment for the subsidiary, the subsidiary's rate base calculation that includes CWIP as a separate line item, and its operating statement with AFUDC as a separate line item from the most recent rate case.

10. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 18. Why is it reasonable to include a portion of the ORCOM System's costs in Kentucky-American's rate base while 100 percent of the cost of operating the existing customer service software is reflected in the proposed rates?

11. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 25.

a. How much of the contribution has been received to date?

b. How much of the contribution will be received by the end of the forecasted test period?

12. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 27. What assurances, if any, can Kentucky-American provide that these projects will be pursued?

13. In its Response to the Commission's Order of June 2, 2000, Item 28, Kentucky-American states that it chose a 5-year period to be consistent with the Commission's actions in Case No. 89-348.[2] In Case No. 89-348, the Commission excluded the unamortized portion of KRS II costs when calculating Kentucky-American's rate base. In its current application, Kentucky-American has requested that unamortized balance of KRS II costs be included in its rate base. Explain how Kentucky-American's request regarding the treatment of the unamortized balance of the KRS II costs is consistent with the Commission's prior Order.

14. a. In its response to the Commission's Order of June 2, 2000, Item 29, Kentucky-American states that the 10-year amortization period was chosen to balance the needs of that Company and its ratepayers. Explain why, aside from a longer amortization period's effect on Kentucky-American's revenue requirement, a 10-year amortization period is appropriate.

b. What studies or analyses has Kentucky-American conducted or commissioned to determine the appropriate amortization period? Provide a copy of each study or analysis performed.

c. Provide all workpapers related to Kentucky-American's calculation of the 10-year period.

[2] Case No. 89-348, Notice of the Adjustment of the Rates of Kentucky-American Water Company Effective on January 28, 1990 (Ky.P.S.C. June 28, 1990).

15. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 30. Assuming arguendo that the Commission allows recovery of pipeline costs in this proceeding, explain why entry of such costs should not be made to Account 426-Miscellaneous Nonutility Expenses.

16. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 31. Kentucky-American's response is not responsive to the interrogatory posed. Explain why, if the recovery period for Bluegrass Water Project Pipeline costs would have been longer had the project been completed, it is reasonable to use a shorter recovery period since the project will not be constructed.

17. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 36.

a. Is Kentucky-American aware of the Commission's policy regarding acquisition adjustments as set forth in the Commission's Order of September 11, 1985 in Case No. 9059?[3]

b. Provide documentary evidence to demonstrate the following:

(1) The purchase price for Kentucky-American's acquisition of Boonesboro Water Association ("BWA") was established through arms-length negotiations.

(2) Kentucky-American's initial investment in BWA plus its cost of restoring BWA facilities to required standards has not and will not adversely impact the overall costs and rates of Kentucky-American's existing and new customers.

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[3] Case No. 9059, An Adjustment of Rates of Delta Natural Gas Company, Inc. (Ky.P.S.C. September 11, 1985) at 3-4.

(3) Kentucky-American has achieved operational economies through its acquisition of BWA.

(4) With Kentucky-American's acquisition of BWA facilities, the purchase price of utility and non-utility property can be clearly identified.

(5) Kentucky-American's purchase of BWA will result in overall benefits in the financial and service aspect of the utility's operation.

c. How did Kentucky-American select a 10-year amortization period?

d. When selecting the appropriate amortization period for the acquisition adjustment, did Kentucky-American consider using the average remaining life of the assets purchased as the amortization period? If yes, why did Kentucky-American not select this approach?

e. What is the remaining useful life of the acquired assets?

18. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 43. For each utility listed in this response,

a. Describe Kentucky-American's efforts to negotiate the purchase of the utility's assets and provide a detailed chronology of these efforts.

b. Identify the party who initiated the negotiations.

19. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 51.

a. Has Kentucky-American developed a cost-based sewer rate for the Rockwell Wastewater Treatment Plant? If yes, provide all workpapers and calculations used to developed this rate.

b. Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 51(b) is not responsive to the interrogatory posed. Identify all other sewer expenditures included in the calculation of the proposed water rates.

20. What version (1971 or 1989) of Kentucky-American's contract with the Service Company did PeopleTech use to evaluate the feasibility of Kentucky-American performing some services in-house rather than continuing the use of the regional office?

21. Why is Kentucky-American's proposal to recover payroll for vacant positions reasonable for rate-making purposes?

22. Refer to Kentucky-American's Workpapers W/P 3-1.

a. (1) Which of the positions listed on the "Rate Case Labor – Dollars" are vacant?

(2) What is the hiring status of each position?

b. Reconcile the grand total of the "Rate Case Labor – Dollars" of $6,615,810 as shown at W/P 3-1, page 35 of 44, with the Labor Costs of $7,032,693 as shown on W/P 3-1, page 1 of 44.

c. For each employee listed on the Rate Case Labor – Dollars," provide a breakdown of payroll expensed and capitalized during the forecasted test period.

d. List all payroll expenses related to lobbying activities. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 57.

23. a. List those employees included in the Annual Incentive Plan that came into their current positions at Kentucky-American from employers other than AWWC or its subsidiaries.

b. Provide for each employee listed a schedule showing his/her current job title and pay rate, starting pay rate at Kentucky-American, and job title and pay rate of position held just prior to employment with Kentucky-American.

c. Did Kentucky-American use a compensation study when developing its annual incentive plan? If yes, provide a copy.

24. Refer to Kentucky-American's Workpapers W/P 3-1, page 44 of 44. What is the basis for Kentucky-American's assumption that AWWC will award the maximum amount in annual incentive awards possible during the forecasted test period?

25. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 59 at 5. Why is it reasonable to include in Kentucky-American's operating expenses for rate-making purposes the cost of employee bonuses awarded for Kentucky-American meeting AWWC's financial goals?

26. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 59 at 9.

a. Is the Long Term Incentive Program discussed in this response the same program as listed at Kentucky-American Workpapers W/P 3-1, Page 44 of 44?

b. If yes, why is it reasonable to include in Kentucky-American's operating expenses for rate-making purposes the cost of employee bonuses awarded for Kentucky-American meeting certain financial goals?

27. What part of the employee stock option expenses included in the forecasted test period are attributable to the Annual and Long-Term Incentive Plans?

28. Refer to Kentucky-American’s Response to the Commission’s Order of June 2, 2000, Item 67. Provide a cost breakdown of the forecasted waste disposal fee of $200,000.

29. Refer to Kentucky-American's Response to LFUCG's Request, Item 15. Provide a breakdown of the $136,083 for each customer classification.

30. Refer to Kentucky-American’s Application at Exhibit 36.

a. List each allocation factor that differs from the factor used to allocate expenses in the cost-of-service study that Kentucky-American submitted in Case No. 97-034.

b. For each factor listed above, explain why a different allocation factor is used.

31. Refer to Kentucky American's response to the AG's Request, Item 26.

a. Explain why the use of the Means Building Construction Cost data is appropriate for establishing 3/4-inch service dollar equivalents.

b. Does the American Water Works Association recognize and approve this allocation method?

32. Refer to Kentucky American's Response to the AG's Request, Item 25. Why is it not appropriate to use the capacity ratios used in Schedule H, page 40 of Kentucky-American’s cost-of-service study to allocate meter costs?

33. Refer to Direct Testimony of Coleman D. Bush at 18. What is the basis for Kentucky American's proposal to be allowed to adjust its rates each January to reflect Kentucky River Authority withdrawal fees without providing public notice?

34. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 102 (c) and (d).

a. Mr. Moul states that the market has priced the stock according to the market valued capital structure rather than the book valued capital structure used by regulators to determine rate of return. How does investment information, such as that found in Value Line, present the capital structure (i.e., market valued equity or book valued equity)? Explain.

b. If the information is presented as book value, explain why investors using such sources would not already incorporate their knowledge of the risk presented by book value capitalization into the price of the stock.

c. (1) Standard & Poor's ("S&P") considers leverage when issuing a bond rating. To achieve a credit rating of AA, S&P requires a debt/capital ratio of under 50 for water utilities. Since Kentucky-American's current credit rating is BBB, S&P does not appear to be rating the company based on a market valuation of the equity component of capital structure. Would it be reasonable to expect an investor to use the credit rating as one of the ways to evaluate the risk of the stock?

(2) If yes, is the market not already incorporating the book value capitalization into the stock price?

d. Are utility stock investors likely to know how utility rates are set and therefore incorporate the risk associated with the book value of capitalization into the stock price thereby eliminating any discrepancy between market valuation and book valuation of equity?

35. Refer to Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 104(b).

a. In the sections provided, Dr. Morin discusses financial leverage in the chapter provided but advocates the use of book value instead of market value in capital structure for the purposes of setting utility rates. Provide textual sources that support Mr. Moul's proposed book to market value financial leverage adjustment.

b. State whether, since Mr. Moul adjusted the betas of the proxy group to allow for differences in capital structures between the companies, the additional leverage adjustment for the use of book value capitalization duplicates a risk adjustment already made.

c. Explain how an investor could determine Kentucky-American's capital structure policy using market values, which fluctuate, instead of book value.

36. Kentucky-American's Response to the Commission's Order of June 2, 2000, Item 102(f)(2), is not responsive to the interrogatory posed. What is the proper treatment if a utility's situation were the reverse of that set forth at pages 41 through 43 of Mr. Moul's testimony?

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cc: Parties of Record