

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

**IN THE MATTER OF:**

<b>COMPLIANCE OF KENTUCKY-AMERICAN</b>	)	
<b>WATER COMPANY, AMERICAN WATER WORKS</b>	)	
<b>COMPANY, RWE AKTIENGESELLSCHAFT AND</b>	)	
<b>THAMES WATER AQUA HOLDINGS GMBH WITH</b>	)	
<b>THE PROVISIONS OF THE ORDERS</b>	)	<b>CASE NO.</b>
<b>APPROVING THE TRANSFER OF CONTROL OF</b>	)	<b>2002-00277</b>
<b>KENTUCKY-AMERICAN WATER COMPANY TO</b>	)	
<b>RWE AKTIENGESELLSCHAFT AND THAMES</b>	)	
<b>WATER AQUA HOLDINGS GMBH</b>	)	

**NOTICE OF SAVINGS AND COSTS TRACKING MECHANISM**

Come Thames Water Aqua Holdings GmbH, RWE Aktiengesellschaft, American Water Works Company, Inc. and Kentucky-American Water Company, and herewith give notice, pursuant to Condition 18 of the Commission's Order dated December 20, 2002, in Case No. 2002-00317, of the development of a mechanism to track the savings and costs resulting from the change of control authorized by the Commission in Cases No. 2002-00018 and 2002-00317.

A copy of the methodology is attached hereto and marked Exhibit A.

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By 

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and Kentucky-American Water Company

## CERTIFICATION

In conformity with paragraph 7 of the Commission's Order dated January 30, 2002, in Case No. 2002-00018, this is to certify that the electronic version of this pleading is a true and accurate copy of the pleading filed in paper medium; that the Petitioners have notified the Commission and the parties in Case No. 2002-00018 by electronic mail on March 14<sup>th</sup>, 2003, that the electronic version of this pleading has been transmitted to the Commission, and that a copy has been served by mail upon:

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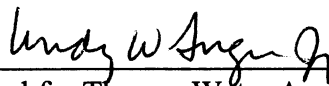
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and that the original and three copies have been filed with the Public Service Commission in paper medium on the 14<sup>th</sup> day of March, 2003.



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Counsel for Thames Water Aqua Holding GmbH,  
RWE AG, American Water Works Company, Inc.  
and Kentucky-American Water Company

**KENTUCKY-AMERICAN WATER  
METHODOLOGY TO COMPLY WITH CONDITION 18  
OF THE KY PSC'S ORDER APPROVING THE RWE TRANSACTION**

**CONDITION – 18**

*No later than March 16, 2003, RWE, Thames, AWWC and KAWC will develop and implement a mechanism to track the savings and costs resulting from the proposed merger and a methodology to allocate such savings and costs and will submit to the Commission in writing a detailed description of that methodology.*

**DISCUSSION**

Compliance with this condition will require monitoring of Kentucky-American's expenses for such items as labor, power chemicals and similar ongoing daily operating costs that may be impacted by technology investments, improved power use expertise and larger bulk purchasing discounts resulting from the RWE transaction. The transaction is also likely to lower Kentucky-American's capital costs as a result of lowering engineering and construction expenditures and improving financial strength.

Monitoring allocated expenses incurred as a result of Kentucky-American's affiliation with the American Water Works Service Company will also be required to track costs and benefits of implementing company-specific and system-wide business initiatives initiated as a result of the RWE transaction to produce cost savings and service enhancements.

**METHODOLOGY**

**Monitoring Operation and Maintenance Expenses**

**Labor and Labor-Related Costs**

Personnel and personnel costs for the year ended December 31, 2002 will be used as the basis for tracking costs, savings, or service enhancements resulting from the RWE transaction. Personnel changes that would have occurred absent that transaction will be identified and segregated from changes that can be directly linked to the RWE transaction. Labor-related cost savings will be determined by using pre-transaction and post-transaction overhead cost factors.

**Power Costs**

Power usage and unit energy costs for the year ended December 31, 2002 will be used as the basis for tracking costs and savings resulting from the RWE transaction. Changes that would have occurred absent the RWE transaction will be identified and segregated from changes directly linked to that transaction.

## **Chemical Costs**

Chemical usage and prices for the year ended December 31, 2002 will be used as the basis for tracking costs and savings resulting from the RWE transaction. Changes that would have occurred absent the RWE transaction will be identified and segregated from changes directly linked to that transaction.

## **Other O&M Expenses**

The three expense categories listed above comprise a major portion of Kentucky-American's Operation and Maintenance expenses. Remaining O&M expenses will be reviewed monthly and monitoring started when Kentucky-American's management becomes aware of changes in those expense categories that may result from the RWE transaction. Kentucky-American's Vice President and Treasurer will assist its President in determining when such tracking should commence.

## **Monitoring Service Company Charges**

Expenses for services provided to Kentucky-American from the American Water Works Service Company are identified on a detailed bill. Changes in the Service Company's workforce will result from the RWE transaction as service enhancements are implemented or projects are undertaken to reduce costs.

Those Service Company costs will be identified through the use of specific numbers on individual timesheets and expense transactions. The use of these "authorization numbers" will facilitate identification of costs linked to the RWE transaction.

Separate reports will be prepared by the supervisors of those individuals to identify cost savings, service enhancements and customer benefits. Costs for individuals working on group projects will be accumulated and net benefits for Kentucky-American customers identified.

## **Monitoring Capital Costs**

### **Construction Costs**

Engineering and construction techniques utilized by Thames Water as well as improved bulk purchasing power have the potential to result in lower costs for Kentucky-American's construction projects. These cost savings will be tracked by analyzing completed construction projects to identify changes resulting from the RWE transaction. The analysis of savings for larger construction projects will be facilitated through the use of information from Service Company engineers. Such analysis will be conducted on a periodic basis.

## **Financing Costs**

The KY PSC determines Kentucky-American's capital structure and rate of return for the recovery of capital costs during the investigation of rate increase requests. As a result, all capital cost savings created by the RWE transaction will be passed on to Kentucky-American's customers as costs and prices are determined in future rate cases. The RWE transaction is likely to lower Kentucky-American's debt cost which can be tracked by comparing Kentucky-American's cost of debt using American Water Capital Corp's debt rating and debt costs using RWE's credit rating. This comparison will identify the portion of the revenue requirement impacted by the RWE transaction.

## **Method of Allocating Cost and Savings to Kentucky-American**

During the investigation of Kentucky-American's future rate increase requests, net savings created by the RWE merger will be passed through to customers by the KY PSC's ratemaking process. Their orders approving the RWE transaction anticipate that costs associated with implementing best practices will only be incurred to the extent that they exceed benefits to the customer. As outlined above, costs will be identified and customer benefits and cost savings tracked. Historical ratemaking techniques will then allocate appropriate costs and savings to Kentucky-American's customers.