

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:)
)
NOTICE OF ADJUSTMENT OF THE RATES OF) **CASE NO. 2004-00103**
KENTUCKY-AMERICAN WATER COMPANY)
EFFECTIVE ON AND AFTER MAY 30, 2004)

REPLY OF KENTUCKY-AMERICAN WATER COMPANY
TO BLUEGRASS FLOW, INC.'S BRIEF

CERTIFICATION

This is to certify that a true and accurate copy of the foregoing has been electronically transmitted to the Public Service Commission on January 11, 2005; that the Public Service Commission and other parties participating by electronic means have been notified of such electronic transmission; that, on January 11, 2005, the original and one (1) copy in paper medium will be hand-delivered to the Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; and that on January 11, 2005, one (1) copy in paper medium will be served upon the following via U.S. Mail:

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Bluegrass FLOW, Inc. ("Flow") argues in its Brief that Kentucky-American Water Company ("Kentucky American Water") has not complied with Condition No. 49 as agreed to in Case No. 2004-00103. That condition is:

"At least 40% of the members of KAWC's Board of Directors will be persons who are not employees or officers of RWE, Thames, TWUS, AWWC, or any other RWE affiliated entity, and who reside within the area that KAWC serves."

Flow correctly states that KAW's Board has eight members, 40% thereof is 3.2, and then makes the argument that mathematics "requires a rounding up to four (4) members who must be independent outside directors to comply with the Condition."

The mathematics involved and conclusion reached is simply in error.

The above quoted condition does not have the word "independent" in it anywhere. The condition simply requires that the individuals on the Board qualifying to meet the condition must not be "employees or officers" of Kentucky American Water or its

affiliated entities. The undersigned, Patricia Freibert and William Sisson, are not employees or officers of Kentucky American Water or any of its affiliated entities.

The mathematics is simple. Kentucky American Water's Board has eight members and 40% of 8 is, indeed, 3.2%; however, third grade math requires rounding down where the fraction is less than one-half of the next integer (3.2 rounded becomes 3).

Kentucky case law is in accord:

“On cross-appeal, Kingmont first contends that the trial court was clearly erroneous in its determination of the percentage of encroachment by two of the cross-appellants' oil wells. The court properly determined that based upon the evidence, the percentages of encroachment by Beulah Phillips No. 1 and D. H. Campbell No. 3 were 4.09% and 3.45%, respectively. The court then erroneously rounded off these figures to 5% and 4%. Clearly, if the intent of the trial court was to **round to the nearest** whole percentage point the figures should have been rounded to 4% and 3%, respectively.” (Emphasis in original.) Howard v. Kingmont Oil Company, et al., 729 S.W.2d 183 (1987).

In addition to the errors included in Flow's analysis of Kentucky American Water's compliance with Condition No. 49 of the Change of Control cases, Flow asks that “. . . no increase of any character be approved until the Commission has satisfied itself after a diligent investigation of the full compliance by KAWC and RWE et al [sic] with all relevant Orders, that any approved rate increase only be initiated on and after the entry of the Commission's future Order finding full compliance, and that refunds be ordered through that date.”

The request clearly is asking the Commission to violate the Kentucky Supreme Court's Opinion in South Central Bell Telephone Company v. Utility Regulatory Commission, 637 S.W.2d 649 (1982). Therein the Commission found a rate of return of 10.61% to be reasonable but reduced it to 10.47% because of service issues. In pointing

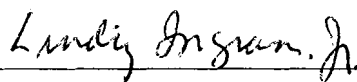
out that the Commission has two separate remedies to enforce its orders (KRS 278.390 authorizing proceedings in the Franklin Circuit Court and KRS 278.990 authorizing fines in some circumstances), the Court concluded that “granting the Commission the authority, in a rate case, to penalize the utility for poor **service** would be an improper extension of the statutory procedure.” (Emphasis in original.) Ratemaking must stand on its own: a utility cannot be denied fair, reasonable and just rates for any extraneous matter.

If the Commission is persuaded that there has been a lack of compliance with any of the conditions agreed to in the Change of Control case, which is denied by Kentucky American Water, it has ample authority to secure that compliance but the delay in awarding fair, just and reasonable rates as requested in this case cannot be conditioned upon extraneous matters to ratemaking.

Kentucky American Water requests that it be awarded fair, just and reasonable rates as set forth in its Brief herein within a statutorily acceptable timeframe.

Respectfully submitted,

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