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 LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT'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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PUBLIC FIRE HYDRANT RATES

The Lexington-Fayette Urban County Government ("LFUCG") argues that because public fire revenues were determined to be 4.0% of the total cost of service study as of November 30, 2001,[1] public fire revenues should be no more than 4% of the revenues awarded in this case.

While that assertion has some appeal at first blush, it ignores the fact that there have been more fire hydrants installed since that cost of service study upon which LFUCG relies and the determination of the installation of hydrants is exclusively within the authority of the LFUCG. The LFUCG, acting through its Division of Fire Protection Services, directs the installation of additional public fire hydrants. Kentucky-American Water Company ("Kentucky American Water") has always and will always comply with those requests to secure the provision of adequate fire protection services. If the percentage of investment for public fire protection services has increased

[1] Application, Exhibit 35.

disproportionately to other investment costs since the last cost of service study, extrapolating percentages from the 2001 cost of service study can serve as a guide but not an absolute rule.

The LFUCG suggests that Kentucky American Water has professed a willingness to discuss different options with respect to the future ownership of public fire hydrants.[2] It therefore asks this Commission to "establish a reasonable rate for the provision of water service by Kentucky-American for such hydrants."[3]

The LFUCG seriously misstates Kentucky American Water's position on ownership of fire hydrants. While this current rate case is neither the forum nor the time to discuss the ownership of public fire hydrants, Kentucky American Water's position was made clear in its response to the LFUCG's Second Data Request, Item 1, wherein it said, in part: "The Company wishes to continue ownership of the fire hydrants, but is willing to discuss the various cost of service methods used in other jurisdictions with the LFUCG."

In the absence of any cost studies in this case attempting to establish a rate for the provision of water service by Kentucky American Water for public fire hydrants, the methodology of charging for each public fire hydrant expected to be in service during the forecasted test year is appropriate.

ACCRUALS

Kentucky American Water has addressed all of the issues raised by the LFUCG wherein it asks the Commission to disapprove the allowance of accrued security costs

[2] LFUCG Brief, p. 8.
[3] LFUCG Brief, p. 9.

except the argument that Kentucky American Water's letter dated July 2, 2002, constitutes an *ex parte* contact which should be a basis for denying the requested relief.

The argument is wrong for two reasons: (1) it did not constitute an inappropriate *ex parte* contact and (2) no final decision has yet been made in response to Kentucky American Water's request for accruals and, as pointed out in Kentucky American briefs, no such approval is required for the establishment of those accruals.

The seminal Kentucky case dealing with *ex parte* contacts is Louisville Gas & Electric Company v. Commonwealth of Kentucky, 862 S.W.2d 897 (1993). An *ex parte* contact is defined as one "relevant to the merits of the proceeding between an interested person and an agency decision maker." All of Kentucky American Water's letters about deferrals took written form, were available to the public, were available through a request under the Open Records Law, and were addressed to the Executive Director. No argument is made that the Executive Director of the Commission is an "agency decisionmaker" and KRS 278.100 does not vest the Executive Director with any decision making authority.[4]

Additionally the court concluded that an improper *ex parte* contact will void a decision only where the decision was tainted so as to make it unfair. A tainted decision is one where the improper contact may have influenced the ultimate decision. Since there

[4] KRS 278.100: "The commission shall appoint an Executive Director, who shall hold office during its pleasure and shall devote his entire time to the duties of his office. The Executive Director shall be selected on the basis of experience and training demonstrating capacity to deal with the problems of management and governmental regulation and knowledge relatable to utility regulation. The Executive Director shall be the chief administrative officer for the commission and shall be responsible for implementing the problems, directing the staff, and maintaining the official records of commission proceedings, including all approved orders."

has been no final decision on the application of Kentucky American Water's request for accruals, no argument can be made that any decision has been tainted.

The establishment of or the denial for the establishment of accruals has absolutely no ratemaking impact until the Commission determines, in a rate case, whether or not Kentucky American Water is entitled to recover the accruals and earn on those accruals during the period of recovery. The "booking" of the accruals by Kentucky American Water and the approval or lack of approval of the Commission for that process has not cost the ratepayers or the LFUCG one single penny. Kentucky American Water has met its obligation under Case No. 2000-120 in that it did indeed apply for permission to accrue security costs (and others) prior to filing this rate case. The Staff's initial determination was in the process of being reconsidered at the time the deferral request was consolidated into this rate case.

Letters to the Executive Director of the Public Service Commission cannot be equated with the president of a regulated utility meeting with two members of a past public service commission to discuss a matter then pending before the commission and the subsequent failure to disclose that meeting. The LFUCG's request cannot be substantiated by any reasonable interpretation of Kentucky law and should be summarily dismissed.

Kentucky American Water acted prudently and expeditiously to protect its assets devoted to the provision of potable water service to its customers. Kentucky American Water should be praised for its efforts and financial commitments, particularly since the local and state governments offered no assistance whatsoever and now argue that the recovery of those costs is inappropriate.

ACTIVATION FEE

Among other things the LFUCG argues that the implementation of the activation fee should be conditioned upon Kentucky American Water's agreement that it has an obligation to collect the LFUCG imposed franchise fee on the revenue collected from the activation fee.

The matter involves an interpretation of Section 9 of the Franchise Agreement with the LFUCG.[5] This is a matter to be resolved between the LFUCG and Kentucky American Water and it would be inconsistent with past Commission practice to impose conditions in rate cases and inconsistent with the Supreme Court's pronouncement in South Central Bell Telephone Co. v. Utility Regulatory Commission, 637 S.W.2d 649 (1982). This case is well known in the public utility regulatory world for the proposition that a public utility is entitled to the establishment of fair, just and reasonable rates and the Commission has ample authority outside of its ratemaking authority to prescribe conduct on the part of its regulated utilities.

OWENTON AND FUTURE ACQUISITIONS

Interestingly the LFUCG proposes a "tracker" to reflect the increased margins from customers that may be added in the future "rather than depending on the speculative filing of a future rate case." No such revenue adjustment outside of the context of an existing rate case is statutorily authorized. The basis for this suggestion seems to be some apparent concern that Kentucky American Water is going to earn more than its allowed rate of return between rate cases because of acquisitions. The LFUCG is unable to support that apparent belief with any historical information. Their request is inappropriate and should be dealt with accordingly.

[5] See LFUCG Second Data Request, Item 17.

KENTUCKY AMERICAN WATER'S BUSINESS PLAN

Even though the discovery in this case has long since terminated, the LFUCG asks that the Commission order Kentucky American Water to file its updated five-year business plan.[6] This is a blatant attempt to discover information not relevant to the pending rate case for reasons not germane or relevant to the rate case and it should be denied.

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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[6] LFUCG Brief, p. 28.