
Kentucky-American Water Company
Assessment of Service Company Services
Year Ended December 31, 2003

Kentucky-American Water Company Assessment of Service Company Services

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I - Introduction

Purpose Of This Study

This study was undertaken to answer three questions:

1. What would be the economic impact on Kentucky-American Water Company (Kentucky-American) if it were to outsource the managerial, professional and technical services that it now receives from American Water Service Company, Inc. (Service Company)?
2. Are the costs of American Water's National Call Center reasonable?
3. Are the services Kentucky-American receives from the Service Company necessary?

Study Results

Concerning question 1, the following conclusions can be drawn from this study:

- On average, the hourly rates for outside service providers are more than **74% higher** (\$2,227,531 / \$3,023,966) than the Service Company's hourly rates.
- The managerial, professional and technical services provided by the Service Company are vital and could not be procured externally by Kentucky-American without careful supervision on the part of Kentucky-American. If these services were contracted entirely to outside providers, Kentucky-American would have to add at least one more position to manage activities of the outside firms. This position would be essential to ensure a high level of quality service is being provided.
- If all the managerial, professional and technical services now provided by the Service Company had been out-sourced during the 12-months ended December 31, 2003, Kentucky-American and its ratepayers would have incurred an **additional \$2,333,931** in expenses. This amount includes the added cost of outside providers and the cost of one Kentucky-American position needed to direct this outsourced work. This is over **71% more** (\$2,333,931 / \$3,285,681) than the Service Company's total billings to Kentucky-American during the year ended December 31, 2003.
- It would be difficult for Kentucky-American to find local service providers with the same specialized water industry expertise as that possessed by the Service Company staff. Service Company personnel spend substantially all their time serving operating water companies. This

specialization brings with it a unique knowledge of water utility operations and regulation that is most likely unavailable from local service providers.

- Service Company costs that cannot be charged directly to operating companies are allocated on the basis of number of customers. This is a straightforward and entirely reasonable methodology. The cost to administer this allocation technique is lower than alternatives that use multiple factors.
- Service Company fees do not include any profit markup. Only its actual cost of service is being recovered from Kentucky-American ratepayers.

Concerning question 2, it was determined that the cost of the Service Company's customer accounts services, including those provided by the National Call Center, **are less than the average of electric utilities in Kentucky and surrounding states.** During the 12-months ended December 31, 2003, the annualized customer accounts cost for Kentucky-American customers was **\$24.38 compared to the 2002 average of \$25.64** for neighboring electric utilities.

Concerning question 3, the following conclusions can be drawn:

- Kentucky-American could not function without the services that are provided to it by the Service Company. These services are the same type of activities that must be carried out by a stand-alone utility company to ultimately provide customers with service.
- There is no redundancy in the services provided by the Service Company and the activities that are performed by Kentucky-American itself.

II - Background

Overview Of American Water Service Company

The Service Company maintains several types of offices from which it provides services to American Water operating companies. They include:

- Corporate Office – Includes American Water's executive management and personnel from the various corporate support services; located in Voorhees, New Jersey.
- National Call Center – Performs customer service functions, including: customer call processing, service order processing, correspondence processing, credit and collections. This single call center facility, located in Alton, Illinois, went into operation in the second quarter of 2001. Kentucky-American transitioned to the National Call Center on October 20, 2003. Previously, this customer service function was performed by employees of Kentucky-American, which incurred the expense on its books.
- National Shared Services Center – In the fourth quarter of 2001, the new Shared Service Center assumed responsibility for various financial, accounting and treasury functions that had been performed by individual operating companies. This arrangement has improved and streamlined the Company's financial processes and allowed operating companies to focus on providing utility service.
- Regional Offices – Regional offices provide certain support services to smaller-grouped operating companies that do not have sufficient workloads to support a full-time staff for various support services. These services include rates and revenues, engineering and operations. Kentucky-American is served by the Southeast Regional office.
- Information Technology Service Centers – These data centers operate mainframes and servers used to run corporate and operating company business applications and the email system. Personnel in the locations also support the application software and provide various IT services (e.g., help desk) to operating companies.

Service Company Expense Categories

The Service Company renders a monthly bill to operating companies. Charges are broken down into the following expense categories:

- Labor – base pay (salaries) of managerial, professional and technical employees
- Labor-Related Overheads - employee benefit costs (payroll taxes, medical coverage, pensions, disability insurance) and other general expenses
- Support - wages and salaries of office support personnel, including secretaries, clerical personnel, telephone operators and mail clerks
- Office Expense - office rent, equipment leases, telephone, electric, office supplies, property taxes, office maintenance
- Vouchers/Journal Entries – (1) travel expenses incurred by Service Company personnel, (2) other items submitted for reimbursement by employees, including professional association dues, (3) outside service contracts for such things as actuarial services, and (4) various other expenditures, including data center expenses for software licenses and hardware maintenance.

Service Company expenses are either assigned directly or allocated to operating companies, as shown in the table below.

Expense Category	Direct		Comments
	Charged	Allocated	
Labor	X	X	Professional personnel working for one or several operating companies
Support		X	Administrative personnel support the professional staff, thus support costs are allocated on the basis of professional labor
Overhead	X	X	These are primarily employee benefit costs that relate directly to labor
Office Expense		X	Are all allocated on the basis of professional labor
Vouchers/Journals	X	X	May be either directly in support of one operating company (e.g., an engineer traveling from the Corporate Office to the operating company) or allocated to several operating companies

A direct charge occurs when Service Company work or expenses are incurred in support of only one operating company. Direct charge examples include work in support of an operating company's rate case, engineering design work on an operating company's project and the preparation of an operating company's financial statements.

Service Company expenses are allocated when more than one operating company benefits from the underlying work. Examples include assessments of new Federal water quality regulations, development of the company-wide materials procurement contracts and creation of company-wide engineering design standards.

Charging Of Service Company Time and Expenses

Service Company transactions are assigned with the following information so there is a proper accounting and eventual charging to an operating company:

- Operating company number, if transaction is a direct charge
- Formula number if transaction is allocated
- Employee hours worked
- Account number for non-labor charges.

Charges originate from the following systems:

- Payroll System
- RVI System (outside vendor payments)
- PCard System (credit card payments)
- Internal Purchase Order System
- Journal entries.

The Service Company's time reporting process enables labor and support charges to be assigned to the proper operating company. Labor charges are based on the time reported by managerial, professional and technical Service Company employees. Every week, Service Company professional employees complete an electronic time sheet (see Schedule 1) that shows:

- Type of service/activity (e.g., rate case data requests, accounting)
- Operating company (for direct charge)
- Work order (where applicable)
- Formula number (for allocation)
- Authorization number (where applicable).

Kentucky-American Water Company
Sample Electronic Time Sheet

Time Sheet for Mike Rink - Lotus Notes

File Edit View Create Actions Section Help

Workspace Mike Rink - Inbox SSC - General Accounting - Inbox Time Sheets - SSC # 2 - Time Sheets1... Time Sheet for Mike Rink notes

Time Sheets - SSC # 2

Employee's Area

Mike Rink
Employee

General Acctg./Rates 03001289 67 04/20/2003 16
Department Emp. No. Dept. No. Week Ending

DESCRIPTION OF SERVICES	O. H.	CO. NO.	Pay Type	LOC.	W.O. NO.	Task Order	FORM. NO.	AUTH. NO.	TOT. HRS.	CHARGEABLE HOURS				
										DATES				
										Mo	Tu	We	Th	Fr
Regular	<input type="checkbox"/>		001	NJ			6100		40	8	8	8	8	8
OT @ 1.5	<input type="checkbox"/>		106						0	0	0	0	0	0
OT @ 1.0	<input type="checkbox"/>		100						0	0	0	0	0	0
OT @ 2.0	<input type="checkbox"/>		125						0	0	0	0	0	0
Vacation	<input type="checkbox"/>		400						0	0	0	0	0	0
Float Holiday	<input type="checkbox"/>		430						0	0	0	0	0	0
Holiday	<input type="checkbox"/>		300						0	0	0	0	0	0
Funeral	<input type="checkbox"/>		566						0	0	0	0	0	0
Sick	<input type="checkbox"/>		250	NJ			6100		0	0	0	0	0	0
Sick without pay (Short-Term Disability)	<input type="checkbox"/>		267						0	0	0	0	0	0

Start Microsoft Excel - 2002 ... Time Sheet for Mike ... [09200] - Account Ledg... 2002 Annual Report Dr... Office 1:22 PM

Cost Accumulation Process

The Service Company cost accumulation process is illustrated in Schedule 2.

At month-end, time report information is processed and direct and allocated professional labor hours tabulated for each operating company. Dollar charges are then calculated using the hourly rate of each Service Company professional employee based upon their base salary (i.e., an employee's hours times their hourly rate of pay).

Support (administrative) personnel charge their time to the activity "General Admin." As described in the table on page 13, their labor charges are allocated to operating companies based upon how their office's professional personnel labor charges are assigned. For instance, if 2% of the Hershey Data Center's professional labor is assigned to Kentucky-American during a month, then 2% of that office's monthly administrative labor charges also is assigned to the operating company.

The overhead cost category is next assigned based on professional and administrative labor costs. Thus, if 2% of the Corporate Office's accumulated professional and support labor is charged to Kentucky-American during the month, then 2% of that month's overhead expenses will be assigned to Kentucky-American.

Each Service Company location's office expenses are allocated to operating companies based on how professional labor charges for that office have been assigned. For instance, if 2% of professional labor from one Service Company office is assigned to Kentucky-American, then 2% of that office's office expenses would be assigned to Kentucky-American. Thus, office expenses are allocated in the very same way as administrative labor.

Vouchers/journal entries may be charged directly or allocated, depending on who benefits from the expenditure. For instance, the cost of a continuing professional education course taken by a professional in a regional office is allocated to the operating companies served by that office. Travel expenses by that same professional to a state rate case proceeding are charged directly to the operating company whose case is being heard.

Kentucky-American Water Company Service Company Cost Accumulation And Assignment Process

Cost Accumulation				Cost Assignment To Operating Companies					
Labor		Other Cost Categories							
Service Company Managers, Professional and Technical Labor		Support Labor-Related Overhe ads Office Expenses Journals and Vouchers							
Time (hours) is reported to: 1. Account (O&M) (direct charged) 2. Authorizations (O&M) (allocated) 3. Work Orders (capital) (direct charged)		Ratio calculated for the actual costs for each category Support / Labor Labor-Related Overhe ads / Labor Office Expenses / Labor Journals and Vouchers / Labor							
Hours are costed-out based on each person's actual salary Dollar amounts accumulated by account, authorization and work order		Ratios are applied to accumulated labor dollars by account, authorization and work order							
Cost Accumulation -- Direct Charges									
(a)		Ratios		Dollar Amounts (b)				(a+b)	
Time Sheet Entries	Labor	Support	Labor Ovhds	Office Exp	Support	Labor Ovhds	Office Exp	J&Vs	Total Costs
Accounting	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Administrative	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Corporate Secretarial	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Engineering	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Human Resources	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Rate Case	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Construction	\$ x	%	%	%	= \$	\$	\$	\$	= \$
etc..									
Cost Accumulation -- Allocated Charges									
(c)		Ratios		Dollar Amounts (d)				(c+d)	
Time Sheet Entries	Labor	Support	Labor Ovhds	Office Exp	Support	Labor Ovhds	Office Exp	J&Vs	Total Costs
Accounting	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Administrative	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Corporate Secretarial	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Engineering	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Human Resources	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Rate Case	\$ x	%	%	%	= \$	\$	\$	\$	= \$
Construction	\$ x	%	%	%	= \$	\$	\$	\$	= \$
etc..									

Operating Company	(e) Direct Charged Work	Allocated Work (f)			Total Costs (e+f)
		# of Customers	% of Total	Allocated Amount etc.	
California	\$	xxx,xxx	%	\$	\$
Tennessee	\$	xxx,xxx	%	\$	\$
Iowa	\$	xxx,xxx	%	\$	\$
Kentucky	\$	xxx,xxx	%	\$	\$
Maryland	\$	xxx,xxx	%	\$	\$
Missouri	\$	xxx,xxx	%	\$	\$
etc.					

2003 Service Company Charges

During the 12-months ended December 31, 2003, the Service Company charged Kentucky-American the following amounts:

	12-Months Ended December 31, 2003 Charges (A)
Labor	\$ 1,759,697.20
Labor-Related Overheads	\$ 545,904.16
Support	\$ 42,165.29
Office Expenses	\$ 355,801.80
Vouchers/JEs	\$ 582,112.60
Total	<u>\$ 3,285,681.05</u>

Note A: includes both O&M expenses and capitalized costs to Kentucky-American

III – Service Company Cost Comparison Approach

Study Approach

The first issue--comparison of Service Company costs to equivalent outside vendors--was evaluated by comparing the cost per hour for work performed by Service Company personnel to the hourly billing rates that would be charged by outside providers of equivalent services. Service Company costs per hour were based on the expenses and hours that were charged to Kentucky-American during the twelve months ended December 31, 2003. Outside providers' billing rates came from surveys of professionals that could perform the services now provided by the Service Company.

The second issue--reasonableness of the National Call Center's costs--was addressed by comparing Kentucky-American's customer accounts expenses to those of neighboring electric utilities. This approach was selected because the costs of outside providers of call center services are not publicly available. However, electric utility customer account expenses can be obtained from the FERC Form 1.

The third issue--the necessity of Service Company services--was first investigated by determining the services provided to Kentucky-American. A determination was then made as to whether these services would be required if Kentucky-American were a stand-alone utility.

During the twelve months ended December 31, 2003, Service Company employees charged 46,015 hours of time to Kentucky-American. As indicated previously, the Service Company billed Kentucky-American \$3,285,681 during that same period.

The cost of Service Company services provided to Kentucky-American during the 12-months ended December 31, 2003 was compared to the following outside benchmarks:

- Managerial, Professional and Technical Services – Includes such services as management, accounting, legal, human resources, information technology, and engineering. The Service Company's cost of these services is compared to the cost that would be charged by outside service providers, including management consultants, attorneys, certified public accountants and professional engineers.
- Customer Accounts Services – Includes customer-related services, such as call center, credit, billing, collection and payment processing. The cost of these services is compared to similar costs incurred by investor-owned electric utilities in Kentucky and surrounding states.

During the 12-months ended December 31, 2003, Service Company charges to Kentucky-American can be placed into the following two categories:

	12-Months Ended December 31, 2003	
	Service Company Charges	
	\$ Amount	Hours
Management, Professional and Technical Services	\$ 3,023,966	39,339
Customer Account Services (A)	\$ 261,716	6,676
Total	\$ 3,285,681	46,015

Note A: These amounts include charges from the National Call Center to which Kentucky-American transitioned in Oct. 2003.

The cost comparisons for each of these categories are detailed in the next two sections of this report.

IV – Managerial, Professional And Technical Services Cost Comparison

Methodology

This cost comparison quantifies the economic impact on Kentucky-American of outsourcing all managerial, professional and technical services now provided by the Service Company. This is accomplished by comparing the cost per hour for Service Company services to those of outside service providers to whom these duties could be assigned.

The first step was to determine which types of outside providers could assume Service Company services. Based on the nature of these services it was determined that the following outside service providers could perform the categories of services indicated.

- Management Consultants - executive and administrative management, risk management services, human resources and communications services
- Attorneys - corporate secretarial and legal services
- Certified Public Accountants - accounting, financial, information systems and rates and revenues
- Professional Engineers - engineering, operations and water quality services.

It should be noted that the services provided by the Belleville lab are assumed to be transferable to professional engineers for purposes of this cost comparison. This was done for two reasons. First, there is no readily available survey of hourly billing rates for outside professionals that perform the types of services provided by Belleville. Second, Belleville personnel have similar educational backgrounds as Service Company engineering personnel. In fact, many Belleville employees have engineering degrees. Thus, it is valid to compare the hourly rates of Belleville services to those of outside engineering firms.

The next step was to calculate the Service Company's hourly rate for each of the four outside service provider categories, based on the dollars and hours charged to Kentucky-American during the 12-months ended December 31, 2003.

Hourly billing rates for outside service providers were next determined using information from pertinent surveys.

Finally, the Service Company's average cost per hour was compared to the average cost per hour for outside providers.

Service Company Hourly Rates

Schedule 3 (page 15) details the assignment of management, professional and technical Service Company charges and hours to outsider provider categories for the 12-months ended December 31, 2003.

Certain adjustments to these dollar and hour amounts were necessary to calculate Service Company hourly rates that are directly comparable to those of outside providers. These adjustments are described below.

- Computer Hardware/Software/Supplies Expenses – Within the Vouchers/Journal Entries expense category are \$29,296 in data center hardware/software leases, maintenance fees and other computer-related payments to outside companies. An outside provider that would take over operation of a data center would recover these expenses over and above the labor necessary to operate the data center.
- Contract Services - The test year includes \$218,155 in Service Company charges associated with existing arrangements with outside professional firms who perform certain corporate-wide services (e.g., financial audit, actuarial services). These professional fees are excluded because the related services have effectively been out-sourced already. These expenses are all in the Vouchers/Journal Entries expense category.
- Travel Expenses – Also within the Vouchers/Journal Entries expense category are \$12,106 in travel expenses for Service Company personnel. Outside service providers bill this to a client in addition to their hourly fees. Here too, it is appropriate to remove this amount from the Service Company hourly rate calculation.

Schedule 4 (page 16) shows how computer hardware/software, outside contract services and travel expense-related Service Company charges are split among the four outside provider categories.

Based on the assignment of expenses and hours shown in Schedules 3 and 4, the Service Company's equivalent costs per hour for the test year ended December 31, 2003 are calculated below.

	Management Consultant	Attorney	Certified Public Accountant	Professional Engineer	Total
Total management, professional & technical services charges	\$ 1,184,890	\$ 25,098	\$ 1,503,350	\$ 310,628	\$ 3,023,966
Less:					
Computer hardware/software	(99)	-	(27,533)	(1,664)	(29,296)
Contract services	(117,107)	(5,691)	(88,372)	(6,985)	(218,155)
Travel expenses	(8,634)	(377)	(2,612)	(484)	(12,106)
Net Expenses (A)	\$ 1,059,050	\$ 19,030	\$ 1,384,833	\$ 301,495	\$ 2,764,408
Total Hours (B)	9,966	123	24,850	4,399	39,339
Average Hourly Rate	\$ 106	\$ 154	\$ 56	\$ 69	

**Kentucky-American Water Company
Test Year Service Company Charges (December 31, 2003) - Total**

		Test Year Service Company Dollars					Test Year Service Company Hours				
		Management Consultant	Attorney	Certified Public Accountant	Professional Engineer	Total	Management Consultant	Attorney	Certified Public Accountant	Professional Engineer	Total
Belleville Lab	Water Quality/Laboratory				\$ 181,392	\$ 181,392				2,712.75	2,712.75
Call Center	Information Systems/Billing				\$ -	\$ -					
Corporate	Accounting			\$ 76,084	\$ 76,084			954.58		954.58	
	Administration	\$ 208,633			\$ 208,633		725.02			725.02	
	Audit			\$ 21,325	\$ 21,325			334.26		334.26	
	Communications	\$ 32,076			\$ 32,076		211.84			211.84	
	Corporate Secretary		\$ 20,348		\$ 20,348			71.88		71.88	
	Engineering			\$ 48,431	\$ 48,431				841.50	841.50	
	Finance			\$ 61,712	\$ 61,712			610.84		610.84	
	Human Resources	\$ 153,562			\$ 153,562		899.62			899.62	
	Information Systems/Billing				\$ -	\$ -					
	Information Systems/Financial Operations			\$ 77	\$ 77						
Water Quality/Corporate				\$ 33,477	\$ 33,477				277.85	277.85	
				\$ 25,332	\$ 25,332				249.83	249.83	
Illinois	Administration	\$ 216			\$ 216						
Indiana	Administration	\$ (1,518)			\$ (1,518)						
	Corporate Secretary		\$ 394		\$ 394			24.00		24.00	
ITS	Accounting			\$ (12,248)	\$ (12,248)						
	Administration	\$ 7,681			\$ 7,681		40.00			40.00	
	Human Resources	\$ 1			\$ 1						
	Information Systems/Billing				\$ -	\$ -					
	Information Systems/Financial			\$ 856,033	\$ 856,033			11,194.61		11,194.61	
Northeast Region	Administration	\$ 13			\$ 13						
	Corporate Secretary		\$ 20		\$ 20						
	Human Resources			\$ 18	\$ 18						
Shared Services	Accounting			\$ 238,845	\$ 238,845			6,682.09		6,682.09	
	Administration	\$ 114,440			\$ 114,440		1,647.01			1,647.01	
	Finance			\$ 68,500	\$ 68,500			1,475.01		1,475.01	
	Human Resources	\$ 8,237			\$ 8,237		75.85			75.85	
	Information Systems/Financial			\$ 147	\$ 147						
Southeast Region	Accounting			\$ 12	\$ 12						
	Administration	\$ 596,343			\$ 596,343		5,170.99			5,170.99	
	Corporate Secretary		\$ 4,336		\$ 4,336			27.46		27.46	
	Engineering			\$ 21,744	\$ 21,744				317.14	317.14	
	Finance			\$ 118,101	\$ 118,101			2,099.80		2,099.80	
	Human Resources	\$ 64,632			\$ 64,632		1,191.35			1,191.35	
	Operations			\$ 229	\$ 229						
	Rates and Revenues			\$ 74,763	\$ 74,763			1,499.09		1,499.09	
Western Region	Administration	\$ 240			\$ 240						
	Human Resources	\$ 15			\$ 15						
	Risk Management	\$ 319			\$ 319		4.38			4.38	
	Water Quality/Region			\$ 4	\$ 4						
Total Service Company Fees		\$ 1,184,890	\$ 25,098	\$ 1,503,350	\$ 310,628	\$ 3,023,966	9,966.06	123.34	24,850.28	4,399.07	39,338.75

Kentucky-American Water Company
Test Year Service Company Charges (December 31, 2003) – Travel, HW/SW and Outside Services

Test Year Service Company Charges					Outside Service Provider Category
Charges By Function	Computer HW/SW	Contract Services	Travel Expenses	Total	
Accounting	\$ -	\$ 17,121	\$ 246	\$ 17,366	Certified Public Accountant
Administration	\$ 72	\$ 68,510	\$ 6,981	\$ 75,563	Management Consultant
Audit	\$ -	\$ 9	\$ 262	\$ 271	Certified Public Accountant
Communications	\$ 26	\$ 8,578	\$ 299	\$ 8,904	Management Consultant
Corporate Secretary	\$ -	\$ 5,691	\$ 377	\$ 6,067	Attorney
Engineering	\$ 1,664	\$ 495	\$ 44	\$ 2,203	Professional Engineer
Finance	\$ 12	\$ 10,880	\$ 976	\$ 11,868	Certified Public Accountant
Human Resources	\$ -	\$ 40,020	\$ 1,354	\$ 41,374	Management Consultant
Information Systems/Financial	\$ 27,521	\$ 60,362	\$ 987	\$ 88,870	Certified Public Accountant
Operations	\$ -	\$ 6,946	\$ 197	\$ 7,142	Professional Engineer
Rates and Revenues	\$ -	\$ -	\$ 141	\$ 141	Certified Public Accountant
Water Quality/Corporate	\$ -	\$ (759)	\$ 154	\$ (605)	Professional Engineer
Water Quality/Laboratory	\$ -	\$ 299	\$ 90	\$ 388	Professional Engineer
Water Quality/Regional	\$ -	\$ 4	\$ -	\$ 4	Professional Engineer
Total	\$ 29,296	\$ 218,155	\$ 12,106	\$ 259,557	

Test Year Service Company Charges				
Recap By Outside Provider	Computer HW/SW	Contract Services	Travel Expenses	Total
Management Consultant	\$ 99	\$ 117,107	\$ 8,634	\$ 125,840
Attorney	\$ -	\$ 5,691	\$ 377	\$ 6,067
Certified Public Accountant	\$ 27,533	\$ 88,372	\$ 2,612	\$ 118,517
Professional Engineer	\$ 1,664	\$ 6,985	\$ 484	\$ 9,133
Total	\$ 29,296	\$ 218,155	\$ 12,106	\$ 259,557

Outside Service Provider Hourly Rates

The next step in the cost comparison was to obtain the average billing rates for each type of outside service provider. The source of this information and the determination of the average rates are described in the paragraphs that follow.

Management Consultants

The cost per hour for management consultants was developed from the 2003 annual survey performed by the Association of Management Consulting Firms—the industry trade organization. The first step in the calculation, presented in Schedule 5, was to determine an average rate by consultant position level. From these rates, a single weighted average hourly rate was calculated based upon the percent of time that is typically applied to a consulting assignment by each consultant position level. This survey includes rates that were in effect during 2002 for firms in the United States. Consultants typically do not limit their practice to any one region and must travel to a client's location. Thus, the U.S. national average is appropriate for comparison. The 2002 average rate was escalated to June 30, 2003—the year's midpoint.

Attorneys

The Kentucky Bar Association does not survey its members as to their hourly billing rates. Therefore, a Kentucky estimate was developed from a survey of Virginia lawyers conducted annually by the Virginia Lawyers Weekly. The average rate for each Virginia firm respondent was adjusted for the cost of living differential between their location and Lexington, Kentucky. The survey includes rates that were in effect at December 31, 2002. Thus, the 2002 average rate was escalated to June 30, 2003—the year's midpoint.

Certified Public Accountants

The average hourly rate for Kentucky certified public accountants was developed from a 2003 survey performed by the American Institute of Certified Public Accountants (AICPA). Hourly rates in the AICPA survey are the average of firms in Kentucky.

The average hourly rate was calculated for a set of typical accountant positions, as shown in Schedule 7. Using an assumed percent of time on a typical assignment, a weighted average hourly rate was calculated. This survey covered hourly rates in effect during 2002, thus they had to be escalated to June 30, 2003—the year's midpoint.

Professional Engineers

The Service Company provided hourly rate information for two outside engineering firms that were used by Kentucky-American in 2003. As presented in Schedule 8, an average rate was developed for each engineering position level. Then, using a typical percentage mix position time for an engineering project, a weighted average cost per hour was calculated.

Kentucky-American Water Company
Billing Rates of U.S. Management Consultants

A. Calculation of Average Hourly Billing Rate by Consultant Position
Survey billing rates were those in effect in 2002 (Note A)

		Average Hourly Rates (Note A)				
		Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner
Average		\$ 147	\$ 174	\$ 233	\$ 296	\$ 341

B. Calculation of Overall Average Hourly Billing Rate Based on a Typical Distribution of Time on an Engagement

		Entry-Level Consultant	Associate Consultant	Senior Consultant	Junior Partner	Senior Partner	
Average Hourly Billing Rate (from above)		\$ 147	\$ 174	\$ 233	\$ 296	\$ 341	
Typical Percent of Time Spent on a Consulting Project		30%	30%	20%	10%	10%	Weighted Average
		\$ 44	\$ 52	\$ 47	\$ 30	\$ 34	\$ 206

<u>Escalation to June 30, 2003 (Note B)</u>	
CPI at December 31, 2002	180.9
CPI at June 30, 2003	183.7
Inflation/Escalation	2.8
Billing Rate At June 30, 2003	\$ 212

Note A: Source is "2003 Survey of U.S. Key Management Information," Association of Management Consulting Firms

Note B: Source is US Bureau of Labor Statistics (<http://data.bls.gov/cgi-bin/surveymost>)

Kentucky-American Water Company
Estimated Billing Rates Of Kentucky Attorneys

Billing rates as of December 31, 2002 (Note A)								
Firm	Virginia Location	Number Of Va Lawyers	Billing Rate Range			Cost of Living Adjustment (C)	Adjusted Rate	
			Low	High	Avg			
LeClair Ryan	Richmond	111	\$ 130	\$ 375	\$ 253	90.3%	\$ 228	
Wilcox & Savage	Norfolk	66	\$ 130	\$ 340	\$ 235	92.4%	\$ 217	
Birch, Stewart, Kolasch & Birch	Falls Church	57	\$ 125	\$ 430	\$ 278	55.5%	\$ 154	
Gentry, Locke, Rakes & Moore	Roanoke	53	\$ 100	\$ 350	\$ 225	85.3%	\$ 192	
Cooley Godward	Reston	50	\$ 50	\$ 700	\$ 375	66.7%	\$ 250	
Veneable, Baetjer and Howard	Vienna	43	\$ 155	\$ 460	\$ 308	72.8%	\$ 224	
	Arlington	33	\$ 180	\$ 500	\$ 340	53.7%	\$ 183	
Wickwire Gavin	Vienna	32	\$ 185	\$ 435	\$ 310	72.8%	\$ 226	
Penstuart	Abingdon	31	\$ 110	\$ 225	\$ 168	95.0%	\$ 159	
McCandlish & Holton	Fairfax	26	\$ 175	\$ 410	\$ 293	52.1%	\$ 152	
Rees Broome & Diaz	Vienna	26	\$ 150	\$ 300	\$ 225	72.8%	\$ 164	
Jones, Blechman, Woltz & Kelly	Newport News	25	\$ 50	\$ 150	\$ 100	93.7%	\$ 94	
Bean, Kinney & Korman	Arlington	24	\$ 175	\$ 400	\$ 288	53.7%	\$ 154	
Frame Law Firm	Richmond	24	\$ 175	\$ 300	\$ 238	90.3%	\$ 214	
Kalbaugh, Pfund & Messersmith	Richmond	23	\$ 100	\$ 300	\$ 200	90.3%	\$ 181	
McCandlish & Lillard	Fairfax	22	\$ 125	\$ 350	\$ 238	52.1%	\$ 124	
Patten, Wornom, Hatten & Diamonstein	Newport News	22	\$ 125	\$ 300	\$ 213	93.7%	\$ 199	
DurriteBradshaw	Richmond	20	\$ 150	\$ 365	\$ 258	90.3%	\$ 233	
Thompson & McMullan	Richmond	19	\$ 140	\$ 350	\$ 245	90.3%	\$ 221	
Cantor Arkema	Richmond	18	\$ 135	\$ 260	\$ 198	90.3%	\$ 178	
Blankenship & Keith	Fairfax	17	\$ 165	\$ 350	\$ 258	52.1%	\$ 134	
Michie Hamlett Lowry Rasmussen	Charlottesville	17	\$ 70	\$ 350	\$ 210	92.3%	\$ 194	
Shuttleworth Ruloff Giordano & Swain	Virginia Beach	17	\$ 125	\$ 375	\$ 250	86.7%	\$ 217	
Cooper Spong & Davis	Portsmouth	16	\$ 105	\$ 210	\$ 158	91.0%	\$ 143	
Vanderpool Forstick & Nishanian	Manassas	15	\$ 145	\$ 260	\$ 203	88.8%	\$ 180	
Trichiol Bancroft McGavin Horvath	Fairfax	14	\$ 110	\$ 250	\$ 180	52.1%	\$ 94	
WootenHart	Roanoke	14	\$ 90	\$ 175	\$ 133	85.3%	\$ 113	
Albo & Oblon	Arlington	13	\$ 175	\$ 250	\$ 213	53.7%	\$ 114	
Parker Pollard & Brown	Richmond	13	\$ 110	\$ 275	\$ 193	90.3%	\$ 174	
Walton & Adams	Reston	13	\$ 150	\$ 325	\$ 238	66.7%	\$ 158	
Bowen Champlin Carr & Rockecharlie	Richmond	12	\$ 125	\$ 250	\$ 188	90.3%	\$ 169	
Crenshaw Ware & Martin	Norfolk	12	\$ 120	\$ 250	\$ 185	92.4%	\$ 171	
Redmon Payton & Braswell	Alexandria	12	\$ 75	\$ 350	\$ 213	53.7%	\$ 114	
Overall Average			\$ 128	\$ 332	\$ 230		\$ 173	
<u>Escalation to June 30, 2003 (Note B)</u>								
							CPI at December 31, 2002	180.9
							CPI at June 30, 2003	183.7
							Inflation/Escalation	2.8
							Billing Rate At June 30, 2003	\$ 178

Note A: Source is Virginia Lawyers Weekly, April 28, 2003

Note B: Source is US Bureau of Labor Statistics (<http://data.bls.gov/cgi-bin/surveymost>)

Note C: Represents Lexington, Kentucky's cost of living as a percent of the Virginia city in which the law firm is located.

Source of this information is www.homefair.com.

Kentucky-American Water Company
Estimated Billing Rates Of Kentucky Certified Public Accountants

A. Calculation of Average Hourly Billing Rate by Public Accounting Position
Survey billing rates were those in effect in 2002 (Note A)

Type of Firm	Average Hourly Billing Rate (Note A)			
	Staff	Senior	Manager	Partner
	Accountant	Accountant		
Larger Firms	\$ 72	\$ 88	\$ 117	\$ 166
Medium-Sized Firms	\$ 70	\$ 76	\$ 91	\$ 135
Average Hourly Rate	\$ 71	\$ 82	\$ 104	\$ 151

B. Calculation of Overall Average Accountant Billing Rate Based Upon Typical Distribution of Time on an Engagement

	Staff	Senior	Manager	Partner	Weighted Average
	Accountant	Accountant			
Average Hourly Billing Rate (From Above)	\$ 71	\$ 82	\$ 104	\$ 151	
Typical Percent of Time Spent on an Accounting Assignment	30%	30%	20%	20%	
	\$ 21	\$ 25	\$ 21	\$ 30	\$ 97

Escalation to June 30, 2003 (Note B)

CPI at December 31, 2002	180.9
CPI at June 30, 2003	183.7
Inflation/Escalation	2.8%
Estimated Average Hourly Billing Rate For CPAs At June 30, 2003	\$ 100

Note A: Source is AICPA's 2003 National PCPS/TSCPA Management of an Accounting Practice Survey

Note B: Source is US Bureau of Labor Statistics (<http://data.bls.gov/cgi-bin/surveymost>)

Kentucky-American Water Company
Billing Rates Of Kentucky Engineers

Note: Billing rates were those in effect in 2003

A. Calculation of Average Hourly Rate by Engineer Position

Name of Firm	Average Hourly Billing Rates			
	CAD Drafter Engineer Tech	Engineer Design Engineer Project Engineer Elect Proj Engineer	Project Manager Project Associate Sr. Mgr. Engineer	Officer Principal Engineer
Firm #1	\$55	\$70	\$122	\$138
Firm #2	\$52	\$79	\$113	\$150

B. Calculation of Overall Average Engineering Hourly Billing Rate

Average Hourly Billing Rate (From Above)	Engineer				Weighted Average
	CAD Drafter Engineer Tech	Design Engineer Project Engineer Elect Proj Engineer	Project Manager Project Associate Sr. Mgr. Engineer	Officer Principal Engineer	
	\$54	\$75	\$117	\$144	
Typical Percent of Time on an Engineering Assignment	30%	35%	25%	10%	
	\$16	\$26	\$29	\$14	\$86

Source: Information provided by American Water Works Service Company

Service Company Versus Outside Provider Cost Comparison

As shown in the table below, Service Company costs per hour are considerably lower than those of outside providers.

Service Provider	12-Months Ended December 31, 2003		
	Service Company	Outside Provider	Difference-- Service Co. Greater(Less) Than Outside
Management Consultant	\$ 106	\$ 212	\$ (106)
Attorney	\$ 154	\$ 178	\$ (24)
Certified Public Accountant	\$ 56	\$ 100	\$ (44)
Professional Engineer	\$ 69	\$ 86	\$ (17)

Based on these cost per hour differentials and the number of hours that the Service Company billed Kentucky-American during the year ended December 31, 2003 the services themselves would cost significantly more—over \$2,227,000—from outside providers (see table below). Thus, on average, outside provider's hourly rates are 74% higher than those of the Service Company (\$2,227,531 / \$3,023,966).

Service Provider	12-Months Ended December 31, 2003		
	Hourly Rate Difference-- Service Co. Greater(Less) Than Outside	Service Company Hours Charged	Dollar Difference
Management Consultant	\$ (106)	9,966	\$ (1,056,396)
Attorney	\$ (24)	123	\$ (2,952)
Certified Public Accountant	\$ (44)	24,850	\$ (1,093,400)
Professional Engineer	\$ (17)	4,399	\$ (74,783)
Net Service Co Less Than Outside Providers			\$ (2,227,531)

Higher hourly rates are not the only negative economic impact that would result from contracting all Service Company services to outside providers. Managing outside firms who would perform 46,015 hours of work would add a considerable workload to the existing Kentucky-American management team. Thus, it would be necessary for Kentucky-American to add at least one position whose responsibility it would be to supervise the outside firms and ensure they delivered quality services. The individual that would fill this position would need a good understanding of each profession being managed. This person must also have management experience and the authority necessary to give them credibility with the outside firms. As calculated in the table below, this position would add another \$106,400 per year to Kentucky-American's personnel expenses.

Cost of Adding Administrative Position To The Staff of Kentucky-American

New Position's Salary	\$	70,000
Benefits	\$	36,400
Total Cost of the New Position	\$	106,400

Thus, the total effect on the ratepayers of Kentucky-American of contracting all services now provided by Service Company would be an increase in their costs of **\$2,333,931** (\$2,227,531 + \$106,400).

Other Cost Comparisons

Every year, the Belleville Lab conducts a comparison of its cost for performing major tests to the cost of using outside testing laboratories. Over the past several years, these surveys have shown the following results been as follows

Year	Number of Major Tests Surveyed	Percent Belleville Lower Than Outside Labs
2000	26	15%
2001	25	19%
2002	24	16%
2003	23	10%

These studies present further evidence that the Service Company arrangement is the lowest-cost alternative for Kentucky-American.

V – Customer Accounts Cost Comparison

Background

It is difficult to compare the cost of American Water's National Call Center with outside providers of the same call center-related services. Call center survey data is proprietary and expensive to obtain. For this reason, Kentucky-American's National Call Center costs are compared to those of neighboring electric utilities because the data necessary to make this comparison is readily available to the public.

Electric utility cost information comes from their FERC Form 1. FERC's chart of accounts is defined in chapter 18, part 101 of Code of Federal Regulations. FERC accounts that contain call center-related expenses and are used in this study's comparison are:

- Account 903 Customer Accounts Expense – Records and Collection Expense
- Account 905 Customer Accounts Expense – Miscellaneous Customer Accounts Expense.

In addition, labor-related overheads charged to the following FERC accounts must be added to the labor components of Accounts 903 and 905.

- Account 926 Employee Pension and Benefits
- Account 408 Taxes Other Than Income (employer's portion of FICA).

Schedule 9 provides FERC's description of what should be charged to these accounts. In questioning the controller of a large Southeastern electric utility, it was determined that expenses of the activities described below are recorded in the designated FERC accounts.

903 Records and Collection Expense

- Customer Call Center – customer calls/contact, credit, order taking/disposition, bill collection efforts, outage calls
- Call Center IT – maintenance of phone banks, voice recognition units, call center software applications, telecommunications
- Customer billing – bill printing, stuffing and mailing
- Remittance processing – processing of customer payments received in the mail
- Bill payment centers – locations where customers can pay their bills in person

905 Miscellaneous Customer Accounts Expense

- Customer Information System IT – maintenance and support of the customer information system

This study assumes the FERC accounts for other electric and gas utilities contain expenses for the same activities.

Kentucky-American Water Company
FERC Account Descriptions

903 – Customer Records and Collection Expenses

This account shall include the cost of labor, materials used and expenses incurred in work on customer applications, contracts, orders, credit investigations, billing and accounting, collections and complaints.

Labor

1. Receiving, preparing, recording and handling routine orders for service, disconnections, transfers or meter tests initiated by the customer, excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
2. Investigations of customers' credit and keeping of records pertaining thereto, including records of uncollectible accounts written off.
3. Receiving, refunding or applying customer deposits and maintaining customer deposit, line extension, and other miscellaneous records.
4. Checking consumption shown by meter readers' reports where incidental to preparation of billing data.
5. Preparing address plates and addressing bills and delinquent notices.
6. Preparing billing data.
7. Operating billing and bookkeeping machines.
8. Verifying billing records with contracts or rate schedules.
9. Preparing bills for delivery, and mailing or delivering bills.
10. Collecting revenues, including collection from prepayment meters unless incidental to meter reading operations.
11. Balancing collections, preparing collections for deposit, and preparing cash reports.
12. Posting collections and other credits or charges to customer accounts and extending unpaid balances.
13. Balancing customer accounts and controls.
14. Preparing, mailing, or delivering delinquent notices and preparing reports of delinquent accounts.
15. Final meter reading of delinquent accounts when done by collectors incidental to regular activities.
16. Disconnecting and reconnecting services because of nonpayment of bills.
17. Receiving, recording, and handling of inquiries, complaints, and requests for investigations from customers, including preparation of necessary orders, but excluding the cost of carrying out such orders, which is chargeable to the account appropriate for the work called for by such orders.
18. Statistical and tabulating work on customer accounts and revenues, but not including special analyses for sales department, rate department, or other general purposes, unless incidental to regular customer accounting routines.
19. Preparing and periodically rewriting meter reading sheets.
20. Determining consumption and computing estimated or average consumption when performed by employees other than those engaged in reading meters.

Materials and expenses

21. Address plates and supplies.
22. Cash overages and shortages.
23. Commissions or fees to others for collecting.
24. Payments to credit organizations for investigations and reports.
25. Postage.
26. Transportation expenses, including transportation of customer bills and meter books under centralized billing procedure.
27. Transportation, meals, and incidental expenses.
28. Bank charges, exchange, and other fees for cashing and depositing customers' checks.
29. Forms for recording orders for services, removals, etc.
30. Rent of mechanical equipment.

905 – Miscellaneous Customer Accounts Expenses

This account shall include the cost of labor, materials used and expenses incurred not provided for in other accounts.

Labor

1. General clerical and stenographic work.
2. Miscellaneous labor.

Materials and expenses

3. Communication service.
4. Miscellaneous office supplies and expenses and stationery and printing other than those specifically provided for in accounts 902 and 903.

Comparison Group

Electric utilities included in the comparison group are shown in the table below. These are companies whose FERC Form 1 show amounts for accounts 903 and 905.

Kentucky	<ul style="list-style-type: none"> • Kentucky Power • Kentucky Utilities 	<ul style="list-style-type: none"> • Louisville Gas & Electric • Union Light, Heat & Power
Illinois	<ul style="list-style-type: none"> • Commonwealth Edison • Illinois Power 	<ul style="list-style-type: none"> • MidAmerica Energy
Indiana	<ul style="list-style-type: none"> • Indiana Michigan Power • Indianapolis Power & Light 	<ul style="list-style-type: none"> • NIPSSCo • Public Service of Indiana
Missouri	<ul style="list-style-type: none"> • Kansas City Power & Light 	
Ohio	<ul style="list-style-type: none"> • Cincinnati Gas & Electric • Cleveland Electric Illum • Columbus Southern Power • Dayton Power & Light 	<ul style="list-style-type: none"> • Ohio Edison • Ohio Power • Toledo Edison
Tennessee	<ul style="list-style-type: none"> • Kingsport Power 	
Virginia	<ul style="list-style-type: none"> • Appalachian Power 	<ul style="list-style-type: none"> • Virginia Electric Power
West Virginia	<ul style="list-style-type: none"> • Wheeling Power 	

Several neighboring electric utilities could not be included in the comparison group because they did not submit the necessary FERC Form 1 data.

Comparison Approach

The basis for this study's comparison is 2002 actual cost per customer. In order to develop this, a cost pool was created for Kentucky-American that was equivalent to the contents of FERC accounts 903 and 905. As shown in the graphic below, Kentucky-American's cost pool contains the expenses of Service Company locations and certain operating company expenses.

American Water
<u>Service Company</u>
Alton Call Center
a. Customer contact
b. Customer order processing
c. Billing information processing
d. Collections
e. Correspondence processing
IT Services
a. Support expenses for the customer information system (ORCOM)
b. Bill preparation and mailing
<u>Operating Company Customer</u>
a. Payment processing

Electric Utilities
FERC Acct 903 - Records and Collection Expense and FERC Acct 905 - Misc Customer Accounts Expense
a. Customer contact
b. Customer order processing
c. Bill preparation and mailing
d. Collections
e. Payment processing
f. Correspondence processing

Kentucky-American Cost Per Customer

In order to make a valid comparison to neighboring electric utilities, certain adjustments had to be made to the applicable Service Company charges to Kentucky-American. First, it was necessary to annualize the National Call Center charges because they covered less than 3 full months of 2003. Another adjustment was necessary because the electric utilities experience an average of 2.5 calls per customer compared to American Water's 1.5 calls per customer. Thus, National Call Center expenses had to be increased, for comparison purposes, to reflect its costs at a 2.5 calls per customer level. As shown below, Kentucky-American's adjusted annual expense per customer is \$24.38—the number that can be compared to neighboring electric utilities' expenses.

Kentucky-American 12/31/03 Test Year Cost Per Customer

Cost Component	12/31/2003 Year Svc Co Charges	Adjustments		Adjusted
		Annualize Call Center Services (A)	Fewer Calls For Water Cos. (B)	
Alton Call Center Customer service	\$ 239,010	\$ 1,195,049	\$ 956,039	\$ 2,390,097
IT/Data Centers Bill preparation and mailing	\$ 22,423			\$ 22,423
Corporate Customer information system support	\$ 283			\$ 283
Operating Company Customer payment processing				\$ 164,976
			Cost Pool Total	\$ 2,577,779
			Total Customers	105,754
			2003 Cost Per Kentucky-American Customer	\$ 24.38

Note A: Adjustment for full year of Call Center expenses

Ky-Am transitioned to the National Call Center in late October 2003. Thus, the test year charges contain just over 2 full months of Call Center costs. This adjustment creates an full year of charges.

Test Year Alton Call Center Charges (2 months service)	\$ 239,010
Cost per month	\$ 119,505
Additional months	10
Total Adjustment A	\$ 1,195,049

Note B: Adjustment for American Water's fewer calls per customer

This adjustment is necessary because water utilities experience fewer calls per customer than do electric utilities.

Test year annualized Call Center charges	\$ 1,434,058	(\$239,009 + \$1,195,049)
Electric utility industry's avg calls/customer	2.50	(source: PA Consulting Group)
American Water's avg calls/customer	1.50	
Percent different	67%	67%
Total Adjustment B	\$ 956,039	

Note C: Estimated customer payment processing expenses

Number of customers	105,754
Number of payments/customer/year	12
Total payments processed/year	1,269,048
Bank charge per item	\$ 0.13
Total estimated annual expense	\$ 164,976



Electric Utility Group Cost Per Customer

Schedule 10 shows the actual 2002 customer accounts expense per customer calculation for the electric utility comparison group. All of the underlying data was taken from the utilities' FERC Form 1.

Summary Of Results

As shown in the table below, American Water's cost per customer is below the electric utility comparison group average. Thus, it can be concluded that the customer accounts-related expenses, including those of the Alton Call Center, assigned by the Service Company to Kentucky-American are reasonable.

Average Customer Accounts Expense Per Customer	
Virginia Electric Power	\$ 10.89
Cleveland Electric Illuminating	\$ 10.89
Ohio Edison	\$ 12.09
Louisville Gas & Electric	\$ 12.10
Illinois Power	\$ 13.32
Toledo Edison	\$ 17.28
Indianapolis Power & Light	\$ 17.79
Dayton Power & Light	\$ 21.22
Union Heat, Light & Power	\$ 21.56
MidAmerican Energy	\$ 22.70
Ky-American Water	\$ 24.38
Comparison Group Average	\$ 25.64
Kansas City Power & Light	\$ 26.11
Public Service of Indiana	\$ 26.21
Kentucky Utilities	\$ 26.85
Cincinnati Gas & Electric	\$ 29.05
Indiana Michigan Power	\$ 30.93
Kingsport Power	\$ 31.02
Columbus & Souther Power	\$ 31.63
Ohio Power	\$ 31.87
Appalachian Power	\$ 32.72
Northern Indiana Public Service	\$ 36.48
Kentucky Power	\$ 36.95
Commonwealth Edison	\$ 39.76
Wheeling Power	\$ 41.38

Kentucky-American Water Company Comparison Group 2002 Actual Customer Accounts Expense Per Customer

	West Virginia		Kentucky		Virginia		
	Wheeling Power	Kentucky Power	Kentucky Utilities	Louisville Gas & Electric	Union Light, Heat & Power	Appalachian Power	Virginia Electric Power
Customer Account Management Cost Pool							
FERC Account Balances:							
Acct 903 - Customer Records & Collection (page 322, line 131)	\$ 1,594,123	\$ 5,939,656	\$ 5,824,785	\$ 3,041,374	\$ 2,266,316	\$ 27,320,386	\$ 17,672,377
Acct 905 - Misc Customer Accounts (page 322, line 133)	\$ 24,767	\$ 129,581	\$ 5,512,855	\$ 898,967	\$ 143,208	\$ 740,150	\$ 1,208
Subtotal	\$ 1,618,890	\$ 6,069,237	\$ 11,337,640	\$ 3,940,341	\$ 2,409,524	\$ 28,060,536	\$ 17,673,585
Add: Employee Benefits & Employer FICA (not included in above amounts)							
Account 926 - Employee Pension & Benefits Note A	\$ 67,559	\$ 227,634	\$ 1,856,488	\$ 574,078	\$ 180,762	\$ 1,408,109	\$ 3,980,177
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 23,585	\$ 97,172	\$ 302,350	\$ 99,653	\$ 148,789	\$ 661,338	\$ 1,998,602
Total Cost Pool	\$ 1,710,034	\$ 6,394,043	\$ 13,496,478	\$ 4,614,072	\$ 2,739,076	\$ 30,129,983	\$ 23,652,364
Total Customers (page 304, line 43)	41,330	173,050	502,698	381,358	127,058	920,835	2,171,975
Customer Account Management Expense per Customer	\$ 41.38	\$ 36.95	\$ 26.85	\$ 12.10	\$ 21.56	\$ 32.72	\$ 10.89
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt							
Account 926 - Employee Pension & Benefits (page 323, line 158)	\$ 777,655	\$ 4,551,631	\$ 16,624,301	\$ 15,872,558	\$ 1,866,527	\$ 22,213,375	\$ 74,277,444
Total Payroll (page 355, line 96)	\$ 4,378,648	\$ 31,338,538	\$ 43,668,605	\$ 44,439,981	\$ 24,780,314	\$ 168,271,409	\$ 601,574,245
Total Benefits as Percent of Payroll	17.8%	14.5%	38.1%	35.7%	7.5%	13.2%	12.3%
Payroll Charged to Customer Accts Expenses (page 354, line 6)	\$ 380,399	\$ 1,567,290	\$ 4,876,610	\$ 1,607,304	\$ 2,399,828	\$ 10,666,749	\$ 32,235,518
Pension & Benefits Pertaining to Customer Accts Expenses	\$ 67,559	\$ 227,634	\$ 1,856,488	\$ 574,078	\$ 180,762	\$ 1,408,109	\$ 3,980,177
Note B: Calculation of Employer's FICA Pertaining to Customer Acct Mgmt							
Payroll Charged to Customer Accts Expenses (page 354, line 6)	\$ 380,399	\$ 1,567,290	\$ 4,876,610	\$ 1,607,304	\$ 2,399,828	\$ 10,666,749	\$ 32,235,518
Employer's Portion of FICA	6.20%	6.20%	6.20%	6.20%	6.20%	6.20%	6.20%
Estimated Employer's Portion of FICA	\$ 23,585	\$ 97,172	\$ 302,350	\$ 99,653	\$ 148,789	\$ 661,338	\$ 1,998,602

Kentucky-American Water Company Comparison Group 2002 Actual Customer Accounts Expense Per Customer

	Ohio						
	Cin Gas & Electric	Cleveland Electric Illum.	Columbus Southern Pwr	Dayton Power & Light	Ohio Edison	Ohio Power	Toledo Edison
Customer Account Management Cost Pool							
FERC Account Balances:							
Acct 903 - Customer Records & Collection (page 322, line 131)	\$ 15,391,668	\$ 5,331,957	\$ 20,197,457	\$ 9,383,999	\$ 8,666,153	\$ 20,321,157	\$ 3,855,388
Acct 905 - Misc Customer Accounts (page 322, line 133)	\$ 601,148	\$ 119,506	\$ 352,442	\$ -	\$ 372,327	\$ 327,998	\$ 112,845
Subtotal	\$ 15,992,816	\$ 5,451,463	\$ 20,549,899	\$ 9,383,999	\$ 9,038,480	\$ 20,649,155	\$ 3,968,233
Add: Employee Benefits & Employer FICA (not included in above amounts)							
Account 926 - Employee Pension & Benefits Note A	\$ 2,341,895	\$ 2,297,237	\$ 779,864	\$ 812,604	\$ 2,620,150	\$ 1,247,219	\$ 1,089,122
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 823,015	\$ 432,634	\$ 300,934	\$ 482,728	\$ 526,011	\$ 399,686	\$ 227,729
Total Cost Pool	\$ 19,157,726	\$ 8,181,334	\$ 21,630,697	\$ 10,679,331	\$ 12,184,642	\$ 22,296,061	\$ 5,285,084
Total Customers (page 304, line 43)	659,442	751,430	683,800	503,157	1,008,197	699,519	305,860
Customer Account Management Expense per Customer	\$ 29.05	\$ 10.89	\$ 31.63	\$ 21.22	\$ 12.09	\$ 31.87	\$ 17.28
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt							
Account 926 - Employee Pension & Benefits (page 323, line 158)	\$ 32,110,512	\$ 20,708,696	\$ 13,027,317	\$ 8,557,993	\$ 26,508,997	\$ 32,288,835	\$ 9,074,219
Total Payroll (page 355, line 96)	\$ 182,010,322	\$ 62,903,651	\$ 81,080,218	\$ 81,998,052	\$ 85,836,183	\$ 166,892,657	\$ 30,602,687
Total Benefits as Percent of Payroll	17.6%	32.9%	16.1%	10.4%	30.9%	19.3%	29.7%
Payroll Charged to Customer Accts Expenses (page 354, line 6)	\$ 13,274,440	\$ 6,977,968	\$ 4,853,768	\$ 7,785,934	\$ 8,484,052	\$ 6,446,555	\$ 3,673,049
Pension & Benefits Pertaining to Customer Accts Expenses	\$ 2,341,895	\$ 2,297,237	\$ 779,864	\$ 812,604	\$ 2,620,150	\$ 1,247,219	\$ 1,089,122
Note B: Calculation of Employer's FICA Pertaining to Customer Acct Mgmt							
Payroll Charged to Customer Accts Expenses (page 354, line 6)	\$ 13,274,440	\$ 6,977,968	\$ 4,853,768	\$ 7,785,934	\$ 8,484,052	\$ 6,446,555	\$ 3,673,049
Employer's Portion of FICA	6.20%	6.20%	6.20%	6.20%	6.20%	6.20%	6.20%
Estimated Employer's Portion of FICA	\$ 823,015	\$ 432,634	\$ 300,934	\$ 482,728	\$ 526,011	\$ 399,686	\$ 227,729

Kentucky-American Water Company Comparison Group 2002 Actual Customer Accounts Expense Per Customer

	Missouri		Illinois		Tennessee
	Kansas City Power & Light	Commonwealth Edison	Illinois Power	MidAmerica Energy	Kingsport Power
Customer Account Management Cost Pool					
FERC Account Balances:					
Acct 903 - Customer Records & Collection (page 322, line 131)	\$ 10,760,612	\$ 126,815,956	\$ 6,838,561	\$ 11,429,185	\$ 1,330,216
Acct 905 - Misc Customer Accounts (page 322, line 133)	\$ 72,595	\$ -	\$ 308,045	\$ 623,726	\$ 24,345
Subtotal	\$ 10,833,207	\$ 126,815,956	\$ 7,146,606	\$ 12,052,911	\$ 1,354,561
Add: Employee Benefits & Employer FICA (not included in above amounts)					
Account 926 - Employee Pension & Benefits Note A	\$ 1,258,756	\$ 11,200,452	\$ 180,884	\$ 2,351,565	\$ 38,398
Account 408 - Taxes Other Than Income (Employer's Portion of FICA) Note B	\$ 454,294	\$ 5,361,423	\$ 308,540	\$ 954,688	\$ 16,963
Total Cost Pool	\$ 12,546,257	\$ 143,377,831	\$ 7,636,030	\$ 15,359,165	\$ 1,409,921
Total Customers (page 304, line 43)	480,540	3,605,711	573,475	676,669	45,450
Customer Account Management Expense per Customer	\$ 26.11	\$ 39.76	\$ 13.32	\$ 22.70	\$ 31.02
Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt					
Account 926 - Employee Pension & Benefits (page 323, line 158)	\$ 27,986,302	\$ 81,413,380	\$ 4,369,022	\$ 34,523,350	\$ 559,075
Total Payroll (page 355, line 96)	\$ 162,910,652	\$ 628,562,676	\$ 120,200,030	\$ 226,061,121	\$ 3,983,527
Total Benefits as Percent of Payroll	17.2%	13.0%	3.6%	15.3%	14.0%
Payroll Charged to Customer Accts Expenses (page 354, line 6)	\$ 7,327,327	\$ 86,474,560	\$ 4,976,457	\$ 15,398,200	\$ 273,592
Pension & Benefits Pertaining to Customer Accts Expenses	\$ 1,258,756	\$ 11,200,452	\$ 180,884	\$ 2,351,565	\$ 38,398
Note B: Calculation of Employer's FICA Pertaining to Customer Acct Mgmt					
Payroll Charged to Customer Accts Expenses (page 354, line 6)	\$ 7,327,327	\$ 86,474,560	\$ 4,976,457	\$ 15,398,200	\$ 273,592
Employer's Portion of FICA	6.20%	6.20%	6.20%	6.20%	6.20%
Estimated Employer's Portion of FICA	\$ 454,294	\$ 5,361,423	\$ 308,540	\$ 954,688	\$ 16,963

Kentucky-American Water Company Comparison Group 2002 Actual Customer Accounts Expense Per Customer

Customer Account Management Cost Pool

FERC Account Balances:

Acct 903 - Customer Records & Collection (page 322, line 131)
 Acct 905 - Misc Customer Accounts (page 322, line 133)
 Subtotal

Add: Employee Benefits & Employer FICA (not included in above amounts)

Account 926 - Employee Pension & Benefits **Note A**
 Account 408 - Taxes Other Than Income (Employer's Portion of FICA) **Note B**

Total Cost Pool

Total Customers (page 304, line 43)

Customer Account Management Expense per Customer

Note A: Calculation of Pension & Benefits Pertaining to Customer Acct Mgmt

Account 926 - Employee Pension & Benefits (page 323, line 158)
 Total Payroll (page 355, line 96)
 Total Benefits as Percent of Payroll

Payroll Charged to Customer Accts Expenses (page 354, line 6)
 Pension & Benefits Pertaining to Customer Accts Expenses

Note B: Calculation of Employer's FICA Pertaining to Customer Acct Mgmt

Payroll Charged to Customer Accts Expenses (page 354, line 6)
 Employer's Portion of FICA

Estimated Employer's Portion of FICA

Indiana					Group Average
Indiana Michigan Pwr	Indianapolis Power & Light	NIPSCO	Pub Service of Indiana		
\$ 16,075,962	\$ 6,365,701	\$ 13,661,073	\$ 15,001,719		\$ 355,085,781
\$ 316,734	\$ 144,262	\$ 34,335	\$ 224,157		\$ 11,085,201
\$ 16,392,696	\$ 6,509,963	\$ 13,695,408	\$ 15,225,876		\$ 366,170,982
\$ 865,232	\$ 1,156,740	\$ 1,564,382	\$ 3,151,600		\$ 41,149,540
\$ 334,714	\$ 278,582	\$ 566,556	\$ 842,884		\$ 15,642,871
\$ 17,592,642	\$ 7,945,285	\$ 15,826,346	\$ 19,220,360		\$ 422,963,394
568,868	446,614	433,798	733,201		16,494,035
\$ 30.93	\$ 17.79	\$ 36.48	\$ 26.21		\$ 25.64
\$ 32,011,761	\$ 20,628,833	\$ 26,326,426	\$ 44,531,184		\$ 550,809,393
\$ 199,737,135	\$ 80,130,942	\$ 153,780,260	\$ 192,092,050		\$3,377,233,903
16.0%	25.7%	17.1%	23.2%		16.3%
\$ 5,398,608	\$ 4,493,259	\$ 9,138,007	\$ 13,594,905		\$ 252,304,379
\$ 865,232	\$ 1,156,740	\$ 1,564,382	\$ 3,151,600		\$ 41,149,540
\$ 5,398,608	\$ 4,493,259	\$ 9,138,007	\$ 13,594,905		\$ 252,304,379
6.20%	6.20%	6.20%	6.20%		6.20%
\$ 334,714	\$ 278,582	\$ 566,556	\$ 842,884		\$ 15,642,871

VI - Need For Service Company Services

Analysis Of Services

The second issue addressed by this study is the need for the services that are rendered to Kentucky-American by the Service Company. First, it was determined specifically what the Service Company does for Kentucky-American. Based on discussions with Service Company personnel, the matrix in Schedule 11 was created showing which entity--Kentucky-American or a Service Company location--is responsible for each of the functions Kentucky-American requires to ultimately provide service to its customers. This matrix was reviewed to determine: (1) if there was redundancy or overlap in the services being provided by the Service Company and (2) if Service Company services are typical of those needed by a stand-alone water utility.

Upon review of Schedule 11, the following conclusions can be drawn:

- There is no redundancy or overlap in the services provided by the Service Company to Kentucky-American. For substantially all of the services listed in Schedule 11, there was only one entity that was primarily responsible for the service.
- The services that the Service Company provides would be necessary even if Kentucky-American were a stand-alone water utility.

Kentucky-American Water Company Designation Of Responsibility For Water Utility Functions

Primarily Responsible Provides Support	P S	Performed By:					
		Kentucky- American	American Water Service Company				
			Customer Call Center	Regional Office	Shared Services	Corporate Office	IT Service Centers
Water Company Function							
Engineering and Construction Management							
	P				S		
	P		S				
					P		
	P				S		
	P		S		S		
	P						
	P		S				
	P		S				
	P						
	P						
	P		S				
	P						
	P						
	P		S				
Water Quality and Purification							
			S		S		P
	S				S		P
	P		S		S		
	P		S		S		
	P		S				S
	S		S		S		P
Transmission and Distribution							
	P						
	P						
	P						
Customer Service							
	P		S		S		
	S	P					
		P					
	P	S					
		P					
	P						
						P	
	S	P					
	S			P			
			S		P		
	P						

**Kentucky-American Water Company
 Designation Of Responsibility For Water Utility Functions**

Primarily Responsible P Provides Support S	Performed By:					
	Kentucky-American	American Water Service Company				
		Customer Call Center	Regional Office	Shared Services	Corporate Office	IT Service Centers
Water Company Function						
Financial Management						
Financial Planning	S		P		S	
Financings—Equity					S	
Financings--Long Term Debt & Preferred (A)						
Short Term Lines of Credit Arrangements (A)						
Investor Relations					P	
Insurance Program Administration					P	
Loss Control/Safety Program Administration	P		S		S	
Pension Fund Asset Management					P	
Cash Management/Disbursements				P		
Internal Auditing					P	
Budgeting and Variance Reporting						
Corporate Guidelines & Instructions					P	
Regional Guidelines & Instructions						
Budget Preparation						
Revenue and O&M	P					
Depreciation and Interest Expense	S					
Budget Preparation--Service Company Charges		S		P	S	S
Capital Budget Preparation--Projects	P			S		
Capital Budget Preparation--Non-Project Work	P					
Prepare Monthly Budget Variance Report ("Budget/Plan Analysis")	P					
Prepare Capital Project Budget Status Report	P			S		
Year-End Projections	P			S		
Accounting and Taxes						
Accounts Payable Accounting	S					
Payroll Accounting	S					
Work Order Accounting	S					
Fixed Asset Accounting	S					
Journal Entry Preparation--Billing Corrections	S					
Journal Entry Preparation--All Others	S					
Financial Statement Preparation	S					
State Commission Reporting	S					
Income Taxes—State						
Income Taxes—Federal						
Property Taxes	S					
Gross Receipts Taxes	S					

Note A: Financings and lines of credit are the responsibility of American Capital Corporation

Kentucky-American Water Company Designation Of Responsibility For Water Utility Functions

Water Company Function	Primarily Responsible P Provides Support S		Performed By:						
	Kentucky-American		American Water Service Company						
			Customer Call Center	Regional Office	Shared Services	Corporate Office	IT Service Centers	Belleville Lab	
Rates									
Rate Studies & Tariff Change Administration	S			P					
Rate Case Planning and Preparation	S			P					
Rate Case Administration	S			P					
Commission Inquiry Response	S			P					
Legal				P		S			
Purchasing and Materials Management				S	S	P			
Specification Development	S				P				
Bid Solicitation	S				P				
Contract Administration	S				P				
Ordering	P								
Inventory Management	P				S				
Human Resources Management							P		
Benefit Program Development							P		
Benefits Program Administration	P		S						
Management Compensation Administration							P		
Wage & Salary Program Design							P		
Wage & Salary Administration	P		S						
Labor Negotiations--Wages	P		S						
Labor Negotiations--Benefits							P		
Labor Negotiations-- Work Rules	P		S						
Training Program Development							P		
Training--Course Delivery	P								
Affirmative Action/EEO--Plan Development	P								
Affirmative Action/EEO--Implementation	P								
Information Systems Services									
Service Company Data Centers								P	
System Operations & Maintenance								P	
Software Maintenance								P	
Network Administration				P				S	
PC Acquisition & Support				P				S	
Help Desk				S				P	

Governance Of Service Company Transactions

There are several ways by which Kentucky-American exercises control over Service Company services and charges. The most important of these are described below.

- **Regional Managing Director Oversight** – The Regional Managing Director of the Southeast Region is on the Executive Management Team of RWE Thames Water. The Regional Managing Director is responsible for the financial performance of each operating company in the region, including Kentucky-American. As part of the Executive Management Team, the Regional Managing Director has equal say in major business decisions of RWE Thames Water and has the ability to monitor Service Company service quality and spending.
- **Operating Company Board Oversight** – Kentucky-American’s board of directors includes members of RWE Thames Water’s Executive Management Team, including its Vice President of Finance and Senior Vice President of External Affairs. This helps ensure that Kentucky-American’s needs are a factor in the delivery of Service Company services.
- **Service Company Budget Review/Approval** – Every operating company president must formally approve the budget for Service Company charges for the next year. These budgeted charges are consolidated with the operating company’s own spending into an overall budget which must be approved by the company’s board of directors.
- **Major Project Review And Approval** – Major projects undertaken by the Service Company must first be reviewed by the operating companies that will pay for the initiatives. Executives authorized to perform this review include the operating company’s president and the Regional Managing Director. Consultants used on these projects who are hired by the Service Company must also be approved by operating companies’ same representatives.
- **Service Company Bill Scrutiny** – Operating company personnel review the monthly Service Company bill for accuracy and reasonableness.
- **Service Company Budget Variance Reporting** – Each month, a summary variance analysis is prepared that explains differences between budgeted and actual Service Company spending. In addition, a more detailed monthly variance report, called the “Statement of Expenses and Billed Charges,” is produced by Service Company location and shows budget versus actual spending for the month and year-to-date by cost category.

- **Operating Company Budget Variance Reporting** - The “Budget/Plan Analysis,” produced monthly by each operating company, has a line item for Management Fees (i.e., Service Company charges). In this way, Service Company budget versus actual charges can be monitored for the month and year-to-date.
- **Capital Project Authorization** - Capital projects estimated to cost over \$100,000 must be approved by the operating company board of directors before any design and construction work begins.

VII - Conclusion

Based on the results of this study, the following major conclusions have been reached:

- The cost of managerial, professional and technical services provided by the Service Company to Kentucky-American is much lower than the cost of outside providers of those same services.
- The National Call Center's costs charged to Kentucky-American are reasonable.
- Services that Kentucky-American receives from the Service Company are necessary.