

S T O L L | K E E N O N | & | P A R K | L L P

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September 24, 2003

RECEIVED

SEP 24 2003

PUBLIC SERVICE  
COMMISSION

Via Hand Delivery

Mr. Thomas Dorman  
Executive Director  
Public Service Commission  
211 Sower Boulevard  
Frankfort, Kentucky 40601

RE: Kentucky-American Water Company - Deferrals

Dear Tom:

As we have previously done by letter dated September 6, 2001, and discussed in a conference with members of the staff on October 25, 2001, the purpose of this letter is to request Commission approval of the establishment of two additional regulatory assets to accrue expenses as required by the Commission's Order dated November 27, 2002, in Case No. 2000-120:

1. **SECURITY COSTS.** Kentucky-American became aware that post-September 11, 2001 enhanced security measures were essential for the continued provision of potable water to its customers. Security measures that, pre September 11, were designed primarily to address deterrence of vandalism or accident avoidance had to be reassessed in light of a substantially heightened risk profile that now include organized terrorist groups intent on deliberately inflicting as much harm to life and property as possible. In light of these new threats it was prudent and necessary for Kentucky-American to implement measures to prevent raw and finished water contamination, infrastructure attacks, and computerized tampering. Kentucky-American sought recovery of the costs associated with the protection of its assets by a tariff filed with the Commission on November 28, 2001, Case 2001-440. Condition 2 in the Commission's order of May 30, 2002, in Case 2002-00018, subsequently accepted by the parties, ordered the withdrawal of the Asset Protection Charge Tariff with consideration for the recovery of costs associated with the protection of water utility assets to occur only in cases for the adjustments of general rates for water service. On June 10, 2002 Kentucky-American filed its notice of the withdrawal of its asset protection tariff. On July 8, 2002 Case 2001-440 was removed from the Commission's docket. Continued protection of the assets devoted to the provision of water

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service is critical. As recently as September 4, 2003, the Department of Homeland Security advised that "Al-Qaeda views critical infrastructure targets in the US as attractive attack options because of their potentially significant economic and psychological impacts. These targets include...Water reservoirs and systems, including dams." To protect its customers Kentucky-American has incurred security expenses through August 22, 2003 of \$2,619,640.88.

2. **CONDEMNATION COSTS.** On July 3, 2003, the Lexington-Fayette Urban County Government filed a Verified Petition in the Fayette Circuit Court seeking to acquire by eminent domain all of the real and personal property of Kentucky-American used in connection with, or reasonably necessary or desirable in connection with the provision of water service in Fayette, Bourbon, Clark, Harrison, Jessamine, Owen, Scott and Woodford Counties, Kentucky. Thereafter, on July 17, 2003, Kentucky-American Water Company filed a Complaint against the Lexington-Fayette Urban County Government alleging that Resolution No. 326-2003 of the Lexington-Fayette Urban County Council authorizing the eminent domain proceeding was invalid. The cost and expenses attendant to these lawsuits will be incurred for the benefit of the customers of Kentucky-American as it is not in their best interest that the local government take over the assets of Kentucky-American and thereby remove governmental regulation of the rates and services to over 105,000 customers. All of the cost and expenses incurred in litigating the attempted takeover should be classified as a regulatory asset.

We will be glad to supply any additional information that the Commissioner's staff may require.

With best regards, I am

Very truly yours,

STOLL, KEENON & PARK, LLP

By

*Lindsey*

Lindsey Ingram, Jr.

/s/

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Paul E. Patton, Governor

Janie A. Miller, Secretary  
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Thomas M. Dorman  
Executive Director  
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October 15, 2003

The Honorable Lindsey W. Ingram, Jr.  
Stoll, Keenon & Park, LLP.  
300 West Vine Street, Suite 2100  
Lexington, Kentucky 40507-1801

RE: Kentucky-American Water Company - Deferrals

Dear Mr. Ingram:

The Commission Staff has reviewed your September 24, 2003 letter requesting authorization for Kentucky-American to establish two regulatory assets to accrue expenses as required by the Commission in its Order in Kentucky-American's last rate case. Specifically, you request authorization to establish regulatory assets to accrue post-September 11, 2001 enhanced security costs and to accrue expenses incurred for litigating the proposed condemnation of Kentucky-American by the Lexington-Fayette Urban County Government (LFUCG).

Based on the information contained in your September 26, 2003 letter, the Commission Staff has concluded that it is not appropriate to grant the authorization you request.

As you point out in your letter, RWE, Thames, AWWC and KAWC accepted Condition 2 of the Commission's May 30, 2002 Order in Case No 2002-00018 which authorized the transfer of control of Kentucky-American. In addition to the withdrawal of the Asset Protection Tariff, Condition 2 prohibited Kentucky-American from applying "... for the recovery of costs associated with the protection of water utility assets except through adjustments in its general rates ...." for five years from the date of the Order. The Staff finds that authorization to establish a regulatory asset to accrue such costs would be a violation of that condition and should not be allowed.

In your letter, you also state that the costs associated with the condemnation lawsuits "Will be incurred for the benefit of the customers of Kentucky-American as it is not in their best interest that the local government take over the assets of Kentucky-



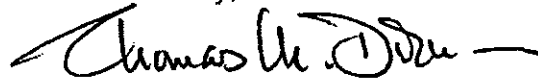
Hon. Lindsey W. Ingram, Jr.  
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American and thereby remove governmental regulation of the rates and services to over 105,000 customers." Although the Commission has authorized the acquisition by RWE, it has made no findings regarding the proposed condemnation by LFUCG. Accordingly, the Staff finds the request to establish a regulatory asset to accrue such costs should not be allowed.

Normally, requests to defer expenses or establish regulatory assets are addressed informally at the Staff level. However, as always, if you desire to pursue this matter, you may petition the Commission for formal consideration of your request.

Feel free to contact me at anytime if you have any questions.

Sincerely,



Thomas M. Dorman,  
Executive Director

